Board of Governors of the Federal Reserve System

Annual Report of Holding Companies—FR Y-6

Report at the close of business as of the end of fiscal year

This Report is required by law: Section 5(c)(1)(A) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)(A)); sections 8(a) and 13(a) of the International Banking Act (12 U.S.C. §§ 3106(a) and 3108(a)); sections 11(a)(1), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a)(1), 602, and 611a); and sections 113, 165, 312, 618, and 809 of the Dodd-Frank Act (12 U.S.C. §§ 5361, 5365, 5412, 1850a(c)(1), and 5468(b)(1)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

NOTE: The *Annual Report of Holding Companies* must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

I, J. Roland Velvin
Name of the Holding Company Director and Official

President, Director
Title of the Holding Company Director and Official

attest that the *Annual Report of Holding Companies* (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter and individual consent to public release of all details in the report concerning that individual.

Roland Velvin
Signature of Holding Company Director and Official

03/28/2019
Date of Signature

Date of Report (top-tier holding company's fiscal year-end):
December 31, 2018
Month / Day / Year

None
Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address

Lockhart Bankshares, Inc
Legal Title of Holding Company

P.O. Box 600
(Mailing Address of the Holding Company) Street / P.O. Box

Lockhart	TX	78644
City	State	Zip Code

111 S. Main St
Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

Randall Till	Treasurer
Name	Title

512-620-9140
Area Code / Phone Number / Extension

512-398-7357
Area Code / FAX Number

rtill@firstlockhart.com
E-mail Address

www.firstlockhart.com
Address (URL) for the Holding Company's web page

For holding companies not registered with the SEC–
Indicate status of Annual Report to Shareholders:
- [x] is included with the FR Y-6 report
- [ ] will be sent under separate cover
- [ ] is not prepared

Is confidential treatment requested for any portion of this report submission? .... 0=No 1=Yes: 0

In accordance with the General Instructions for this report (check only one),
1. a letter justifying this request is being provided along with the report .... ☐
2. a letter justifying this request has been provided separately ... ☐

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

For Federal Reserve Bank Use Only

RSSD ID ______
C.I. ______

Public reporting burden for this information collection is estimated to vary from 1.3 to 101 hours per response, with an average of 5.50 hours per response, including time to gather and maintain data in the required form and to review instructions and complete the information collection. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551, and to the Office of Management and Budget, Paperwork Reduction Project (7100-0297), Washington, DC 20503.

For Use By Tiered Holding Companies

Top-tiered holding companies must list the names, mailing address, and physical locations of each of their subsidiary holding companies below.

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

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(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Lockhart Bankshares, Inc

Form FR Y-6

December 31, 2018

Responses to Report Items

<table>
<tr><td><u>Item No. 1a</u></td><td>Not registered with Securities Exchanged Commision, Consolidated financial statements, which have been audited by the Holding Company's CPA firm, are attached.</td></tr>
<tr><td><u>Item No. 2</u></td><td>An organization chart is presented in Exhibit A.</td></tr>
<tr><td><u>Item No. 2b.</u></td><td>Submitted via e-mail on 03/29/2018</td></tr>
<tr><td><u>Item No. 3 Part (1)</u></td><td></td></tr>
</table>

Fred A. Moore

Voting percentage:	13.930%
Shares owned:	21,161

Lockhart, Texas-US 78644
Citizenship: USA

Laura Moore

Voting percentage:	2.253%
Shares owned:	3,426

Lockhart, Texas-US 78644
Citizenship: USA

* **Margaret E. Dailey**

Shares owned :	8,914
Voting percentage:	5.860%

College Station, TX-USA 77845
Citizenship: USA

* This includes the shares held for Custodial for Sophia K. Dailey Under TUTMA

Shares owned :	283
Voting percentage:	0.186%

* This includes shares held by Christopher R. Dailey

Shares owned :	1,795
Voting Percentage:	1.18%

Lockhart Bankshares, Inc

Form FR Y-6

December 31, 2018

Continued)

Item No. 3 Part (1)

Glen C. Moore, Trustee of the Glen C. Moore
Revocable Trust
Lockhart, Texas-US 78644
Citizenship: USA

Shares owned:	11,000
Voting percentage:	7.233%

Conrad C. Ohlendorf & Geraldine Ohlendorf

Shares Owned:	9,961
Voting percentage:	6.550%

Lockhart, Texas-US 78644
Citizenship: USA

Geraldine Ohlendorf

Shares Owned:	906
Voting percentage:	0.596%

Lockhart, Texas-US 78644
Citizenship: USA

Item No. 3 Part (2)

None

Item No. 4

Principal shareholders, directors, and executive officers of Lockhart Bankshares, Inc. are presented in Exhibit B.

Exhibit A

Lockhart Bankshares, Inc.

Organization Chart

December 31, 2018

Lockhart Bankshares, Inc.
LEI#: N/A
Lockhart, Texas, USA
Incorporated in Texas
100% Ownership of

First-Lockhart National Bank
LEI # 549300RZIWJWJ035S336
Lockhart, Texas, USA
Incorporated in Texas

There are no Bank Holding Company investments from debts previously contracted, fiduciary relationships, or in non-voting equity shares.

Exhibit B

Lockhart Bankshares,Inc.

Principal Shareholders, Directors, and Executive Officers

7

December 31, 2018

(1)Name and Address	(2) Occupation	(3)Title & Position w/Holding Co.	(3)(b) Title & Position with Subs (include name of sub)	(3)(c) Title & Postion w/Other Businesses (include names of businesses)	(4)(a)Voting Percentage in Bank Holding Company	(4)(b) Percentage of Voting Shares in Subs (include names of Subs)	(4)(c) List names of other companies (including partnerships) if 25% or more of voting securites are held (List names of companies & percentage of voting Securites)	%
J. Roland Velvin Lockhart, Texas-US	Banker	Director and President	Director & President/CEO First-Lockhart National Bank	N/A	0.007%	None	N/A	N/A
Alan C. Fielder Lockhart, Texas-US	Attorney	Vice Chairman	Director & Vice Chairman First-Lockhart National Bank	N/A	1.432%	None	Alan C. Fielder-Attorney at Law Flowers-McDowell Abstract Co.	100% 100%
Jeffry Y. Michelson Lockhart, Texas-US	Automobile Dealer & Service	Director	Director First-Lockhart National Bank	General Manager Michelson Investments LLC	0.875%	None	Michelson Investments, LLC	60.00%
Laura Moore Lockhart, Texas-US	Retired Teacher	Director	Director First-Lockhart National Bank	N/A	2.253%	None	None	
Fred Moore Lockhart, Texas-US	Retired Judge	Principal Shareholder	None	N/A	13.930%	None	None	N/A
Carl R. Ohlendorf Lockhart, Texas-US	Insurance Agent	Director	Director First-Lockhart National Bank	Owner Carl Ohlendorf Ins dba Rucker-Ohlendorf Ins.	0.742%	None	Carl Ohlendorf Ins. dba Rucker-Ohlendorf Ins.	100%

Exhibit B

Lockhart Bankshares,Inc.

Principal Shareholders, Directors, and Executive Officers

December 31, 2018

(1)Name and Address	(2) Occupation	(3)Title & Position w/Holding Co.	(3)(b) Title & Position with Subs (include name of sub)	(3)(c) Title & Postion w/Other Businesses (include names of businesses)	(4)(a)Voting Percentage in Bank Holding Company	(4)(b) Percentage of Voting Shares in Subs (include names of Subs)	(4)(c) List names of other companies (including partnerships) if 25% or more of voting securites are held (List names of companies & percentage of voting Securites)	%
Amelia P. Smith Lockhart, Texas -US	Realtor	Director	Director First-Lockhart National Bank	N/A	2.109%	None	Countywide Realty, L.P.	49.50%
							Countywide, L.P.	49.50%
							Smith Pearce Investments, LP	49.50%
							Smith Inventory, LLC	49.50%
							Jim Smith Rental, LLC	49.50%
							Jack Pearce, LLC	49.50%
							200 Colorado, LLC	49.50%
							300 Commerce, LLC	49.50%
							Smith Pearce Management, LLC	49.50%
							James W Smith Jr. Ins Trust	100.00%
							Five Oaks, LLC	49.50%
Margaret K. Dailey College Station, Texas-US	Education Consultant	Chairman	Director First-Lockhart National Bank	Secretary Dailey Electric	5.861%	None	Dailey Service, Inc	100%
							Tradition Prop, LLC	50%
							8330 Jones Rd.	50%
							West Mersea, LLC	100%
							Dailey Company, Inc	50%
							Dailey Electric, Inc	50%
Randall Till Lockhart, Texas-US	Banker	Treasurer	Sr. Vice President/Controller First-Lockhart National Bank	N/A	0.00%	None	N/A	
Natalie Cain Seguin, Texas-US	Banker	Secretary	Human Resource Officer First-Lockhart National Bank	N/A	0.00%	None	N/A	

Results: A list of branches for your holding company: LOCKHART BANKSHARES, INC. (1995998) of LOCKHART, TX.
The data are as of 12/31/2018. Data reflects information that was received and processed through 01/06/2019.

Reconciliation and Verification Steps
1. In the **Data Action** column of each branch row, enter one or more of the actions specified below
2. If required, enter the date in the **Effective Date** column

Actions
OK: If the branch information is correct, enter 'OK' in the **Data Action** column.
Change: If the branch information is incorrect or incomplete, revise the data, enter 'Change' in the **Data Action** column and the date when this information first became valid in the **Effective Date** column.
Close: If a branch listed was sold or closed, enter 'Close' in the **Data Action** column and the sale or closure date in the **Effective Date** column.
Delete: If a branch listed was never owned by this depository institution, enter 'Delete' in the **Data Action** column.
Add: If a reportable branch is missing, insert a row, add the branch data, and enter 'Add' in the **Data Action** column and the opening or acquisition date in the **Effective Date** column.

If printing this list, you may need to adjust your page setup in MS Excel. Try using landscape orientation, page scaling, and/or legal sized paper.

Submission Procedure
When you are finished, send a saved copy to your FRB contact. See the detailed instructions on this site for more information.
If you are e-mailing this to your FRB contact, put your institution name, city and state in the subject line of the e-mail.

Note:
To satisfy the **FR Y-10 reporting requirements**, you must also submit FR Y-10 Domestic Branch Schedules for each branch with a **Data Action** of Change, Close, Delete, or Add.
The FR Y-10 report may be submitted in a hardcopy format or via the FR Y-10 Online application - https://y10online.federalreserve.gov.

* FDIC UNINUM, Office Number, and ID_RSSD columns are for reference only. Verification of these values is not required.

Data Action	Effective Date	Branch Service Type	Branch ID_RSSD*	Popular Name	Street Address	City	State	Zip Code	County	Country	FDIC UNINUM*	Office Number*	Head Office	Head Office ID_RSSD*	Comments
OK	2/28/2019	Full Service (Head Office)	631150	FIRST-LOCKHART NATIONAL BANK	111 SOUTH MAIN STREET	LOCKHART	TX	78644	CALDWELL	UNITED STATES	Not Required	Not Required	FIRST-LOCKHART NATIONAL BANK	631150	
OK	2/28/2019	Full Service	4642716	AUSTIN BANKING CENTER	319 W SLAUGHTER LANE	AUSTIN	TX	78748	TRAVIS	UNITED STATES	Not Required	Not Required	FIRST-LOCKHART NATIONAL BANK	631150	
OK	2/28/2019	Full Service	4462950	KYLE BRANCH	800 WEST FM 150	KYLE	TX	78640	HAYS	UNITED STATES	Not Required	Not Required	FIRST-LOCKHART NATIONAL BANK	631150	
OK	2/28/2019	Limited Service	4395469	120 WEST SAN ANTONIO STREET DRIVE THRU	120 WEST SAN ANTONIO STREET	LOCKHART	TX	78644	CALDWELL	UNITED STATES	Not Required	Not Required	FIRST-LOCKHART NATIONAL BANK	631150	
OK	2/28/2019	Limited Service	4395450	207 WEST SAN ANTONIO STREET DRIVE THRU	207 WEST SAN ANTONIO STREET	LOCKHART	TX	78644	CALDWELL	UNITED STATES	Not Required	Not Required	FIRST-LOCKHART NATIONAL BANK	631150	

CONSOLIDATED FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT

LOCKHART BANKSHARES, INC. AND SUBSIDIARY

December 31, 2018 and 2017

LOCKHART BANKSHARES, INC. AND SUBSIDIARY

December 31, 2018 and 2017

TABLE OF CONTENTS

INDEPENDENT AUDITOR'S REPORT

Audit Committee
Lockhart Bankshares, Inc.
Lockhart, Texas

We have audited the accompanying consolidated financial statements of Lockhart Bankshares, Inc. and Subsidiary which are comprised of the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated 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; this includes 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lockhart Bankshares, Inc. and Subsidiary as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

2909 Sherwood Way, Suite 204, San Angelo, TX 76901
325.949.2567 | www.HambyHengeli.com

Report on Consolidating Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information on pages 35 and 38 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations of the individual companies, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The supplemental consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting records used to prepare the consolidated financial statements and to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

San Angelo, Texas
March 21, 2019

LOCKHART BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	December 31, 2018	December 31, 2017
ASSETS		
Cash and due from banks	$ 11,255,390	$ 6,687,806
Certificates of deposit in banks	2,728,000	1,984,000
Securities available for sale	50,084,396	52,173,670
Nonmarketable equity securities	652,697	550,697
Loans held for sale	58,822	442,716
Loans, net	192,465,998	180,416,206
Premises and equipment, net	7,403,443	6,751,074
Deferred tax asset	1,166,824	-
Bank owned life insurance	5,296,254	5,155,887
Other real estate owned	324,000	371,544
Accrued interest receivable	836,960	789,894
Other assets	613,957	538,918
	$ 272,886,741	$ 255,862,412
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing	$ 55,728,053	$ 57,716,145
Interest-bearing	189,114,150	171,962,902
Total deposits	244,842,203	229,679,047
Note payable	697,500	787,500
Accrued interest payable	127,005	66,139
Other liabilities	2,895,209	2,735,301
Total liabilities	248,561,917	233,267,987
Commitments (Notes F, J and L)		
Stockholders' equity		
Common stock - $1 par value, 300,000 shares authorized, 154,592 shares issued	154,592	154,592
Capital surplus	2,508,916	2,508,916
Treasury stock, at cost - 2,628 shares in 2018, 2,508 shares in 2017	(307,600)	(290,800)
Retained earnings	23,056,402	20,878,778
Accumulated other comprehensive loss	(1,087,486)	(657,061)
Total stockholders' equity	24,324,824	22,594,425
	$ 272,886,741	$ 255,862,412

The accompanying notes are an integral part of these consolidated financial statements

LOCKHART BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

	Years ended December 31, 2018	Years ended December 31, 2017
Interest income		
Loans, including fees	$ 9,699,449	$ 8,889,419
Debt securities:		
Taxable	916,848	785,722
Tax-exempt	213,960	208,667
Other interest and dividends	164,918	167,186
Total interest income	10,995,175	10,050,994
Interest expense		
Deposits	1,829,209	1,351,852
Borrowed funds and other	125,763	39,414
Total interest expense	1,954,972	1,391,266
Provision for loan losses	120,000	105,000
Net interest income after provision for loan losses	8,920,203	8,554,728
Noninterest income		
Service charges on deposit accounts	993,956	1,062,244
Net gain on sale of loans	667,269	706,347
Net gain on sale of assets[1]	8,770	26,657
Other income	460,471	504,898
Total noninterest income	2,130,466	2,300,146
Noninterest expense		
Salaries and employee benefits	4,672,627	4,314,323
Occupancy and equipment	997,194	993,797
Other general and administrative	2,904,400	2,605,023
Total noninterest expense	8,574,221	7,913,143
Income before income taxes	2,476,448	2,941,731
Income tax expense (benefit)	(395,651)	-
NET INCOME	$ 2,872,099	$ 2,941,731

[1] Net gain on sale of assets includes $-0- and $21,279 accumulated other comprehensive income reclassifications for unrealized net gains on available for sale securities for 2018 and 2017, respectively.

The accompanying notes are an integral part of these consolidated financial statements

LOCKHART BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Years ended December 31, 2018	2017
Net income	$ 2,872,099	$ 2,941,731
Other comprehensive income (loss)		
Gross unrealized gains (losses) on securities available for sale	(719,503)	5,586
Reclassification adjustment for (gains) losses realized in net income	-	(21,279)
Net unrealized losses	(719,503)	(15,693)
Tax effect	289,078	-
Total other comprehensive loss	(430,425)	(15,693)
TOTAL COMPREHENSIVE INCOME	$ 2,441,674	$ 2,926,038

The accompanying notes are an integral part of these consolidated financial statements

LOCKHART BANKSHARES, INC. SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years Ended December 31, 2018 and 2017

	Common Stock	Capital Surplus	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2016	$ 151,005	$ 1,992,388	$ (290,800)	$ 19,412,375	$ (641,368)	$ 20,623,600
Issuance of common stock	3,587	516,528	-	-	-	520,115
Net income	-	-	-	2,941,731	-	2,941,731
Other comprehensive loss	-	-	-	-	(15,693)	(15,693)
Cash dividends paid	-	-	-	(1,475,328)	-	(1,475,328)
Balance at December 31, 2017	154,592	2,508,916	(290,800)	20,878,778	(657,061)	22,594,425
Purchase of treasury stock	-	-	(16,800)	-	-	(16,800)
Net income	-	-	-	2,872,099	-	2,872,099
Other comprehensive loss	-	-	-	-	(430,425)	(430,425)
Cash dividends paid	-	-	-	(694,475)	-	(694,475)
Balance at December 31, 2018	$ 154,592	$ 2,508,916	$ (307,600)	$ 23,056,402	$ (1,087,486)	$ 24,324,824

The accompanying notes are an integral part of these consolidated financial statements

LOCKHART BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31, 2018	2017
Cash flows from operating activities		
Net income	$ 2,872,099	$ 2,941,731
Adjustments to reconcile net income to cash provided by operating activities		
Writedowns on other real estate	47,544	-
Net amortization of discount on investment securities	350,786	376,834
Provision for loan losses	120,000	105,000
Depreciation and amortization expense	488,329	531,921
Gain on sale of premises and equipment	(8,770)	(5,378)
Gain on sale of investment securities	-	(21,279)
Federal Home Loan Bank stock dividend	(7,800)	(2,700)
Deferred income taxes	(877,746)	-
Increase in cash surrender value of bank owned life insurance	(140,367)	(138,684)
Net change in:		
Loans held for sale	383,894	(442,716)
Accrued interest receivable	(47,066)	(93,443)
Accrued interest payable	60,866	(29,235)
Other assets and other liabilities	84,892	(12,221)
Cash provided by operating activities	3,326,661	3,209,830
Cash flows from investing activities		
Purchases of certificates of deposit in banks	(744,000)	(248,000)
Proceeds from securities available for sale:		
Sales	-	6,388,514
Maturities and calls	27,525,000	16,000,000
Principal paydowns	4,485,285	3,887,613
Purchases of securities available for sale	(30,991,300)	(35,720,402)
Purchase of of Federal Home Loan Bank stock	(94,200)	-
Purchase of Federal Reserve Bank stock	-	(15,000)
Proceeds from sales of premises and equipment	250	8,500
Loans originated, net of principal collections	(12,169,792)	(9,627,691)
Additions to premises and equipment	(1,132,201)	(284,652)
Cash used for investing activities	(13,120,958)	(19,611,118)
Cash flows from financing activities		
Net change in deposits	15,163,156	5,856,576
Advances on Federal Home Loan Bank borrowings	71,160,000	4,100,000
Principal payments on Federal Home Loan Bank borrowings	(71,160,000)	(4,100,000)
Repayments on debt	(90,000)	(90,000)
Proceeds from issuance of common stock	-	520,115
Cash paid to purchase treasury stock	(16,800)	-
Cash dividends paid	(694,475)	(1,475,328)
Cash provided by financing activities	14,361,881	4,811,363
Net change in cash and cash equivalents	4,567,584	(11,589,925)
Cash and cash equivalents, beginning of year	6,687,806	18,277,731
Cash and cash equivalents, end of year	$ 11,255,390	$ 6,687,806
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest on deposits and borrowed funds	$ 1,894,106	$ 1,365,158
Income taxes	509,596	-

The accompanying notes are an integral part of these consolidated financial statements

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of Lockhart Bankshares, Inc. and Subsidiary conform to accounting principles generally accepted in the United States of America and to general practice within the banking industry. The following is a summary of the significant accounting and reporting policies:

Nature of Operations and Principles of Consolidation

Lockhart Bankshares, Inc. is a bank holding company which owns 100% of the common stock of First-Lockhart National Bank ("the Bank"). The entities are collectively referred to as "the Company". Significant intercompany accounts and transactions have been eliminated in consolidation.

The Company provides a variety of banking services to individuals and businesses through their locations in Lockhart, Austin, San Marcos and Kyle, Texas. Their primary deposit products are checking, savings and term deposit accounts. Their primary lending products are real estate, commercial and consumer loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. There are no significant concentrations of loans to any one industry or customer. However, the customer's ability to repay their loans is dependent on the real estate and general economic conditions in the area. The Bank is subject to competition from other financial institutions and to regulation by certain federal agencies. The Bank undergoes periodic examinations by these regulatory authorities.

Use of Estimates

To prepare financial statements in conformity with accounting principles generally accepted in the United States of America management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided and actual results could differ.

Cash and Cash Equivalents

For the purpose of the statements of cash flows, cash and cash equivalents include cash, deposits with other financial institutions with maturities fewer than 90 days, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in other financial institutions, and federal funds purchased.

Balances in transaction accounts at other financial institutions and at the Federal Home Loan Bank may exceed amounts covered by federal deposit insurance. Management regularly evaluates the credit risk associated with other financial institutions and believes that the Company is not exposed to any significant credit risks on cash and cash equivalents.

Certificates of Deposit in Banks

Certificates of deposit in banks are carried at cost, and are fully covered by federal deposit insurance.

Investment Securities

Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

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

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as an impairment charge to earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which is recognized as an impairment charge to earnings, and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Nonmarketable Equity Securities

The Company, as a member of the Federal Reserve Bank and the Federal Home Loan Bank of Dallas (FHLB), is required to maintain an investment in the capital stock of each. The Company also maintains an investment in the capital stock of TIB – The Independent BankersBank. No ready market exists for these stocks, and they have no readily determinable fair value. For financial reporting purposes, such stock is considered restricted and is carried at cost, minus impairment, if any under the caption "nonmarketable equity securities."

Periodically, management evaluates these securities for other-than-temporary impairment. Management reviews for impairment based on the ultimate recoverability of the cost basis in the stock. Both cash and stock dividends are reported as income.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value. Net unrealized losses, if any, are recognized through a valuation allowance charged to earnings. Income from sales of loans is recognized at the time of sale, and consists of origination fees, service release premiums, yield spread premiums and certain miscellaneous fees. All loans are sold with recourse limited to certain events of default occurring within 120 days of the loans' origination dates. The Company does not retain servicing rights on loans sold.

Loans

The Company grants real estate, commercial, agricultural and consumer loans to customers. A substantial portion of the loan portfolio is represented by real estate and commercial loans throughout central Texas. The ability of the Company's borrowers to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Real estate (commercial real estate or consumer real estate) loans are underwritten after evaluating and understanding the borrower's ability to repay the loan through operating profitably and effectively growing their business. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Management monitors and evaluates commercial real estate loans based on collateral and risk grade criteria. As a general rule, the Company avoids financing special use projects unless strong secondary support is present to help mitigate risk.

With respect to loans to builders, the Company generally requires the borrower to have a proven record of success and an expertise in the building industry. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained.

These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Commercial loans are subject to underwriting standards and processes similar to real estate loans. The Company's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial loans are primarily made based on the credit quality and cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee to add strength to the credit and reduce the risk on a transaction to an acceptable level; however, some short-term loans may be made on an unsecured basis to the most credit worthy borrowers. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Due to the nature of accounts receivable and inventory secured loans, the Company closely monitors credit availability and collateral through the use of various tools, including, but not limited to borrowing-base formulas, review of accounts receivable aging schedules, periodic inventory audits, and/or collateral inspections.

Agricultural loans are made to sound and prudent farmers and ranchers within our market area even though agriculture may be an unstable industry. In order to minimize risk, sound lending policies are extremely important, taking into consideration not only the value of collateral offered but also the performance history and anticipated cash flow from a given farming or ranching operation. All agricultural loan applications require cash flow projection for the coming farming season, and the projection must show a margin between income and expense that is sufficient to repay the loan from normal farm operations. All agriculture loans will be supported by a perfected first security interest position in the products being produced.

The Company minimally originates non-real estate consumer loans based on the borrower's proven earning capacity over the term of the loan. The Company monitors payment performance periodically for consumer loans to identify any deterioration in the borrower's financial strength. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by management and staff. This activity, coupled with a relatively small volume of consumer loans, minimizes risk.

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 loan losses. Interest income is accrued on the unpaid principal balance.

Past due loans are any loans for which payments of interest, principal or both have not been received within the timeframes designated by the loan agreements. Loans with payments in arrears but for which borrowers have resumed making scheduled payments are considered past due until arrearages are brought current. Loans that experience insignificant payment delays or payment shortfalls generally are not considered past due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

The accrual of interest on any loan is discontinued at the time the loan is specifically determined to be impaired unless the loan is well secured and in process of collection. Additionally, loans are placed on nonaccrual at an earlier date if collection of principal or interest is considered doubtful. When placing a loan on nonaccrual status, interest accrued to date is generally reversed and is charged against the current year's interest income. Payments received on a loan on nonaccrual status are applied against the balance of the loan. A loan is returned to accrual status when principal and interest are no longer past due and collectability is no longer doubtful.

Troubled debt restructurings are loans for which concessions in terms have been made as a result of the borrower experiencing financial difficulty. Generally, concessions granted to customers include lower interest rates and modification of the payment stream to lower or defer payments. Interest on troubled debt restructurings is accrued under the new terms if the loans are performing and full collection of principal and interest is expected. However, interest accruals are discontinued on troubled debt restructurings that meet the Company’s nonaccrual criteria.

Generally, loans are charged off in whole or in part on a loan-by-loan basis after they become significantly past due and based upon management’s review of the collectability of all or a portion of the loan unless the loan is in the process restructuring. Charge off amounts are determined based upon the carrying amount of loans and the amount estimated to be collectible as determined by analyses of expected future cash flows and the liquidation of loan collateral.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses, and is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgement, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired when, based on current information and events, it is probable that the Company will not collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings (TDRs) and are classified as impaired.

Factors considered by management in determining whether a loan is impaired include payment status, collateral value, the borrower's financial condition and overall loan quality as determined by an internal loan grading system. Included in impaired loans are all nonaccrual loans and all accruing troubled debt restructurings. Loans that experience insignificant payment delays or payment shortfalls generally are not considered impaired. For impaired loans for which repayment is expected solely from the collateral, impairment is measured based on the fair value of the collateral. For other impaired loans, impairment may be measured based on the fair value of the collateral or on the present value of expected future cash flows discounted at the loan's original effective interest rate. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance.

Troubled debt restructurings are individually evaluated for impairment and included in the separately identified impairment disclosures. TDRs are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a TDR is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For TDRs that subsequently default, the Company determines the amount of the allowance on that loan in accordance with the accounting policy for the allowance for loan losses on loans individually identified as impaired.

The general component relates to non-impaired loans, and is based on historical loss experience adjusted for the effects of economic factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio's historical loss experience. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. Economic factors include the following: economic conditions; industry conditions; changes in lending policies and procedures; trends in the volume and terms of loans; the experience, ability and depth of lending staff; levels and trends in delinquencies and impaired loans; levels and trends in charge-off and recovery activity; levels and trends of loan quality as determined by an internal loan grading system; portfolio concentrations.

The quality of the Company's loan portfolio is assessed as a function of the levels of past due loans and impaired loans, and internal credit quality ratings which are updated quarterly by management. The ratings on the Company's internal credit scale are broadly grouped into the categories "pass", "pass-watch, "special mention", "substandard" and "doubtful." Loans with a pass rating are those loans with minimal identified credit risk. Pass-watch loans include loans with minor credit quality issues identified since the loan was originated, as well as any loans with a perceived potential for, or with recently occurring payment deterioration. Special mention loans include those with potential credit weaknesses which deserve management's attention but for which full collection of contractual principal and interest is not significantly at risk. Substandard loans are those loans that have well-defined weakness that put full collection of contractual principal or interest at risk. Loans rated doubtful are those for which it is probable that the Company will not collect all contractual principal or interest. Loans rated doubtful are generally also placed on nonaccrual and considered impaired. The credit quality ratings are an important part of the Company's overall credit risk management process and are considered in the determination of the allowance for loan losses. Due to the added risks associated with loans which are graded as special mention or substandard that are not classified as impaired, an additional analysis is performed to determine whether an allowance is needed that is not fully captured by the historical loss experience. While historical loss experience by loan segment and migration of loans to higher risk classifications are considered, the following factors are also considered in determining the level of needed allowance on such loans: the historical loss rates (or severity) of loans specifically classified as special mention, substandard or doubtful; and the trends in the collateral on the loans included within these classifications

Determination of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance. Such agencies may require the Company to recognize additional losses based on their judgments about information available to them at the time of their examination.

Premises and Equipment

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets. Maintenance and repairs, which do not extend the useful lives of buildings and equipment, are charged to expense as incurred.

Other Real Estate Owned

Foreclosed assets are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement.

Also included in other real estate is property originally acquired for future expansion but no longer intended to be used for that purpose.

Subsequent to classification as other real estate, valuations are periodically performed by management and the assets are carried at the lower of the initial carrying amount or fair value less estimated costs to sell. If fair value declines subsequent to classification as other real estate, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Bank Owned Life Insurance

The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Income Taxes

The Company, with the consent of its shareholders, elected to revoke its Subchapter S election, and will be taxed at the corporate level beginning January 1, 2018.

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

Prior to January 1, 2018, the Company had elected to be taxed under the provisions of Subchapter S of the Internal Revenue Code. Under those provisions, the Company did not pay corporate income taxes on its taxable income. Instead, the stockholders of the Company included their respective shares of the Company’s net operating income or loss in their individual tax returns. Accordingly no income taxes are reflected in the consolidated financial statements for the year ended December 31, 2017.

The Company is no longer subject to examination by taxing authorities for years before 2015.

Retirement Plans

Employee 401(k) and profit sharing plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been relinquished. Control over transferred assets is deemed to be relinquished when the assets have been isolated from the Company, 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 the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Restrictions on Cash

Cash on hand or on deposit with the Federal Reserve Bank was required to meet regulatory reserve and clearing requirements.

Dividend Restrictions

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to shareholders.

Fair Value Measurements

Fair values of financial instruments are estimated using the relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgement regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Comprehensive Income

Components of comprehensive income are net income and all other non-owner changes in equity. The only component of other comprehensive income consists of net unrealized holding gains and losses on available-for-sale securities, net of tax.

Adoption of New Accounting Standards and Newly Issued Not Yet Effective Accounting Standards

ASU 2014-09 "*Revenue from Contracts with Customers*" *(Topic 606).* In May 2014, FASB issued ASU 2014-09 which implements a common revenue standard that clarifies the principles for recognizing revenue. Multiple clarifications to the standard have been issued. The standard will supersede most current revenue recognition requirements when it becomes effective. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, (v) recognize revenue when (or as) the entity satisfies the performance obligation. The Company will adopt Topic 606 in 2019, as required for non-public business entities. The Company is finalizing its assessment and has identified the revenue line items within the scope of this new guidance. The adoption of this standard is not expected to result in a material change for revenue because the majority of the Company's financial instruments are not within the scope of Topic 606. Revenue streams within Other Noninterest Income the Company is evaluating include Service Charges on Deposit Accounts.

ASU 2016-01"Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities". In January 2016, the FASB issued ASU 2016-01 which amends a number of accounting standards, including: (1) Requiring equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in income; (2) Requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (3) Requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables); (4) Simplifying the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (5) Clarifying that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets; (6) Eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost; and (7) Eliminating the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities. The Company will adopt this new guidance in 2019. The adoption of this standard is not expected to have a material effect on the consolidated financial statements, however, it may impact the fair value disclosures included in Note N.

ASU 2016-02 "Leases" (Topic 842). In February 2016, the FASB amended existing guidance that will require lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and *Topic 606 - Revenue from Contracts with Customers*. The new guidance also requires enhanced disclosure about an entity's leasing arrangements. The Company will adopt Topic 842 in the first quarter of 2020, as required for non-public business entities. An entity may adopt the new guidance by either restating prior periods and recording a cumulative effect adjustment at the beginning of the earliest comparative period presented or by recording a cumulative effect adjustment at the beginning of the period of adoption. The Company plans to record a cumulative effect adjustment at the beginning of the period of adoption. The Company is currently evaluating the overall effect that the guidance will have on its consolidated financial statements and disclosures.

ASU 2016-13 "Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments" (Topic 326). In June 2016, FASB issued guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the guidance amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The Company will adopt Topic 326 in the first quarter of 2022, as required for non-public business entities. The Company has formed a CECL committee that is assessing data and system needs in order to evaluate the impact of adopting the new guidance. The Company may recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective. The cumulative-effect adjustment will be recognized in retained earnings as of the beginning of the first reporting period in which the guidance is effective. At this time, the impact to the allowance for loan losses balance is being evaluated.

ASU 2017-08 "Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities". In March 2017, the FASB amended existing guidance to shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount, the discount continues to be amortized to maturity. This guidance becomes effective for annual reporting periods beginning after December 15, 2019 and interim reporting periods beginning after December 15, 2020. Early adoption is permitted. The Company/Bank has elected to early adopt his guidance effective January 1, 2017, the impact of the adoption was not material to the consolidated financial statements or disclosures.

ASU 2018-13 "Fair Value Measurement (Topic 820) – Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement. In August 2018, the FASB issued ASU 2018-13 to remove from, modify, and add to existing fair value measurement disclosures requirements. The disclosure requirements that are removed include the following: (1) transfers between Level 1 and Level 2 of the fair value hierarchy; (2) the policy for determining when transfers between any of the three levels have occurred; (3) the valuation processes used for Level 3 measurements; (4) for nonpublic entities, the changes in unrealized gains or losses presented in earnings for Level 3 instruments held at the balance sheet date. The following disclosure requirements are modified (1) the Level 3 roll forward is eliminated for nonpublic entities, but disclosure of transfers in and out of Level 3 as well as purchases and issuances are required; (2) the Level 3 measurement uncertainty disclosure should communicate information about the uncertainty at the balance sheet date. Additionally, nonpublic entities will be required to disclose some form of quantitative information about significant unobservable inputs used in Level 3 fair value measurement. The ASU is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. In addition, an entity may early adopt any of the removed or modified disclosures immediately and delay adoption of the new disclosures until the effective date. The Company is currently evaluating the overall effect that the guidance will have on its consolidated financial statements and disclosures.

<u>Subsequent Events</u>

The Company has evaluated subsequent events for recognition and disclosure through March 21, 2019 which is the date the financial statements were available to be issued.

<u>Reclassifications</u>

Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or stockholders' equity.

NOTE B – CERTIFICATES OF DEPOSIT IN BANKS

Scheduled maturities of certificates of deposit in banks are as follows at December 31, 2018:

Year ending December 31,	
2019	$ 1,488,000
2020	248,000
2021	-
2022	496,000
2023	496,000
Thereafter	-
	$ 2,728,000

NOTE C – INVESTMENT SECURITIES

The following presents information related to the Company's portfolio of debt securities:

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale				
U.S. Government agencies	$ 16,053,036	$ -	$ (302,804)	$ 15,750,232
Obligations of state and political subdivisions	9,173,307	41,456	(163,164)	9,051,599
Mortgage-backed	24,269,682	-	(947,077)	23,322,605
Other asset-backed	1,964,935	-	(4,975)	1,959,960
	$ 51,460,960	$ 41,456	$ (1,418,020)	$ 50,084,396

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale				
U.S. Government agencies	$ 16,078,991	$ 12,344	$ (102,176)	$ 15,989,159
Obligations of state and political subdivisions	9,809,320	118,064	(75,610)	9,851,774
Mortgage-backed	26,942,420	-	(609,683)	26,332,737
	$ 52,830,731	$ 130,408	$ (787,469)	$ 52,173,670

The amortized cost and estimated market value of debt securities at December 31, 2018, by contractual maturity are as follows:

	Available for Sale	
	Amortized Cost	Fair Value
Due in one year or less	$ 994,343	$ 989,128
Due after one year through five years	16,328,916	16,059,396
Due after five years through ten years	4,639,315	4,554,404
Due after ten years	3,263,769	3,198,903
	25,226,343	24,801,831
Securities without fixed maturities	26,234,617	25,282,565
	$ 51,460,960	$ 50,084,396

Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations without call or prepayment penalties.

At December 31, 2018 and 2017, investment securities with carrying values of $28,290,801 and $21,068,355, respectively, were pledged to secure public deposits and for other purposes.

During 2018 there were no sales of investment securities. During 2017 there were gross realized gains of $36,331 and gross realized losses of $15,052 on the sale of investment securities.

Information pertaining to securities with gross unrealized losses, at December 31, 2018 and 2017 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	December 31, 2018			
	Less than 12 months		Over 12 months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Securities available for sale				
U.S. Government agencies	$ 15,826	$ 2,979,664	$ 286,978	$ 12,770,568
Obligations of state and political subdivisions	10,478	636,902	152,686	4,794,330
Mortgage-backed	6,808	182,404	940,269	21,498,565
Other asset-backed	4,975	1,959,961	-	-
	$ 38,087	$ 5,758,931	$ 1,379,933	$ 39,063,463

	December 31, 2017			
	Less than 12 months		Over 12 months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Securities available for sale				
U.S. Government agencies	$ 59,132	$ 9,992,653	$ 43,044	$ 1,960,503
Obligations of state and political subdivisions	25,882	3,329,850	49,728	1,400,709
Mortgage-backed	201,242	13,310,002	408,441	13,022,735
	$ 286,256	$ 26,632,505	$ 501,213	$ 16,383,947

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

NOTE D – NONMARKETABLE EQUITY SECURITIES

Nonmarketable equity securities carried at cost are as follows:

	December 31,	
	2018	2017
Federal Reserve Bank	$ 178,100	$ 178,100
Federal Home Loan Bank of Dallas	409,700	307,700
TIB - The Independent BankersBank	64,897	64,897
	$ 652,697	$ 550,697

NOTE E – LOANS

Major classifications of loans are as follows:

	December 31, 2018	December 31, 2017
Real Estate		
Construction & Development	$ 14,561,704	$ 17,357,481
Owner Occupied Commercial Real Estate (CRE)	49,637,327	45,081,495
Non-Owner Occupied Commercial Real Estate (CRE)	46,551,444	38,378,411
1-4 Family	67,469,859	64,367,455
Farmland	4,094,948	4,865,216
Real Estate - Other	2,451,091	3,547,209
Commercial & Industrial	6,683,953	4,996,708
Agricultural Production	972,345	1,118,468
Consumer and Other	3,005,806	3,583,287
	195,428,477	183,295,730
Less: Allowance For Loan Losses	(2,962,479)	(2,879,524)
Total Loans	$ 192,465,998	$ 180,416,206

Transactions for the years ended December 31, 2018 and 2017 in the allowance for loan losses were as follows:

Year Ended December 31, 2018

	Real Estate	Commercial	Agricultural Production	Consumer and Other	Unallocated	Total
Balance at December 31, 2017	$ 2,244,434	$ 185,371	$ 3,915	$ 129,103	$ 316,701	$ 2,879,524
Provision for loan losses	201,904	11,232	(512)	(32,376)	(60,248)	120,000
Charge-offs	-	(56,718)	-	(16,542)	-	(73,260)
Recoveries	11,000	17,209	-	8,006	-	36,215
Net (charge-offs) recoveries	11,000	(39,509)	-	(8,536)	-	(37,045)
Balance at December 31, 2018	$ 2,457,338	$ 157,094	$ 3,403	$ 88,191	$ 256,453	$ 2,962,479

Year Ended December 31, 2017

	Real Estate	Commercial	Agricultural Production	Consumer and Other	Unallocated	Total
Balance at December 31, 2016	$ 2,299,034	$ 124,756	$ 4,199	$ 91,246	$ 343,502	$ 2,862,737
Provision for loan losses	(67,600)	156,165	(284)	43,520	(26,801)	105,000
Charge-offs	-	(121,051)	-	(8,719)	-	(129,770)
Recoveries	13,000	25,501	-	3,056	-	41,557
Net (charge-offs) recoveries	13,000	(95,550)	-	(5,663)	-	(88,213)
Balance at December 31, 2017	$ 2,244,434	$ 185,371	$ 3,915	$ 129,103	$ 316,701	$ 2,879,524

Components of the allowance for loan losses, and the related carrying amounts of loans for which the allowance is determined, are as follows:

	Year Ended December 31, 2018					
	Real Estate	Commercial	Agricultural Production	Consumer and Other	Unallocated	Total
Allocation of Allowance To:						
Impaired loans - evaluated individually	$ -	$ -	$ -	$ -	$ -	$ -
Impaired loans - evaluated collectively	-	-	-	-	-	-
Total impaired loans	-	-	-	-	-	-
Unimpaired loans - evaluated collectively	2,457,338	157,094	3,403	88,191	256,453	2,962,479
	$ 2,457,338	$ 157,094	$ 3,403	$ 88,191	$ 256,453	$ 2,962,479
Recorded Investment In:						
Impaired loans - evaluated individually	$ 466,714	$ -	$ -	$ -	$ -	$ 466,714
Impaired loans - evaluated collectively	-	-	-	-	-	-
Total impaired loans	466,714	-	-	-	-	466,714
Unimpaired loans - evaluated collectively	184,299,659	6,683,953	972,345	3,005,806	-	$ 194,961,763
	$ 184,766,373	$ 6,683,953	$ 972,345	$ 3,005,806	$ -	$ 195,428,477

	Year Ended December 31, 2017					
	Real Estate	Commercial	Agricultural Production	Consumer and Other	Unallocated	Total
Allocation of Allowance To:						
Impaired loans - evaluated individually	$ -	$ 54,218	$ -	$ -	$ -	$ 54,218
Impaired loans - evaluated collectively	-	-	-	-	-	-
Total impaired loans	-	54,218	-	-	-	54,218
Unimpaired loans - evaluated collectively	2,244,434	131,153	3,915	129,103	316,701	2,825,306
	$ 2,244,434	$ 185,371	$ 3,915	$ 129,103	$ 316,701	$ 2,879,524
Recorded Investment In:						
Impaired loans - evaluated individually	$ 448,234	$ 56,718	$ -	$ -	$ -	$ 504,952
Impaired loans - evaluated collectively	-	-	-	-	-	-
Total impaired loans	448,234	56,718	-	-	-	504,952
Unimpaired loans - evaluated collectively	173,149,033	4,939,990	1,118,468	3,583,287	-	182,790,778
	$ 173,597,267	$ 4,996,708	$ 1,118,468	$ 3,583,287	$ -	$ 183,295,730

Information relative to impaired loans is as follows:

	December 31, 2018				Year Ended December 31, 2018
	Recorded Investment In Impaired Loans With No Valuation Allowance	Recorded Investment In Impaired Loans With A Valuation Allowance	Total Impaired Loans	Valuation Allowance on Impaired Loans	Average Impaired Loans
Real Estate					
Construction & Development	$ -	$ -	$ -	$ -	$ -
Owner Occupied CRE	466,714	-	466,714	-	182,990
Non-Owner Occupied CRE	-	-	-	-	-
1-4 Family	-	-	-	-	-
Farmland	-	-	-	-	-
Real Estate - Other	-	-	-	-	-
Commercial & Industrial	-	-	-	-	11,344
Agricultural	-	-	-	-	-
Consumer and Other	-	-	-	-	-
Total	$ 466,714	$ -	$ 466,714	$ -	$ 194,334

	December 31, 2017				Year Ended December 31, 2017
	Recorded Investment In Impaired Loans With No Valuation Allowance	Recorded Investment In Impaired Loans With A Valuation Allowance	Total Impaired Loans	Valuation Allowance on Impaired Loans	Average Impaired Loans
Real Estate					
Construction & Development	$ -	$ -	$ -	$ -	$ -
Owner Occupied CRE	-	-	-	-	-
Non-Owner Occupied CRE	-	-	-	-	-
1-4 Family	-	-	-	-	153,097
Farmland	-	-	-	-	-
Real Estate - Other	448,234	-	448,234	-	187,900
Commercial & Industrial	-	56,718	56,718	54,218	30,458
Agricultural	-	-	-	-	-
Consumer and Other	-	-	-	-	-
Total	$ 448,234	$ 56,718	$ 504,952	$ 54,218	$ 371,455

There are no commitments to extend credit on impaired loans at December 31, 2018. Interest income recognized on impaired loans was immaterial for the years ended December 31, 2018 and 2017. Also, the Company did not have any troubled debt restructurings at December 31, 2018 and 2017.

The carrying amounts of loans by performance status are as follows:

	December 31, 2018				
	Accruing Loans				
	Current	30-89 Days Past Due	90 Days or More Past Due	Nonaccrual Loans	Total Loans
Real Estate					
Construction & Development	$ 14,561,704	$ -	$ -	$ -	$ 14,561,704
Owner Occupied CRE	49,170,613	-	-	466,714	49,637,327
Non-Owner Occupied CRE	46,498,085	53,359	-	-	46,551,444
1-4 Family	67,424,366	45,493	-	-	67,469,859
Farmland	4,094,948	-	-	-	4,094,948
Real Estate - Other	2,451,091	-	-	-	2,451,091
Commercial & Industrial	6,645,776	38,177	-	-	6,683,953
Agricultural	972,345	-	-	-	972,345
Consumer and Other	3,005,806	-	-	-	3,005,806
Total	$ 194,824,734	$ 137,029	$ -	$ 466,714	$ 195,428,477

	December 31, 2017				
	Accruing Loans				
	Current	30-89 Days Past Due	90 Days or More Past Due	Nonaccrual Loans	Total Loans
Real Estate					
Construction & Development	$ 17,357,481	$ -	$ -	$ -	$ 17,357,481
Owner Occupied CRE	45,081,495	-	-	-	45,081,495
Non-Owner Occupied CRE	38,378,411	-	-	-	38,378,411
1-4 Family	63,522,336	845,119	-	-	64,367,455
Farmland	4,850,216	15,000	-	-	4,865,216
Real Estate - Other	3,023,975	75,000	-	448,234	3,547,209
Commercial & Industrial	4,939,990	-	-	56,718	4,996,708
Agricultural	1,118,468	-	-	-	1,118,468
Consumer and Other	3,583,287	-	-	-	3,583,287
Total	$ 181,855,659	$ 935,119	$ -	$ 504,952	$ 183,295,730

The carrying amounts of loans by credit quality indicator are as follows:

	December 31, 2018				
	Pass	Pass-Watch	Special Mention	Substandard	Total Loans
Real Estate					
Construction & Development	$ 14,561,704	$ -	$ -	$ -	$ 14,561,704
Owner Occupied CRE	49,086,181	84,432	-	466,714	49,637,327
Non-Owner Occupied CRE	43,765,063	2,786,381	-	-	46,551,444
1-4 Family	63,843,352	2,288,881	1,337,626	-	67,469,859
Farmland	4,094,948	-	-	-	4,094,948
Real Estate - Other	2,444,297	-	-	6,794	2,451,091
Commercial	6,510,804	-	166,562	6,587	6,683,953
Agricultural	972,345	-	-	-	972,345
Consumer and Other	2,891,589	114,217	-	-	3,005,806
Total Loans	$ 188,170,283	$ 5,273,911	$ 1,504,188	$ 480,095	$ 195,428,477

	December 31, 2017				
	Pass	Pass-Watch	Special Mention	Substandard	Total Loans
Real Estate					
Construction & Development	$ 16,409,841	$ 947,640	$ -	$ -	$ 17,357,481
Owner Occupied CRE	44,624,423	-	95,600	361,472	45,081,495
Non-Owner Occupied CRE	36,713,902	1,664,509	-	-	38,378,411
1-4 Family	60,421,675	2,485,482	1,460,298	-	64,367,455
Farmland	4,865,216	-	-	-	4,865,216
Real Estate - Other	2,691,328	343,955	500,126	11,800	3,547,209
Commercial	4,762,850	-	184,676	49,182	4,996,708
Agricultural	1,118,468	-	-	-	1,118,468
Consumer and Other	3,539,329	20,117	23,841	-	3,583,287
Total Loans	$ 175,147,032	$ 5,461,703	$ 2,264,541	$ 422,454	$ 183,295,730

NOTE F – PREMISES AND EQUIPMENT

Premises and equipment are as follows:

	December 31, 2018	December 31, 2017
Land	$ 3,131,912	$ 2,331,643
Buildings and improvements	6,413,739	6,367,155
Furniture, fixtures and equipment	3,387,921	3,159,145
Software	-	209,103
Vehicles	183,368	181,201
Construction in progress	166,884	60,147
	13,283,824	12,308,394
Accumulated depreciation	(5,880,381)	(5,557,320)
	$ 7,403,443	$ 6,751,074

Operating Leases

In October 2017, the Company entered into an agreement to lease their San Marcos branch location. Future minimum rent commitments, before considering renewal portions that generally are present, are as follows:

Year Ending December 31,	
2019	$ 32,496
2020	24,372
2021	-
2022	-
2023	-
Thereafter	-
	$ 56,868

The Company also leases office space in one of their branch locations to another business. Rental income, net of certain operating expenses, under this lease amounted to $43,872 and $44,440 for 2018 and 2017, respectively.

Future minimum rental income to be received in connection with the long-term operating lease at December 31, 2018 is as follows:

Year Ending December 31,	
2019	$ 49,008
2020	16,436
2021	-
2022	-
2023	-
Thereafter	-
	$ 65,444

NOTE G - DEPOSITS

Time deposits that meet or exceed the FDIC insurance limit of $250,000 at December 31, 2018 and 2017 was $8,946,352 and $6,188,911, respectively.

At December 31, 2018, the scheduled maturities of time deposits are as follows:

Year Ending December 31,	
2019	$ 40,993,649
2020	4,384,467
2021	326,574
2022	81,065
2023	-
	$ 45,785,755

NOTE H - BORROWINGS

Note Payable

The Company has an amortizing note payable with one of its correspondent banks that is set to mature on September 1, 2020. Principal payments of $22,500, plus all accrued interest are due quarterly, with the balance due at maturity. For 2017, interest accrued at the Wall Street Journal Prime rate plus 0.5%, resulting in a rate of 5.0% at December 31, 2017. In 2018 the note was renewed and interest accrues at the Wall Street Journal Prime rate resulting in a rate of 5.5% at December 31, 2018. The note is secured by the common stock of the Bank. At December 31, 2018 and 2017 $697,500 and $787,500 was outstanding, respectively.

Federal Home Loan Bank Borrowings

The Company periodically utilizes the Federal Home Loan Bank for short-term borrowings. There were no advances outstanding at December 31, 2018 or 2017. However, the Company has entered into a blanket lien agreement with the Federal Home Loan Bank in which certain mortgage loans and investment securities can be used as collateral for future advances. Based on the value of the collateral as well as Company's holdings of FHLB stock, the Company is eligible to borrow up to a total of $107.3 million at December 31, 2018.

Lines of Credit

The Company has a $2,100,000 line of credit with one of its correspondent banks. The line is collateralized by the common stock of the Bank and matures September 1, 2020. Interest accrues at the Wall Street Journal Prime rate resulting in a rate of 5.5% at December 31, 2018. No amounts were outstanding under the line at December 31, 2018 and 2017.

The Company also has an unsecured federal funds lines of credit with one of its correspondent banks. At December 31, 2018, the Company was eligible to borrow $7,500,000. No amounts were outstanding under this line at December 31, 2018 and 2017. Federal funds lines are uncommitted and funding requests made by the Company are subject to the lending institution's approval and funding availability at the time of request.

NOTE I – INCOME TAXES

Allocation of federal income taxes between current and deferred positions is as follows:

	Year ended December 31, 2018
Current federal provision	$ 477,694
Deferred provision (benefit)	(873,345)
	$ (395,651)

The differences between the statutory federal income tax rate and the effective tax rates are summarized as follows:

	2018
Statutory federal tax rate	21.0%
Increase (decrease) in tax resulting from	
Establishment of deferred tax asset	(33.3)
Tax-exempt interest income	(3.6)
Other	(0.1)
Effective tax rate	-16.0%

Listed below are the components of the net deferred tax asset:

	2018
Deferred tax assets	
Allowance for loan losses	$ 622,121
Deferred compensation	486,597
Other real estate owned	9,984
Unrealized loss on securities available for sale	289,078
Other	147
	1,407,927
Deferred tax liabilities	
Depreciation	(224,338)
Federal Home Loan Bank stock	(2,352)
Investment in Valesco Commerce Street Capital LP	(14,413)
	(241,103)
Net deferred tax asset	$ 1,166,824

NOTE J – LOAN COMMITMENTS AND OTHER RELATED ACTIVITY

Some financial instruments, such as loan commitments, credit lines, letters of credit and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

At December 31, 2018 and 2017, the following financial instruments were outstanding whose contract amounts represent credit risk:

	2018	2017
Unfunded commitments to extend credit	$ 14,316,118	$ 17,194,801
Commercial and standby letters of credit	484,708	424,708

NOTE K – MINIMUM REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in at a rate of 0.625% per year from 0.0% for 2015 to 2.5% on January 1, 2019. The capital conservation buffer for 2018 is 1.875% and for 2017 is 1.25%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes, as of December 31, 2018, that the Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations 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 year-end 2018 and 2017, the most recent regulatory notification 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.

The Bank's actual and required capital amounts and ratios as of December 31, 2018 and 2017 are presented in the following table.

	Actual		Minimum capital requirement		Minimum to be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(dollars in thousands)			
As of December 31, 2018						
Total capital (to risk weighted assets)	$ 28,417	15.1%	$ 15,104	8.0%	$ 18,880	10.0%
Tier 1 capital (to risk weighted assets)	26,050	13.8%	11,328	6.0%	15,104	8.0%
Common tier 1 capital (to risk weighted assets)	26,050	13.8%	8,496	4.5%	12,272	6.5%
Tier 1 capital (to average assets)	26,050	9.6%	10,855	4.0%	13,568	5.0%
As of December 31, 2017						
Total capital (to risk weighted assets)	$ 26,293	14.3%	$ 14,714	8.0%	$ 18,393	10.0%
Tier 1 capital (to risk weighted assets)	23,987	13.0%	11,036	6.0%	14,714	8.0%
Common tier 1 capital (to risk weighted assets)	23,987	13.0%	8,277	4.5%	11,955	6.5%
Tier 1 capital (to average assets)	23,987	9.3%	10,285	4.0%	12,856	5.0%

NOTE L – EMPLOYEE BENEFIT PLANS

The Company has a 401(k) plan in which substantially all eligible employees may participate. Employees may contribute up to 100% of their compensation subject to certain limits based on federal tax laws. The Company makes matching contributions at the discretion of the Board of Directors. The matching contribution made to the 401(k) retirement plan for the years ended December 31, 2018 and 2017 totaled $115,885 and $114,109, respectively.

The Company has an Incentive Compensation Plan for key members of management, which includes both a cash and a deferred compensation component. Payments under this plan are based upon the performance of the Company as well as the individual's ability to meet specific goals each year. The deferred portion of the employee's bonus is paid out five years after it was contributed to the Plan. As of December 31, 2018 and 2017, the Company has accrued $210,087 and $190,973, respectively for cash bonus payments to be paid the following January. Additionally, the Company has recorded a deferred compensation payable totaling $1,097,569 and $960,737, at December 31, 2018 and 2017, respectively. This has been included in "Other Liabilities" on the Balance Sheet.

The Company also has several former employees which receive payments for compensation previously deferred. As of December 31, 2018 and 2017, the Company has recorded a liability of $656,722 and $735,388, related to these payments. This has been included in "Other Liabilities" on the Balance Sheet.

The Company has a Phantom Stock Plan in which two executives participate. As of December 31, 2018 and 2017, the Company has $562,838 and $537,300, respectively accrued for liabilities under the phantom stock option plan. This has been included in "Other Liabilities" on the Balance Sheet.

NOTE M – RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Company has granted loans to executive officers, principal shareholders and directors and parties affiliated with those persons (collectively, "insiders"). The Company has loans to insiders aggregating $1,904,597 and $1,186,975 at December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017, deposits from insiders totaled $2,059,690 and $2,812,493, respectively.

NOTE N – FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants, excluding transaction costs. When measuring fair value, entities should maximize the use of observable inputs and minimize the use of unobservable inputs. The following describes the three levels of inputs that may be used to measure fair value:

- *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* - Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

- *Level 3 Inputs* - Unobservable inputs that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

The Company used the following methods and significant assumptions to estimate fair value:

Securities Available for Sale – Securities are recorded at fair value on a recurring basis based upon measurements obtained from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, market consensus prepayment speeds, credit information and the bonds' terms and conditions, among other things (Level 2).

Mortgage Loans Held for Sale – The Company does not record loans held for sale at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect declines in value based on commitments in hand from investors or prevailing investor yield requirements (Level 2).

Impaired Loans – The Company does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs that are based on the current appraised or market-quoted value of the underlying collateral or (2) the full charge-off of the loan carrying value. In some cases, the properties for which market quotes or appraised values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for collateral-dependent impaired loans are obtained from real estate brokers or other third-party consultants (Level 3).

Other Real Estate Owned – The Company does not record other real estate at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these properties to reflect the current appraised value (less an estimate of cost to sell). In some cases, the properties for which appraised values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for real estate held for sale are obtained from independent appraisers (Level 3).

The following table provides the hierarchy and fair value for each major category of assets and liabilities recorded at fair value on a recurring basis:

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Securities available for sale				
U.S. Government agencies	$ -	$ 15,750,232	$ -	$ 15,750,232
Obligations of state and political subdivisions	-	9,051,599	-	9,051,599
Mortgage-backed	-	23,322,605	-	23,322,605
Other asset-backed	-	1,959,960	-	1,959,960
	$ -	$ 50,084,396	$ -	$ 50,084,396

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Securities available for sale				
U.S. Government agencies	$ -	$ 15,989,159	$ -	$ 15,989,159
Obligations of state and political subdivisions	-	9,851,774	-	9,851,774
Mortgage-backed	-	26,332,737	-	26,332,737
	$ -	$ 52,173,670	$ -	$ 52,173,670

During 2018 and 2017, there were no Level 3 assets or liabilities measured at fair value on a recurring basis.

Assets and liabilities recorded at fair value on a non-recurring basis are summarized below.

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Loans held for sale	$ -	$ 58,822	$ -	$ 58,822
Impaired loans	-	-	466,714	466,714
Other real estate owned	-	-	324,000	324,000

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Loans held for sale	$ -	$ 442,716	$ -	$ 442,716
Impaired loans	-	-	450,734	450,734
Other real estate owned	-	-	371,544	371,544

Impaired loans, which are measured for impairment using the fair value of collateral for collateral dependent loans, had a carrying amount of $466,714, with no valuation allowance at December 31, 2018. Impaired loans, had a carrying amount of $504,952, and a valuation allowance of $54,218 at December 31, 2017.

At December 31, 2018 other real estate owned had an initial cost basis of $371,544 with a valuation allowance of $47,544. At December 31, 2017 other real estate owned had an initial cost basis of $371,544 with no valuation allowance.

SUPPLEMENTAL CONSOLIDATING SCHEDULES

LOCKHART BANKSHARES, INC. AND SUBSIDIARY

SUPPLEMENTAL CONSOLIDATING BALANCE SHEET

December 31, 2018

	Lockhart Bankshares, Inc.	First-Lockhart National Bank	Eliminations	Consolidated
ASSETS				
Cash and due from banks	$ 62,765	$ 11,255,390	$ (62,765)	$ 11,255,390
Certificates of deposit in banks	-	2,728,000	-	2,728,000
Securities available for sale	-	50,084,396	-	50,084,396
Nonmarketable equity securities	-	652,697	-	652,697
Investment in First-Lockhart National Bank	24,962,756	-	(24,962,756)	-
Loans held for sale	-	58,822	-	58,822
Loans, net	-	192,465,998	-	192,465,998
Premises and equipment, net	-	7,403,443	-	7,403,443
Deferred tax asset	-	1,166,824	-	1,166,824
Bank owned life insurance	-	5,296,254	-	5,296,254
Other real estate owned	-	324,000		324,000
Accrued interest receivable	-	836,960	-	836,960
Other assets	19	613,938	-	613,957
	$ 25,025,540	$ 272,886,722	$ (25,025,521)	$ 272,886,741
LIABILITIES AND STOCKHOLDERS' EQUITY				
Liabilities				
Deposits				
Noninterest-bearing	$ -	$ 55,790,818	$ (62,765)	$ 55,728,053
Interest-bearing	-	189,114,150	-	189,114,150
Total deposits	-	244,904,968	(62,765)	244,842,203
Note payable	697,500		-	697,500
Accrued interest payable	3,216	123,789	-	127,005
Other liabilities	-	2,895,209	-	2,895,209
Total liabilities	700,716	247,923,966	(62,765)	248,561,917
Stockholders' equity				
Common stock	154,592	240,000	(240,000)	154,592
Capital surplus	2,508,916	5,696,433	(5,696,433)	2,508,916
Treasury stock, at cost	(307,600)	-	-	(307,600)
Retained earnings	23,056,402	20,113,809	(20,113,809)	23,056,402
Accumulated other comprehensive loss	(1,087,486)	(1,087,486)	1,087,486	(1,087,486)
Total stockholders' equity	24,324,824	24,962,756	(24,962,756)	24,324,824
	$ 25,025,540	$ 272,886,722	$ (25,025,521)	$ 272,886,741

LOCKHART BANKSHARES, INC. AND SUBSIDIARY

SUPPLEMENTAL CONSOLIDATING STATEMENT OF INCOME

Year Ended December 31, 2018

	Lockhart Bankshares, Inc.	First-Lockhart National Bank	Eliminations	Consolidated
Interest income				
Loans, including fees	$ -	$ 9,699,449	$ -	$ 9,699,449
Debt securities:				
Taxable	-	916,848	-	916,848
Tax-exempt	-	213,960	-	213,960
Other interest and dividends	-	164,918	-	164,918
Total interest income	-	10,995,175	-	10,995,175
Interest expense				
Deposits	-	1,829,209	-	1,829,209
Borrowed funds and other	39,624	86,139	-	125,763
Total interest expense	39,624	1,915,348	-	1,954,972
Provision for loan losses	-	120,000	-	120,000
Net interest income after provision for loan losses	(39,624)	8,959,827	-	8,920,203
Noninterest income				
Service charges on deposit accounts	-	993,956	-	993,956
Dividends from subsidiary	865,807	-	(865,807)	-
Net gain on sale of loans	-	667,269	-	667,269
Net gain on sale of assets	-	8,770	-	8,770
Other income	-	460,471	-	460,471
Total noninterest income	865,807	2,130,466	(865,807)	2,130,466
Noninterest expense				
Salaries and employee benefits	-	4,672,627	-	4,672,627
Occupancy and equipment	-	997,194	-	997,194
Other general and administrative	32,092	2,872,308	-	2,904,400
Total noninterest expense	32,092	8,542,129	-	8,574,221
Income before equity in undistributed net income of subsidiary	794,091	2,548,164	(865,807)	2,476,448
Equity in undistrubited net income of bank subsidiary	2,062,948	-	(2,062,948)	-
Income before income taxes	2,857,039	2,548,164	(2,928,755)	2,476,448
Income tax expense (benefit)	(15,060)	(380,591)	-	(395,651)
NET INCOME	$ 2,872,099	$ 2,928,755	$ (2,928,755)	$ 2,872,099

LOCKHART BANKSHARES, INC. AND SUBSIDIARY

SUPPLEMENTAL CONSOLIDATING BALANCE SHEET

December 31, 2017

	Lockhart Bankshares, Inc.	First-Lockhart National Bank	Eliminations	Consolidated
ASSETS				
Cash and due from banks	$ 55,006	$ 6,687,806	$ (55,006)	$ 6,687,806
Certificates of deposit in banks	-	1,984,000	-	1,984,000
Securities available for sale	-	52,173,670	-	52,173,670
Nonmarketable equity securities	-	550,697	-	550,697
Investment in First-Lockhart National Bank	23,330,233	-	(23,330,233)	-
Loans held for sale	-	442,716	-	442,716
Loans, net	-	180,416,206	-	180,416,206
Premises and equipment, net	-	6,751,074	-	6,751,074
Bank owned life insurance	-	5,155,887	-	5,155,887
Other real estate owned	-	371,544	-	371,544
Accrued interest receivable	-	789,894	-	789,894
Other assets	-	538,918	-	538,918
	$ 23,385,239	$ 255,862,412	$ (23,385,239)	$ 255,862,412
LIABILITIES AND STOCKHOLDERS' EQUITY				
Liabilities				
Deposits				
Noninterest-bearing	$ -	$ 57,771,151	$ (55,006)	$ 57,716,145
Interest-bearing	-	171,962,902	-	171,962,902
Total deposits	-	229,734,053	(55,006)	229,679,047
Note payable	787,500	-	-	787,500
Accrued interest payable	3,314	62,825	-	66,139
Other liabilities	-	2,735,301	-	2,735,301
Total liabilities	790,814	232,532,179	(55,006)	233,267,987
Stockholders' equity				
Common stock	154,592	240,000	(240,000)	154,592
Capital surplus	2,508,916	5,696,433	(5,696,433)	2,508,916
Treasury stock, at cost	(290,800)	-	-	(290,800)
Retained earnings	20,878,778	18,050,861	(18,050,861)	20,878,778
Accumulated other comprehensive loss	(657,061)	(657,061)	657,061	(657,061)
Total stockholders' equity	22,594,425	23,330,233	(23,330,233)	22,594,425
	$ 23,385,239	$ 255,862,412	$ (23,385,239)	$ 255,862,412

LOCKHART BANKSHARES, INC. AND SUBSIDIARY

SUPPLEMENTAL CONSOLIDATING STATEMENT OF INCOME

Year Ended December 31, 2017

	Lockhart Bankshares, Inc.	First-Lockhart National Bank	Eliminations	Consolidated
Interest income				
Loans, including fees	$ -	$ 8,889,419	$ -	$ 8,889,419
Debt securities:				
Taxable	-	785,722	-	785,722
Tax-exempt	-	208,667	-	208,667
Other interest and dividends	-	167,186	-	167,186
Total interest income	-	10,050,994	-	10,050,994
Interest expense				
Deposits	-	1,351,852	-	1,351,852
Borrowed funds and other	38,921	493	-	39,414
Total interest expense	38,921	1,352,345	-	1,391,266
Provision for loan losses	-	105,000	-	105,000
Net interest income after provision for loan losses	(38,921)	8,593,649	-	8,554,728
Noninterest income				
Service charges on deposit accounts	-	1,062,244	-	1,062,244
Dividends from subsidiary	1,594,726	-	(1,594,726)	-
Net gain on sale of loans	-	706,347	-	706,347
Net gain on sale of assets	-	26,657	-	26,657
Other income	-	504,898	-	504,898
Total noninterest income	1,594,726	2,300,146	(1,594,726)	2,300,146
Noninterest expense				
Salaries and employee benefits	-	4,314,323	-	4,314,323
Occupancy and equipment	-	993,797	-	993,797
Other general and administrative	24,274	2,580,749	-	2,605,023
Total noninterest expense	24,274	7,888,869	-	7,913,143
Income before equity in undistributed net income of subsidiary	1,531,531	3,004,926	(1,594,726)	2,941,731
Equity in undistrubited net income of bank subsidiary	1,410,200	-	(1,410,200)	-
NET INCOME	$ 2,941,731	$ 3,004,926	$ (3,004,926)	$ 2,941,731