

TRINITY BANK, N.A.

Financial Statements

December 31, 2023 and 2022

(With Independent Auditor's Report Thereon)



PAYNE & SMITH, LLC
Certified Public Accountants

Independent Auditor's Report

The Board of Directors
Trinity Bank, N.A.
Fort Worth, Texas

Opinion

We have audited the accompanying financial statements of Trinity Bank, N.A. (Bank), which comprise the balance sheets as of December 31, 2023 and 2022 and the related statements of income, comprehensive income, changes in stockholder's equity and cash flows for the years then ended and the related notes to the financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2023 and 2022, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Bank and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter-Adoption of New Accounting Standard

As discussed in Note 1 to the financial statements, on January 1, 2023, the Bank changed its accounting method for estimating losses from the incurred loss methodology (Incurred Loss) to the current expected credit loss (CECL) methodology by adopting new accounting guidance under ASC Topic 326, *Financial Instruments-Credit Losses*. The CECL methodology generally applies to financial assets measured at amortized cost, including loan receivables, debt securities held to maturity, and certain off-balance sheet credit exposures. The change was adopted using the modified-retrospective and prospective approach transition methods. Accordingly, the accounting change has been applied as of the initial date of application, January 1, 2023 without restating the prior year's financial statements. Our opinion is not modified with respect to that matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Bank's ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements. In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of the Bank's internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Bank's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Payne & Smith, LLC

March 16, 2024

TRINITY BANK, N.A.

Balance Sheets

December 31, 2023 and 2022

(Thousands, except for share amounts and par value)

	<u>2023</u>	<u>2022</u>
<u>ASSETS</u>		
Cash and cash equivalents	\$ 45,675	\$ 25,562
Securities available for sale	139,973	134,628
Loans:		
Gross loans	297,423	281,857
Allowance for credit loss-loans	<u>(5,224)</u>	<u>(4,323)</u>
Net loans	292,199	277,534
Bank premises and equipment	2,387	2,196
Other assets	<u>5,653</u>	<u>5,361</u>
	<u>\$ 485,887</u>	<u>\$ 445,281</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Deposits:		
Noninterest bearing	\$ 130,602	\$ 159,568
Interest bearing	<u>301,602</u>	<u>240,883</u>
Total deposits	432,204	400,451
Other liabilities	2,664	1,779
Commitments and contingencies	-	-
Stockholders' equity:		
Common stock, \$5 par value, 1,295,373 shares authorized, 1,259,474 and 1,259,114 shares issued, and 1,086,402 and 1,091,588 shares outstanding at December 31, 2023 and 2022, respectively	6,297	6,296
Additional paid-in capital	8,188	8,028
Retained earnings	46,606	41,424
Accumulated other comprehensive loss, net of tax benefit of \$723 and \$1,547 at December 31, 2023 and 2022, respectively	<u>(2,718)</u>	<u>(5,820)</u>
	58,373	49,928
Treasury stock, at cost	<u>(7,354)</u>	<u>(6,877)</u>
Total stockholders' equity	<u>51,019</u>	<u>43,051</u>
	<u>\$ 485,887</u>	<u>\$ 445,281</u>

See accompanying notes to financial statements.

TRINITY BANK, N.A.

Statements of Income

For the Years Ended December 31, 2023 and 2022

(Thousands, except share information)

	<u>2023</u>	<u>2022</u>
Interest income:		
Interest and fees on loans	\$ 19,145	\$ 13,324
Interest and dividends on securities	3,510	3,040
Interest on interest bearing deposits in other banks	1,379	735
Other	<u>26</u>	<u>25</u>
Total interest income	<u>24,060</u>	<u>17,124</u>
Interest expense:		
Interest on deposit accounts	8,591	2,043
Interest on federal funds purchased	<u>20</u>	<u>-</u>
Total interest expense	<u>8,611</u>	<u>2,043</u>
Net interest income	15,449	15,081
Credit loss expense-loans	<u>-</u>	<u>-</u>
Net interest income after credit loss expense	<u>15,449</u>	<u>15,081</u>
Noninterest income:		
Service charges on deposit accounts	247	239
Other	<u>396</u>	<u>314</u>
Total noninterest income	<u>643</u>	<u>553</u>
Noninterest expense:		
Salaries and employee benefits	4,699	4,525
Occupancy, furniture and equipment	454	490
Loss on sales of available for sale securities	40	182
Professional fees	102	96
Other	<u>1,652</u>	<u>1,792</u>
Total noninterest expense	<u>6,947</u>	<u>7,085</u>
Net income before income tax expense	9,145	8,549
Income tax expense	<u>1,130</u>	<u>1,280</u>
Net income	<u>\$ 8,015</u>	<u>\$ 7,269</u>
Net income per weighted average share:		
Basic	<u>\$ 7.36</u>	<u>\$ 6.66</u>
Fully diluted	<u>\$ 7.04</u>	<u>\$ 6.37</u>
Weighted average shares outstanding:		
Basic	<u>1,088,694</u>	<u>1,091,194</u>
Fully diluted	<u>1,138,741</u>	<u>1,140,259</u>

See accompanying notes to financial statements.

TRINITY BANK, N.A.

Statements of Comprehensive Income

For the Years Ended December 31, 2023 and 2022

(Thousands)

	<u>2023</u>	<u>2022</u>
Net income	\$ 8,015	\$ 7,269
Other comprehensive income (loss), net of tax, on securities available for sale:		
Change in unrealized gain (loss) during the period net of tax expense (benefit) of \$816 and (\$1,961) for 2023 and 2022, respectively	3,070	(7,379)
Reclassification adjustment for net loss included in net income, net of tax benefit of \$8 and \$38 for 2023 and 2022, respectively	<u>32</u>	<u>144</u>
Other comprehensive income (loss)	<u>3,102</u>	<u>(7,235)</u>
Total comprehensive income	<u>\$ 11,117</u>	<u>\$ 34</u>

See accompanying notes to financial statements.

TRINITY BANK, N.A.

Statements of Changes in Stockholders' Equity

For the Years Ended December 31, 2023 and 2022

(Thousands)

	Common	Additional	Retained	Accumulated Other Comprehensive	Treasury	
	<u>Stock</u>	<u>Paid-in Capital</u>	<u>Earnings</u>	<u>Income (Loss)</u>	<u>Stock</u>	<u>Total</u>
Balance at January 1, 2022	\$ 6,232	\$ 7,545	\$ 35,831	\$ 1,415	\$ (6,495)	\$ 44,528
Exercise of stock options	64	323	-	-	-	387
Stock compensation expense	-	160	-	-	-	160
Purchase of treasury stock	-	-	-	-	(753)	(753)
Sale of treasury stock	-	-	-	-	371	371
Net income	-	-	7,269	-	-	7,269
Other comprehensive loss	-	-	-	(7,235)	-	(7,235)
Dividends	<u>-</u>	<u>-</u>	<u>(1,676)</u>	<u>-</u>	<u>-</u>	<u>(1,676)</u>
Balance at December 31, 2022	6,296	8,028	41,424	(5,820)	(6,877)	43,051
Cumulative effect of change in accounting principal	<u>-</u>	<u>-</u>	<u>(1,027)</u>	<u>-</u>	<u>-</u>	<u>(1,027)</u>
Balance at January 1, 2023 (as adjusted for change in accounting principal)	6,296	8,028	40,397	(5,820)	(6,877)	42,024
Exercise of stock options	1	25	-	-	-	26
Stock compensation expense	-	151	-	-	-	151
Purchase of treasury stock	-	-	-	-	(1,974)	(1,974)
Sale of treasury stock	-	(16)	-	-	1,497	1,481
Net income	-	-	8,015	-	-	8,015
Other comprehensive income	-	-	-	3,102	-	3,102
Dividends	<u>-</u>	<u>-</u>	<u>(1,806)</u>	<u>-</u>	<u>-</u>	<u>(1,806)</u>
Balance at December 31, 2023	<u>\$ 6,297</u>	<u>\$ 8,188</u>	<u>\$ 46,606</u>	<u>\$ (2,718)</u>	<u>\$ (7,354)</u>	<u>\$ 51,019</u>

See accompanying notes to financial statements.

TRINITY BANK, N.A.

Statements of Cash Flows

For the Years Ended December 31, 2023 and 2022

(Thousands)

	<u>2023</u>	<u>2022</u>
Cash flows from operating activities:		
Net income	\$ 8,015	\$ 7,269
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	285	277
Amortization of securities	880	1,419
Loss on sales of securities available for sale	40	182
Credit loss expense-loans	-	-
(Gain) loss on disposal of bank premises and equipment	(58)	53
Stock compensation expense	151	160
Deferred tax benefit	(242)	(67)
Net change in:		
Increase in other assets	(602)	(167)
Increase in other liabilities	605	598
Net cash provided by operating activities	<u>9,074</u>	<u>9,724</u>
Cash flows from investing activities:		
Net decrease in interest bearing deposits in other banks	-	256
Purchases of securities available for sale	(542,909)	(386,375)
Proceeds from sales, maturities and calls of securities available for sale	540,571	378,375
Net increase in loans	(15,685)	(41,557)
Net decrease in PPP loans	-	9,380
Proceeds from disposal of bank premises and equipment	58	-
Purchases of premises and equipment	<u>(476)</u>	<u>(408)</u>
Net cash used in investing activities	<u>(18,441)</u>	<u>(40,329)</u>
Cash flows from financing activities:		
Net decrease in demand deposits, NOW and savings accounts	(7,352)	(4,317)
Net increase in certificates of deposit	39,105	18,660
Purchase of treasury stock	(1,974)	(753)
Sale of treasury stock	1,481	371
Cash dividends paid to stockholders	(1,806)	(1,676)
Exercise of stock options	<u>26</u>	<u>387</u>
Net cash provided by financing activities	<u>29,480</u>	<u>12,672</u>
Net increase (decrease) in cash and cash equivalents	20,113	(17,933)
Cash and cash equivalents at beginning of period	<u>25,562</u>	<u>43,495</u>
Cash and cash equivalents at end of period	<u><u>\$ 45,675</u></u>	<u><u>\$ 25,562</u></u>

See accompanying notes to financial statements.

TRINITY BANK, N.A.

Notes to Financial Statements

December 31, 2023 and 2022

1. Summary of Significant Accounting Policies

The following is a summary of the significant accounting policies used by Trinity Bank, N.A. (Bank) in the preparation of its financial statements. These accounting policies conform to generally accepted accounting principles and practices generally followed within the banking industry. A description of the more significant of these policies follows.

Business

The Bank, a national bank located in Fort Worth, Texas, began operations on May 28, 2003. The Bank provides a full range of banking services to individual and corporate customers and is subject to competition from other local, regional, and national financial institutions. The Bank is also subject to the regulations of certain federal agencies and undergoes periodic examinations by those regulatory authorities.

The summary of the significant accounting policies of the Bank is presented to assist in understanding the Bank's financial statements. The financial statements and notes are the representation of the Bank's management, who are responsible for their integrity and objectivity.

Accounting Standards Adopted in 2023

On January 1, 2023, the Bank adopted ASU 2016-13 *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (ASC 326). This standard replaced the incurred loss methodology (Incurred Loss) with an expected loss methodology that is referred to as the current expected credit loss (CECL) methodology. CECL requires an estimate of credit losses for the remaining estimated life of the financial asset using historical experience, current conditions, and reasonable and supportable forecasts and generally applies to financial assets measured at amortized cost, including loan receivables and held to maturity debt securities, and some off-balance sheet credit exposures such as unfunded commitments to extend credit. Financial assets measured at amortized cost will be presented at the net amount expected to be collected by using an allowance for credit losses. Purchased credit deteriorated (PCD) loans will receive an initial allowance at the acquisition date that represents an adjustment to the amortized cost basis of the loan, with no impact to earnings.

In addition, CECL made changes to the accounting for available for sale debt securities. CECL requires credit losses to be presented as an allowance rather than as a write-down on available for sale debt securities if management does not intend to sell and does not believe that it is more likely than not, they will be required to sell.

The Bank adopted ASC 326 and all related subsequent amendments thereto effective January 1, 2023 using the modified retrospective approach for all financial assets measured at amortized cost and off-balance sheet credit exposures. The transition adjustment of the adoption of CECL included an increase to the allowance for credit losses-loans of approximately \$1,020,000 which is presented as a reduction to net loans outstanding, and an increase to the allowance for credit losses-unfunded loan commitments of approximately \$280,000, which is recorded within other liabilities. The Bank recorded a net decrease to retained earnings of approximately \$1,027,000 as of January 1, 2023 for the cumulative effect of adopting CECL, which reflects the transition adjustments noted above, net of the applicable deferred tax assets recorded. Results for reporting periods beginning after January 1, 2023 are presented under CECL while prior period amounts continue to be reported in accordance with previously applicable accounting standards (Incurred Loss).

In March 2022, the FASB issued Accounting Standards Update 2022-02, *Financial Instruments-Credit Losses (Topic 326); Trouble Debt Restructurings and Vintage Disclosures*. The amendments in this update require an entity measure and record the lifetime expected credit losses on an asset within the scope upon origination or acquisition and, accordingly, credit losses from loans modified as troubled debt restructurings (TDRs) have been incorporated into the allowance for credit losses - loans. The amendments relate to all entities after they have adopted ASU 2016-13. The amendments eliminate the TDR recognition and measurement guidance and instead require an entity evaluate whether the modification represents a new loan or a continuation of an existing loan. Public Business Entities (PBEs) are required to disclose current-period write offs by year of origination for financing receivables and net investments in leases. The Bank adopted this standard during the first quarter of 2023 and the adoption of this standard did not have a material impact on the Bank's financial statements.

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The following table details the impact of the adoption of ASC 326 on the allowance for credit losses and retained earnings as of January 1, 2023:

	<u>Pre-Adoption Allowance</u>	<u>Impact of Adoption</u>	<u>Post-Adoption Allowance</u>	<u>Cumulative Effect on Retained Earnings</u>
Loans				
Construction, land development, land	\$ 385	\$ 219	\$ 604	\$ 173
Farmland	69	(9)	60	(7)
1-4 family residential properties	199	(13)	186	(10)
Nonfarm nonresidential owner occupied	667	(24)	643	(19)
Nonfarm nonresidential other	<u>528</u>	<u>90</u>	<u>618</u>	<u>71</u>
Total real estate	1,848	263	2,111	208
Commercial	2,471	757	3,228	598
Agricultural	-	-	-	-
Consumer	4	-	4	-
Other	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 4,323</u>	<u>\$ 1,020</u>	<u>\$ 5,343</u>	<u>\$ 806</u>
Off-balance sheet credit exposures	<u>\$ -</u>	<u>\$ 280</u>	<u>\$ 280</u>	<u>\$ 221</u>

The Bank elected not to measure an allowance for credit losses for accrued interest receivable and instead elected to reverse interest income on loans or securities that are placed on nonaccrual status, which is generally when the instrument is 90 days past due, or earlier if the Bank believes the collection of interest is doubtful. The Bank has concluded that this policy results in the timely reversal of uncollectible interest.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for credit losses and valuation of other real estate owned. While management uses available information to recognize losses on loans and other real estate owned, future provisions may be necessary based on changes in local economic conditions. In addition, banking regulators, as an integral part of their examination process, periodically review the Bank's allowance for credit losses and other real estate owned losses. They may require the Bank to record additional provisions for losses based on their judgment about information available to them at the time of their examination.

A significant portion of the Bank's loans are secured by real estate and related assets located in local markets. Accordingly, the ultimate collectability of this portion of the Bank's loan portfolio is susceptible to changes in local economic conditions.

Cash and Cash Equivalents

For the purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, other short-term investments and federal funds sold. All highly liquid investments with an initial maturity of less than ninety days are considered to be cash equivalents.

Debt Securities

Certain debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Trading securities are recorded at fair value with changes in fair value included in earnings. Securities not classified as held to maturity or trading, are classified as available for sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Interest income includes amortization of purchase premiums or discounts. Premiums and discounts on securities are generally amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Premiums on callable debt securities are amortized to their earliest call date. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

A debt security is placed on nonaccrual status at the time any principal or interest payments become 90 days delinquent. Interest accrued but not received for a security placed on nonaccrual is reversed against interest income.

Fair value of investment securities is determined based on methodologies in accordance with generally accepted accounting principles. Fair values are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates and yield curves. Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments or an estimate of fair value by using a range of fair value estimates in the market place as a result of the illiquid market specific to the type of security.

Loans

The Bank grants commercial, real estate, agricultural, and consumer loans to customers. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge offs and the allowance for credit losses-loans. Interest income is accrued on the unpaid principal balance. Fees and costs associated with originating loans are generally deferred and recognized over the life of the loan as an adjustment of yield.

TRINITY BANK, N.A.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. In determining whether or not a borrower may be unable to meet payment obligations for each class of loans, the Bank considers the borrower's debt service capacity through the analysis of current financial information, if available, and/or current information with regards to the Bank's collateral position. Regulatory provisions typically require the placement of a loan on nonaccrual status if (i) principal or interest has been in default for a period of 90 days or more unless the loan is both well secured and in the process of collection or (ii) full payment of principal and interest is not expected. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed against interest income. Interest on nonaccrual loans is accounted for on the cash basis or cost recovery method until qualifying for return to accrual status. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

Allowance for Credit Losses (ACL)

As discussed in the Accounting Standards Adopted in 2023 caption, the Bank adopted *Accounting Standards Update (ASU) 2016-13, Financial Instruments-Credit Losses (ASC 326): Measurement of Credit Losses on Financial Instruments*, on January 1, 2023. In connection with the adoption of ASC 326, the Bank revised certain accounting policies to align its significant accounting policies with the requirements of the new standard. The revised accounting policies are described below.

Allowance For Credit Losses (ACL)-Available for Sale Securities

For available for sale securities in an unrealized loss position, the Bank assesses whether (i) the Bank intends to sell or (ii) it is more likely than not that the Bank will be required to sell the security before recovery of its amortized cost basis. If either case is affirmative, any previously recognized allowances are charged-off and the security's amortized cost is written down to fair value through income. If neither case is affirmative, the security is evaluated to determine whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency and any adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an ACL is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an ACL is recognized in other comprehensive income. Adjustments to the ACL are reported in the income statement as a component of credit loss expense, if applicable. Management has made the accounting policy election to exclude accrued interest receivable on available for sale securities from the estimate of credit losses. Available for sale securities are charged-off against the allowance or, in the absence of any allowance, written down through income when deemed uncollectible by management or when either of the aforementioned criteria regarding intent or requirement to sell is met.

Prior to the adoption of ASU 2016-13, declines in the fair value of held to maturity and available for sale securities below their cost that were deemed to be other than temporary were reflected in earnings as realized losses. In estimating other-than-temporary impairment losses prior to January 1, 2023, the Bank considered, among other things, (i) the length of time and the extent to which the fair value had been less than cost, (ii) the financial condition and near-term prospects of the issuer and (iii) the intent and the ability to retain the investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Allowance for Credit Losses (ACL)-Loans

The ACL on loans is a contra-asset valuation account, calculated in accordance with ASC 326, that is deducted from the amortized cost basis of loans to present the best estimate of the net amount expected to be collected. Loans are charged-off against the allowance when deemed uncollectible. Adjustments to the allowance are reported in the income statement as a component of credit loss expense. The Bank has made the accounting policy election to exclude accrued interest receivable on loans from the estimate of credit losses. The Bank estimates the allowance balance using relevant available information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. Historical credit loss experience provides the basis for the estimation of expected credit losses. Adjustments to historical loss information are made for differences in current loan-specific risk characteristics such as differences in underwriting standards, portfolio mix, delinquency level, or term, as well as for changes in environmental conditions, such as changes in unemployment rates, property values, or other relevant factors. Further information regarding the policies and methodology used to estimate the ACL on loans is presented in Note 5.

TRINITY BANK, N.A.

Allowance For Credit Losses (ACL) Off-Balance Sheet Credit Exposures

The Bank maintains a separate ACL on off-balance sheet credit exposures, including unfunded loan commitments, financial guarantees, and letters of credit, which is included in other liabilities on the balance sheet, unless the obligation is unconditionally cancellable. The relating ACL is calculated in accordance with ASC 326 and is adjusted as a provision for (or reversal of) credit loss expense. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over the estimated life of such commitments. The allowance is calculated using the same aggregate reserve rates calculated for the funded portion of the loan segment and applied to the amount of commitments expected to fund.

Restricted Equity Securities

Restricted equity securities include Federal Reserve Bank stock, which is carried at cost on the balance sheets. This equity security is restricted, in that it can only be sold back to the respective institution or another member institution at par. Therefore, it is less liquid than other marketable equity securities. The Bank views its investment in restricted stock as a long-term investment. Accordingly, when evaluating for impairment, the value is determined based on the ultimate recovery of the par value, rather than recognizing temporary declines in value. No impairment has been recorded on this security.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Bank has entered into, or intends to enter into in the future, commitments to extend credit including commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

Bank Premises and Equipment

Land is carried at cost. Bank premises and furniture and equipment are carried at cost, less accumulated depreciation and amortization computed using the straight-line method over the estimated useful lives of the related property.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in noninterest expense.

Repurchase Agreements

From time to time, the Bank sells certain securities under agreements to repurchase. The agreements are treated as financings, and the obligations to repurchase securities sold are reflected as a liability in the balance sheets. The dollar amount of securities underlying the agreements remains in the asset account.

Income Taxes

Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Accounting principles generally accepted in the United States of America require Bank management to evaluate tax positions taken by the Bank. Management evaluated the Bank's tax positions and concluded that the Bank had taken no uncertain tax positions that require recognition or disclosure in the financial statements. Therefore, no liability for tax penalties has been included in the financial statements. With few exceptions, the Bank is no longer subject to income tax examinations by the U.S. federal, state, or local tax authorities for years before 2020.

Revenue Recognition

In general, for revenue not associated with financial instruments, guarantees and lease contracts, the Bank applies the following steps when recognizing revenue from contracts with customers: (i) identify the contract, (ii) identify the performance obligations, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations and (v) recognize revenue when a performance obligation is satisfied. The Bank's contracts with customers are generally short term in nature, typically due within one year or less or cancellable by the Bank or the customer upon a short notice period. Performance obligations for customer contracts are generally satisfied at a single point in time, typically when the transaction is complete, or over time. For performance obligations satisfied over time, the Bank primarily uses the output method, directly measuring the value of the products/services transferred to the customer, to determine when performance obligations have been satisfied. The Bank typically receives payment from customers and recognizes revenue concurrent with the satisfaction of performance obligations. In most cases, this occurs within a single financial reporting period. For payments received in advance of the satisfaction of performance obligations, revenue recognition is deferred until such time as the performance obligations have been satisfied. In cases where the Bank has not received payment despite satisfaction of performance obligations, an estimate of the amount due in the period performance obligations have been satisfied is accrued. For contracts with variable components, only amounts for which collection is probable are accrued. The Bank generally acts in a principal capacity, on its own behalf, in most of its contracts with customers. In such transactions, revenue and the related costs to provide the services on a gross basis are accrued. In some cases, the Bank may act in an agent capacity, deriving revenue through assisting other entities in transactions with customers. In such transactions, revenue and the related costs to provide services are recognized on a net basis. These transactions recognized on a net basis primarily relate to fees derived from customers' use of various interchange and ATM/debit card networks.

Advertising

Advertising costs are expensed as incurred.

Comprehensive Income (Loss)

Comprehensive income (loss) includes both net income and other comprehensive income (loss), which includes the change in unrealized gains and losses on securities available for sale.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (i) the assets have been isolated from the Bank, (ii) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (iii) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Fair Values of Financial Instruments

ASC Topic 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and requires certain disclosures about fair value measurements. In general, fair values of financial instruments are based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Bank's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time.

Stock Compensation Plans

The Bank recorded approximately \$151,000 and \$160,000 of compensation expense in regard to its stock compensation plans during 2023 and 2022, respectively. Under generally accepted accounting principles, compensation expense for stock options is based on the fair value of the award on the measurement date. The fair value of stock options is estimated by the Bank using the Black-Scholes option-pricing model. The fair value on non-vested stock awards is generally the market price of the Bank's stock on the date of grant.

Treasury Stock

Treasury stock is recorded at cost. The Bank had 173,072 and 167,526 shares held in treasury at December 31, 2023 and 2022, respectively.

Earnings Per Share

Earnings per share is computed in accordance with ASC Topic 260, *Earnings Per Share*, which requires dual presentation of basic and fully diluted earnings per share (EPS) for entities with complex capital structures. Basic EPS is based on net income divided by the weighted-average number of shares outstanding during the period. Diluted EPS includes the dilutive effect of potential common stock using the treasury stock method only if the effect on earnings per share is dilutive.

Earnings per common share are computed by dividing net income by the weighted-average number of shares outstanding for the year. The weighted-average number of common shares outstanding for basic earnings per share computations was 1,088,694 and 1,091,194 for the years ended December 31, 2023 and 2022, respectively. The weighted-average number of common shares outstanding for fully diluted earnings per share computations was 1,138,741 and 1,140,259 for the years ended December 31, 2023 and 2022, respectively.

Subsequent Events

The Bank has evaluated events and transactions for potential recognition or disclosure through March 16, 2024, the date the financial statements were available to be issued.

Reclassification

Certain amounts previously reported have been reclassified to conform to the current format.

2. Recent Accounting Pronouncements

In January 2017, the FASB issued Accounting Standards Update 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The update simplifies the measurement of goodwill impairment by eliminating the requirement that an entity compute the implied fair value of goodwill based on the fair values of its assets and liabilities to measure impairment. Instead, goodwill impairment will be measured as the difference between the fair value of the reporting unit and the carrying value of the reporting unit. ASU 2017-04 is effective for fiscal years beginning after December 15, 2022. Early application was permitted. The adoption of ASU 2017-04 did not have a material impact on the Bank's financial statements.

In June 2022, the FASB issued Accounting Standards Update 2022-03, *Fair Value Measurement (Topic 820); Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*. The amendments in this update clarify that a contractual restriction on the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, is not considered in measuring fair value. The amendments also require certain disclosures for equity securities subject to contractual sale restrictions: (1) the fair value of equity securities subject to contractual sale restrictions reflected in the balance sheet, (2) the nature and remaining duration of the restriction(s), (3) the circumstances that could cause a lapse in the restriction(s). The amendments are effective for PBEs for fiscal years beginning after December 15, 2023 and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2024 and interim periods within those fiscal years. Early adoption is permitted. The adoption of ASU 2022-03 is not expected to have a material impact on the Bank's financial statements.

3. Statement of Cash Flows

The Bank reports on a net basis its cash receipts and cash payments for time deposits accepted and repayments of those deposits, loans made to customers and principal collections on those loans.

The Bank uses the indirect method to present cash flows from operating activities. Other supplemental cash flow information for the years ended December 31, 2023 and 2022 is presented as follows (in thousands):

	<u>2023</u>	<u>2022</u>
Cash transactions:		
Interest expense paid	\$ <u>8,278</u>	\$ <u>1,857</u>
Income taxes paid	\$ <u>1,460</u>	\$ <u>1,255</u>

4. Debt Securities

The amortized cost (net of any allowance for credit loss), gross unrealized gains and losses, and estimated fair values of the Bank's investment securities as classified in the accompanying balance sheet are as follows (in thousands):

<u>Securities Available for Sale</u>	<u>Amortized Cost, Net</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
December 31, 2023:				
Municipal securities	\$ 143,414	\$ 1,304	\$ 4,745	\$ 139,973
December 31, 2022:				
Municipal securities	\$ 141,995	\$ 357	\$ 7,724	\$ 134,628

Accrued interest receivable on securities available for sale totaled approximately \$1,508,000 and \$1,461,000 at December 31, 2023 and 2022, respectively, and is included in other assets in the accompanying balance sheets. Accrued interest is excluded from the estimate of credit losses.

Substantially all of the securities in the municipal securities portfolio were issued by the State of Texas or political subdivisions or agencies within the State of Texas. At December 31, 2023, the Bank had investments in securities available for sale from Harris County, Fort Bend County, and Montgomery County of approximately \$16,496,000, \$10,964,000, and \$6,843,000, respectively, representing 33%, 22%, and 13%, respectively of the Bank's total equity.

The amortized cost (net of any allowance for credit loss) and estimated fair value of debt securities at December 31, 2023 by contractual maturity are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Securities Available for Sale</u>	
	<u>Amortized Cost, Net</u>	<u>Fair Value</u>
Due in one year or less	\$ 6,596	\$ 6,504
Due from one year to five years	31,330	30,419
Due from five years to ten years	60,284	58,417
Due after ten years	45,204	44,633
	<u>\$ 143,414</u>	<u>\$ 139,973</u>

Proceeds from the sales of securities available for sale were approximately \$16,780,000 and \$16,748,000 for the years ended December 31, 2023 and 2022, respectively. Gross gains of approximately \$146,000 and \$5,000 and gross losses of approximately \$186,000 and \$187,000 were recognized on the sale of securities available for sale in 2023 and 2022, respectively.

Securities carried at approximately \$14,817,000 at December 31, 2023 were pledged to secure public and trust deposits. There were no securities classified as available for sale which were pledged as collateral for purposes required or permitted by law at December 31, 2022.

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Unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2023 and 2022 are summarized as follows (in thousands):

	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Losses</u>	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Losses</u>	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Losses</u>
<u>Securities Available for Sale</u>						
December 31, 2023:						
State and political subdivisions	\$ 15,058	\$ 122	\$ 88,919	\$ 4,623	\$ 103,977	\$ 4,745
December 31, 2022:						
State and political subdivisions	\$ 66,213	\$ 2,985	\$ 55,787	\$ 4,739	\$ 122,000	\$ 7,724

As of December 31, 2023, no allowance for credit losses has been recognized on available for sale securities in an unrealized loss position as management believes the impairments detailed in the table above are temporary and does not believe any of the securities are impaired due to credit quality. This is based upon an analysis of the underlying risk characteristics, including credit ratings, and other qualitative factors related to the available for sale securities and in consideration of the Bank's historical credit loss experience and internal forecasts. The issuers of these securities continue to make timely principal and interest payments under the contractual terms of the securities. As of December 31, 2023, management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that the Bank will not have to sell any such securities before a recovery of cost. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity or repricing date or if market yields for such investments decline.

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5. Loans and Allowance for Credit Losses on Loans

Loans at December 31, 2023 and 2022 consisted of the following (in thousands):

	<u>2023</u>	<u>2022</u>
Real estate:		
Construction, land development, land	\$ 30,724	\$ 25,083
Farmland	1,656	4,471
1-4 family residential properties	15,615	12,948
Nonfarm nonresidential owner occupied	46,563	43,783
Nonfarm nonresidential other	<u>40,025</u>	<u>34,414</u>
Total real estate	134,583	120,699
Commercial	163,017	161,255
Consumer	<u>306</u>	<u>283</u>
	297,906	282,237
Unearned fees	(483)	(380)
Allowance for credit losses-loans	<u>(5,224)</u>	<u>(4,323)</u>
	<u>\$ 292,199</u>	<u>\$ 277,534</u>

The Bank extends commercial and consumer credit primarily to customers in the state of Texas. At December 31, 2023 and 2022, a significant portion of the Bank's loans were collateralized with real estate. The real estate collateral provides an alternate source of repayment in the event of default by the borrower, and may deteriorate in value during the time the credit is extended. The weakening of real estate markets may have an adverse effect on the Bank's profitability and asset quality. If the Bank were required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, earnings and capital could be adversely affected. Additionally, the Bank has loans secured by inventory, accounts receivable, equipment, marketable securities, or other assets. The debtors' ability to honor their contracts on all loans is substantially affected by the general economic conditions of the region.

Sound risk management practices and appropriate levels of capital are essential elements of a sound commercial real estate lending program (CRE) for financial institutions. Concentrations of CRE exposures add a dimension of risk that compounds the risk inherent in individual loans. Interagency guidance on CRE concentrations describe sound risk management practices which include board and management oversight, portfolio management, management information systems, market analysis, portfolio stress testing and sensitivity analysis, credit underwriting standards, and credit risk review functions. Management believes it has implemented these practices in order to monitor its CRE. An institution which has reported loans for construction, land development, and other land loans representing 100% or more of total risk based capital, or total non-owner occupied commercial real estate loans representing 300% or more of the institution's total risk based capital and the outstanding balance of commercial real estate loan portfolio has increased by 50% or more during the prior 36 months, may be identified for further supervisory analysis by regulators to assess the nature and risk posed by the concentration. At December 31, 2023 and 2022, the Bank had total commercial real estate loans of \$117,312,000 and \$103,280,000, respectively. Included in these amounts, the Bank had construction, land development, and other land loans representing 53% and 47%, respectively, of its tier I capital plus the allowance for credit loss-loans at December 31, 2023 and 2022. The Bank had non-owner occupied commercial real estate loans representing 122% and 112% of its tier I capital plus the allowance for credit loss-loans for the years ending December 31, 2023 and 2022, respectively.

Accrued Interest Receivable

Accrued interest receivable on loans totaled approximately \$1,129,000 and \$766,000 at December 31, 2023 and 2022, respectively, and is included in other assets in the accompanying balance sheets. Accrued interest is excluded from the estimate of credit losses.

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Nonaccrual Loans

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions.

The Bank had no nonaccrual loans at December 31, 2023. Nonaccrual loans, segregated by class of loans at December 31, 2022 under the Incurred Loss Method, is as follows, (in thousands):

	Incurred Loss December 31, 2022
	<u>Total Nonaccrual</u>
Real estate:	
Construction, land development, land	\$ -
Farmland	-
1-4 family residential properties	-
Nonfarm nonresidential owner occupied	-
Nonfarm nonresidential other	-
Total real estate	-
Commercial	171
Consumer	-
Other	-
	<u>\$ 171</u>

Impaired Loans

Prior to the adoption of ASC 326 on January 1, 2023, loans were reported as impaired when, based on current information and events, it was probable the Bank would be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment was evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan was impaired, a specific valuation allowance was allocated, if necessary, so that the loan was reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment was expected solely from the collateral. Interest payments on impaired loans were typically applied to principal unless collectability of the principal amount was reasonably assured, in which case interest was recognized on a cash basis. Impaired loans, or portions thereof, were charged off when deemed uncollectible. Impaired loans may include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. Average impaired loans during the year ended December 31, 2022 were approximately \$215,000. No significant interest income was recognized on impaired loans during 2022. Following is a summary of information pertaining to impaired loans at December 31, 2022 (in thousands):

	Unpaid Principal <u>Balance</u>	<u>Recorded Investment</u>			Related <u>Allowance</u>
		With No <u>Allowance</u>	With <u>Allowance</u>	<u>Total</u>	
Real estate:					
Construction, land development, land	\$ -	\$ -	\$ -	\$ -	\$ -
Farmland	-	-	-	-	-
1-4 family residential properties	-	-	-	-	-
Multi-family residential	-	-	-	-	-
Nonfarm nonresidential owner occupied	-	-	-	-	-
Nonfarm nonresidential other	-	-	-	-	-
Total real estate	-	-	-	-	-
Commercial	249	171	-	171	-
Consumer	-	-	-	-	-
	<u>\$ 249</u>	<u>\$ 171</u>	<u>\$ -</u>	<u>\$ 171</u>	<u>\$ -</u>

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Collateral-Dependent Loans

At December 31, 2023, the Bank had no significant loans for which repayment was dependent upon the operation or sale of collateral.

Loan Modifications

Effective January 1, 2023, the Bank adopted the provision of ASU 2022-02, which eliminated the TDR recognition and measurement guidance and instead require an entity evaluate whether the modification represents a new loan or a continuation of an existing loan.

The Bank had no loans that were experiencing financial difficulty which had been modified during the years ended December 31, 2023 and 2022. The Bank is not committed to lend additional funds to debtors whose loans have been modified.

Loans in Process of Foreclosure

At December 31, 2023, the Bank had no loans secured by properties for which foreclosure proceedings were in process.

Past Due Loans

The Bank had no significant past due loans at December 31, 2023 and 2022.

Credit Quality Information

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, including: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. The Bank uses the following definitions for risk ratings:

Pass

Loans classified as pass are loans with low to average risk.

Special Mention

Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Bank's credit position at some future date.

Substandard

Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful

Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

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As of December 31, 2023, and based on the most recent analysis performed, the risk category of loans by class and year of origination/renewal (in accordance with ASC 326) is as follows (in thousands):

	<u>Total Loans Amortized Cost Basis by Origination Year</u>				
	<u>2023</u>	<u>2022</u>	<u>2021</u>	<u>Prior</u>	<u>Total</u>
December 31, 2023:					
Construction, land development, land:					
Risk Rating					
Pass	\$ 9,562	\$ 4,375	\$ 15,535	\$ 1,252	\$ 30,724
Special mention	-	-	-	-	-
Substandard	-	-	-	-	-
Doubtful	-	-	-	-	-
Total construction, land development, land loans	<u>\$ 9,562</u>	<u>\$ 4,375</u>	<u>\$ 15,535</u>	<u>\$ 1,252</u>	<u>\$ 30,724</u>
Farmland:					
Risk Rating					
Pass	\$ 358	\$ -	\$ 345	\$ 821	\$ 1,524
Special mention	-	-	-	-	-
Substandard	-	-	-	132	132
Doubtful	-	-	-	-	-
Total farmland loans	<u>\$ 358</u>	<u>\$ -</u>	<u>\$ 345</u>	<u>\$ 953</u>	<u>\$ 1,656</u>
1-4 family residential properties:					
Risk Rating					
Pass	\$ 9,737	\$ 939	\$ 2,711	\$ 2,228	\$ 15,615
Special mention	-	-	-	-	-
Substandard	-	-	-	-	-
Doubtful	-	-	-	-	-
Total 1-4 family residential properties loans	<u>\$ 9,737</u>	<u>\$ 939</u>	<u>\$ 2,711</u>	<u>\$ 2,228</u>	<u>\$ 15,615</u>
Nonfarm nonresidential owner occupied:					
Risk Rating					
Pass	\$ 5,328	\$ 12,844	\$ 2,619	\$ 25,582	\$ 46,373
Special mention	-	-	-	-	-
Substandard	-	-	-	190	190
Doubtful	-	-	-	-	-
Total nonfarm nonresidential owner occupied loans	<u>\$ 5,328</u>	<u>\$ 12,844</u>	<u>\$ 2,619</u>	<u>\$ 25,772</u>	<u>\$ 46,563</u>
Nonfarm nonresidential other:					
Risk Rating					
Pass	\$ 14,533	\$ 20,867	\$ 1,836	\$ 2,789	\$ 40,025
Special mention	-	-	-	-	-
Substandard	-	-	-	-	-
Doubtful	-	-	-	-	-
Total nonfarm nonresidential other loans	<u>\$ 14,533</u>	<u>\$ 20,867</u>	<u>\$ 1,836</u>	<u>\$ 2,789</u>	<u>\$ 40,025</u>
Commercial:					
Risk Rating					
Pass	\$ 84,062	\$ 37,407	\$ 22,932	\$ 16,943	\$ 161,344
Special mention	-	-	450	1,000	1,450
Substandard	-	-	-	223	223
Doubtful	-	-	-	-	-
Total commercial loans	<u>\$ 84,062</u>	<u>\$ 37,407</u>	<u>\$ 23,382</u>	<u>\$ 18,166</u>	<u>\$ 163,017</u>
Consumer:					
Risk Rating					
Pass	\$ 190	\$ 68	\$ 35	\$ 13	\$ 306
Special mention	-	-	-	-	-
Substandard	-	-	-	-	-
Doubtful	-	-	-	-	-
Total consumer loans	<u>\$ 190</u>	<u>\$ 68</u>	<u>\$ 35</u>	<u>\$ 13</u>	<u>\$ 306</u>

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As of December 31, 2022, and based on the most recent analysis performed, the risk category of loans by class is as follows (in thousands):

	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
December 31, 2022:					
Real estate:					
Construction, land development, land	\$ 25,083	\$ -	\$ -	\$ -	\$ 25,083
Farmland	4,323	-	148	-	4,471
1-4 family residential properties	12,948	-	-	-	12,948
Nonfarm nonresidential owner occupied	43,570	-	213	-	43,783
Nonfarm nonresidential other	<u>34,414</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>34,414</u>
Total real estate	120,338	-	361	-	120,699
Commercial	159,199	1,450	606	-	161,255
Consumer	<u>283</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>283</u>
	<u>\$ 279,820</u>	<u>\$ 1,450</u>	<u>\$ 967</u>	<u>\$ -</u>	<u>\$ 282,237</u>

Allowance For Credit Losses (ACL) - Loans

The allowance for credit losses-loans represents management's best estimate of current expected credit losses on loans considering available information, from internal and external sources, relevant to assessing collectability over the loans' contractual terms, adjusted for expected prepayments. Credit loss expense related to loans reflects the totality of actions taken on all loans for a particular period including any necessary increases or decreases in the allowance related to changes in credit loss expectations associated with specific loans or pools of loans. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate appropriateness of the allowance is dependent upon a variety of factors beyond the Bank's control, including the performance of the loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

Management may also adjust its assumptions to account for differences between expected and actual losses from period to period. The variability of management's assumptions could alter the ACL on loans materially and impact future results of operations and financial condition. The loss estimation models and methods used to determine the allowance for credit losses are continually refined and enhanced.

Methodology

The Bank is utilizing a third-party model to tabulate its estimate of current expected credit losses, using a weighted average remaining maturity (WARM) methodology. In accordance with ASC 326, the Bank has segmented its loan portfolio based on similar risk characteristics which include type/purpose of the loans, underlying collateral and historical credit loss patterns. The Bank utilizes relevant economic data for its reasonable and supportable forecasting of current expected credit losses. In determining the quantitative component of the calculation, the average annual charge off rate for the Bank is calculated for each loan pool. To further adjust the allowance for credit losses for expected losses not already included within the quantitative component of the calculation, the Bank considers qualitative adjustment factors.

The allowance is comprised of three distinct reserve components as discussed below:

Specific Reserve for Loans Individually Evaluated

The Bank identifies loan relationships that may have credit weaknesses. Such loan relationships are identified primarily through the analysis of loan evaluations and past due loan reports. Each loan so identified is then individually evaluated to determine whether it is probable that the Bank will be unable to collect all amounts due in accordance with the contractual terms of the underlying loan agreement. The Bank performs an analysis based on the fair value of the loan's collateral, which is generally determined utilizing current appraisals, less estimated selling costs if the loan is collateral dependent or the present value of expected future cash flows from the loan discounted at the loans effective interest rate. A specific reserve is established in an amount equal to the excess, if any, of the recorded investment in the loan over the fair value of its underlying collateral, less estimated costs to sell.

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Quantitative Reserve for Loans Collectively Evaluated

In determining the quantitative reserve for loans collectively evaluated, the Bank stratifies the loan portfolio into similar loan segments. The Bank then determines a “look back” period that is intended to be the historical period which best reflects the expected environment for the future of the Bank’s current loan portfolio. The Bank calculates an average annual historical loss rate for each loan segment using peer loss rate data and/or the Bank’s historical loss rate for the lookback period selected, with a minimum loss rate of 0.110%. The calculation of the average historical loss rate is then adjusted for reasonable and supportable forecast periods. The adjusted annual historical loss rate (including any forecast adjustments) is then applied to the balance of the loan segment over the expected average life of the respective loan segment.

Qualitative Reserve for Loans Collectively Evaluated

Management qualitatively adjusts model results for risk factors that are not considered within the modeling processes but are nonetheless relevant in assessing the expected credit losses within the loan pools. These qualitative factors (Q-Factors) and other qualitative adjustments may increase or decrease the estimate of expected credit losses by a calculated percentage or amount based upon the estimated level of risk. The various risks that may be considered in making Q-Factor and other qualitative adjustments include, among other things, the impact of (i) changes in lending policies and procedures, including changes in underwriting standards and practices for collections, write-offs, and recoveries, (ii) actual and expected changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the loan pools, (iii) changes in the nature and volume of the loan pools and in the terms of the underlying loans, (iv) changes in the experience, ability, and depth of the lending management and staff, (v) changes in volume and severity of past due financial assets, the volume of nonaccrual assets, and the volume and severity of adversely classified or graded assets, (vi) changes in the quality of the credit review function, (vii) changes in the value of the underlying collateral for loans that are non-collateral dependent, (viii) the existence, growth, and effect of any concentrations of credit and (ix) other factors such as the regulatory, legal and technological environments; competition; and events such as natural disasters or health pandemics. The qualitative adjustment factor for each loan segment is then applied over the expected life of the loan segment.

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Allowance for Credit Losses-Loans

The following table presents details of the allowance for credit losses-loans segregated by loan portfolio segment as of December 31, 2023, calculated in accordance with the CECL methodology described above, (in thousands):

	Loans			Allowance for Credit Losses -Loans		
	Individually	Collectively	Total	Individually	Collectively	Total
	<u>Evaluated</u>	<u>Evaluated</u>		<u>Evaluated</u>	<u>Evaluated</u>	
Real estate:						
Construction, land development, land	\$ -	\$ 30,724	\$ 30,724	\$ -	\$ 676	\$ 676
Farmland	-	1,656	1,656	-	20	20
1-4 family residential properties	-	15,615	15,615	-	170	170
Nonfarm nonresidential owner occupied	-	46,563	46,563	-	604	604
Nonfarm nonresidential other	-	40,025	40,025	-	623	623
Total real estate	-	134,583	134,583	-	2,093	2,093
Commercial	-	163,017	163,017	-	3,126	3,126
Consumer	-	306	306	-	5	5
	<u>\$ -</u>	<u>\$ 297,906</u>	<u>\$ 297,906</u>	<u>\$ -</u>	<u>\$ 5,224</u>	<u>\$ 5,224</u>

Prior to the adoption of ASC 326, the Bank's individual allowance for loan loss (ALLL) allocations were established for probable losses on specific loans. The Bank's general ALLL allocations were established based upon historical loss experience for similar loans with similar characteristics and on economic conditions and other qualitative risk factors both internal and external to the Bank. Further information pertaining to the ALLL at December 31, 2022 is as follows (in thousands):

	Loan Evaluation			ALLL Allocations			
	Individually	General	Total loans	Individually	General		Total ALLL
					Historical	Other	
Real estate:							
Construction, land development, land	\$ -	\$ 25,083	\$ 25,083	\$ -	\$ -	\$ 385	\$ 385
Farmland	-	4,471	4,471	-	-	69	69
1-4 family residential properties	-	12,948	12,948	-	-	199	199
Nonfarm nonresidential owner occupied	-	43,783	43,783	-	-	667	667
Nonfarm nonresidential other	-	34,414	34,414	-	-	528	528
Total real estate	-	120,699	120,699	-	-	1,848	1,848
Commercial	171	161,084	161,255	-	-	2,471	2,471
Consumer	-	283	283	-	-	4	4
	<u>\$ 171</u>	<u>\$ 282,066</u>	<u>\$ 282,237</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,323</u>	<u>\$ 4,323</u>

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Allowance for Credit Losses-Loans

An analysis of the allowance for credit losses-loans for the years ended December 31, 2023 and 2022 is as follows (in thousands):

	Beginning <u>Balance</u>	Cumulative Effect of Change in Accounting <u>Principle</u>	<u>Provision</u>	<u>Charge offs</u>	<u>Recoveries</u>	Ending <u>Balance</u>
December 31, 2023:						
Real estate:						
Construction, land development, land	\$ 385	\$ 219	\$ 72	\$ -	\$ -	\$ 676
Farmland	69	(9)	(40)	-	-	20
1-4 family residential properties	199	(13)	(16)	-	-	170
Nonfarm nonresidential owner occupied	667	(24)	(39)	-	-	604
Nonfarm nonresidential other	<u>528</u>	<u>90</u>	<u>5</u>	<u>-</u>	<u>-</u>	<u>623</u>
Total real estate	1,848	263	(18)	-	-	2,093
Commercial	2,471	757	17	(127)	8	3,126
Consumer	<u>4</u>	<u>-</u>	<u>1</u>	<u>-</u>	<u>-</u>	<u>5</u>
	<u>\$ 4,323</u>	<u>\$ 1,020</u>	<u>\$ -</u>	<u>\$ (127)</u>	<u>\$ 8</u>	<u>\$ 5,224</u>
December 31, 2022:						
Real estate:						
Construction, land development, land	\$ 491	\$ -	\$ (106)	\$ -	\$ -	\$ 385
Farmland	101	-	(32)	-	-	69
1-4 family residential properties	176	-	23	-	-	199
Nonfarm nonresidential owner occupied	659	-	8	-	-	667
Nonfarm nonresidential other	<u>378</u>	<u>-</u>	<u>150</u>	<u>-</u>	<u>-</u>	<u>528</u>
Total real estate	1,805	-	43	-	-	1,848
Commercial	2,496	-	(42)	-	17	2,471
Consumer	<u>5</u>	<u>-</u>	<u>(1)</u>	<u>-</u>	<u>-</u>	<u>4</u>
	<u>\$ 4,306</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 17</u>	<u>\$ 4,323</u>

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6. Bank Premises and Equipment

Bank premises and equipment at December 31, 2023 and 2022 consisted of the following (in thousands):

	<u>2023</u>	<u>2022</u>
Land	\$ 422	\$ 422
Building and improvements	2,490	2,351
Furniture, fixtures and equipment	1,630	2,277
Autos	<u>264</u>	<u>184</u>
	4,806	5,234
Accumulated depreciation	<u>(2,419)</u>	<u>(3,038)</u>
	<u><u>\$ 2,387</u></u>	<u><u>\$ 2,196</u></u>

7. Deposits

Deposits at December 31, 2023 and 2022 are summarized as follows (in thousands):

	<u>2023</u>		<u>2022</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
Noninterest bearing demand accounts	\$ 130,602	30.2	\$ 159,568	40.0
Interest bearing demand accounts	30,318	7.0	37,095	9.2
Limited access money market accounts	169,935	39.3	141,544	35.3
Certificates of deposit, \$250,000 and greater	33,839	7.9	36,298	9.0
Certificates of deposit, less than \$250,000	<u>67,510</u>	<u>15.6</u>	<u>25,946</u>	<u>6.5</u>
	<u><u>\$ 432,204</u></u>	<u><u>100.0</u></u>	<u><u>\$ 400,451</u></u>	<u><u>100.0</u></u>

The Bank had brokered deposits of approximately \$10,000,000 at both December 31, 2023 and 2022, respectively.

At December 31, 2023, scheduled maturities of certificates of deposit accounts are as follows (in thousands):

Less than one year	\$ 96,364
One to three years	4,985
Over three years	<u>-</u>
	<u><u>\$ 101,349</u></u>

8. Other Borrowings

Securities Sold Under Agreements to Repurchase

From time to time, the Bank has borrowings incurred in connection with securities sold under agreements to repurchase. Repurchase agreements are secured borrowings. The Bank pledges investment securities to secure these borrowings. The fair value of investment securities pledged to secure repurchase agreements may decline. The Bank manages this risk by having a policy to pledge securities valued above the gross outstanding balance of repurchase agreements. The Bank had no securities sold under agreements to repurchase during the years ended December 31, 2023 and 2022.

Federal Reserve Bank Term Funding Program

The Bank is a participant in the Bank Term Funding Program (BTFP) established and administered by the Federal Reserve Bank to ensure eligible banks and depository institutions have access to additional funding to meet the needs of all their depositors. The Program offers advances of up to one year to eligible banks and depository institutions pledging collateral eligible for purchase by the Federal Reserve Banks in open market operations at par value thereby eliminating an institution's need to quickly sell those securities in times of stress. At December 31, 2023, the Bank had no BTFP advances outstanding. BTFP advances are collateralized by municipal securities. The Bank has available approximately \$14,326,000 from the BTFP through pledged securities at December 31, 2023.

Other

The Bank has unused federal funds lines available from commercial banks of approximately \$22,500,000 at December 31, 2023.

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9. Income Taxes

The provision for income taxes for the years ended December 31, 2023 and 2022 consisted of the following (in thousands):

	<u>2023</u>	<u>2022</u>
Income tax expense (benefit):		
Current	\$ 1,372	\$ 1,347
Deferred	<u>(242)</u>	<u>(67)</u>
Income tax expense	<u>\$ 1,130</u>	<u>\$ 1,280</u>

The difference between the federal income tax at the statutory rate of 21% and the effective tax rate for the years ended December 31, 2023 and 2022 is primarily due to tax exempt interest income from municipal securities partially offset by certain expenses not deductible for federal income tax purposes.

A reconciliation of the expected tax expense based on the federal statutory rate to the actual expense for federal income taxes is as follows (in thousands):

	<u>2023</u>	<u>Percent</u>	<u>2022</u>	<u>Percent</u>
Tax expense based on statutory rate	\$ 1,920	21.0	\$ 1,795	21.0
Non-taxable income	(722)	(7.9)	(638)	(7.5)
Net non-deductible expenses	156	1.7	73	0.9
Other	<u>(224)</u>	<u>(2.4)</u>	<u>50</u>	<u>1</u>
	<u>\$ 1,130</u>	<u>12.4</u>	<u>\$ 1,280</u>	<u>15.0</u>

Deferred income taxes reflect the net tax effects of temporary differences between the recorded amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purpose. Significant components of the Bank's deferred tax assets and liabilities as of December 31, 2023 and 2022 are as follows (in thousands):

	<u>2023</u>	<u>2022</u>
Deferred tax assets:		
Net unrealized depreciation on securities available for sale	\$ 723	\$ 1,547
Allowance for credit losses-loans for book in excess of tax	1,008	794
Allowance for credit losses-off-balance sheet credit exposures	59	-
Deferred compensation	217	179
Other	<u>118</u>	<u>26</u>
Total deferred tax assets	<u>2,125</u>	<u>2,546</u>
Deferred tax liabilities:		
Premises and equipment basis for book in excess of tax	35	14
Other	<u>-</u>	<u>133</u>
Total deferred tax liabilities	<u>35</u>	<u>147</u>
Net deferred tax asset	<u>\$ 2,090</u>	<u>\$ 2,399</u>

Included in other assets at December 31, 2023 and 2022 is a deferred tax asset of approximately \$2,090,000 and \$2,399,000, respectively. Additionally, and included in other assets at December 31, 2023 and 2022 is a current income tax receivable of approximately \$95,000 and \$6,000, respectively.

In connection with the adoption of ASC 326 referred to in Note 1, the Bank recognized a deferred tax asset of approximately \$273,000 regarding the increase in the allowance for credit losses-loans and allowance for credit losses-off balance sheet exposures effective January 1, 2023.

10. Financial Instruments

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

At December 31, 2023 and 2022, the approximate amounts of these financial instruments were as follows (in thousands):

	<u>2023</u>	<u>2022</u>
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 157,774	\$ 132,362
Standby letters of credit	<u>793</u>	<u>572</u>
	<u>\$ 158,567</u>	<u>\$ 132,934</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Management evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Standby letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank's policy for obtaining collateral and the nature of such collateral is essentially the same as that involved in making commitments to extend credit.

Allowance For Credit Losses (ACL)-Off-Balance Sheet Credit Exposures

The ACL on off-balance sheet credit exposures is a liability account, calculated in accordance with ASC 326, representing expected credit losses over the contractual period for which the Bank are exposed to credit risk resulting from a contractual obligation to extend credit. No allowance is recognized if the Bank has the unconditional right to cancel the obligation. Off-balance sheet credit exposures primarily consist of amounts available under outstanding lines of credit and letters of credit detailed in the table above. For the period of exposure, the estimate of expected credit losses considers both the likelihood that funding will occur and the amount expected to be funded over the estimated remaining life of the commitment or other off-balance sheet exposure. The likelihood and expected amount of funding are based on historical utilization rates. The amount of the allowance represents management's best estimate of expected credit losses on commitments expected to be funded over the contractual life of the commitment. Estimating credit losses on amounts expected to be funded uses the same methodology as described for loans in Note 5 as if such commitments were funded.

The following table details activity in the allowance for credit losses on off-balance sheet credit exposures for the years ending December 31, 2023 and 2022, (in thousands):

	<u>2023</u>	<u>2022</u>
Beginning balance	\$ -	\$ -
Impact of adopting ASC 326	280	-
Credit loss expense	<u>-</u>	<u>-</u>
Ending balance	<u>\$ 280</u>	<u>\$ -</u>

11. Commitments and Contingencies

From time to time, the Bank may be involved in legal actions arising from normal business activities. There were no such legal actions or pending litigation at December 31, 2023 and 2022.

The Bank does not anticipate any material losses as a result of commitments and contingent liabilities.

12. Significant Group Concentrations of Credit Risk

Most of the Bank's business activity is with customers located within Texas. Such customers are normally also depositors of the Bank.

The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers.

The contractual amounts of credit related financial instruments such as commitments to extend credit, credit card arrangements, and letters of credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer default, and the value of any existing collateral become worthless.

The nature of the Bank's business requires that it maintain amounts due from banks which, at times, may exceed federally insured limits. The Bank has not experienced any losses from such accounts.

13. Related Party Transactions

In the ordinary course of business, the Bank has and expects to continue to have transactions, including borrowings, with its officers, directors and their affiliates. In the opinion of management, such transactions are on the same terms, including interest rates and collateral requirements, as those prevailing at the time for comparable transactions with unaffiliated persons. At December 31, 2023 and 2022, the aggregate amounts of such loans were approximately \$20,549,000 and \$15,923,000, respectively. During 2023 new loans totaled \$4,934,000 and a new director was elected to the Board with loans totaling approximately \$5,220,000. Net repayments on loans during 2023 totaled approximately \$5,528,000. Additionally, the Bank had unfunded commitments to these parties of approximately \$18,807,000 and \$5,442,000 at December 31, 2023 and 2022, respectively.

From time to time, an officer of the Bank may purchase a participation in certain loans made by the Bank that are in excess of the Bank's legal lending limit. There were no related party loan participations outstanding at December 31, 2023 and 2022.

14. Fair Value Disclosures

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Bank utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- *Level 1 Inputs*-Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- *Level 2 Inputs*-Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.
- *Level 3 Inputs*-Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Bank's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Bank's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Bank's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Furthermore, the reported fair value amounts have not been comprehensively revalued since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein.

Assets and liabilities measured at fair value on a recurring basis at December 31, 2023 and 2022 are as follows (in thousands):

	Fair Value Measurements Using		
	Level 1	Level 2	Level 3
December 31, 2023:			
Securities available for sale (1)	\$ -	\$ 139,973	\$ -
December 31, 2022:			
Securities available for sale (1)	\$ -	\$ 134,628	\$ -

(1) Securities are measured at fair value on a recurring basis, generally monthly.

Certain financial and non-financial assets may be measured at fair value on a non-recurring basis; that is, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). There were no financial assets and non-financial assets, measured at fair value on a non-recurring basis as of December 31, 2023 and 2022.

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Following is a table that summarizes the fair values of all financial instruments of the Bank at December 31, 2023 and 2022, followed by methods and assumptions that were used by the Bank in estimating the fair value of the classes of financial instruments not covered by FASB ASC Topic 820. The estimated fair value amounts of financial instruments have been determined by the Bank using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Bank could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The estimated fair values of the Bank's financial instruments at December 31, 2023 and 2022 were as follows (in thousands):

		Total Estimated Fair Value		
	Carrying <u>Amount</u>	Level 1 <u>Inputs</u>	Level 2 <u>Inputs</u>	Level 3 <u>Inputs</u>
December 31, 2023:				
Financial assets:				
Cash and cash equivalents	\$ 45,675	\$ 45,675	\$ -	\$ -
Securities available for sale	139,973	-	139,973	-
Loans	292,199	-	-	281,096
Accrued interest receivable	2,651	2,651	-	-
Financial liabilities:				
Deposits	432,204	-	-	405,626
Accrued interest payable	538	538	-	-
Off-balance sheet instruments:				
Commitments to extend credit	-	-	-	-
Standby letters of credit	-	-	-	-
December 31, 2022:				
Financial assets:				
Cash and cash equivalents	\$ 25,562	\$ 25,562	\$ -	\$ -
Securities available for sale	134,628	-	134,628	-
Loans	277,534	-	-	265,058
Accrued interest receivable	2,239	2,239	-	-
Financial liabilities:				
Deposits	400,451	-	-	400,508
Accrued interest payable	205	205	-	-
Off-balance sheet instruments:				
Commitments to extend credit	-	-	-	-
Standby letters of credit	-	-	-	-

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The following methods and assumptions were used by the Bank in estimating the fair values of financial instruments as disclosed herein:

Cash and cash equivalents

The carrying amounts of cash and short-term instruments approximate their fair value.

Securities available for sale

Fair values for securities excluding restricted equity securities, are based on quoted market prices.

Loans

For variable-rate loans that reprice frequently and have no significant changes in credit risk, fair values are based on carrying values. Fair values for fixed-rate commercial real estate, mortgage, consumer and commercial loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposits

The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed term money market accounts and certificates of deposit (CD's) approximate their fair values at the reporting date. Fair values for fixed-rate CD's are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Accrued interest

The carrying amounts of accrued interest approximate their fair values.

Off-balance sheet instruments

Fair values for off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements taking into account the remaining terms of the agreements and the counterparties' credit standings.

15. Employee Benefit Plan

The Bank has a 401(k) profit sharing plan (Plan) to provide retirement benefits for employees. The Plan covers all eligible employees. The Board of Directors determines the amount of discretionary contributions to the Plan and employees vest in those contributions over a six year period. Contributions to the Plan of approximately \$172,000 and \$173,000, respectively, were made during the years ended December 31, 2023 and 2022.

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16. Stock Options

The Bank has established the 2003 Stock Option Plan (2003 Plan), the 2015 Stock Option Plan (2015 Plan) and the 2023 Stock Plan (2023 Plan). The purpose of the plans is to encourage ownership of the Bank's common stock by key employees of the Bank and to provide increased incentive for key employees to render services and to exert maximum effort for the success of the Bank. The Plans are administered by the Board of Directors. The 2003 Plan expired in 2015 and all options granted under the 2003 Plan had been exercised as of December 31, 2022. The 2015 Plan expired in 2023, however, certain options granted under the 2015 Plan remain outstanding at December 31, 2023 and 2022. Under the provisions of the 2023 Plan a total of 110,000 shares of common stock are available to be granted in the form of either incentive stock options (ISOs) or nonqualified stock options. The option price, vesting schedule and exercise period are determined for each grant by the Board of Directors. As of December 31, 2023 and 2022, a total of 99,670 and 94,700 options were outstanding. At December 31, 2023 and 2022, the Board of Directors had determined that 55,048 and 42,285, respectively, of the options granted had vested. At December 31, 2023, 105,835 options were available for grant under the 2023 Plan.

A summary of option transactions and options outstanding during the years ended December 31, 2023 and 2022 is as follows:

	2023		2022	
	Number of	Option Price	Number of	Option Price
	Shares Underlying		Shares Underlying	
	<u>Options</u>	<u>Per Share</u>	<u>Options</u>	<u>Per Share</u>
Outstanding at January 1	94,700	\$47.00 to \$80.01	101,300	\$25.60 to \$75.00
Granted during the year	7,000	\$85.00	7,500	\$76.00 to \$80.01
Forfeited during the year	(1,670)	\$76.00	(1,440)	\$58.50
Exercised during the year	<u>(360)</u>	\$59.83 to \$76.00	<u>(12,660)</u>	\$25.60 to \$59.83
Outstanding at December 31	<u>99,670</u>	\$47.00 to \$85.00	<u>94,700</u>	\$47.00 to \$80.01
Exercisable at December 31	<u>55,048</u>		<u>42,285</u>	
Weighted average remaining contractual life	<u>5.37</u>		<u>6.09</u>	

A summary of the status of the Bank's nonvested shares at December 31, 2023 and 2022, and changes during the years then ended is as follows:

	2023		2022	
	Nonvested Shares	Weighted Average Grant	Nonvested Shares	Weighted Average Grant
	<u>Under Option</u>	<u>Date Fair Value</u>	<u>Under Option</u>	<u>Date Fair Value</u>
Nonvested at January 1	52,415	\$ 12.51	59,350	\$ 11.62
Granted during the year	7,000	27.39	7,500	17.58
Vested during the year	(13,123)	11.42	(12,995)	10.45
Forfeited during the year	<u>(1,670)</u>	12.06	<u>(1,440)</u>	5.18
Nonvested at December 31	<u>44,622</u>	<u>\$ 15.01</u>	<u>52,415</u>	<u>\$ 12.51</u>

All of the options have a contractual term of 10 years. The options vest based on the performance of the Bank calculated by the return on equity. The number of options that will ultimately vest will depend on the Bank's performance.

The Bank recognized approximately \$151,000 and \$160,000, respectively in compensation expense related to the granting of these awards during 2023 and 2022. Accordingly, as provided by ASC Topic 718, *Stock Compensation*, additional paid-in capital has also been increased by \$151,000 and \$160,000, respectively, in the accompanying Statements of Changes in Stockholders' Equity for the years ended December 31, 2023 and 2022.

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During 2023 and 2022, the Bank granted options to purchase 7,000 and 7,500 shares of its common stock for option pricing ranging from \$76.00 to \$85.00 per share. The fair value of each option grant was estimated using the Black-Scholes option-pricing model with the following assumptions:

	<u>2023</u>	<u>2022</u>
Dividend yield	0.00%	0.00%
Expected life	10 years	10 years
Expected volatility	4.66%	4.51% to 4.60%
Risk-free interest rate	3.87% to 3.91%	1.63% to 2.79%

The expected volatility is based upon historical volatility of banks in the state of Texas. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield in effect at the date of the grant. The expected life is based on historical exercise experience. The dividend yield was assumed to be 0.00%.

17. Stockholders' Equity and Regulatory Matters

The Bank is subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Failure to meet capital requirements can initiate regulatory action. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2023 and 2022, the Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations for banking institutions provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At December 31, 2023 and 2022, the most recent regulatory notifications categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

Actual and required capital amounts and ratios of the Bank are presented below (amounts in thousands):

	<u>Amount</u>	<u>Actual Ratio</u>	<u>Minimum Required for Capital Adequacy Purposes Amount</u>	<u>Ratio</u>	<u>Minimum to be Well Capitalized under Prompt Corrective Action Provisions Amount</u>	<u>Ratio</u>
December 31, 2023:						
Total capital to risk weighted assets	\$ 57,972	17.16%	\$ 27,024	8.00%	\$ 33,780	10.00%
Tier 1 (core) capital to risk weighted assets	53,737	15.91%	20,268	6.00%	27,018	8.00%
Common Tier 1 (CET1)	53,737	15.91%	15,201	4.50%	21,957	6.50%
Tier 1 (core) capital to average assets	53,737	11.15%	19,278	4.00%	24,098	5.00%
December 31, 2022:						
Total capital to risk weighted assets	\$ 52,819	16.74%	\$ 25,242	8.00%	\$ 31,553	10.00%
Tier 1 (core) capital to risk weighted assets	48,871	15.49%	18,932	6.00%	25,242	8.00%
Common Tier 1 (CET1)	48,871	15.49%	14,199	4.50%	20,509	6.50%
Tier 1 (core) capital to average assets	48,871	10.73%	18,227	4.00%	22,784	5.00%