

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, Bill Stovall

Name of the Holding Company Director and Official

CEO / 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.

Bill Stovall
 Signature of Holding Company Director and Official

03/22/2017

Date of Signature

For holding companies *not* registered with the SEC—

Indicate status of Annual Report to Shareholders:

- is included with the FR Y-6 report
- will be sent under separate cover
- is not prepared

For Federal Reserve Bank Use Only

RSSD ID _____

C.I. _____

Date of Report (top-tier holding company's fiscal year-end):

December 31, 2016

Month / Day / Year

N/A

Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address

Midland Bancshares Inc.

Legal Title of Holding Company

P.O. Box 3903

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

Midland TX 79702

City State Zip Code

401 W. Texas Midland, TX. 79701

Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

Sandra Villarreal Controller

Name Title

432-262-1701

Area Code / Phone Number / Extension

432-262-1753

Area Code / FAX Number

svillarreal@cnbt.com

E-mail Address

www.cnbt.net

Address (URL) for the Holding Company's web page

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

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 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

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City State Zip Code

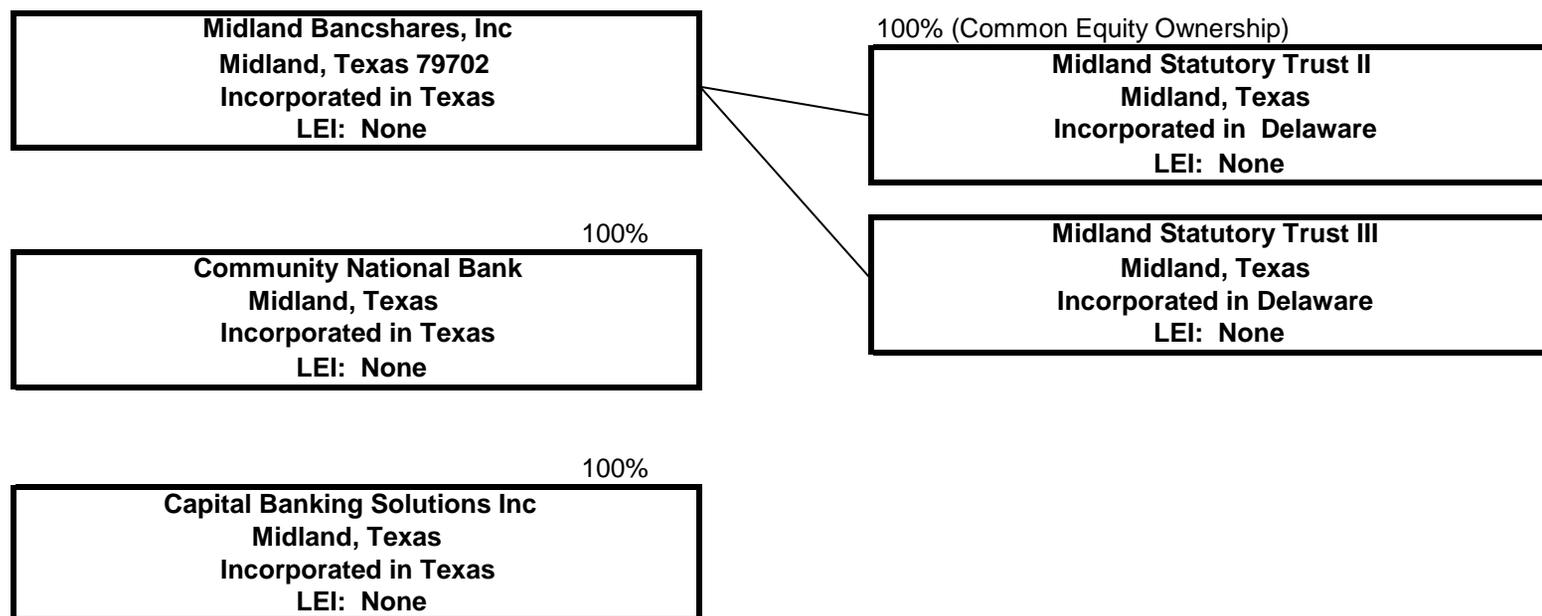
Physical Location (if different from mailing address)

MIDLAND BANCSHARES, INC
MIDLAND, TEXAS
FISCAL YEAR ENDING 12/31/2016
FORM FRY - 6

Report Item:

1. Midland Bancshares, Inc. does prepare an annual report for its shareholders. Two copies of the annual report are enclosed. Midland Bancshares, inc. is not registered with the SEC.

2a. Organizational Chart:



#2b. Domestic branch listing provided to the Federal Reserve Bank
Submitted via email on 03/10/17

Results: A list of branches for your depository institution: **COMMUNITY NATIONAL BANK (ID_RSSD: 293053)**.
 This depository institution is held by **MIDLAND BANCSHARES, INC. (2868950)** of **MIDLAND, TX**.
 The data are as of **12/31/2016**. Data reflects information that was received and processed through **01/10/2017**.

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		Full Service (Head Office)	293053	COMMUNITY NATIONAL BANK	401 WEST TEXAS AVENUE	MIDLAND	TX	79701	MIDLAND	UNITED STATES	17260	0	COMMUNITY NATIONAL BANK	293053	
OK		Full Service	2012052	A. STREET BRANCH	719 WEST LOUISIANA AVENUE	MIDLAND	TX	79701	MIDLAND	UNITED STATES	256819	6	COMMUNITY NATIONAL BANK	293053	
OK		Full Service	2260442	CUTHBERT BRANCH	3005 WEST CUTHBERT AVENUE	MIDLAND	TX	79701	MIDLAND	UNITED STATES	256821	7	COMMUNITY NATIONAL BANK	293053	
OK		Full Service	506557	EAST FLORIDA BRANCH	601 EAST FLORIDA AVENUE	MIDLAND	TX	79701	MIDLAND	UNITED STATES	16702	5	COMMUNITY NATIONAL BANK	293053	
OK		Full Service	3010345	MIDLAND DRIVE BRANCH	1609 NORTH MIDLAND DRIVE	MIDLAND	TX	79703	MIDLAND	UNITED STATES	257712	2	COMMUNITY NATIONAL BANK	293053	
OK		Full Service	3651122	PLAZA OAKS BRANCH	2101 WEST WADLEY AVENUE, SUITE 21	MIDLAND	TX	79705	MIDLAND	UNITED STATES	464049	12	COMMUNITY NATIONAL BANK	293053	
OK		Full Service	1902763	SAN MIGUEL SQUARE BRANCH	3303 NORTH MIDKIFF ROAD, SUITE 101	MIDLAND	TX	79705	MIDLAND	UNITED STATES	257711	1	COMMUNITY NATIONAL BANK	293053	
OK		Full Service	3538362	TREMONT BRANCH	5329 LOOP 250 NORTH	MIDLAND	TX	79707	MIDLAND	UNITED STATES	360959	4	COMMUNITY NATIONAL BANK	293053	
OK		Full Service	3884836	EAST ODESSA BRANCH	2659 JOHN BEN SHEPPERD PARKWAY	ODESSA	TX	79761	ECTOR	UNITED STATES	492758	13	COMMUNITY NATIONAL BANK	293053	
OK		Full Service	3388941	ODESSA BRANCH	619 NORTH GRANT AVENUE, SUITE 100	ODESSA	TX	79761	ECTOR	UNITED STATES	445515	11	COMMUNITY NATIONAL BANK	293053	
OK		Full Service	268163	STANTON BRANCH	1211 LAMESA HIGHWAY	STANTON	TX	79782	MARTIN	UNITED STATES	32123	8	COMMUNITY NATIONAL BANK	293053	

MIDLAND BANCSHARES, INC
MIDLAND , TEXAS
FISCAL YEAR ENDING 12/31/2016
FORM FRY - 6
DIRECTORS AND EXECUTIVE OFFICERS

Report Item:

#3. **Securities holders**

Current securities holders with ownership, control or holdings of 5% or more with power to vote as of fiscal year ending 12/31/2016

Name and Address (1)(a)	Country of Citizenship (1)(b)	Number of Voting Shares (1)(c)	Percentage of Voting Shares in Holding Company (1)(c)
Jeb B. Hughes Midland, TX 79707	USA	83,210	9.6374%
Yates Entities Artesia, NM 88210	USA	74,455	8.6234%
James A. Hightower Midland, TX 79705	USA	43,827	5.0761%

#3-2. **Securities holders not listed on 3-1.** N/A

MIDLAND BANCSHARES, INC							
MIDLAND, TEXAS							
FISCAL YEAR ENDING 12/31/2016							
FORM FRY - 6							
DIRECTORS AND EXECUTIVE OFFICERS							
Report Item 4: Insiders							
Name and Address (1)	Principal Occupation if other than with the Bank Holding Company (2)	Title and Position with the Bank Holding Company (3)	Title and Position with Subsidiaries (3)(b)	Title and Position with Other Businesses (3)(c)	Percentage of Voting Shares in Holding Company (4)(a)	Percentage of Voting Shares in Subsidiaries (4)(b)	List Names of other companies (4)(c)
Stan C. Conley Midland, TX 79707	Investor	Director	N/A	Owner - Craig Investment Owner - The Check Sore Owner/Manager - Amerimed	2.0858%	None	Craig Investment Co. - 100% The Check Store - 100% Amerimed RX, LP - 100%
				Owner - PB Mortgage			Permian Basin Mortgage Group, LLC - 46%
Stephen T. Goree Midland, TX 79705	Agri Business Company Owner	Director	N/A	President - STC Limited Partner - GGB	4.1445%	None	STC Prpoerties Inc - 90% GGB Leasing LP - 100%
				President - Anchor B&S			Anchor Bolt & Supply Inc - 90%
				President - Goree Cattle			Goree Cattle Co., LLC - 50%
				President - Goree O&G			Goree Oil & Gas LLC - 100%
				President - STG Dev			STG Development - 100%
				President - Sierra Gulf			Sierra Gulf Equip., LLC - 100%
				President - Legado			Legado Investments LLC - 40%
				President - Goree L&C			Goree Land & Cattle LLC - 100%
				President - Goree Family			Goree Family LP - 99.50%
				President - Goree Mgmt			Goree Management LLC - 49%
				President - Agri			Agri Properties - 100%
				President - Hargor			Hargor LLC - 50%
				President - STG Dev II			STG Development II - 95%
James A. Hightower Midland, TX 79705	Real Estate Developer	Director	N/A	General/LP - Loraine at Tx Office Tower Owner/Mgr - MMJC Owner/Mgr - Hightower Prop	5.0761%	None	Loraine at Texas Office Tower LTD - 90% MMJC Properties LC - 90% Hightower Properties - 75%
Jeb B. Hughes Midland, TX 79707	Banker	Chairman of The Board	N/A	N/A	9.6374%	None	N/A

John E. Malone Midland, TX 79707	N/A	Director	N/A	N/A	0.9266%	None	N/A
Patrick M. Moore Midland, TX 79707	Investor	Director	N/A	Owner - 4/Moore Inc Owner - MJL Owner - MJLR Owner - GPAT	3.1150%	None	4/Moore Inc. - 100% MJL Inc - 100% MJLR LLC - 100% GPAT LLC - 100%
Kenneth A. Peeler Midland, TX 79705	N/A	Director	N/A	N/A	1.0520%	None	N/A
John D. Perini Artesia, NM 88210	Oil & Gas Co. Executive	Director	N/A	CFO/Director - Yates Petroleum	0.0232%	None	N/A
Melvin G. Riggs, Jr. Midland, TX 79707	Oil & Gas Co. Executive	Director	N/A	COO/Director - Clayton Williams	1.5418%	None	Clayton Williams Energy, Inc - 25.20%
Dr. Tulsi Dyal Singh Midland, TX 79705	Retired Physician	Director	N/A	Shareholder - Abacus/Valcom Chairman, Board of Directors - Amadura	1.2740%	None	Abacus Computers, Inc. dba Valcom Computers - 31% Amadura Corporation - 50%
Bill D. Stovall Midland, TX 79707	Banker	Director and CEO	N/A	N/A	4.7837%	None	N/A
Word B. Wilson Midland, TX 79701	Investor	Director	N/A	VP/Director - Wilson Bros President - WB Wilson Inv Corp President - WB Wilson LLC LTD Partner - Wil-Gor President - GW President - Wall St Partners Manager - Flyguys President - Wilson Family Charitable Foundation President - Terra Firma Manager - Basin SWD	2.9824%	None	Wilson Bros. Leasing Co., Inc - 26.60 Word B Wilson Investments - 100% Word B Wilson LLC - 100% Wil-Gor Energy LTD - 50% GW Energy Inc - 50% Wall Street Partners LP - 100% Flyguys Aviation LLC - 33% Wilson Family Charitable Foundation - 100% Terra Firma Energy LTD - 80% Basin SWD LLC - 100%
					36.6424%		
*****All Shareholders of Midland Bancshares, Inc. are U.S.A. Citizens.							

**MIDLAND BANCSHARES, INC.
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS
AND
SUPPLEMENTARY INFORMATION

together with

REPORT OF INDEPENDENT AUDITORS

FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

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Report of Independent Auditors

To the Board of Directors and Shareholders of
Midland Bancshares, Inc. and Subsidiaries

We have audited the accompanying consolidated financial statements of Midland Bancshares, Inc. and Subsidiaries (the Company) which comprises the consolidated statements of financial condition as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the years then ended and the related notes to the financial statements. We also have audited the Company's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C) as of December 31, 2016 based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework*.

Management's Responsibility for the Financial Statements and Internal Control over Financial Reporting

The Company's management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of effective internal controls over financial reporting relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying Management Report Regarding Statement of Management's Responsibilities, Compliance with Designated Laws and Regulations, and Management's Assessment of Internal Control over Financial Reporting.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects.

An audit of the consolidated financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements 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.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists. The procedures selected depend on the auditor's judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also involves obtaining an understanding of internal control over financial reporting and testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances.

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

Definition and Inherent Limitations of Internal Control

An institution's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our audit of Company's internal control over financial reporting included controls over the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, with the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C). An institution's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinions

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Midland Bancshares, Inc. and Subsidiaries as of December 31, 2016 and 2015, 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. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016 based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework*.

Dennis Kinard & Co., PC
Certified Public Accountants

Abilene, Texas
March 6, 2017

MIDLAND BANCSHARES, INC.

Management Report Regarding Statement of Management's Responsibilities, Compliance with Designated Laws and Regulations, and Management's Assessment of Internal Control over Financial Reporting Midland Bancshares, Inc. and Subsidiaries

Statement of Management's Responsibilities

The management of Midland Bancshares, Inc. and Subsidiaries (the Company) is responsible for preparing the Company's annual consolidated financial statements in accordance with generally accepted accounting principles; for designing, implementing, and maintaining an adequate internal control structure and procedures for financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C); and for complying with the federal laws and regulations pertaining to insider loans and the federal and, if applicable, state laws and regulations pertaining to dividend restrictions.

Management's Assessment of Compliance With Designated Laws and Regulations

The management of the Company has assessed the Company's compliance with the federal laws and regulations pertaining to insider loans and the federal and, if applicable, state laws and regulations pertaining to dividend restrictions during the fiscal year that ended on December 31, 2016. Based upon its assessment, management has concluded that the Company complied with the federal laws and regulations pertaining to insider loans and the federal and, if applicable, state laws and regulations pertaining to dividend restrictions during the fiscal year that ended on December 31, 2016.

Management's Assessment of Internal Control Over Financial Reporting

The Company's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America and financial statements for regulatory reporting purposes, i.e., the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C). The Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and financial statements for regulatory reporting purposes, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Internal control over financial reporting has inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), as of December 31, 2016, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework*. Based upon its assessment, management has concluded that, as of December 31, 2016, the Company's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), is effective based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework*.

The Company's internal control over financial, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), as of December 31, 2016 has been audited by Davis Kinard & Co, PC, an independent public accounting firm, as stated in their report dated March 6, 2017.



Jeb B. Hughes
Chairman of the Board



William D. Stovall
Chief Executive Officer



Ryan Lovell
Senior Vice President and Chief Financial Officer

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Consolidated Statements of Financial Condition

December 31, 2016 and 2015

Assets	<u>2016</u>	<u>2015</u>
Cash and due from banks	\$ 22,625,320	\$ 24,225,099
Cash and cash equivalents	<u>22,625,320</u>	<u>24,225,099</u>
Interest bearing deposits in banks	135,786,408	56,388,529
Securities available for sale	79,418,079	233,105,640
Investment in Midland Statutory Trust II	85,000	85,000
Investment in Midland Statutory Trust III	202,000	202,000
Loans held for sale	1,186,948	668,415
Loans receivable, net of allowance for loan losses of \$15,139,587 in 2016 and \$10,831,499 in 2015	724,327,868	711,275,087
Accrued interest receivable	3,015,577	3,816,246
Premises and equipment	7,951,327	8,491,134
Foreclosed assets	3,254,571	-
Goodwill	15,251,182	15,251,182
Cash surrender value of life insurance	24,246,400	23,606,107
Restricted investments held at cost	2,200,685	1,773,644
Deferred tax asset	1,995,752	405,310
Other assets	<u>2,821,674</u>	<u>1,348,511</u>
	<u>\$ 1,024,368,791</u>	<u>\$ 1,080,641,904</u>
 Liabilities and Shareholders' Equity		
Noninterest bearing	\$ 511,087,487	\$ 492,104,310
Interest bearing	<u>397,663,408</u>	<u>468,014,972</u>
Total deposits	908,750,895	960,119,282
Accrued expenses and other liabilities	882,355	2,175,263
Subordinated debentures	<u>9,512,000</u>	<u>9,512,000</u>
Total liabilities	919,145,250	971,806,545
 Shareholders' equity		
Common stock, \$1 par value; 2,000,000 shares authorized; 887,391 and 875,247 shares issued in 2016 and 2015, respectively; 879,122 and 863,406 shares outstanding in 2016 and 2015, respectively	887,391	875,247
Preferred stock, \$10 par value; 2,000 shares authorized; 1,826 shares issued and outstanding in 2016 and 2015	18,260	18,260
Capital surplus	43,957,494	43,049,575
Retained earnings	60,742,035	65,031,612
Treasury stock, at cost	(306,365)	(433,529)
Net unrealized (depreciation) appreciation on available for sale securities, net of taxes (benefit) expense of \$(40,532) and \$158,412 in 2016 and 2015, respectively	(75,274)	294,194
Total shareholders' equity	<u>105,223,541</u>	<u>108,835,359</u>
	<u>\$ 1,024,368,791</u>	<u>\$ 1,080,641,904</u>

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

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Consolidated Statements of Income
Years Ended December 31, 2016 and 2015

	2016	2015
Interest income		
Loans, including fees	\$ 35,419,890	\$ 34,228,737
Debt securities		
Taxable	1,149,875	1,786,580
Tax exempt	557,499	724,528
Deposits with banks	608,741	564,064
Total interest income	37,736,005	37,303,909
Interest expense		
Deposits	1,090,544	942,552
Line of credit	-	171,219
Subordinated debentures	229,105	191,977
Total interest expense	1,319,649	1,305,748
Net interest income	36,416,356	35,998,161
Provision for loan losses	20,805,788	5,086,199
Net interest income after provision for loan losses	15,610,568	30,911,962
Noninterest income		
Service charges on deposit accounts	910,700	1,036,061
Real estate mortgage fees	819,054	1,174,693
Debit card income	766,902	941,127
Net gain on sale of securities (includes \$524,819 related to accumulated other comprehensive earnings reclassification in 2016)	524,819	-
Net appreciation on cash surrender value of life insurance	640,293	406,910
Other income	962,644	712,756
Total noninterest income	4,624,412	4,271,547
Noninterest expenses		
Salaries and employee benefits	13,278,994	14,155,611
Occupancy and equipment expense	3,141,803	3,113,121
IT and data processing	1,287,655	1,232,649
Loan expense	1,008,185	266,227
FDIC assessments	802,079	609,424
Director compensation	521,500	553,500
Loss on sale of foreclosed assets	17,913	-
Other expense	3,263,664	3,327,308
Total noninterest expenses	23,321,793	23,257,840
(Loss) income before income taxes	(3,086,813)	11,925,669
Income tax (benefit) expense	(1,520,822)	3,880,910
Net (loss) income	\$ (1,565,991)	\$ 8,044,759

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

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Net (loss) income	\$ (1,565,991)	\$ 8,044,759
Other items of comprehensive income		
Change in unrealized (depreciation) appreciation on investment securities available for sale, before tax	(43,593)	200,228
Reclassification adjustment for realized gain on investment securities included in net (loss) income	<u>(524,819)</u>	<u>-</u>
Total other items of comprehensive (loss) income	<u>(568,412)</u>	<u>200,228</u>
Comprehensive (loss) income before tax	(2,134,403)	8,244,987
Income tax benefit (expense) related to other items of comprehensive income	<u>198,944</u>	<u>(70,080)</u>
Comprehensive (loss) income	\$ <u><u>(1,935,459)</u></u>	\$ <u><u>8,174,907</u></u>

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

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES
Consolidated Statements of Shareholders' Equity
Years Ended December 31, 2016 and 2015

	<u>Common Stock</u>	<u>Preferred Stock</u>
Balance at January 1, 2015	\$ 869,623	\$ -
Sale of treasury stock	-	-
Sale of preferred stock	-	18,260
Stock options exercised	5,624	-
Net income for 2015	-	-
Dividends paid	-	-
Stock-based compensation	-	-
Net changes in unrealized appreciation on available for sale securities, net of taxes of \$70,080	-	-
	<hr/>	<hr/>
Balance at December 31, 2015	875,247	18,260
Sale of treasury stock	-	-
Stock options exercised	12,144	-
Net loss for 2016	-	-
Dividends paid	-	-
Net changes in unrealized depreciation on available for sale securities, net of tax benefit of \$198,944	-	-
	<hr/>	<hr/>
Balance at December 31, 2016	<u>\$ 887,391</u>	<u>\$ 18,260</u>

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

<u>Capital Surplus</u>	<u>Retained Earnings</u>	<u>Treasury Stock, at Cost</u>	<u>Net Unrealized Appreciation (Depreciation) on Available for Sale Securities, Net of Taxes</u>	<u>Total Shareholders' Equity</u>
\$ 24,329,180	\$ 58,704,852	\$ (505,903)	\$ 164,046	\$ 83,561,798
174,838	-	72,374	-	247,212
18,241,740	-	-	-	18,260,000
248,305	-	-	-	253,929
-	8,044,759	-	-	8,044,759
-	(1,717,999)	-	-	(1,717,999)
55,512	-	-	-	55,512
-	-	-	130,148	130,148
43,049,575	65,031,612	(433,529)	294,194	108,835,359
190,209	-	127,164	-	317,373
717,710	-	-	-	729,854
-	(1,565,991)	-	-	(1,565,991)
-	(2,723,586)	-	-	(2,723,586)
-	-	-	(369,468)	(369,468)
<u>\$ 43,957,494</u>	<u>\$ 60,742,035</u>	<u>\$ (306,365)</u>	<u>\$ (75,274)</u>	<u>\$ 105,223,541</u>

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

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

	2016	2015
Cash flows from operating activities		
Net (loss) income	\$ (1,565,991)	\$ 8,044,759
Adjustments to reconcile net (loss) income to net cash provided by operating activities		
Provision for loan losses	20,805,788	5,086,199
Net amortization of securities	1,927,515	3,144,466
Depreciation	996,989	1,067,265
Net realized gain on sales of available for sales securities	(524,819)	-
Appreciation in cash surrender value of life insurance	(640,293)	(406,910)
Loss on sale of foreclosed assets	17,913	-
Deferred income tax	(1,316,036)	(488,409)
Stock based compensation	-	55,512
Net change in		
Loans held for sale	(518,533)	1,165,012
Accrued interest receivable	800,669	80,151
Net change in deferred tax asset	(75,462)	(418,328)
Other assets	(1,473,163)	(215,587)
Accrued expenses and other liabilities	(1,292,908)	915,704
Net cash provided by operating activities	17,141,669	18,029,834
Cash flows from investing activities		
Net change in interest bearing deposits in banks	(79,397,879)	86,875,439
Activity in available for sale securities		
Sales	82,049,852	-
Maturities, prepayments and calls	222,544,320	210,789,917
Purchases	(152,877,719)	(152,042,957)
Purchase of life insurance policies	-	(10,664,449)
Net change in restricted investments held at cost	(427,041)	(29,715)
Proceeds from sale of foreclosed assets	1,649,823	-
Loan originations and principal collections, net	(38,780,876)	(66,337,276)
Additions to premises and equipment	(457,182)	(956,025)
Net cash provided by investing activities	34,303,298	67,634,934
Cash flows from financing activities		
Net change in deposits	(51,368,387)	(98,530,974)
Net change in short term borrowing	-	(4,248,000)
Proceeds from sale of preferred stock	-	18,260,000
Proceeds from sale of treasury stock	317,373	247,212
Proceeds from exercise of stock options	729,854	253,929
Dividends paid	(2,723,586)	(1,717,999)
Net cash used in financing activities	(53,044,746)	(85,735,832)
Net change in cash and cash equivalents	(1,599,779)	(71,064)
Cash and cash equivalents at beginning of year	24,225,099	24,296,163
Cash and cash equivalents at end of year	\$ 22,625,320	\$ 24,225,099

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

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 1: Summary of Significant Accounting Policies

Nature of Operations

Midland Bancshares, Inc. (the Company) and its subsidiary, Community National Bank (the Bank), provide loans and banking services to consumers and commercial customers in Midland, Texas and the surrounding area. Capital Banking Solutions, Inc. (CBS) was formed on September 18, 2014 as a subsidiary of the Bank to provide consulting services to other banks. The accounting and reporting policies of the Company conform with U.S. generally accepted accounting principles and to general practices of the banking industry. Policies and practices which materially affect the determination of financial position, results of operations and cash flows are summarized as follows:

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and fair value of financial instruments.

Significant Group Concentrations of Credit Risk

Most of the Company's activities are with customers located within Midland and the surrounding areas. Note 2 discusses the types of securities in which the Company invests. Note 3 discusses the types of lending in which the Company engages. The Company does not have any significant concentrations to any one industry or customer, other than the oil and gas industry that is prevalent in Midland and the surrounding areas.

The Company carries certain assets with other financial institutions which are subject to credit risk by the amount such assets exceed federal deposit insurance limits. At December 31, 2016 and 2015, the deposits, as reported by the banks, were \$86,657,391 and \$43,491,818, respectively. Management monitors the financial stability of correspondent banks and considers amounts advanced in excess of FDIC insurance limits to present no significant additional risk to the Company.

Cash and Cash Equivalents

For the purpose of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold and securities purchased under agreements to resell, all of which mature within ninety days.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 1: Summary of Significant Accounting Policies – continued

Cash and Cash Equivalents – continued

The Company is required to maintain average balances on hand or with the Federal Reserve Bank. The Company's requirement was \$-0- as of December 31, 2016 and 2015.

Interest Bearing Deposits in Banks

Interest bearing deposits in banks mature within one year and are carried at cost.

Securities

Certain debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Securities not classified as held to maturity, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses.

In determining whether other-than-temporary impairment exists, management considers many factors, including (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. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Investments in equity securities are carried at the lower of cost or estimated fair value. Any changes to the cost basis of these investments are recorded in the income statement. These investments are reviewed annually to determine if an impairment charge is necessary. As of December 31, 2016 and 2015, no impairment charges were recorded.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or market. Gains and losses on loan sales (sales proceeds minus carrying value) are recorded in noninterest income, and direct loan origination costs and fees are deferred at origination of the loan and are recognized in noninterest income upon sale of loan.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 1: Summary of Significant Accounting Policies – continued

Loans

The Company grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by commercial loans throughout the Midland County area. The ability of the Company's debtors to honor their contracts is dependent upon the general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off which are measured at historical cost are generally reported at their outstanding unpaid principal balances net of any unearned income, charge-offs, and unamortized deferred fees and costs on originated loans. Under generally accepted accounting principles, loan origination fees and certain direct origination costs are deferred and recognized as adjustments to interest income over the lives of the related loans. Management believes not deferring such fees and costs and amortizing them over the life of the related loan does not materially affect the Company's financial position or results of operations. Unearned income is amortized to interest income using a level yield methodology.

The Company makes disclosures of loans and other financing receivables and the related allowance in accordance with ASC Topic 310, *Receivables*. The accounting guidance defines a portfolio segment as the level at which an entity develops and documents a systematic methodology to determine the allowance for credit losses, and a class of financing receivables as the level of disaggregation of portfolio segments based on the initial measurement attribute, risk characteristics and methods for assessing risk. The Company's portfolio segments are Real estate, Construction, Energy, Consumer and Commercial. The classes of financing receivables within the real estate segment are 1-4 Residential and Commercial real estate. The remaining portfolio segments contain a single class of financing receivables. Under this accounting guidance, the allowance is presented by portfolio segment.

Allowance for Loan Losses

The allowance for credit losses, which includes the allowance for loan losses and the reserve for unfunded lending commitments, represents management's estimate of probable losses inherent in the Company's lending activities. The allowance for loan losses does not include amounts related to accrued interest receivable as accrued interest receivable is reversed when a loan is placed on nonaccrual status.

The allowance for loan losses represents the estimated probable credit losses in funded consumer and commercial loans while the reserve for unfunded lending commitments, including standby letters of credit and binding unfunded loan commitments, represents estimated probable credit losses on these unfunded credit instruments based on utilization assumptions. Credit exposures deemed to be uncollectible are charged against these accounts. Cash recovered on previously charged off amounts is recorded as a recovery to these accounts.

Management evaluates the adequacy of the allowance for loan losses based on the combined total of these two components. The Company performs periodic and systematic detailed reviews of its lending portfolios to identify credit risks and assess the overall collectability of those portfolios. The allowance on certain homogenous loan portfolios is based on aggregated portfolio segment evaluations.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 1: Summary of Significant Accounting Policies – continued

Allowance for Loan Losses – continued

Loss forecast models are utilized for these portfolios which consider a variety of factors including, but not limited to, historical loss experience, estimated defaults or foreclosures based on portfolio trends, delinquencies, bankruptcies, economic conditions and credit scores.

The Company's real estate portfolio segment is comprised primarily of homogenous loans secured by residential and commercial real estate. The amount of losses incurred in the homogenous loan pools is estimated based upon how many of the loans will default and the loss in the event of default. Using modeling methodologies, the Company estimates how many of the homogenous loans will default based on the individual loans' attributes aggregated into pools of homogenous loans with similar attributes. The attributes that are most significant to the probability of default and are used to estimate default include the loan-to-value, borrower credit score, months since origination, geography, and present collection status. The estimate is based on the Company's historical experience with the loan portfolio. The estimate is adjusted to reflect an assessment of environmental factors that are not reflected in the historical data, such as changes in real estate values, local and national economies, underwriting standards and the regulatory environment.

The allowance on the remaining portfolio segments (Construction, Energy, Consumer and Commercial) are calculated using loss rates delineated by risk rating and product type. Factors considered when assessing loss rates include the value of the underlying collateral, the industry of the obligor, the obligor's liquidity and other financial and qualitative factors. These statistical models are updated regularly for changes in economic and business conditions. Included in the analysis of these loan portfolios are reserves which are maintained to cover uncertainties that affect the Company's estimate of probable losses including economic uncertainty and large single defaults.

Nonperforming loans are reviewed in accordance with applicable accounting guidance on impaired loans and troubled debt restructurings (TDRs). If necessary, a specific allowance is established for these loans if they are deemed to be impaired. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all the circumstances surrounding the loan and the borrower, including the length of delay, the reason for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of the loan.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 1: Summary of Significant Accounting Policies – continued

Allowance for Loan Losses – continued

The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are subject of a restructuring agreement.

In addition to the allowance for loan losses, the Company also estimates probable losses related to unfunded lending commitments, such as letters of credit and financial guarantees, and binding unfunded loan commitments. Unfunded lending commitments are subject to individual reviews and are analyzed and segregated by risk according to the Company's internal risk rating scale. These risk classifications, in conjunction with an analysis of historical loss experience, utilization assumptions, current economic conditions, performance trends within the portfolio and any other pertinent information, result in the estimation of the reserve for unfunded lending commitments.

The allowance for credit losses related to the loan portfolio is reported as a part of loans in the consolidated statement of condition whereas the reserve for unfunded lending commitments is reported on the consolidated statement of condition in accrued expenses and other liabilities. Provision for credit losses related to the loan portfolio and unfunded lending commitments is reported separately in the consolidated statement of income.

Nonperforming Loans, Charge-Offs and Delinquencies

Nonperforming loans generally include loans that have been placed on nonaccrual status including nonaccrual loans whose contractual terms have been restructured in a manner that grants a concession to a borrower experiencing financial difficulties.

The entire balance of a loan is contractually delinquent if the minimum payment is not received by the specified due date on the customer's billing statement. Interest and fees continue to accrue on past due loans until the date the loan goes into nonaccrual status, if applicable.

The outstanding balance of real estate secured loans, including all classes of financing receivables within the real estate portfolio segment, that is in excess of the estimated property value, less estimated costs to sell, is charged off no later than the end of the month in which the account becomes 180 days past due. The estimated property value, less costs to sell, is determined utilizing appraisals or broker price opinions of the fair value of the collateral. The outstanding balance of loans within the remaining loan segments (Construction, Energy, Consumer and Commercial) are charged off no later than the end of the month in which the account becomes 120 days past due. For secured loans, accounts are written down to the collateral value.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 1: Summary of Significant Accounting Policies – continued

Nonperforming Loans, Charge-Offs and Delinquencies – continued

The fair value of the collateral is estimated by management based on current financial information, inspections, and appraisals. For unsecured loans, the outstanding balance is written off.

Loans within all portfolio segments are generally placed on nonaccrual status and classified as nonperforming at 90 days past due. Accrued interest receivable is reversed when a loan is placed on nonaccrual status. Interest collections on nonaccruing loans for which the ultimate collectability of principal is uncertain are applied as principal reductions; otherwise, such collections are credited to interest income when received. These loans may be restored to accrual status when all principal and interest is current and full repayment of the remaining contractual principal and interest is expected, or when the loan otherwise becomes well-secured and is in the process of collection.

Loans whose contractual terms have been modified in a TDR and are current at the time of the restructuring remain on accrual status if there is demonstrated performance prior to the restructuring and repayment in full under the restructured terms is expected. Otherwise, the loans are placed on nonaccrual status and reported as nonperforming until there is sustained repayment performance for a reasonable period, generally six months. TDRs that are on accrual status are reported as performing TDRs through the end of the calendar year in which the restructuring occurred or the year in which the loans are returned to accrual status, however, will continue to be reported as an impaired loan until paid in full due to the inherent risk associated with a TDR. In addition, if accruing TDRs bear less than a market rate of interest at the time of modification, they are reported as performing TDRs throughout the remaining lives of the loans.

The allowance for loan losses is established as losses are estimated to have occurred 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.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revisions as more information becomes available.

Troubled Debt Restructured Loans

A troubled debt restructured loan is a loan which the Company, for reasons related to a borrower's financial difficulties, grants a concession to the borrower that the Company would not otherwise consider. The loan terms which have been modified or restructured due to a borrower's financial difficulty, include but are not limited to a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-aging, extensions, deferrals, renewals and rewrites. A troubled debt restructured loan would generally be considered impaired in the year of modification and will be considered impaired for the remainder of the loan until paid in full.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 1: Summary of Significant Accounting Policies – continued

Financial Instruments

In the ordinary course of business the Company has entered into commitments to extend credit, including standby letters of credit. Such financial instruments are recorded when they are funded.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are initially recorded at fair value less estimated cost to sell at the date of foreclosure. All write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan loss. After foreclosure, property held for sale is carried at the lower of the new cost basis or fair value less cost to sell and depreciation is not recorded.

Impairment losses on property to be held and used are measured at the amount by which the carrying amount of a property exceeds its fair value and depreciated based on the remaining useful life. Costs of significant property improvements are capitalized, whereas cost related to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of the property to lower of its costs or fair value less costs to sell.

Banking Premises and Equipment

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation and amortization computed on the straight-line method over the estimated useful lives of the assets or the expected terms of the leases, if shorter.

Income Taxes

On January 1, 2009, the Company adopted changes to FASB ASC 740 – *Accounting for Income Taxes* related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions. The Company had no unrecognized tax benefits and believes it has no uncertain tax positions at December 31, 2016 and 2015.

The Company's income tax expense consists of a current and a deferred component. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 1: Summary of Significant Accounting Policies – continued

Income Taxes – continued

The term more likely than not means a likelihood of more than 50%; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information.

The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company recognizes interest and penalties on income taxes as a component of income tax expense. During the year ended December 31, 2016, the Company recognized no interest and penalties. Based on management's analysis, the Company did not have any uncertain tax positions as of December 31, 2016 and 2015. The Company files income tax returns in the U.S. federal jurisdiction and the state of Texas. There are currently no income tax examinations underway for these jurisdictions. The Company's income tax returns are subject to examination by the relevant taxing authorities as follows: U.S. federal income tax returns for tax years 2013 and forward; Texas income and margin tax returns for tax years 2012 and forward.

In May of 2006, the State of Texas implemented a new tax on taxable margin, effective for years ended after December 31, 2006. For the Company, taxable margin is revenue less interest expense. The margin tax was insignificant for the year ended December 31, 2016. The deferred tax component of this tax is insignificant.

Cash Surrender Value of Life Insurance

The Company has purchased life insurance policies on certain executives. Life insurance policies are initially recorded at cost at the date of purchase. Subsequent to purchase, the policies are periodically adjusted for changes in contract value. The adjustment to contract value increases or decreases the carrying value of the policies and is recorded as an income or expense on the consolidated statement of income.

Derivatives

Derivatives are recognized as assets and liabilities on the statement of condition and measured at fair value. For exchange-traded contracts, fair value is based on quoted market prices. For nonexchange traded contracts, fair value is based on dealer quotes, pricing models, discounted cash flow methodologies, or similar techniques for which the determination of fair value may require significant management judgment or estimation.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 1: Summary of Significant Accounting Policies – continued

Derivative Loan Commitments

Mortgage loan commitments that relate to the origination of a mortgage that will be held for sale upon funding are considered derivative instruments under the derivatives and hedging accounting guidance (FASB ASC 815, *Derivatives and Hedging*). Loan commitments that are derivatives are recognized at fair value on the statement of condition in other assets and other liabilities with changes in their fair values recorded in noninterest income.

Forward Loan Commitments

The Company carefully evaluates all loan sales agreements to determine whether they meet the definition of a derivative under FASB ASC 815 as facts and circumstances may differ significantly.

If agreements qualify, to protect against the price risk inherent in derivative loan commitments, the Company uses "best efforts" forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments. Accordingly, forward loan sale commitments are recognized at fair value on the statement of condition in other assets and liabilities with changes in their fair values recorded in other noninterest income.

The Company estimates the fair value of its forward loan sales commitments using a methodology similar to that used for derivative loan commitments.

Treasury Stock

Treasury stock is accounted for on the cost method and consists of 8,269 shares in 2016 and 11,841 shares in 2015.

Advertising

Advertising costs are expensed as incurred. Advertising expenses for the years ended December 31, 2016 and 2015 amounted to \$82,654 and \$127,850, respectively.

Business Combinations, Goodwill and Other Intangible Assets

Authoritative accounting guidance requires that all business combinations initiated after June 30, 2001 are accounted for under the purchase method and addresses the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination. The guidance addresses the initial recognition and measurement of intangible assets acquired in a business combination and the accounting for goodwill and other intangible assets subsequent to their acquisition. The guidance provides that intangible assets with finite useful lives be amortized and that goodwill and intangible assets with indefinite lives not be amortized, but rather be tested at least annually for impairment. The goodwill recorded on acquisitions amounted to \$15,251,182 and is not subject to amortization. The Company conducted a goodwill impairment test for the years ended December 31, 2016 and 2015. There were no reductions of recorded goodwill resulting from the impairment test.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 1: Summary of Significant Accounting Policies – continued

Stock Based Compensation

Stock compensation authoritative guidance requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. The guidance permits entities to use any option-pricing model that meets the fair value objective in the guidance.

The Company elected to adopt the guidance on October 1, 2007 under the modified prospective method.

Software Development Costs

The Company capitalizes certain costs incurred to produce proprietary software used to process money transfers. Such costs, including coding, testing, and product quality assurance, are capitalized once technological feasibility has been established. Amortization is computed on a case-by-case basis over the estimated economic life of the software, which is 5 years.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-9, Revenue from Contracts with Customers (Topic 606). This guidance is a comprehensive new revenue recognition standard that will supersede substantially all existing revenue recognition guidance. The new standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under existing guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. On July 9, 2015, the FASB agreed to delay the effective date of the standard by one year. Therefore, the new standard will be effective in the first quarter of 2018 and is not expected to have a significant impact to the Company's financial statements.

In January 2016, the FASB issued ASU No. 2016-01 "Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities." The amendment has a number of provisions including the requirements that public business entities use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, a separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e. securities or loans receivables), and eliminating the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendment is effective for annual and interim reporting periods beginning after December 15, 2017. The Company is evaluating the potential impact of the amendment on the Company's financial statements.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 1: Summary of Significant Accounting Policies – continued

Recent Accounting Pronouncements - continued

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) intended to improve financial reporting regarding leasing transactions. The new standard affects all companies and organizations that lease assets. The standard will require organizations to recognize on the statement of financial condition the assets and liabilities for the rights and obligations created by those leases if the lease terms are more than 12 months. The guidance also will require qualitative and quantitative disclosures providing additional information about the amounts recorded in the financial statements. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is evaluating the potential impact of the amendment on the Company's financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326) intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The standard requires an organization to measure 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. The standard also requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. Additionally, the standard amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this update are effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. All entities may adopt the amendments in this update earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. An entity will apply the amendments in this update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach). The Company believes the amendments in this update will have an impact on the Company's financial statements and is working to evaluate the significance of that impact.

Preferred Stock

The Company has the authority to issue up to 2,000 shares of preferred stock. The preferred stock is available for issuance from time to time to strengthen the Bank's capital ratios, support loan growth and for general corporate purposes.

The preferred stock has a subscription price of \$10,000 per share and a par value of \$10 per share. Cumulative dividends will accrue at a rate of 5% per annum. Dividends are payable quarterly in arrears on each January 15, April 15, July 15 and October 15.

The Company has the option to redeem the preferred shares three years after the date the shares are issued, which was December 2015. The Company must redeem the preferred shares five years after the shares are issued, which is December 2020. The preferred stock is callable in December 2018. The preferred stock ranks senior to the common stock with respect to the payments of dividends and distributions and amounts payable upon liquidation, dissolution and winding up of the Company. The preferred stock generally is non-voting.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 2: Securities

The amortized cost and fair value of securities, with gross unrealized gains and losses, follows:

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>Available for Sale</u>				
U.S. government and agency	\$ 40,981,573	\$ 36,472	\$ -	\$ 41,018,045
State and political subdivisions	38,552,312	9,284	(161,562)	38,400,034
Total securities available for sale	\$ 79,533,885	\$ 45,756	\$ (161,562)	\$ 79,418,079

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>Available for Sale</u>				
U.S. government and agency	\$ 165,736,633	\$ 188,133	\$ (64,334)	\$ 165,860,432
State and political subdivisions	66,916,401	414,170	(85,363)	67,245,208
Total securities available for sale	\$ 232,653,034	\$ 602,303	\$ (149,697)	\$ 233,105,640

For the year ended December 31, 2016, proceeds from sales of securities available for sale amounted to \$82,049,852, and gross realized gains amounted to \$527,462 and gross realized losses amounted to \$2,643. For the year ended December 31, 2015, there were no proceeds from sales of securities available for sale, and no gross realized gains or losses.

At December 31, 2016 and 2015, securities with a carrying value of \$76,063,776 and \$164,391,261, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2016, follows:

	Available for Sale	
	Amortized Cost	Fair Value
Due in one year or less	\$ 46,591,071	\$ 46,595,367
Due from one to five years	32,942,814	32,822,712
Total	\$ 79,533,885	\$ 79,418,079

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 2: Securities – continued

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position for twelve months or more:

Category (number of securities)	December 31, 2016			
	Less than 12 months		12 months or longer	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
State and political subdivision (59,6)	\$ 29,318,114	\$ 153,731	\$ 4,404,544	\$ 7,831
Total	<u>\$ 29,318,114</u>	<u>\$ 153,731</u>	<u>\$ 4,404,544</u>	<u>\$ 7,831</u>

Category (number of securities)	December 31, 2015			
	Less than 12 months		12 months or longer	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government and agency (41)	\$ 71,461,101	\$ 64,334	\$ -	\$ -
State and political subdivision (31, 10)	28,845,806	47,106	5,369,581	38,257
Total	<u>\$ 100,306,907</u>	<u>\$ 111,440</u>	<u>\$ 5,369,581</u>	<u>\$ 38,257</u>

U.S. Government and agency

The unrealized losses on the Company's investment in U.S. government and agency securities were caused by interest rate increases. The Company purchased those investments at a discount relative to their face amount, and the contractual cash flows of those investments are guaranteed by an agency of the U.S. government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost bases of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2015.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 2: Securities – continued

State and political subdivisions

The unrealized losses on the Company's investment in state and political subdivisions securities were caused by interest rate increases. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost bases of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2016 and 2015.

Other-than-temporary impairment

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns 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) evaluation by the Company of (a) its intent to sell a debt security prior to recovery and (b) whether it is more likely than not the Company will have to sell the debt security prior to recovery. As of December 31, 2016 and 2015, no investment securities were other-than-temporarily impaired.

NOTE 3: Loans

A summary of the balances of loans follows:

	December 31,	
	2016	2015
Real estate	\$ 305,456,498	\$ 288,433,018
Construction	65,685,954	62,745,208
Energy	95,041,037	112,750,848
Consumer	15,150,096	12,481,171
Commercial	258,133,870	245,696,341
	739,467,455	722,106,586
Less: Allowance for loan losses	(15,139,587)	(10,831,499)
Loans, net	\$ 724,327,868	\$ 711,275,087

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 3: Loans – continued

The following table sets forth information regarding the activity in the allowance for loans losses for the year ended December 31, 2016 (in thousands):

	<u>Real estate</u>	<u>Construction</u>	<u>Energy</u>	<u>Consumer</u>	<u>Commercial</u>	<u>Total</u>
<i>Allowance for credit losses:</i>						
Beginning balance	\$ 5,586	\$ 656	\$ 492	\$ 155	\$ 3,942	\$ 10,831
Charge-offs	(723)	(331)	(6,098)	(254)	(9,441)	(16,847)
Recoveries	2	-	8	15	324	349
Provision	(2,570)	625	7,259	182	15,310	20,806
Ending balance	<u>\$ 2,295</u>	<u>\$ 950</u>	<u>\$ 1,661</u>	<u>\$ 98</u>	<u>\$ 10,135</u>	<u>\$ 15,139</u>
Ending balance allocated						
to loans individually evaluated						
for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 230</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 230</u>
Ending balance allocated						
to loans collectively evaluated						
for impairment	<u>\$ 2,295</u>	<u>\$ 950</u>	<u>\$ 1,431</u>	<u>\$ 98</u>	<u>\$ 10,135</u>	<u>\$ 14,909</u>
<i>Loans receivable</i>						
Ending balance of						
loans individually evaluated						
for impairment	\$ 7,900	\$ -	\$ 14,295	\$ 52	\$ 1,133	\$ 23,380
Ending balance of						
loans collectively evaluated						
for impairment	<u>297,556</u>	<u>65,686</u>	<u>80,746</u>	<u>15,098</u>	<u>257,001</u>	<u>716,087</u>
Ending balance	<u>\$ 305,456</u>	<u>\$ 65,686</u>	<u>\$ 95,041</u>	<u>\$ 15,150</u>	<u>\$ 258,134</u>	<u>\$ 739,467</u>

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 3: Loans – continued

The following table sets forth information regarding the activity in the allowance for loans losses for the year ended December 31, 2015 (in thousands):

	<u>Real estate</u>	<u>Construction</u>	<u>Energy</u>	<u>Consumer</u>	<u>Commercial</u>	<u>Total</u>
<i>Allowance for credit losses:</i>						
Beginning balance	\$ 2,709	\$ 518	\$ 993	\$ 104	\$ 3,832	\$ 8,156
Charge-offs	-	-	-	(13)	(2,867)	(2,880)
Recoveries	-	9	-	-	460	469
Provision	<u>2,877</u>	<u>129</u>	<u>(501)</u>	<u>64</u>	<u>2,517</u>	<u>5,086</u>
Ending balance	<u>\$ 5,586</u>	<u>\$ 656</u>	<u>\$ 492</u>	<u>\$ 155</u>	<u>\$ 3,942</u>	<u>\$ 10,831</u>
Ending balance allocated to loans individually evaluated for impairment	<u>\$ 227</u>	<u>\$ -</u>	<u>\$ 413</u>	<u>\$ -</u>	<u>\$ 1,669</u>	<u>\$ 2,309</u>
Ending balance allocated to loans collectively evaluated for impairment	<u>\$ 5,359</u>	<u>\$ 656</u>	<u>\$ 79</u>	<u>\$ 155</u>	<u>\$ 2,273</u>	<u>\$ 8,522</u>
<i>Loans receivable</i>						
Ending balance of loans individually evaluated for impairment	\$ 5,320	\$ 681	\$ 751	\$ -	\$ 7,806	\$ 14,558
Ending balance of loans collectively evaluated for impairment	<u>283,113</u>	<u>62,064</u>	<u>112,000</u>	<u>12,481</u>	<u>237,890</u>	<u>707,548</u>
Ending balance	<u>\$ 288,433</u>	<u>\$ 62,745</u>	<u>\$ 112,751</u>	<u>\$ 12,481</u>	<u>\$ 245,696</u>	<u>\$ 722,106</u>

The Company monitors credit quality within its portfolio segments based on primary credit quality indicators. All of the Company's loans are evaluated using pass rated or reservable criticized as the primary credit quality indicator. The term reservable criticized refers to those loans that are internally classified or listed by the Company as special mention, substandard, doubtful or loss. These assets pose an elevated risk and may have a high probability of default or total loss.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 3: Loans – continued

The classifications of loans reflect a judgment about the risks of default and loss associated with the loan. The Company reviews the ratings on credits monthly. Ratings are adjusted to reflect the degree of risk and loss that is felt to be inherent in each credit as of each monthly reporting period. The methodology is structured so that specific allocations are increased in accordance with deterioration in credit quality (and a corresponding increase in risk and loss) or decreased in accordance with improvement in credit quality (and a corresponding decrease in risk and loss).

Credits rated special mention show clear signs of financial weaknesses or deterioration in credit worthiness, however, such concerns are not so pronounced that the Company generally expects to experience significant loss within the short-term. Such credits typically maintain the ability to perform within standard credit terms and credit exposure is not as prominent as credits rated more harshly.

Credits rated substandard are those in which the normal repayment of principal and interest may be, or has been, jeopardized by reason of adverse trends or developments of a financial, managerial, economic or political nature, or important weaknesses exist in collateral. A protracted workout on these credits is a distinct possibility. Prompt corrective action is therefore required to strengthen the Company's position, and/or to reduce exposure and to assure that adequate remedial measures are taken by the borrower. Credit exposure becomes more likely in such credits and a serious evaluation of the secondary support to the credit is performed.

Credits rated doubtful are those in which full collection of principal appears highly questionable, and which some degree of loss is anticipated, even though the ultimate amount of loss may not yet be certain and/or other factors exist which could affect collection of debt. Based upon available information, positive action by the Company is required to avert or minimize loss. Credits rated doubtful are generally also placed on nonaccrual.

Credits rated loss are those that are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

Pass rated refers to loans that are not considered criticized. In addition to this primary credit quality indicator, the Company uses other credit quality indicators for certain types of loans.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 3: Loans – continued

The following table sets forth information regarding the internal classification of the loan portfolio as of December 31, 2016 and 2015 (in thousands):

	December 31, 2016					
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
Real estate:						
1-4 Residential	\$ 64,339	\$ -	\$ 599	\$ -	\$ -	\$ 64,938
Commercial real estate	207,209	5,178	28,131	-	-	240,518
Construction	65,040	-	646	-	-	65,686
Energy	72,012	-	22,368	661	-	95,041
Consumer	14,305	12	833	-	-	15,150
Commercial	229,456	10,399	18,279	-	-	258,134
Total	<u>\$ 652,361</u>	<u>\$ 15,589</u>	<u>\$ 70,856</u>	<u>\$ 661</u>	<u>\$ -</u>	<u>\$ 739,467</u>
	December 31, 2015					
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
Real estate:						
1-4 Residential	\$ 60,749	\$ 674	\$ 1,322	\$ -	\$ -	\$ 62,745
Commercial real estate	212,729	-	12,732	227	-	225,688
Construction	62,064	-	681	-	-	62,745
Energy	90,281	9,949	12,521	-	-	112,751
Consumer	12,437	-	44	-	-	12,481
Commercial	217,357	9,209	19,130	-	-	245,696
Total	<u>\$ 655,617</u>	<u>\$ 19,832</u>	<u>\$ 46,430</u>	<u>\$ 227</u>	<u>\$ -</u>	<u>\$ 722,106</u>

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 3: Loans – continued

The following table sets forth information regarding the credit risk profile based on payment activity of the loan portfolio (in thousands):

	December 31, 2016			December 31, 2015		
	Performing	Nonperforming	Total	Performing	Nonperforming	Total
Real estate:						
1-4 Residential	\$ 64,763	\$ 175	\$ 64,938	\$ 62,049	\$ 696	\$ 62,745
Commercial real estate	232,793	7,725	240,518	221,064	4,624	225,688
Construction	65,686	-	65,686	62,064	681	62,745
Energy	80,746	14,295	95,041	112,001	750	112,751
Consumer	15,098	52	15,150	12,481	-	12,481
Commercial	257,001	1,133	258,134	237,889	7,807	245,696
Total	<u>\$ 716,087</u>	<u>\$ 23,380</u>	<u>\$ 739,467</u>	<u>\$ 707,548</u>	<u>\$ 14,558</u>	<u>\$ 722,106</u>

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 3: Loans – continued

The following table sets forth information regarding the delinquencies within the loan portfolio as of (in thousands):

	December 31, 2016					
	30-89 Days	90 Days	Total	Current	Total	Recorded
	Past Due	and Greater	Past Due		Loans	Investment > 90 Days and Still Accruing
Real estate:						
1-4 Residential	\$ 288	\$ -	\$ 288	\$ 64,650	\$ 64,938	\$ -
Commercial real estate	190	-	190	240,328	240,518	-
Construction	584	-	584	65,102	65,686	-
Energy	-	169	169	94,872	95,041	169
Consumer	44	-	44	15,106	15,150	-
Commercial	4,673	192	4,865	253,269	258,134	192
Total	<u>\$ 5,779</u>	<u>\$ 361</u>	<u>\$ 6,140</u>	<u>\$ 733,327</u>	<u>\$ 739,467</u>	<u>\$ 361</u>

	December 31, 2015					
	30-89 Days	90 Days	Total	Current	Total	Recorded
	Past Due	and Greater	Past Due		Loans	Investment > 90 Days and Still Accruing
Real estate:						
1-4 Residential	\$ 245	\$ -	\$ 245	\$ 62,500	\$ 62,745	\$ -
Commercial real estate	239	-	239	225,449	225,688	-
Construction	249	-	249	62,496	62,745	-
Energy	868	-	868	111,883	112,751	-
Consumer	53	-	53	12,428	12,481	-
Commercial	970	55	1,025	244,671	245,696	55
Total	<u>\$ 2,624</u>	<u>\$ 55</u>	<u>\$ 2,679</u>	<u>\$ 719,427</u>	<u>\$ 722,106</u>	<u>\$ 55</u>

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 3: Loans – continued

The following table sets forth information regarding the nonaccrual within the loan portfolio as of December 31, 2016 (in thousands):

	<u>2016</u>	<u>2015</u>
Real estate:		
1-4 Residential	\$ 175	\$ 696
Commercial real estate	7,725	4,545
Construction	-	681
Energy	13,875	-
Consumer	4	-
Commercial	1,076	7,369
Total	<u>\$ 22,855</u>	<u>\$ 13,291</u>

A loan is considered impaired, in accordance with the impairment accounting guidance, when based on current information and events, it is probable that the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans but also include loans modified in troubled debt restructurings (including those accruing interest) when concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. The Company did not recognize any interest income on a cash basis on impaired loans during the years ended December 31, 2016 and 2015.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 3: Loans – continued

The following table sets forth information regarding modifications within the loan portfolio (dollars in thousands):

	2016		
	Number	Pre-Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Troubled Debt Restructuring			
Real estate:			
1-4 Residential	-	\$ -	\$ -
Commercial real estate	-	-	-
Construction	-	-	-
Energy	3	8,899	8,432
Consumer	2	53	49
Commercial	22	1,846	982
	2015		
	Number	Pre-Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Troubled Debt Restructuring			
Real estate:			
1-4 Residential	-	\$ -	\$ -
Commercial real estate	1	184	79
Construction	1	680	681
Energy	2	884	750
Consumer	-	-	-
Commercial	24	2,879	2,476

There have been no subsequently defaulted troubled debt restructurings.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 3: Loans – continued

The following table sets forth information regarding impaired loans as of December 31, 2016 (in thousands):

	<u>Recorded</u> <u>Investment</u>	<u>Unpaid</u> <u>Principal</u> <u>Balance</u>	<u>Related</u> <u>Allowance</u>	<u>Average</u> <u>Recorded</u> <u>Investment</u>	<u>Interest</u> <u>Income</u> <u>Recognized</u>
With no related allowance:					
Real estate:					
1-4 Residential	\$ 175	\$ 197	\$ -	\$ 436	\$ 11
Commercial real estate	7,725	7,725	-	4,691	171
Construction	-	-	-	341	-
Energy	13,875	17,045	-	5,345	521
Consumer	52	52	-	26	4
Commercial	1,133	1,778	-	2,959	15
With a related allowance:					
Real estate:					
1-4 Residential	-	-	-	-	-
Commercial real estate	-	-	-	1,483	-
Construction	-	-	-	-	-
Energy	420	420	230	2,178	46
Consumer	-	-	-	-	-
Commercial	-	-	-	1,511	-
Total:					
Real estate:					
1-4 Residential	175	197	-	436	11
Commercial real estate	7,725	7,725	-	6,174	171
Construction	-	-	-	341	-
Energy	14,295	17,465	230	7,523	567
Consumer	52	52	-	26	4
Commercial	1,133	1,778	-	4,470	15
	<u>\$ 23,380</u>	<u>\$ 27,217</u>	<u>\$ 230</u>	<u>\$ 18,970</u>	<u>\$ 768</u>

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 3: Loans – continued

The following table sets forth information regarding impaired loans as of December 31, 2015 (in thousands):

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With no related allowance:					
Real estate:					
1-4 Residential	\$ 696	\$ 696	\$ -	\$ 348	\$ 22
Commercial real estate	1,658	1,658	-	921	18
Construction	681	681	-	341	-
Energy	-	-	-	-	-
Consumer	-	-	-	-	-
Commercial	4,785	5,059	-	3,132	278
With a related allowance:					
Real estate:					
1-4 Residential	-	-	-	-	-
Commercial real estate	2,966	2,966	227	1,483	-
Construction	-	-	-	-	-
Energy	751	751	413	776	44
Consumer	-	-	-	-	-
Commercial	3,021	3,272	1,669	1,553	140
Total:					
Real estate:					
1-4 Residential	696	696	-	348	22
Commercial real estate	4,624	4,624	227	2,404	18
Construction	681	681	-	341	-
Energy	751	751	413	776	44
Consumer	-	-	-	-	-
Commercial	7,806	8,331	1,669	4,685	418
	<u>\$ 14,558</u>	<u>\$ 15,083</u>	<u>\$ 2,309</u>	<u>\$ 8,554</u>	<u>\$ 502</u>

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 4: Foreclosed Assets

A summary of the balance of foreclosed assets is as follows:

	December 31,	
	2016	2015
Commercial real estate	\$ 1,607,000	\$ -
Residential real estate	305,000	-
Reposessed assets	1,342,571	-
Total foreclosed assets	\$ 3,254,571	\$ -

Expenses applicable to foreclosed assets included the following:

	Years Ended December 31,	
	2016	2015
Net loss on sale	\$ (17,913)	\$ -
Operating expenses net of rental income	(149,947)	-
Expenses related to foreclosed assets, net	\$ (167,860)	\$ -

NOTE 5: Premises and Equipment

A summary of the cost and accumulated depreciation of premises and equipment follows:

	December 31,	
	2016	2015
Land	\$ 2,041,050	\$ 2,041,050
Building and improvements	5,705,243	5,400,899
Equipment	6,314,642	5,897,495
Software	1,639,173	1,639,173
Construction in progress	280,199	544,508
	15,980,307	15,523,125
Accumulated depreciation	(8,028,980)	(7,031,991)
	\$ 7,951,327	\$ 8,491,134

Depreciation expense for the years ended December 31, 2016 and 2015 amounted to \$996,989 and \$1,067,265, respectively.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 6: Deposits

The aggregate amount of time deposits that meet or exceed the FDIC limit of \$250,000 or more at December 31, 2016 and 2015 was \$47,090,987 and \$42,192,783, respectively. At December 31, 2016, the scheduled maturities of time deposits are as follows:

2017	\$ 52,893,191
2018	2,512,354
2019	<u>1,754,027</u>
	<u>\$ 57,159,572</u>

NOTE 7: Income Taxes

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

	December 31,	
	2016	2015
Current federal income tax (benefit) expense	\$ (178,943)	\$ 4,297,319
Current state income tax (benefit) expense	(25,843)	72,000
Deferred federal income tax benefit	<u>(1,316,036)</u>	<u>(488,409)</u>
Total (benefit) provision for income tax	<u>\$ (1,520,822)</u>	<u>\$ 3,880,910</u>

Income tax expense, as a percentage of pretax earnings, differs from the statutory federal income tax rate at December 31, 2016 and 2015 is as follows:

	2016	2015
Income tax (benefit) expense at the statutory rate	35.0 %	35.0 %
State income taxes	0.8	0.6
Nontaxable earnings	16.5	(3.5)
Nondeductible expenses	(1.2)	0.4
Other	<u>(1.8)</u>	<u>-</u>
Effective tax rate	<u>49.3 %</u>	<u>32.5 %</u>

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 7: Income Taxes – continued

Income exempt from federal income tax is the primary reason the effective tax rate differs from statutory federal income tax rates. The components of the net deferred tax asset (liability), included in other liabilities, are as follows:

	December 31,	
	2016	2015
Deferred tax assets		
Loans receivable	\$ 5,518,389	\$ 3,932,237
Unrealized loss on securities available for sale	40,532	-
	5,558,921	3,932,237
Deferred tax liabilities		
Premises and equipment	(293,932)	(345,100)
Intangible asset amortization deductible for tax purposes	(3,217,890)	(2,997,782)
Unrealized gain on securities available for sale	-	(158,412)
Other	(51,347)	(25,633)
	(3,563,169)	(3,526,927)
Net deferred tax asset	\$ 1,995,752	\$ 405,310

NOTE 8: Off-Balance-Sheet Activities

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

The Company's exposure to credit risk is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At December 31, 2016 and 2015, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	2016	2015
Commitments to extend credit	\$ 217,785,940	\$ 187,145,332
Standby letters of credit	9,438,894	14,905,376

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 8: Off-Balance-Sheet Activities – continued

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee.

The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company generally holds collateral supporting those commitments if deemed necessary.

The Company has no other off-balance-sheet arrangements or transactions with unconsolidated, special purpose entities that would expose the Company to liability that is not reflected on the face of the financial statements.

NOTE 9: Legal Contingencies

Various legal claims also arise from time to time in the normal course of business which, in the opinion of management, will have no material effect on the Company's financial statements.

NOTE 10: Related Party Transaction

In the ordinary course of business, the Company has granted loans to principal officers and directors and their affiliates.

Annual activity consisted of the following:

	December 31,	
	2016	2015
Beginning balance	\$ 2,975,032	\$ 14,825,457
Additions	4,052,702	3,971,400
Repayments	(559,858)	(15,821,825)
Ending balance	<u>\$ 6,467,876</u>	<u>\$ 2,975,032</u>

Deposits from related parties held by the Company at December 31, 2016 and 2015 amounted to \$33,083,676 and \$31,769,894, respectively.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 11: Minimum Regulatory Capital Requirements

The Company (on a consolidated basis) and the Bank are 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 material effect on the Company's and Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and 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. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as defined in the regulations) to risk weighted assets (as defined) and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2016 and 2015, that the Company and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2016, the most recent notification from the Office of the Comptroller of the Currency categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

Beginning January 1, 2015, community banking organizations became subject to a new regulatory rule recently adopted by federal banking agencies (commonly referred to as Basel III). The new rule establishes a new regulatory framework that incorporates revisions to the Basel capital framework, strengthens the definition of regulatory capital, increases risk-based capital requirements, and amends the methodologies for determining risk-weighted organizations. Basel III includes a multiyear transition period from January 1, 2015 through December 31, 2019.

Management believes that as of December 31, 2016, the Bank would meet all capital requirements under the Basel III Capital rules on a fully phased-in basis as if the requirements were currently in effect; however, final rules are subject to regulatory discretion and could result in the need for additional capital levels in the future.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 11: Minimum Regulatory Capital Requirements – continued

There are no conditions or events since the notification that management believes have changed the Bank's category. The Company's and the Bank's actual capital amounts and ratios as of December 31, 2016 and 2015 are also presented in the table (in thousands).

	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
December 31, 2016:						
Total Risk-Based Capital to Risk Weighted Assets						
Consolidated	\$ 86,174	9.8 %	\$ 70,404	8.0 %	\$ N/A	N/A
Bank	112,792	12.8	70,346	8.0	87,933	10.0 %
Common Equity Tier I Capital (CETI) to Risk Weighted Assets						
Consolidated	75,119	8.5	39,602	4.5	N/A	N/A
Bank	101,746	11.6	39,570	4.5	57,156	6.5
Tier I Capital to Risk Weighted Assets						
Consolidated	75,119	8.5	52,803	6.0	N/A	N/A
Bank	101,746	11.6	52,760	6.0	70,346	8.0
Tier I Capital to Adjusted Total Assets						
Consolidated	75,119	7.5	40,296	4.0	N/A	N/A
Bank	101,746	10.1	40,296	4.0	50,370	5.0
December 31, 2015:						
Total Risk-Based Capital to Risk Weighted Assets						
Consolidated	\$ 89,588	9.9 %	\$ 72,224	8.0 %	\$ N/A	N/A
Bank	116,157	12.9	72,174	8.0	90,218	10.0 %
Common Equity Tier I Capital (CETI) to Risk Weighted Assets						
Consolidated	78,462	8.7	40,626	4.5	N/A	N/A
Bank	105,031	11.6	40,598	4.5	58,642	6.5
Tier I Capital to Risk Weighted Assets						
Consolidated	78,462	8.7	54,168	6.0	N/A	N/A
Bank	105,031	11.6	54,131	6.0	72,174	8.0
Tier I Capital to Adjusted Total Assets						
Consolidated	78,462	7.3	43,071	4.0	N/A	N/A
Bank	105,031	9.8	43,071	4.0	53,839	5.0

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 12: Employee Benefit Plan

Profit-Sharing Plan

The Bank has a profit-sharing plan covering substantially all employees. The plan is a qualified salary reduction plan under Section 401(k) of the Internal Revenue Code, which allows deferral of compensation, effective January 1, 1987. The plan became effective February 29, 2000. Under this plan, the Bank's annual contribution to the plan cannot exceed five percent (5%) of eligible compensation, three percent (3%) of which is nondiscretionary and the other two percent (2%) is at the discretion of the Bank's Board of Directors. Bank contributions are made in the form of cash or treasury stock. The Bank contributed \$360,643 and \$357,539 to the profit-sharing plan in 2016 and 2015, respectively.

Deferred Compensation Plans

The Company has entered into deferred compensation contracts with current key employees. The contracts provide fixed benefits payable in equal annual installments after a 7 year vesting period. The Company purchased life insurance contracts that may be used to fund the payments. The charge to expense is based on the present value computations of anticipated liabilities. For the years ended December 31, 2016 and 2015, the total expense was \$93,611 and \$328,562, respectively. The Company has recorded a liability for the deferred compensation plan of \$535,394 and \$478,388 at December 31, 2016 and 2015, respectively, which are included in accrued expenses and other liabilities in the consolidated statements of financial condition.

Stock Option Plan

The Company has entered into various stock option agreements that grant options to its officers for a fixed number of shares of common stock. The exercise price of each option equals the book value of the Company's stock on the date of grant and is directly adjusted for dividends paid over the life of the option. Due to the direct reduction of dividends paid adjusting the exercise price of the options, the option valuation model does not utilize a dividend yield as a factor. All options have maximum terms that extend through the end of employment or retirement.

Vesting periods range from one to seven years from the date of grant. Effective January 1, 2006, the Company adopted new authoritative guidance, which requires that compensation cost relating to share-based payment transactions be recognized in the financial statements with measurement based upon the fair value of the equity or liability instruments issued. For the years ended December 31, 2016 and 2015, the Company recognized compensation expense related to stock options totaling \$-0- and \$55,512, respectively, and is included as a part of salaries and employee benefits in the statement of income. As of December 31, 2016, the remaining compensation expense has been fully recognized.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 12: Employee Benefit Plan – continued

Stock Option Plan – continued

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model. The expected volatility is based on historical volatility. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on historical exercise experience. No options were granted during the year ended December 31, 2016 or 2015.

A summary of the status of the Company's stock option plans is presented below:

	2016		2015	
	Shares	Wtd. Avg. Ex. Price	Shares	Wtd. Avg. Ex. Price
Outstanding, beginning of year	13,248	\$ 61.78	18,872	\$ 58.44
Granted	-	-	-	-
Exercised	(12,144)	60.92	(5,624)	44.45
Cancelled	-	-	-	-
	1,104	\$ 69.76	13,248	\$ 61.78
Outstanding, end of year	1,104	\$ 69.76	13,248	\$ 61.78
Exercisable at end of year	1,104	\$ 69.76	13,248	\$ 61.78

Information pertaining to options outstanding at December 31, 2016 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Shares Exercisable	Weighted Average Exercise Price
\$30-\$84	1,104	19.47	\$ 69.76	1,104	\$ 69.76
Total	1,104	19.47	\$ 69.76	1,104	\$ 69.76

There were no non-vested stock options at December 31, 2016 or 2015.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 13: Restrictions on Dividends

Federal and state banking regulations place certain restrictions on dividends paid by the Bank to the Company. Such regulations generally restrict cash dividends for the year 2017 to the extent of the Bank's earnings for 2017 plus \$3,199,589 of available earnings from prior years. In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

NOTE 14: Fair Value Measurements

Authoritative guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs.

An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

Authoritative guidance requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement costs). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability.

Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, authoritative guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 14: Fair Value Measurements – continued

The fair value hierarchy is as follows:

Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (for example, interest rates, volatilities, prepayment speeds, loss severities, credit risks and default rates) or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

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

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Securities Available for Sale - Securities classified as available for sale are reported at fair value utilizing Level 1 and Level 2 inputs. For these securities, the Company obtains fair value measurements 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, live trading levels, trade execution data, market consensus prepayments speeds, credit information and the bond's terms and conditions, among other things.

Impaired Loans - Impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on internally customized discounting criteria.

Foreclosed Assets – Fair values are valued at the time the loan is foreclosed upon and the asset is transferred from loans. The value is based upon primarily third party appraisals, less costs to sell. The appraisals are generally discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and the client's business. Such discounts are typically significant and result in Level 3 classification of the inputs for determining fair value. Foreclosed assets are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same or similar factors above.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 14: Fair Value Measurements – continued

The following table summarizes financial assets and nonfinancial liabilities measured at fair value on a recurring basis as of December 31, 2016 and 2015, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

December 31, 2016				
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Financial assets:				
Investment securities				
U.S. government and agency	\$ -	\$ 41,018,045	\$ -	\$ 41,018,045
State and political subdivision	-	38,400,034	-	38,400,034
Total financial assets	\$ -	\$ 79,418,079	\$ -	\$ 79,418,079
December 31, 2015				
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Financial assets:				
Investment securities				
U.S. government and agency	\$ -	\$ 165,860,432	\$ -	\$ 165,860,432
State and political subdivision	-	67,245,208	-	67,245,208
Total financial assets	\$ -	\$ 233,105,640	\$ -	\$ 233,105,640

Certain nonfinancial assets are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 14: Fair Value Measurements – continued

The following table summarizes financial assets and nonfinancial liabilities, measured at fair value on a nonrecurring basis as of December 31, 2016 and 2015, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

December 31, 2016				
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Financial assets:				
Impaired loans	\$	\$	\$ 23,150,000	\$ 23,150,000
Foreclosed assets	-	-	3,254,571	3,254,571
	\$ -	\$ -	\$ 26,404,571	\$ 26,404,571
December 31, 2015				
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Financial assets:				
Impaired loans	\$ -	\$ -	\$ 12,249,000	\$ 12,249,000
	\$ -	\$ -	\$ 12,249,000	\$ 12,249,000

During the years ended December 31, 2016 and 2015, certain impaired loans were remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for possible loan losses based upon the fair value of the underlying collateral. At December 31, 2016, impaired loans with a carrying value of \$23,380,000 were reduced by specific valuation allowance allocations totaling \$230,000 to a reported fair value of \$23,150,000. At December 31, 2015, impaired loans with a carrying value of \$14,558,000 were reduced by specific valuation allowance allocations totaling \$2,309,000 to a total reported fair value of \$12,249,000. The fair value of impaired loans is determined based on collateral valuations utilizing Level 3 valuation inputs.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 14: Fair Value Measurements – continued

Quantitative information about Significant Unobservable Inputs Used in Level 3 Fair Value Measurements – The following table represents the Company’s Level 3 financial assets and liabilities, the valuation techniques used to measure the fair value of those financial assets and liabilities, and the significant unobservable inputs and the ranges of values for those inputs:

<u>Instrument</u>	<u>Fair Value at December 31, 2016</u>	<u>Principal Valuation Technique</u>	<u>Significant Unobservable Inputs</u>	<u>Range of Significant Input Values</u>
Impaired loans	\$ 23,150,000	Appraisal of collateral (1)	Appraisal adjustment	10-35%
Foreclosed assets	3,254,571	Appraisal of collateral (1)	Appraisal adjustment	10-35%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable, less associated allowance.

<u>Instrument</u>	<u>Fair Value at December 31, 2015</u>	<u>Principal Valuation Technique</u>	<u>Significant Unobservable Inputs</u>	<u>Range of Significant Input Values</u>
Impaired loans	\$ 12,249,000	Appraisal of collateral (1)	Appraisal adjustment	10-35%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable, less associated allowance.

Impaired loans that are unsecured are fully reduced by specific valuation allowances.

Those financial instruments not subject to the initial implementation of this guidance, are required to have their fair value disclosed, both assets and liabilities recognized and not recognized in the statement of financial condition, for which it is practicable to estimate fair value. Below is a table that summarizes the fair market values of all financial instruments of the Company at December 31, 2016, followed by methods and assumptions that were used by the Company in estimating the fair value of the classes of financial instruments. The estimated fair value amounts of financial instruments have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret data to develop the estimates of fair value.

Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts (in thousands).

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 14: Fair Value Measurements – continued

The estimated carrying values, and related estimated fair values, of the Company's financial instruments are as follows (in thousands):

	Carrying Amount	Total Estimated Fair Value		
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
December 31, 2016				
Financial assets				
Cash and cash equivalents	\$ 22,625	\$ 22,625	\$ -	\$ -
Interest bearing deposits	135,786	135,786	-	-
Loans held for sale	1,187	-	1,187	-
Loans receivable	701,178	-	-	699,531
Accrued interest receivable	3,016	3,016	-	-
Restricted investments held at cost	2,201	2,201	-	-
Cash surrender value of life insurance	24,246	24,246	-	-
Financial liabilities				
Deposit liabilities				
Noninterest bearing	511,087	511,087	-	-
Interest bearing	397,663	-	-	398,718
Accrued interest payable	103	103	-	-
Subordinated debentures	9,512	-	-	9,512
December 31, 2015				
Financial assets				
Cash and cash equivalents	\$ 24,225	\$ 24,225	\$ -	\$ -
Interest bearing deposits	56,389	56,389	-	-
Loans held for sale	668	-	668	-
Loans receivable	699,026	-	-	697,266
Accrued interest receivable	3,816	3,816	-	-
Restricted investments held at cost	1,744	1,744	-	-
Cash surrender value of life insurance	23,606	23,606	-	-
Financial liabilities				
Deposit liabilities				
Noninterest bearing	492,104	492,104	-	-
Interest bearing	468,015	-	-	463,213
Accrued interest payable	142	142	-	-
Subordinated debentures	9,512	-	-	9,512

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 14: Fair Value Measurements – continued

The following methods and assumptions were used by the Company in estimating the fair value of the above classes of financial instruments.

Cash and Cash Equivalents, Interest Bearing Deposits, Accrued Interest Receivable, and Accrued Interest Payable - The carrying amounts approximate fair value due to the relatively short period of time between the origination of these instruments and their expected realization.

Loans Held for Sale - These loans are reported at the lower of cost or fair value. Fair value is determined based on expected proceeds based on sales contracts and commitments.

Loans Receivable, Net - Fair values are estimated by stratifying the loan portfolio into groups of loans with similar financial characteristics. Loans are segregated by type such as real estate, commercial, and consumer, with each category further segmented into fixed and adjustable rate interest terms.

For mortgage loans, the Company uses the secondary market rates in effect for loans that have similar characteristics. The fair value of other fixed rate loans is calculated by discounting scheduled cash flows through the anticipated maturities adjusted for prepayment estimates. Adjustable interest rate loans are assumed to approximate fair value because they generally reprice within the short term. Fair values are adjusted for credit risk based on assessment of risk identified with specific loans, and risk adjustments on the remaining portfolio based on credit loss experience.

Assumptions regarding credit risk are judgmentally determined using specific borrower information, internal credit quality analysis, and historical information on segmented loan categories for non-specific borrowers.

Restricted Investments Carried at Cost - The carrying value of these investments approximates fair value based on the redemption provisions contained in each.

Cash surrender value of life insurance - The carrying amount of Bank owned life insurance is based on information received from the insurance carriers indicating the financial performance of the policies and the amount the Company would receive should the policies be surrendered.

Deposits Liabilities - The fair value of deposits with no stated maturity, such as checking, passbook, and money market, is equal to the amount payable on demand. The fair value of time certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar maturities.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 14: Fair Value Measurements – continued

Subordinated Debentures - The fair value of the Company's debentures are estimated using discounted cash flow analysis based on the interest rate that would be effective December 31, 2016, if the borrowings repriced according to their stated terms.

Off-balance-sheet Instruments - Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. These instruments have no carrying value.

NOTE 15: Subordinated Debentures

On September 15, 2005, the Company completed the private placement of \$2,810,000 in subordinated debentures to Midland Statutory Trust II (Trust II). Trust II funded the purchase of the subordinated debentures through the sale of trust preferred securities to Preferred Term Securities, Ltd. XIX with a liquidation value of \$2,810,000. The annual percentage rate of the interest payable on the subordinated debentures and distributions payable on the preferred securities is 3-Month LIBOR plus 1.70% (currently 2.67%). Dividends on the preferred securities are cumulative and Trust II may defer the payments as long as no acceleration event of default has occurred and is continuing, by extending the interest payment period on the debentures for up to twenty (20) consecutive quarterly periods. The preferred securities mature in September 2035.

On September 21, 2006, the Company completed the private placement of \$6,702,000 in subordinated debentures to Midland Statutory Trust III (Trust III). Trust III funded the purchase of the subordinated debentures through the sale of trust preferred securities to Preferred Term Securities, Ltd. XIX with a liquidation value of \$6,702,000. The annual percentage rate of the interest payable on the subordinated debentures and distributions payable on the preferred securities is 3-Month LIBOR plus 1.70% (currently 2.67%). Dividends on the preferred securities are cumulative and Trust III may defer the payments as long as no acceleration event of default has occurred and is continuing, by extending the interest payment period on the debentures for up to twenty (20) consecutive quarterly periods. The preferred securities mature in December 2036.

Subordinated debt may be included in regulatory Tier 1 capital subject to a limitation that such amounts not exceed 25% of Tier 1 capital. The remainder of subordinated debt is included in Tier II capital. There is no limitation for inclusion of subordinated debt in total risk-based capital and, as such, all subordinated debt was included in total risk-based capital. Interest expense on the subordinated debentures was \$229,105 and \$191,977 for the years ended December 31, 2016 and 2015.

NOTE 16: Lines of Credit

As of December 31, 2016, the Bank has unused commitments from four commercial banks to fund purchases up to \$69,000,000.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 17: Supplementary Cash Flow Information

	<u>2016</u>		<u>2015</u>
Interest paid	\$ 1,359,107	\$	1,309,748
Income tax paid	-		2,780,000
Assets acquired through foreclosure	4,922,307		-

NOTE 18: Derivatives

Derivative Loan Commitments

Mortgage loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Company enters into commitments to fund residential mortgage loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A mortgage loan commitment binds the Company to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock. Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from exercise of the loan commitment might decline from inception of the rate lock to funding of the loan due to increases in mortgage interest rates.

If interest rates increase, the value of these loan commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increases. The notional amount of undesignated mortgage loan commitments was \$4,689,809 and \$4,179,757 at December 31, 2016 and 2015, respectively. The fair value of such commitments was insignificant.

Forward Loan Sale Commitments

To protect against the price risk inherent in derivative loan commitments, the Company utilizes "best efforts" forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments.

With a "best efforts" contract, the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. Generally, the price the investor will pay the seller for an individual loan is specified prior to the loan being funded (for example, on the same day the lender commits to lend funds to a potential borrower).

The Company expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments. The notional amount of undesignated forward loan sale commitments was \$4,689,809 and \$4,179,757 at December 31, 2016 and 2015, respectively. The fair value of such commitments was insignificant.

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE 19: Reclassifications

Certain prior year balances on the Consolidated Statement of Financial Condition, the Consolidated Statement of Income, and the Consolidated Statement of Cash Flows have been reclassified in order to conform with the current year presentation. The reclassifications had no effect on net income or shareholders' equity.

NOTE 20: Subsequent Events

The Company has evaluated all subsequent events through March 6, 2017, the date the consolidated financial statements were available to be issued.

Report of Independent Auditors On Supplementary Information

To the Board of Directors and Shareholders of
Midland Bancshares, Inc. and Subsidiaries

We have audited the consolidated financial statements of **Midland Bancshares, Inc. and Subsidiaries** as of and for the years ended December 31, 2016 and 2015, and our report thereon dated March 6, 2017, which expressed an unmodified opinion on those consolidated financial statements, appears on page 1. Our audits were made for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating, parent company, and bank financial statements are presented for the purposes of additional analysis and are 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 information has been subjected to the auditing procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or 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 information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Davis Kinard & Co, PC
Certified Public Accountants

Abilene, Texas
March 6, 2017

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES
 Consolidating Statement of Financial Condition
 December 31, 2016

Assets	Midland Bancshares, Inc.	Community National Bank and Subsidiary
	Inc.	Subsidiary
Cash and due from banks	\$ 439,826	\$ 22,625,320
Cash and cash equivalents	439,826	22,625,320
Interest bearing deposits in banks	-	135,786,408
Securities available for sale	-	79,418,079
Investment in Midland Statutory Trust II	85,000	-
Investment in Midland Statutory Trust III	202,000	-
Investment in subsidiaries	113,590,295	-
Loans held for sale	-	1,186,948
Loans receivable, net of allowance for loan losses	-	724,327,868
Accrued interest receivable	-	3,015,577
Premises and equipment	-	7,951,327
Foreclosed assets	-	3,254,571
Goodwill	-	15,251,182
Cash surrender value of life insurance	-	24,246,400
Restricted investments held at cost	-	2,200,685
Deferred tax asset	-	1,995,752
Other assets	429,151	2,392,523
	\$ 114,746,272	\$ 1,023,652,640
Liabilities and Shareholders' Equity		
Noninterest bearing	\$ -	\$ 511,527,313
Interest bearing	-	397,663,408
Total deposits	-	909,190,721
Accrued expenses and other liabilities	10,731	871,624
Subordinated debentures	9,512,000	-
Total liabilities	9,522,731	910,062,345
Shareholders' equity		
Common stock	887,391	1,750,000
Preferred stock	18,260	-
Capital surplus	43,957,494	67,704,793
Retained earnings	60,742,035	44,210,776
Treasury stock, at cost	(306,365)	-
Net unrealized (depreciation) on available for sale securities, net of tax	(75,274)	(75,274)
Total shareholders' equity	105,223,541	113,590,295
	\$ 114,746,272	\$ 1,023,652,640

<u>Eliminations</u>	<u>Consolidated</u>
\$ (439,826)	\$ 22,625,320
<u>(439,826)</u>	<u>22,625,320</u>
-	135,786,408
-	79,418,079
-	85,000
-	202,000
(113,590,295)	-
-	1,186,948
-	724,327,868
-	3,015,577
-	7,951,327
-	3,254,571
-	15,251,182
-	24,246,400
-	2,200,685
-	1,995,752
-	<u>2,821,674</u>
<u>\$ (114,030,121)</u>	<u>\$ 1,024,368,791</u>
\$ (439,826)	\$ 511,087,487
-	397,663,408
<u>(439,826)</u>	<u>908,750,895</u>
-	882,355
-	9,512,000
<u>(439,826)</u>	<u>919,145,250</u>
(1,750,000)	887,391
-	18,260
(67,704,793)	43,957,494
(44,210,776)	60,742,035
-	(306,365)
75,274	(75,274)
<u>(113,590,295)</u>	<u>105,223,541</u>
<u>\$ (114,030,121)</u>	<u>\$ 1,024,368,791</u>

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Consolidating Statement of Income

Year Ended December 31, 2016

	Midland Bancshares, Inc.	Community National Bank and Subsidiary
Interest income		
Loans, including fees	\$ -	\$ 35,432,179
Debt securities		
Taxable	6,912	1,142,963
Tax exempt	-	557,499
Deposits with banks	-	608,741
Total interest income	6,912	37,741,382
Interest expense		
Deposits	-	1,090,544
Subordinated debentures	229,105	-
Total interest expense	229,105	1,090,544
Net interest (loss) income	(222,193)	36,650,838
Provision for loan losses	-	20,805,788
Net interest (loss) income after provision for loan losses	(222,193)	15,845,050
Noninterest income		
Service charges on deposit accounts	-	910,700
Real estate mortgage fees	-	819,054
Equity in (loss) earnings of subsidiaries	(1,393,314)	-
Debit card income	-	766,902
Net gain on sale of securities	-	524,819
Net appreciation on cash surrender value of life insurance	-	640,293
Other income	-	962,644
Total noninterest income	(1,393,314)	4,624,412
Noninterest expenses		
Salaries and employee benefits	-	13,278,994
Occupancy and equipment expense	-	3,141,803
IT and data processing	-	1,287,655
Loan expense	-	1,008,185
FDIC assessments	-	802,079
Director compensation	-	521,500
Loss on sale of foreclosed assets	-	17,913
Other expense	43,464	3,232,489
Total noninterest expenses	43,464	23,290,618
Loss before income taxes	(1,658,971)	(2,821,156)
Income tax benefit	(92,980)	(1,427,842)
Net loss	\$ (1,565,991)	\$ (1,393,314)

<u>Eliminations</u>	<u>Consolidated</u>
\$ (12,289)	\$ 35,419,890
-	
-	1,149,875
-	557,499
-	608,741
<u>(12,289)</u>	<u>37,736,005</u>
-	1,090,544
-	229,105
<u>-</u>	<u>1,319,649</u>
(12,289)	36,416,356
-	20,805,788
<u>-</u>	<u>20,805,788</u>
(12,289)	15,610,568
-	910,700
-	819,054
1,393,314	-
-	766,902
-	524,819
-	640,293
-	962,644
<u>1,393,314</u>	<u>4,624,412</u>
-	13,278,994
-	3,141,803
-	1,287,655
-	1,008,185
-	802,079
-	521,500
-	17,913
(12,289)	3,263,664
<u>(12,289)</u>	<u>23,321,793</u>
1,393,314	(3,086,813)
-	(1,520,822)
<u>-</u>	<u>(1,520,822)</u>
\$ <u>1,393,314</u>	\$ <u>(1,565,991)</u>

MIDLAND BANCSHARES, INC. AND SUBSIDIARIES

Consolidating Statement of Cash Flows

Year Ended December 31, 2016

	Midland Bancshares, Inc.	Community National Bank and Subsidiary
Cash flows from operating activities		
Net loss	\$ (1,565,991)	\$ (1,393,314)
Adjustments to reconcile net loss to net cash provided by operating activities		
Provision for loan losses	-	20,805,788
Net amortization of securities	-	1,927,515
Depreciation	-	996,989
Net realized gain on sales of available for sales securities	-	(524,819)
Appreciation in cash surrender value of life insurance	-	(640,293)
Loss on sale of foreclosed assets	-	17,913
Deferred income tax	-	(1,316,036)
Undistributed loss of subsidiaries	3,618,314	-
Net change in		
Loans held for sale	-	(518,533)
Accrued interest receivable	-	800,669
Net change in deferred tax asset	-	(75,462)
Other assets	(92,978)	(1,380,185)
Accrued expenses and other liabilities	-	(1,292,908)
Net cash provided by operating activities	1,959,345	17,407,324
Cash flows from investing activities		
Net change in interest bearing deposits in banks	-	(79,397,879)
Activity in available for sale securities		
Sales	-	82,049,852
Maturities, prepayments and calls	-	222,544,320
Purchases	-	(152,877,719)
Net change in restricted investments held at cost	-	(427,041)
Proceeds from sale of foreclosed assets	-	1,649,823
Loan originations and principal collections, net	-	(38,780,876)
Additions to premises and equipment	-	(457,182)
Net cash provided by investing activities	-	34,303,298
Cash flows from financing activities		
Net decrease in deposits	-	(51,085,401)
Proceeds from sale of treasury stock	317,373	-
Proceeds from exercise of stock options	729,854	-
Dividends paid	(2,723,586)	(2,225,000)
Net cash used in financing activities	(1,676,359)	(53,310,401)
Net change in cash and cash equivalents	282,986	(1,599,779)
Cash and cash equivalents at beginning of year	156,840	24,225,099
Cash and cash equivalents at end of year	\$ 439,826	\$ 22,625,320

<u>Eliminations</u>	<u>Consolidated</u>
\$ 1,393,314	\$ (1,565,991)
-	20,805,788
-	1,927,515
-	996,989
-	(524,819)
-	(640,293)
-	17,913
-	(1,316,036)
(3,618,314)	-
-	(518,533)
-	800,669
-	(75,462)
-	(1,473,163)
-	(1,292,908)
<u>(2,225,000)</u>	<u>17,141,669</u>
-	(79,397,879)
-	82,049,852
-	222,544,320
-	(152,877,719)
-	(427,041)
-	1,649,823
-	(38,780,876)
-	(457,182)
<u>-</u>	<u>34,303,298</u>
(282,986)	(51,368,387)
-	317,373
-	729,854
2,225,000	(2,723,586)
<u>1,942,014</u>	<u>(53,044,746)</u>
(282,986)	(1,599,779)
<u>(156,840)</u>	<u>24,225,099</u>
\$ <u><u>(439,826)</u></u>	\$ <u><u>22,625,320</u></u>

MIDLAND BANCSHARES, INC.
(PARENT COMPANY)
Statements of Financial Condition
December 31, 2016 and 2015

Assets	2016	2015
Cash and due from banks	\$ 439,826	\$ 156,840
Investment in Midland Statutory Trust II	85,000	85,000
Investment in Midland Statutory Trust III	202,000	202,000
Investment in subsidiaries	113,590,295	117,578,077
Other assets	429,151	336,173
	\$ 114,746,272	\$ 118,358,090
 Liabilities and Shareholders' Equity		
Accrued expenses and other liabilities	\$ 10,731	\$ 10,731
Subordinated debentures	9,512,000	9,512,000
Total liabilities	9,522,731	9,522,731
 Shareholders' equity		
Common stock	887,391	875,247
Preferred stock	18,260	18,260
Capital surplus	43,957,494	43,049,575
Retained earnings	60,742,035	65,031,612
Treasury stock, at cost	(306,365)	(433,529)
Net unrealized (depreciation) appreciation on available for sale securities, net of tax	(75,274)	294,194
Total shareholders' equity	105,223,541	108,835,359
	\$ 114,746,272	\$ 118,358,090

MIDLAND BANCSHARES, INC.
(PARENT COMPANY)
Statements of Income
Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Income		
Interest income	\$ 6,912	\$ 5,813
Total income	<u>6,912</u>	<u>5,813</u>
Expenses		
Interest on subordinated debentures	229,105	191,977
Interest on line of credit	-	171,219
Other expense	43,464	62,851
Total expenses	<u>272,569</u>	<u>426,047</u>
Loss before income taxes and equity in earnings of subsidiaries	(265,657)	(420,234)
Income tax benefit	<u>(92,980)</u>	<u>(147,090)</u>
Loss before equity in earnings of subsidiaries	(172,677)	(273,144)
Equity in earnings of subsidiaries		
Dividend income	2,225,000	1,500,000
Undistributed (loss) earnings of subsidiaries	<u>(3,618,314)</u>	<u>6,817,903</u>
Total equity in (loss) earnings of subsidiaries	<u>(1,393,314)</u>	<u>8,317,903</u>
Net (loss) income	<u>\$ (1,565,991)</u>	<u>\$ 8,044,759</u>

MIDLAND BANCSHARES, INC.
(PARENT COMPANY)
Statements of Cash Flows
Years Ended December 31, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Net (loss) income	\$ (1,565,991)	\$ 8,044,759
Adjustments to reconcile net (loss) income to net cash provided by operating activities		
Undistributed loss (earnings) of subsidiaries	3,618,314	(6,817,903)
Stock based compensation	-	55,512
Net change in		
Other assets	(92,978)	(147,110)
Accrued expenses and other liabilities	-	(2)
Net cash provided by operating activities	1,959,345	1,135,256
Cash flows from investing activities		
Capital contribution to subsidiary	-	(13,980,000)
Net cash used in investing activities	-	(13,980,000)
Cash flows from financing activities		
Net change in short term borrowing	-	(4,248,000)
Proceeds from sale of preferred stock	-	18,260,000
Proceeds from sale of treasury stock	317,373	247,212
Proceeds from exercise of stock options	729,854	253,929
Dividends paid	(2,723,586)	(1,717,999)
Net cash (used in) provided by financing activities	(1,676,359)	12,795,142
Net change in cash and cash equivalents	282,986	(49,602)
Cash and cash equivalents at beginning of year	156,840	206,442
Cash and cash equivalents at end of year	\$ 439,826	\$ 156,840

COMMUNITY NATIONAL BANK AND SUBSIDIARY
 Statements of Financial Condition
 December 31, 2016 and 2015

Assets	2016	2015
Cash and due from banks	\$ 22,625,320	\$ 24,225,099
Cash and cash equivalents	22,625,320	24,225,099
Interest bearing deposits in banks	135,786,408	56,388,529
Securities available for sale	79,418,079	233,105,640
Loans held for sale	1,186,948	668,415
Loans receivable, net of allowance for loan losses	724,327,868	711,275,087
Accrued interest receivable	3,015,577	3,816,246
Premises and equipment	7,951,327	8,491,134
Foreclosed assets	3,254,571	-
Goodwill	15,251,182	15,251,182
Cash surrender value of life insurance	24,246,400	23,606,107
Restricted investments held at cost	2,200,685	1,773,644
Deferred tax asset	1,995,752	405,310
Other assets	2,392,523	1,012,338
	\$ 1,023,652,640	\$ 1,080,018,731

Liabilities and Shareholders' Equity

Noninterest bearing	\$ 511,527,313	\$ 492,261,150
Interest bearing	397,663,408	468,014,972
Total deposits	909,190,721	960,276,122
Accrued expenses and other liabilities	871,624	2,164,532
Total liabilities	910,062,345	962,440,654

Shareholders' equity

Common stock	1,750,000	1,750,000
Capital surplus	67,704,793	67,704,793
Undivided profits	44,210,776	47,829,090
Net unrealized (depreciation) appreciation on available for sale securities, net of tax	(75,274)	294,194
Total shareholders' equity	113,590,295	117,578,077
	\$ 1,023,652,640	\$ 1,080,018,731

COMMUNITY NATIONAL BANK AND SUBSIDIARY

Statements of Income

Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Interest income		
Loans, including fees	\$ 35,432,179	\$ 34,228,737
Debt securities		
Taxable	1,142,963	1,780,767
Tax exempt	557,499	724,528
Deposits with banks	608,741	564,064
Total interest income	<u>37,741,382</u>	<u>37,298,096</u>
Interest expense		
Deposits	1,090,544	942,552
Total interest expense	<u>1,090,544</u>	<u>942,552</u>
Net interest income	36,650,838	36,355,544
Provision for loan losses	20,805,788	5,086,199
Net interest income after provision for loan losses	15,845,050	31,269,345
Noninterest income		
Service charges on deposit accounts	910,700	1,036,061
Real estate mortgage fees	819,054	1,174,693
Debit card income	766,902	941,127
Net gain on sale of securities	524,819	-
Net appreciation on cash surrender value of life insurance	640,293	406,910
Other income	962,644	712,756
Total noninterest income	<u>4,624,412</u>	<u>4,271,547</u>
Noninterest expenses		
Salaries and employee benefits	13,278,994	14,155,611
Occupancy and equipment expense	3,141,803	3,113,121
IT and data processing	1,287,655	1,232,649
Loan expense	1,008,185	266,227
FDIC assessments	802,079	609,424
Director compensation	521,500	553,500
Loss on sale of foreclosed assets	17,913	-
Other expense	3,232,489	3,264,457
Total noninterest expenses	<u>23,290,618</u>	<u>23,194,989</u>
(Loss) income before income taxes	(2,821,156)	12,345,903
Income tax (benefit) expense	(1,427,842)	4,028,000
Net (loss) income	\$ <u>(1,393,314)</u>	\$ <u>8,317,903</u>

COMMUNITY NATIONAL BANK AND SUBSIDIARY

Statements of Cash Flows

Years Ended December 31, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Net income	\$ (1,393,314)	\$ 8,317,903
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	20,805,788	5,086,199
Net amortization of securities	1,927,515	3,144,466
Depreciation	996,989	1,067,265
Net realized gain on sales of available for sales securities	(524,819)	-
Appreciation in cash surrender value of life insurance	(640,293)	(406,910)
Loss on sale of foreclosed assets	17,913	-
Deferred income tax	(1,316,036)	(488,409)
Net change in		
Loans held for sale	(518,533)	1,165,012
Accrued interest receivable	800,669	80,151
Net change in deferred tax asset	(75,462)	(418,328)
Other assets	(1,380,185)	(68,477)
Accrued expenses and other liabilities	(1,292,908)	915,706
Net cash provided by operating activities	17,407,324	18,394,578
Cash flows from investing activities		
Net change in interest bearing deposits in banks	(79,397,879)	86,875,439
Activity in available for sale securities		
Sales	82,049,852	-
Maturities, prepayments and calls	222,544,320	210,789,917
Purchases	(152,877,719)	(152,042,957)
Purchase of life insurance policies	-	(10,664,449)
Net change in restricted investments held at cost	(427,041)	(29,715)
Proceeds from sale of foreclosed assets	1,649,823	-
Loan originations and principal collections, net	(38,780,876)	(66,337,276)
Additions to premises and equipment	(457,182)	(956,025)
Net cash provided by investing activities	34,303,298	67,634,934
Cash flows from financing activities		
Net (decrease) increase in deposits	(51,085,401)	(98,580,576)
Capital contributions from Midland Bancshares, Inc.	-	13,980,000
Dividends paid	(2,225,000)	(1,500,000)
Net cash used in financing activities	(53,310,401)	(86,100,576)
Net change in cash and cash equivalents	(1,599,779)	(71,064)
Cash and cash equivalents at beginning of year	24,225,099	24,296,163
Cash and cash equivalents at end of year	\$ 22,625,320	\$ 24,225,099