



TEXAS SECURITY

BANK

2016 ANNUAL REPORT

ELEVATING THE
CHAMPIONS
OF FREE
ENTERPRISE

In our country, the free market rewards innovators and entrepreneurs. At Texas Security Bank, we do, too. As an independent bank, we believe our success hangs on the prosperity of our customers. So we do all we can to help individuals and business owners flourish. As this year's annual report shows, our approach works. That's the brilliance of free enterprise. It keeps us all open for business.



Dear fellow shareholders,

Year 2016 was another great one for your Bank! Our net income and earnings per share both increased by 33%, totaling record levels of \$3.6 million and \$1.52, respectively. Loans grew 14% with loan balances ending at \$282 million. Net Interest Income grew \$1.6 million, or 15%. Despite seven years of “near zero” managed interest rates, our net interest margin was 4.11% for the year. Given the continued interest rate challenges, most banks struggled to have a margin near 4%. Our non-interest income was up 21% as we achieved record-breaking mortgage and SBA loan sales activity. Despite the growth, our credit quality remained strong and our non-interest expenses grew modestly.

We all would agree that 2016 was also an exhausting political campaign year. However, it ended with high expectations of favorable regulatory and tax reform as well as a more advantageous rate environment. Finally, after eight years of economic headwinds, we believe this year could bring tailwinds of growth for the Bank and its clients. As such, we have been doing some “campaigning” of our own as we have presented our thoughts on the future with our recent stock offering memorandum meetings. Some highlights of the presentation are on the adjacent page.

If you or a business associate needs financial solutions, let’s start a conversation! We would appreciate the opportunity to help. There is no greater compliment than receiving a referral, and they are our best source of new business. Thank you for your continued encouragement, investment and confidence.



Craig Scheef
Chairman, President and
Chief Executive Officer



Larry Bennett
Executive Vice President
Chief Financial Officer



Chris Jones
Executive Vice President
Chief Credit Officer

Values

- Honesty & Integrity
- Growth
- Team Players
- Independent Thinking
- Exemplary Customer Service
- Winning by Results
- Problem Solving
- Creativity
- Discipline to Process
- Diligence

The future’s growing brighter

As you can see in this annual report, your Bank has grown its balance sheet and pretax income on a compounded annual growth rate of over 30% and over 60%, respectively, during the past five years. While pleased with the progress, we believe that there is more opportunity to come. Last year, the Board worked with Management to develop a three-year growth plan. As a result, the Board approved a debt and equity raise by the Bank to provide additional capital for future expansion. We are pleased to announce that our debt placement was successfully completed in January 2017. This spring, the Company is offering 500,000 shares in a private placement to provide the Bank with a higher lending limit to facilitate growth, provide resources for additional business development talent, increase the Bank’s regulatory capital and for other general corporate purposes.

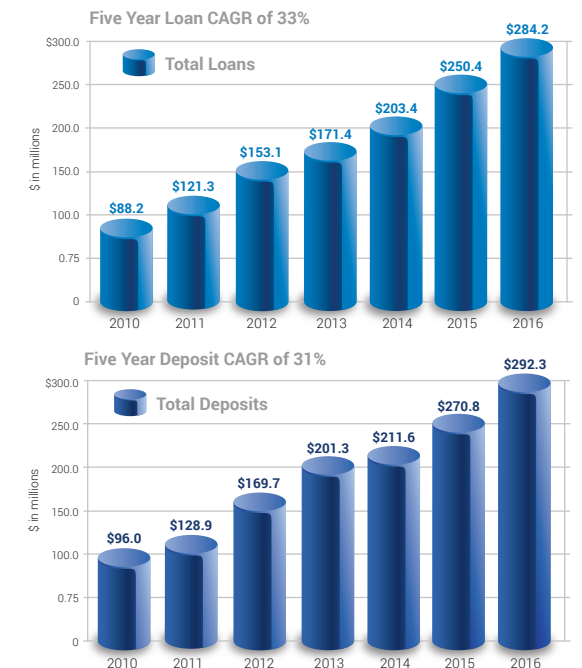
Together, the tailwind of regulatory reform, tax reform, rising rates and business-friendly government attitude will provide the best economic climate since the Bank was formed in 2008. We are excited about the future, and believe the best is yet to come!

The Trump Bump industry expectations

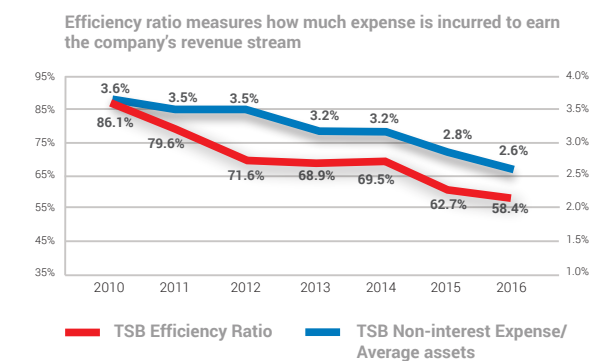
- 6 basis points (bps) ROE increase
- 60 bps increase on Total Common Equity ROE
- Regulatory reform to lower burden/
Dodd Frank Amendments
- Lower taxes (benefits TSB and our clients)
- Pro growth/fiscal spending/infrastructure spending
- Rising interest rates with steepened yield curve
(bank is asset sensitive – up 100 bps = \$250k income)
- Best environment since early 2000s

Source: Keefe, Bruyette & Woods

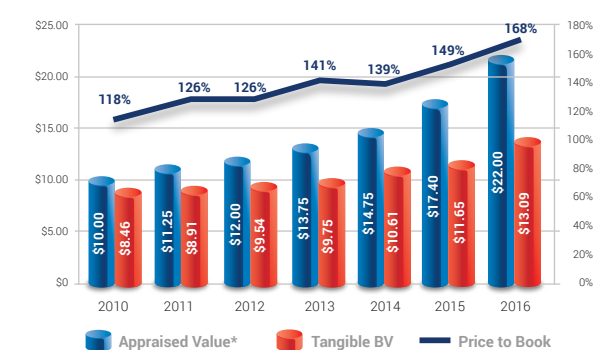
Balance Sheet Growth



Efficiency Measurement



Enhancing Shareholder Value





Having built our business from the ground up, we can help you build yours.

In addition to providing capital and management resources, we do more. In 2016, the Texas Security Bank Business Institute presented 10 educational forums to enhance your knowledge in 10 critical business disciplines. Want to join us in 2017? Just visit TexasSecurityBank.com to learn more.

JANUARY

**You've got the entrepreneurial spirit
Now get the expertise**
Jeff Whittle, Whittle & Partners

Jeff Whittle introduced the Entrepreneurial Operating System, a simple, complete business management system that empowers leadership to operate their companies at optimal levels.

FEBRUARY

Do you have Traction in your business?
Jeff Whittle, Whittle & Partners

Now that you've built your business, do you have a plan to get it to the next level? Jeff Whittle shared part 2 of *Traction*, the Entrepreneurial Operating System, including a system for achieving faster growth and increased profitability.

MARCH

**Economic outlook 2016:
What are the impacts to your business?**
Murphy Davis, Sr., Sentry Management, Inc.

In this informative seminar, Murphy Davis explained the dynamics of the new economic world order of 2016 and how to best position your business.

APRIL

How to capitalize for healthy growth
Chris Jones, Texas Security Bank

Having the right capital structure to fund your business is vital to healthy growth, but what is the right funding option for you? In this seminar, Chris Jones discussed funding options and how to match the need with the most appropriate source and structure.

MAY

Demystifying projections
Casey Herr, Texas Security Bank

In this seminar, Casey Herr gave participants the tools to evaluate the impact of capital structure and future funding needs, including tips for developing KPIs.

JUNE

Trends in cyber security
Chuck Easttom, Computer Scientist, Author and Inventor

In this seminar, Chuck Easttom discussed today's cyber threats and best defense strategies to maintain personal and business security, including mitigation strategies.

AUGUST

Managing your balance sheet
Glenn P. Cato, Advisory Services

In this interactive seminar, Glenn Cato discussed cash management challenges, utilizing cash flow to grow your business and measure financial health, and how to keep a healthy bottom line.

SEPTEMBER

Permission vs. interruption: digital marketing
Vlad Molchadski, BizTraffic.com

Your business might cease to exist without inbound marketing. But what if you united your sales with marketing efforts using inbound methodology? Vlad shared how digital marketing can help grow your sales.

OCTOBER

How to Increase the ROI on employee costs
Jason Williford, Applied Behavioral Analytics

In this interactive seminar, Jason helped participants address specific personnel challenges, including job fit analysis and employee performance against job performance.

NOVEMBER

Building and protecting your organizational culture
Matthew R. Briggs, PeopleWorks International, Inc.

Ask yourself what the culture is in your organization. Is it what you want? Does it support your company's objectives, values and mission? Matthew shared how to develop and strengthen your culture into a powerful tool.

Sometimes who you know is as important as what you know.

We know you're busy and efficiency is critical. That's why Texas Security Bank has formed strategic partnerships to provide you with top market products and services to support your growing business.

We can help you with merchant processing, commercial and consumer insurance, receivable factoring, commercial credit and purchasing cards, payroll services, professional employee management (PEO) services and investment/brokerage services. Each of these trusted partners has been selected based on their competitive pricing, high level of expertise and quality of service. Most of all, you can trust that just like your banker, our partners will put you first.

Now that you know that Texas Security Bank is the right person to know, call us with your challenges and opportunities. We'll respond. We'll get moving. You can count on that.



Shon Cass
SVP, Retail Banking and Cash Management

Securities and Insurance Products not insured by FDIC or any Federal Government Agency – May lose value – Not a Deposit of or Guaranteed by the Bank or any Bank Affiliate. Insurance products are offered through non-bank affiliates of TSB and are underwritten by unaffiliated insurance companies. Products and Services are offered by Texas Security Bank and its affiliates.

"From helping to secure an SBA loan to working with TSB's strategic partners for corporate credit cards and credit card machine, TSB takes care of me. Great partnership!"

Russell Griffin, President, APS Building Services, Inc.



Then and now: a look at our performance

Below is a summary of Texas Security Bankshares, Inc. performance since 2013. Pages 6 to 11 present the Texas Security Bank comparative financial statements for the years ended December 31, 2015 and 2016. These reports are presented in our annual audited financial statements. You may request complete audited financial statements, including the independent auditors' opinions and the required notes to the financial statements, at any time from me.

Our auditors have expressed an unmodified opinion on our financial statements for both 2015 and 2016. This means that the financial statements present fairly, in all material respects, the financial position of Texas Security Bank and all subsidiaries and the results of the Company's operations and cash flows for these years.

Larry Bennett

Executive Vice President, Chief Financial Officer, Chief Operating Officer, Texas Security Bank

(in whole dollars, except per share data)

	2013	2014	2015	2016
OPERATING RESULTS				
Net interest income	\$ 8,352,973	\$ 9,191,221	\$ 10,471,089	\$ 12,079,792
Provision for loans	294,783	241,598	423,571	442,401
Non-interest income	1,273,458	1,127,122	1,436,636	1,870,980
Net realized (loss)/gain on securities	-0-	360,478	249,879	165,273
Non-interest expense	6,751,724	7,535,763	7,722,303	8,304,464
Earnings before provision for income taxes	\$ 2,579,924	\$ 2,901,460	\$ 4,011,730	\$ 5,369,180
Federal income tax	714,315	935,171	1,328,774	1,790,620
Net income (loss)	\$ 1,865,609	\$ 1,966,289	\$ 2,682,956	\$ 3,578,560
AT YEAR END				
Total assets	\$ 228,972,216	\$ 245,463,182	\$ 303,592,746	\$ 328,210,170
Loans, net of allowance	169,420,475	201,206,326	247,879,852	281,428,761
Investments in securities & deposits	34,894,567	28,303,729	33,702,693	33,908,952
Deposits	201,096,517	211,457,197	270,604,844	292,176,471
Stockholders' equity	23,310,056	24,871,244	27,635,446	31,155,258
Common shares outstanding (net of treasury)	2,389,543	2,343,546	2,412,168	2,355,322
OTHER FINANCIAL DATA				
Return on total assets	.90%	.84%	.96%	1.14%
Return on stockholders' equity	7.90%	8.22%	10.20%	12.04%
Loans to deposits	85%	96%	93%	96%
Loan loss reserves to loans	1.16%	1.09%	1.04%	1.03%
Charge-offs net of recoveries	0.15%	-0-	0.02%	0.02%
PER SHARE DATA				
Net income	\$ 0.79	\$ 0.84	\$ 1.14	\$ 1.52
Book value	\$ 9.76	\$ 10.61	\$ 11.74	\$ 13.23

Texas Security Bankshares, Inc. and Subsidiary Consolidated Balance Sheets for the Years Ended December 31, 2016 and 2015

	2016	2015
ASSETS		
Cash and cash equivalents	\$ 1,569,841	\$ 1,724,811
Federal funds sold	3,000,000	-0-
Interest bearing deposits in other banks	10,669,794	11,885,379
Total cash and cash equivalents	15,239,635	13,610,190
Securities purchased under agreements to resell	473,294	4,333,878
Time deposits in other banks	250,000	1,497,000
Securities available for sale	22,515,864	27,871,815
Loans held for sale	764,100	582,200
Loans	280,664,661	247,297,652
Bank premises and equipment	5,537,585	5,765,044
Accrued interest receivable	802,396	765,487
Other assets	1,962,635	1,869,480
Total assets	\$328,210,170	\$ 303,592,746
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Non-interest bearing	\$ 85,244,999	\$ 79,164,122
Interest bearing	206,931,472	191,440,722
Total deposits	292,176,471	270,604,844
Other borrowings	3,231,576	3,669,472
Accrued interest payable	379,796	254,181
Other liabilities	1,267,069	1,428,803
Commitments and contingencies	-0-	-0-
Stockholders' equity:		
Common stock, \$5 par value; 5,000,000 shares authorized, 2,874,592 and 2,754,118 shares issued, respectively; 2,532,642 and 2,412,168 outstanding, respectively	14,372,960	13,770,590
Additional paid-in capital	13,708,888	13,045,380
Stock issued with notes receivable	(1,773,200)	(686,220)
Retained earnings	9,499,646	5,921,086
Accumulated other comprehensive (loss) income	(37,829)	199,817
Less: Treasury stock, at cost, 341,950 shares at December 31, 2016 and 2015	(4,615,207)	(4,615,207)
Total stockholders' equity	31,155,258	27,635,446
Total liabilities and stockholders' equity	\$328,210,170	\$ 303,592,746

"What makes TSB different is the people. They know you and they treat you as a person, not as an account number."

Daniel B. Prescott, Jr., President, Transformance



Texas Security Bankshares, Inc. and Subsidiary
Consolidated Statements of Income for the Years Ended December 31, 2016 and 2015

	2016	2015
INTEREST INCOME		
Interest and fees on loans	\$ 12,629,450	\$ 11,158,129
Interest on investment securities	513,295	571,068
Interest on securities purchased under agreements to resell	35,975	11,262
Interest on other accounts	123,924	53,889
Total interest income	13,302,644	11,794,348
INTEREST EXPENSE		
Interest and fees on deposit accounts	1,077,613	1,166,220
Interest on other borrowings	145,239	157,039
Total interest expense	1,222,852	1,323,259
Net interest income	12,079,792	10,471,089
Provision for loan losses	442,401	423,571
Net interest income after provision	11,637,391	10,047,518
NON-INTEREST INCOME		
Service charges on deposit accounts	478,637	365,938
Premiums and fees on sales of loans held for sale	907,642	634,676
Gain on sales of SBA loans	178,172	151,325
Gain on sales of investment securities	165,273	249,879
Other	306,529	284,697
Total non-interest income	2,036,253	1,686,515
NON-INTEREST EXPENSE		
Salaries and employee benefits	5,024,264	4,520,270
Occupancy of bank premises	778,961	770,933
Professional fees	382,915	381,618
Data processing and IT management	696,345	669,611
Regulatory assessments	191,913	160,274
Software costs	102,105	83,712
Other	1,127,961	1,135,885
Total non-interest expense	8,304,464	7,722,303
Net income before income tax expense	5,369,180	4,011,730
Income tax expense	1,790,620	1,328,774
Net income	\$ 3,578,560	\$ 2,682,956

Texas Security Bankshares, Inc. and Subsidiary
Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2016 and 2015

	2016	2015
Net income	\$ 3,578,560	\$ 2,682,956
Other comprehensive (loss) income:		
Unrealized (loss) gain arising during the period on investment securities available for sale, net of income taxes of \$66,231 in 2016 and \$89,156 in 2015	(128,566)	173,067
Reclassification adjustment for realized gains on investment securities available for sale included in net income, net of income taxes of \$56,193 in 2016 and \$84,959 in 2015	(109,080)	(164,920)
Total other comprehensive income (loss)	(237,646)	8,147
Total comprehensive income	\$ 3,340,914	\$ 2,691,103

Texas Security Bankshares, Inc. and Subsidiary
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2016 and 2015

	Common Stock	Additional Paid-In Capital	Stock Issued with Notes Receivable	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance, Jan. 1, 2015	13,427,480	12,629,171	-0-	3,238,130	191,670	(4,615,207)	24,871,244
Stock-based compensation	-0-	73,099	-0-	-0-	-0-	-0-	73,099
Sale of common stock, 68,622 shares	343,110	343,110	(686,220)	-0-	-0-	-0-	-0-
Comprehensive income (loss) and net income	-0-	-0-	-0-	2,682,956	8,147	-0-	2,691,103
Balance, Dec. 31, 2015	13,770,590	13,045,380	(686,220)	5,921,086	199,817	(4,615,207)	27,635,446
Stock-based compensation	-0-	59,635	-0-	-0-	-0-	-0-	59,635
Sale of common stock, 120,474 shares	602,370	603,873	(1,086,980)	-0-	-0-	-0-	119,263
Comprehensive income (loss) and net income	-0-	-0-	-0-	3,578,560	(237,646)	-0-	3,340,914
Balance, Dec. 31, 2016	\$14,372,960	\$13,708,888	\$(1,773,200)	\$ 9,499,646	\$ (37,829)	\$(4,615,207)	\$ 31,155,258

"TSB helped us grow our business by securing a loan that three other banks could not do. Plus, it was easy and painless!"

Michael Lurie, President, Lanseth, Inc., Dba The Leather Sofa Company



Consolidated Statements of Cash Flows for the Years Ended December 31, 2016 and 2015

Texas Security Bankshares, Inc. and Subsidiary

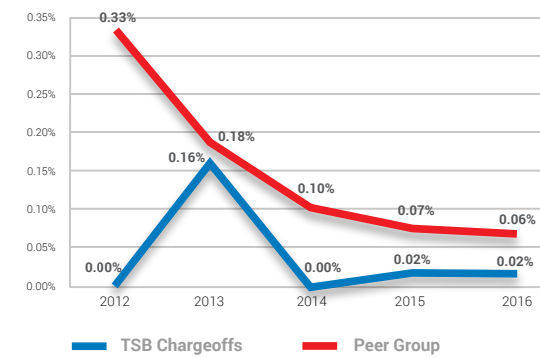
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 3,578,560	\$ 2,682,956
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	618,007	624,457
Provision for loan losses	442,401	423,571
Proceeds from sale of loans held for sale	30,992,053	22,897,200
Net originations of loans held for sale	(30,266,311)	(21,629,574)
Gain on sales of securities	(165,273)	(249,879)
Gain on sales of SBA loans	(178,172)	(151,325)
Stock-based compensation	59,635	73,099
Premiums and fees on sales of loans held for sale	(907,642)	(634,676)
(Increase) decrease in accrued interest and other assets	(173,178)	(363,625)
Increase (decrease) in accrued expenses and other liabilities	86,307	547,992
Net cash provided by operating activities	4,086,387	4,220,196
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Maturities, calls, sales and principal paydowns received	270,927,071	174,891,532
Purchases	(266,015,271)	(174,420,543)
Net originations of loans	(33,631,238)	(47,578,722)
Additions to bank premises and equipment	(98,082)	(41,737)
Net increase in securities purchased under agreements to resell	3,860,584	(4,333,878)
Net (increase) decrease in time bearing deposits in other banks	1,247,000	(1,497,000)
Net cash used in investing activities	(23,709,936)	(52,980,348)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net changes in deposits	21,571,627	59,147,647
Payments of other borrowings, net of payments	(437,896)	(4,334,474)
Proceeds from sale of common stock	119,263	-0-
Net cash provided by financing activities	21,252,994	54,813,173
Net (decrease) increase in cash and cash equivalents	1,629,445	6,053,021
Cash and cash equivalents at beginning of year	13,610,190	7,557,169
Cash and cash equivalents at end of year	\$ 15,239,635	\$ 13,610,190
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 1,097,237	\$ 1,280,748
Cash paid for income taxes	\$ 2,150,000	\$ 1,540,000

Financial Trends

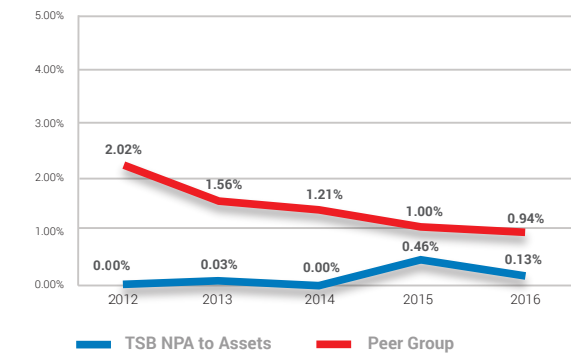
Texas Security Bankshares, Inc. and Subsidiary

Credit Quality

Little or no charge-offs despite significant loan growth

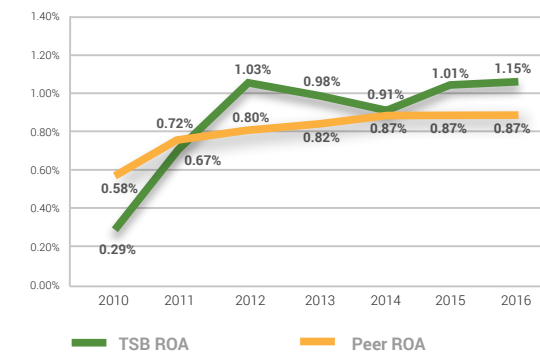


No significant non-performing assets despite significant growth

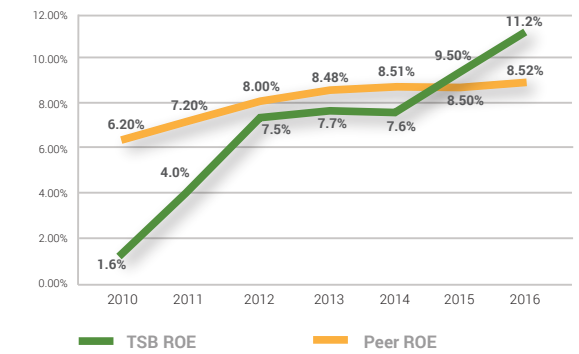


Profitability Metrics

ROA improvement from completed infrastructure improvements since 2014 and growing revenues 18% a year

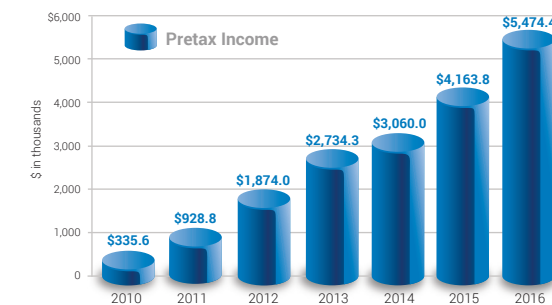


Momentum towards full utilization of excess capital from denovo years

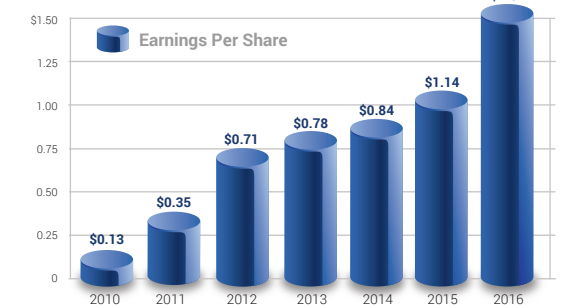


Pretax Income and EPS Growth

Five Year CAGR of 83%
Current Year Growth of 31%



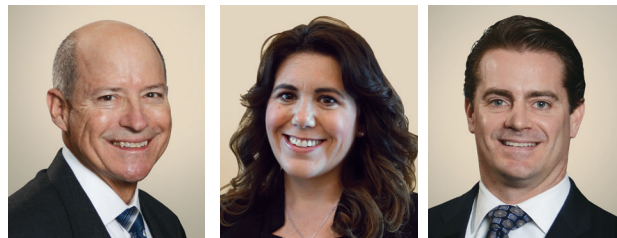
Five Year CAGR of 63%
Current Year Growth of 33%



"Unlike other banks, TSB has discretion – the ability to really evaluate a business' risk and potential and make a local decision. Huge difference."

Kyle Rhodes, CEO/Founder, Focus Staff

Meet our leadership



Market Presidents (left to right)

C.D. Heinen
Senior Vice President, Metrocrest Market President

Casey Herr
Senior Vice President, Garland Market President

Ben Parkey
Senior Vice President, Turtle Creek Market President

Board of Directors

Craig Scheef	<i>Chairman, President & CEO, Texas Security Bank</i>
Chris Jones	<i>Chief Credit Officer, Texas Security Bank</i>
Larry Bennett	<i>Chief Financial Officer, Texas Security Bank</i>
Kip Kernodle	<i>Retired, CFO & Director, Allflex Holdings, Inc.</i>
Drew Keith	<i>VP/CFO, Fritz Duda Company</i>
Cortney Liddiard	<i>CEO, Ball Ventures, LLC</i>
Scott Miller	<i>Principal, Miller Global Investments, LLC</i>
LeAnn Nabors	<i>CFO, The Wright Group</i>
Gina Norris	<i>SVP Partner Relations, Matthews Southwest</i>
Langhorne Reid	<i>President, Arcady Capital, Inc.</i>
Larry Waisanen	<i>Retired, EVP/CFO Lafarge North America, Inc.</i>

Leadership Team (left to right)

Bonnie Nichols	<i>SVP, Chief Compliance Officer</i>
Larry Bennett	<i>EVP, Chief Financial Officer</i>
Libby Smith	<i>SVP, Mortgage Lending</i>
Chris Jones	<i>EVP, Chief Credit Officer</i>
Craig Scheef	<i>Chairman, President and CEO</i>
Shon Cass	<i>SVP, Retail Banking and Cash Management</i>



I am extremely impressed with the service level that Texas Security Bank provides. Not only do they meet expectations, they invest in their customers by providing monthly education on ways to improve our businesses.

Michael Cremen, President
United Onesource



TEXAS SECURITY
BANK

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