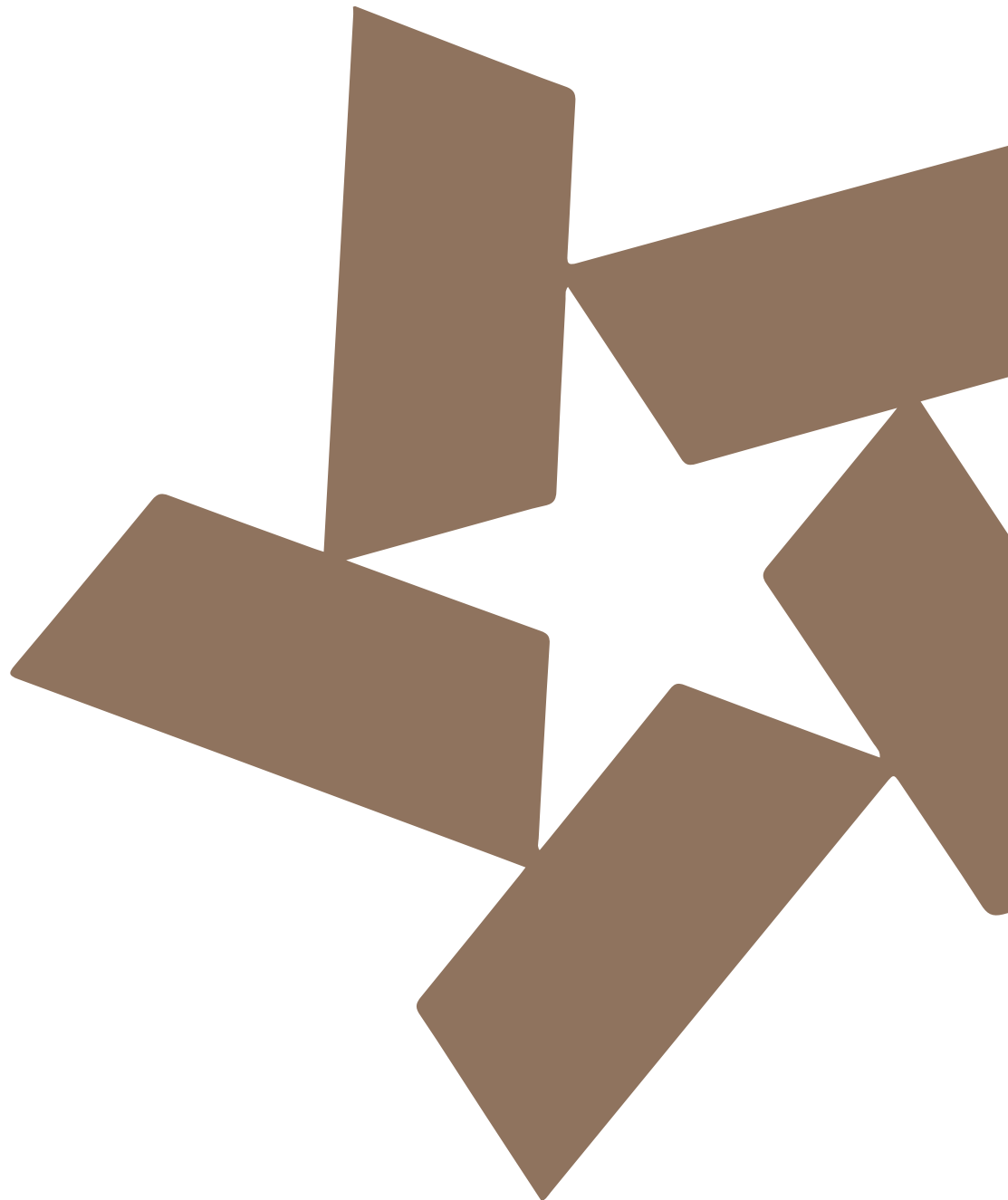


**TEXAS REGIONAL BANK**

**ANNUAL  
REPORT | 2016**



2010



2013



2015



2016



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May 2017 will mark the seventh operating year for Texas Regional Bank. Each year we have continued to expand our brand and build market share to become the “Bank of Choice” in the Rio Grande Valley (RGV). At the end of 2016, our organization covered the RGV with nine locations and more than \$600 million in assets. In 2017, we plan to break ground on new facilities in Harlingen and Edinburg, with more planned in the next three years.

Over the next several years we will focus on entering new markets as we expand the franchise in the RGV. Since 2015, the TRB Board has recognized a growing economic risk of regional concentration. Knowing Texas Regional Bank would continue to gain market share in the Valley, we could see a developing need to diversify geographically and expand into regions with other types of economic engines.

Before the founding of Texas Regional Bank, several disruptions in the economy created a unique opportunity for our bank to capture market share, providing a path for success. Today those disruptions are nonexistent in the RGV and other Texas markets. Therefore, we now concentrate on identifying markets that are growing organically at a rate well above state averages.

The target area most obvious to us is the Texas Hill Country north of San Antonio and west of Austin. An October 2016 *Forbes* article, “America’s Next Great Metropolis Is Taking Shape In Texas,” illustrates our Board’s wisdom in selecting this “fastest-growing region in the country” for our first move beyond the RGV. (While San Antonio and Austin also are great markets, they are big, built out, and well banked.)

The RGV and Hill Country economies are very different, yet complementary. While the RGV thrives on agriculture, international trade, manufacturing, and transportation, the Hill Country concentrates on technology, recreation, retirement, and quality of life venues. And, while the RGV workforce is predominantly blue-collar, the Hill Country has a more highly-technical, white-collar employment base.

On February 24th, we finalized the acquisition of the Blanco banks, with locations in Blanco, Bulverde, Fredericksburg, and Wimberley. This acquisition helps to achieve our goal of spreading economic risk through geographical diversification. Moreover, in the next few years, we expect this expansion will deliver shareholder value equal to what has been delivered from the RGV.

## 2016 GROWTH



Simultaneous with the acquisition, we began work to expand our brand into additional markets in the Hill Country. On April 17th, TRB opened Loan Production Offices in San Marcos and Lakeway with a team of seven seasoned bankers who have hit the ground running. Our five-year plan is to operate a total of ten Hill Country locations west of I-35 and North of I-10, as we pursue our goal of being the “Bank of Choice” led by *The people you know* in all of the regions we serve.

Texas Regional Bank will continue to look at opportunities that make geographic and economic sense to the organization and its shareholders. In addition, because of the Hill Country’s potential, we will open a common stock offering in June to fuel the anticipated growth of this new market. While existing shareholders will have the opportunity to purchase additional shares, we plan to target influential individuals in the Hill Country. As we always say, the success of the bank correlates directly with the size and influence of our shareholder base.

Many thanks for your ongoing confidence in and support of Texas Regional Bank.

Assets  
**10.7%**  
Growth

Loans  
**11.3%**  
Growth

Revenue  
**35.9%**  
Growth



At the onset of 2016, the direction of the bank was set by strategically establishing new and higher goals. The goals aimed to achieve efficiencies and complete specific tasks and projects to increase profitability.

Accordingly, our bank managers created strategic plans for their respective departments. Each department identified three measurable goals that would improve the bottom line and enhance shareholder value.

As we pulled our team together and prepared for an acquisition, our sales team assumed an important role in expanding our brand and building stronger customer relations. Subsequently, Texas Regional Bank originated its first bank wide sales blitz, which ran from August 22 to September 12, 2016. Eight of our nine TRB banking centers participated. Each banking center was assigned a three-week period to cold-call, follow-up, and make presentations, attempting to collect deposit accounts and referrals for TRB's products and services. A member of the sales team was coupled with each market to enhance their efforts and give added support.

Overall, the quantitative turnout for Texas Regional Bank was record breaking as we opened triple-digit accounts. Through this strategic exercise, friendly competition between branches afforded opportunities for employee team building and cross-training within our markets. We finished our first sales blitz with 531 calls, 47 Connect Banking presentations, and 38 referrals.

As evidenced by this success, we are prepared to carry our bank into 2017 with a team that is second to none. In the first quarter of 2017, we will conduct our second sales blitz, applying the knowledge gained as an advantage to surpass the 2016 numbers. This will serve as a great opportunity to build relationships and attract new customers to do business with *The people you know*.

## 2016 TOTALS

It is a privilege to manage both sides of our organization, operations and lending, and guide our team in growing Texas Regional Bank, one customer, one account, and one loan at a time. Because our seasoned, professional bankers are results driven, customer oriented, and always focused on the tasks at hand, we had another outstanding year in 2016.

### Loans

Our market presence and brand recognition continues to expand. In 2016, we again set a high bar for loan growth, ending the year at \$344.2 million in loans, an 11.3% increase over 2015.

Under Brent Baldree's leadership, the loan team was reorganized in 2016, helping us exceed the goals set for the year. We continue to recruit and promote the best bankers in the business, extending our motto, *The people you know* throughout our footprint. Additionally, we acquired Blanco National Bank, a strategic move to diversify our holdings, gain talent, and take advantage of opportunities that exist in this fast growing area.

We continually benefit from having the strongest credit team in the Rio Grande Valley, led by Gaby Garza. Gaby and her team consistently produce at a high level, ensuring our organization remains solid in each of the markets we serve.

### Deposits

In 2016, we grew transactional deposits by 11.3%, ending the year with \$560 million in deposits. We continued to remodel our banking centers to incorporate TRB Rooms and enhance service areas. Online and mobile banking improved year over year in functionality, capability, and volume.

Cross-training all branch employees in teller functions, new accounts, and customer service has made a difference. These universal bankers are providing a better customer experience and producing greater efficiencies throughout the organization.

Central Deposit Operations, led by Ronda Johnson, diligently supports every department within Texas Regional Bank, ensuring that customers receive the relationship style of banking they have come to expect. In 2015, we made big changes with proven results; 2016 was better, and we look forward to an even stronger 2017.

Finally, our IT and Security teams are continually updating our systems to protect you and Texas Regional Bank from cyber-security risks. We are committed to being vigilant in this effort, to combat this ever-growing threat.



**Assets**  
**\$616.1**  
million

**Loan Portfolio**  
**\$344.2**  
million

**Volunteer Hours**  
**10,200**

## SOUTH TEXAS



Our slogan, *The people you know*, is as meaningful today as when we began operations in 2010. Whether campaigning for our business partnerships or strengthening community outreach, the Texas Regional Bank family has continued to increase brand awareness, leading to another strong year.

Our lending team continues to be the best in the region. We have hand-selected lenders who have a broad range of experience and are involved in their communities. This past year we shifted several lenders in our larger markets to meet market demand and increase our presence. As a result, we finished the year with \$348 million in loans, equating to 11% overall growth. We continue to grow market share in Mission and Weslaco with Edinburg and Brownsville leading our growth in 2016. Our lenders also contributed more than 7,000 hours in volunteer service to help strengthen the communities we call home.

After serving as Chief Lending Officer for several years, I now have a new role as Regional Market President. This position affords me the opportunity to focus on the growth of our bank throughout South Texas. We currently serve our customers with nine banking centers: in Falfurrias and across the Rio Grande Valley from Brownsville to Mission. By the end of 2017, our hope is to open another banking center in Edinburg. We will continue to increase our brick-and-mortar presence in strategic locations in order to better serve communities and connect with customers from areas outside of our current markets.

As a community and regional bank with local bankers, we take pride in providing our customers with excellent banking products and services. We are committed to being the “Bank of Choice” in South Texas.

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## HILL COUNTRY

Blanco National Bank merged with Texas Regional Bank (TRB) on February 24, 2017. The two organizations have many common threads, one of which is the attention given to customers. I appreciate TRB’s sensitivity to the dynamics of the merger and the care taken to alleviate concerns of the Blanco National Bank customers. In particular, many customers have commented very favorably on the March 9th Town Square party, which gave them a chance to meet and talk with some of the fine TRB folks. That sort of attention goes a long way toward making a smooth transition.

TRB’s expertise in commercial lending will greatly enhance the service provided to our existing customers, and increase the potential for attracting quality new customers. The Hill Country presents a rich opportunity for those prepared to seize it. This merger should allow us to achieve unprecedented growth in all areas.



**Fred Del Barrio, Jr.**  
Restaurant Industry

**Bob Boggus**  
Automobile Dealership

**Andy Browder**  
Telecommunications

**Bryan Burke**  
Accounting

**Jane Burkholder**  
Insurance Services

**Bill Conner**  
Industrial Equipment & Supplies

**John Cowen**  
Import/Export

**Tony Falcon, M.D.**  
Medical

**Ephraim Flores**  
Software Development

**Jose E. Garcia**  
Produce Distribution

**David Garza**  
Pharmaceuticals

**Jimmy Garza**  
Produce Distribution

**Lawrence "Chip" Gift**  
Financial Investments

**Rolando Gonzalez**  
Real Estate Investments

**John D. Guevara**  
Legal Services

**Kalim Habet, M.D.**  
Medical

**Jasen Hardison**  
Real Estate Investments

**Claude "Sonny" Hildreth**  
Private Investigation & Consulting

**Alan Johnson**  
Consulting

**Don "D.J." Johnson**  
Automobile Dealership

**Wendell Johnson**  
Real Estate Investments

**Pat Kornegay**  
Aviation

**Charles Marina**  
Real Estate Investments

**Mike McLarty**  
Insurance Services

**Reba Cardenas McNair**  
Real Estate Development

**Michael Moore**  
Legal Services

**Mike Murphy**  
Pharmaceuticals

**Lance Neuhaus**  
Agriculture Equipment & Supplies

**Keith Padilla**  
Insurance Services

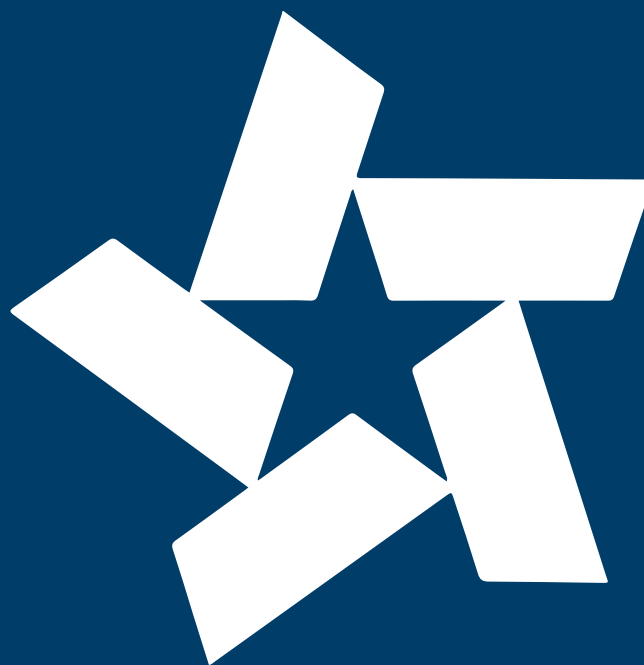
**Mary Lou Ray**  
Legal Services

**Hector M. Rivera**  
Business & Tax Services

**Bob Shepard**  
Insurance Services

**Alberto Vega**  
Funeral Services

**Bill Youngblood**  
Agriculture



## SENIOR ADVISORY BOARD MEMBERS

Since its inception in 2010, Texas Regional Bank has grown steadily and methodically. Ambitious goals of opening new markets or offering strategic new services have been set and achieved every year. In 2016, a major development was the addition of TRB Mortgage, which launched on September 1, 2016, as a two-person department, led by Rachelle Cisneros, Vice President of Mortgage Operations, along with Stephany Price, Mortgage Loan Officer.

TRB Mortgage was developed over a six-month period by Adriana McElrath, First Vice President/Corporate Administration and Rachelle Cisneros, one of the best mortgage professionals in the Rio Grande Valley. The process included identifying goals and objectives that fit our style of relationship banking and ensuring the department had what it needed to succeed.

A primary goal is to facilitate the American dream of homeownership for TRB customers by providing affordable, common-sense financing. This is done by offering products and programs that promote sensible, long-term homeownership. As CEO Paul Moxley has noted, "This is something our customers have wanted since we opened our doors." Moreover, a fully operational mortgage department was a critical prerequisite for our expansion into the Texas Hill Country.

TRB Mortgage has beat all of its monthly goals, booking 16 loans totaling \$3.7 million and developing a pipeline that continually grows. It is now a four-person team and will expand as needed to meet the demands of the market and expectations of our customers.

**TRB Mortgage offers:**

- Conventional Loans
- Federal Housing Administration (FHA) Loans
- Veterans Affairs (VA) Loans
- Rural Development Loans
- Jumbo Loans
- Fixed & Adjustable Rate Loans



**RACHELLE CISNEROS**  
VICE PRESIDENT  
MORTGAGE OPERATIONS



**ADRIANA MCELRATH**  
VICE PRESIDENT OF  
CORPORATE ADMINISTRATION



**STEPHANY PRICE**  
MORTGAGE LOAN OFFICER





At TRB Wealth Management, our goal is to provide you the financial freedom you've worked hard to earn. We act as fiduciaries and always put your interests first. Many studies show the majority of conventional wealth managers underperform the market over time. Conventional managers often ignore the hidden impact of high expenses and taxes, which reduce your overall portfolio return. TRB approaches wealth management differently, using an evidence-based investment strategy that is backed by over 60 years of academic research.

Our philosophy is simple yet effective: let the markets work for you. We believe it is best to be and stay fully invested in a proper asset allocation for your age and circumstances. Our investment portfolios are designed to reduce risk through global diversification, keep fees low, and be extremely tax efficient. Each portfolio is designed strategically to meet specific financial needs and goals. At the end of the day, we want our clients to be comfortable financially, so they can spend more time pursuing their other interests.

At TRB Trust, we have highly trained and skilled personnel to assist with various types of trust services. Our staff is experienced in handling personal trust services such as: Living Trusts, Testamentary Trusts, Standby Trusts, Charitable Trusts, Court Created Trusts and Life Insurance Trusts. We also handle Estate Administration for the disposition of your estate according to your desired wishes as stated in your Will. We will file the necessary tax returns required by the Internal Revenue Service. We have Custodial Accounts which allow you to make the investment decisions, and we provide the asset custody, recordkeeping and other administrative tasks.

Upon first meeting, our approach is tailored to your needs. We have customized, comprehensive strategies ready to discuss with you.

Currently, TRB Trust & Wealth Management manage in excess of \$300 million for more than 500 families in the Rio Grande Valley and the State of Texas.



L to R: John Tippet, Yolanda Torres, Rick Garcia, Bobby Farris, David Estes, Irma Murray, Vincent Richards, Hortencia Villarreal, Sal Garcia



# THE PEOPLE YOU KNOW HELPING IN OUR COMMUNITIES

*"We are humbled by the outpouring of support from TRB. They are always ready to volunteer at a job site, sponsor an event, and serve on our family selection committee. We are blessed to have such a generous bank in our community."*

- Wayne Lowry  
Executive Director  
Habitat for Humanity of the Rio Grande Valley





The idea for Texas Regional Bank emerged in 2008 when four businessmen recognized the community banking void in their local region caused by the consolidation of privately-held community and regional banks. Over the years, locally-owned banks had decreased, reducing the banking choices in many parts of Texas.

Michael Scaief, Bobby Farris, Tudor Uhlhorn and Bill Elliff, experienced leaders in business and the community, set out to develop a regional banking franchise committed to the success of the community. The group identified what had been successful among local regional banks in the past and adopted these strategies as operating principles.

Key objectives in their business plan were to:

- Hire top bankers who know their customers, and can make decisions
- Build a broad shareholder base and ownership structure, so no one family could control more than 10% of the bank
- Raise enough capital to be effective in the market
- Embrace technological advances to accommodate emerging and future banking trends.

Initially, the group intended to establish a brand new banking operation in the Rio Grande Valley of Texas. But, as their planning came together in mid-2009, the strategy changed, from chartering a new bank to acquiring an existing franchise. In September 2009, a revised business plan was submitted to regulators and Texas State Bankshares, Inc. (TSBI) was organized to serve as the bank's holding company, in anticipation of an acquisition.

The TSBI board soon was charged with raising capital to acquire Falfurrias State Bank. In February 2010, the capital raise began, with a goal of \$18 million. The community response was overwhelming and, in less than six weeks, the holding company closed its capital raise with nearly \$24 million from approximately 160 different families.

On May 4, 2010, Texas State Bankshares, Inc. acquired 100% of the stock of Falfurrias State Bank. Ninety days into the acquisition, the charter was relocated to Harlingen. The bank was renamed Texas Regional Bank, and its relationship style of banking articulated in the new tag line, *The people you know*. Texas Regional Bank celebrated another milestone in its history on November 18, 2013, when Border Capital Bank was acquired. Texas Regional Bank continues to find opportunities to grow and be a leader in community banking. In November 2016, Texas Regional Bank announced its plans to acquire Blanco National Bank and on February 24, 2017, the acquisition was complete.

Today, Texas Regional Bank has assets of approximately \$820 million and 13 banking centers across the Rio Grande Valley and the Texas Hill Country.

 **The People You Know**



# HELLO TEXAS HILL

NOVEMBER 29, 2016 at 4:30 PM TEXAS REGIONAL BANK MADE THE ANNOUNCEMENT IT WAS

## San Antonio Express-News

EXPRESSNEWS.COM AND MYSA.COM | Tuesday, December 6, 2016 | THE VOICE OF SOUTH TEXAS SINCE 1865

### Texas Regional Bank to buy Blanco National

By Patrick Danner  
STAFF WRITER

Blanco National Bank, a Hill Country institution with four branches, has entered into an agreement to be acquired by Texas Regional Bank of Harlingen pending regulatory approvals.

Terms weren't disclosed, but the transaction is expected to be completed in the first quarter of next year.

"Texas Regional Bank has been searching for the right opportunity in the Hill Country and found it with Blanco National Bank," Texas Regional Bank Chairman Michael Scaief said in a statement. "Blanco

National Bank will provide the foundation for Texas Regional Bank to extend its core banking, wealth management and mortgage divisions throughout the Hill Country."

The Harlingen-based bank primarily operates in the Rio Grande Valley, so it's jumping over the San Antonio market to acquire Blanco National Bank. Scaief said he prefers to operate on the periphery of San Antonio and Austin, and has no immediate plans to enter either market.

Texas Regional Bank had \$606.8 million in assets, about \$334 million in loans and \$546.8 million in deposits as of Sept. 30. Blanco National Bank had \$183.2 million in assets, about \$97

million in loans and \$163.3 million in deposits as of Sept. 30.

They combined institution would be the 91st largest bank in Texas based on assets after the sale is final, according to the most recent data from the Texas Department of Banking.

Started in 2010 with the acquisition of Falfurrias State Bank, Texas Regional Bank has nine branches Brownsville, Edinburg, Falfurrias, Mission, Weslaco and McAllen. It has about 150 employees.

Blanco National Bank's branches are in Blanco, Fredericksburg, Wimberly and Spring Branch. It has about 60 employees.

Texas Regional Bank expects

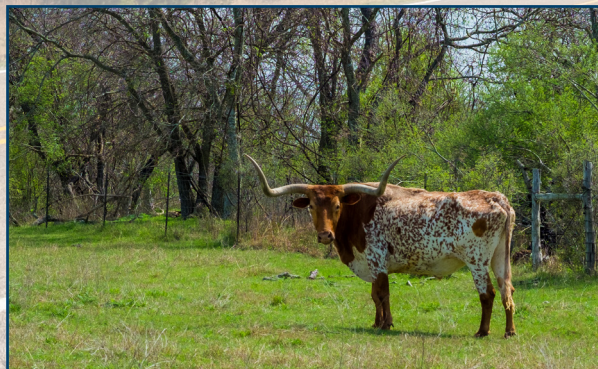
to retain all of Blanco National Bank's employees, Scaief said. Mark Tidwell, president and CEO of Blanco National Bank, will become market president in the Hill Country for Texas Regional Bank.

The boards of the parent companies of Blanco National Holdings Inc. and Texas State Bancshares already have voted for the deal. Blanco National Holdings shareholders still have to vote on the transaction, but are expected to support it.

The deal still requires the approval of the Federal Reserve Board and the Texas Department of Banking

[pdanner@express-news.net](mailto:pdanner@express-news.net)

The announcement of the merger between Texas Regional Bank and Blanco National Bank was another milestone for our organization. This strategic move provides the foundation for Texas Regional Bank to extend its core banking, wealth management, and mortgage divisions throughout the Hill Country and other regions in Texas.





# COUNTRY

WAS MOVING INTO THE TEXAS HILL COUNTRY.



BLANCO



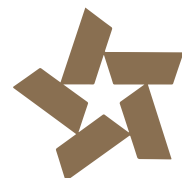
BULVERDE



FREDERICKSBURG



WIMBERLEY







### **Asset Growth**

In 2016, Texas Regional Bank continued to build its core assets. We ended the year at \$616.1 million in total assets, an increase of \$59.8 million over 2015, or 10.7% growth. We believe in controlled, profitable growth in line with our business model and creation of true and lasting relationships with residents of communities we serve. We focus continually on building our team with people you know and implementing the right controls to successfully expand the organization.

### **Loan Growth**

Loans continue to be the highest yielding investment for Texas Regional Bank. Growing the loan portfolio with quality assets is important for our continued success. Fortunately, we realized excellent growth in 2016, with the loan portfolio reaching \$344.2 million by December 31, 2016. This is a \$35 million, or 11.3% increase, from December 31, 2015. We anticipate even stronger loan growth this year. We will continue to focus on small businesses and complete banking relationships to build the core value of Texas Regional Bank.

### **Net Income and Shareholder Value**

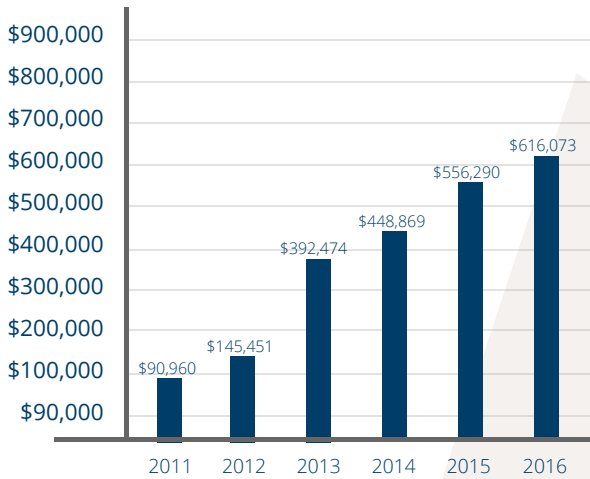
In 2016, Texas Regional Bank achieved record net income. Net income grew by over \$775 thousand, increasing from \$2.2 million in 2015 to \$2.9 million in 2016. This is a 39.5% increase, despite some extraordinary expenses in 2016. These improved earnings are a direct result of the strong loan growth mentioned above, continuing redeployment of very liquid and low-yielding investments into higher yielding securities, and control over operating expenses. The securities portfolio grew from \$171.3 million in 2015 to \$197.7 million in 2016, a \$26.4 million, or 15.4% increase. Texas Regional Bank also enhanced operational efficiencies in 2016, improving our efficiency ratio by 5.73%. Efficiency ratio is a measure of a bank's overhead relative to its revenue: the lower the ratio, the better. The increased revenue from loan growth and higher yielding investments, coupled with reduced expenses, added significant income to the bottom line.

The Board is intent on creating long-term shareholder value. We have invested in building infrastructure to support a sound organization and meaningful customer relationships. The result is a company owned by many not few, with tremendous momentum and solid franchise value. We hope to have a similar story to tell in 2017.



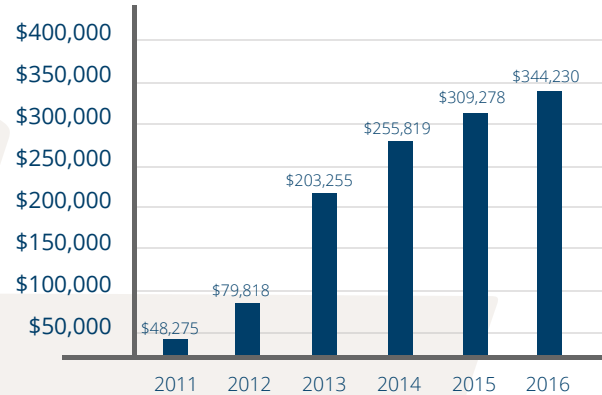
# FINANCIAL HIGHLIGHTS FOR TEXAS REGIONAL BANK

## Assets (in 000's)



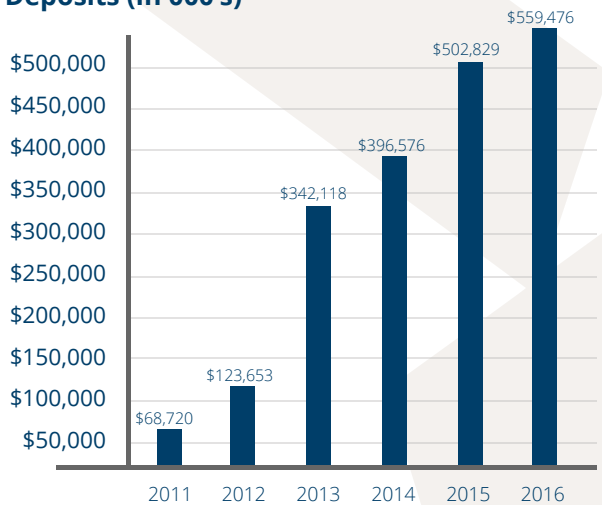
Texas Regional Bank ended the year with a capitalization level of 8.58%, which is excellent.

## Net Loans (in 000's)



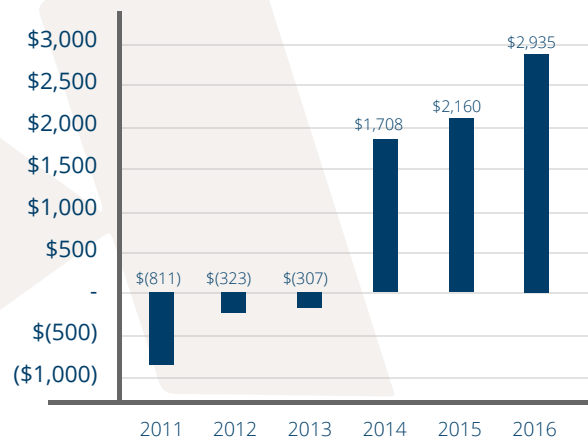
In the past year, Texas Regional Bank has increased net loans by \$35 million, resulting in 11.3% growth for the year.

## Deposits (in 000's)



In the past year, Texas Regional Bank has increased its total deposits by \$56.6 million, resulting in 11.3% growth for the year.

## Net Income (in 000's)



Texas Regional Bank ended the year with net income of \$2.9 million, a 35.9% increase over prior year.

	DEC-11	DEC-12	DEC-13	DEC-14	DEC-15	DEC-16
Assets	\$90,960	\$145,451	\$392,474	\$448,869	\$556,290	\$616,073
Net Loans	\$48,275	\$79,818	\$203,255	\$255,819	\$309,278	\$344,230
Deposits	\$68,720	\$123,653	\$342,118	\$396,576	\$502,829	\$559,476
Equity	\$21,946	\$21,667	\$46,590	\$49,208	\$50,794	\$52,886
Net Income	\$(811)	\$(323)	\$(307)	\$1,708	\$2,160	\$2,935
Loans to Assets	53%	55%	52%	57%	56%	56%
Loans to Deposits	70%	65%	59%	65%	62%	62%

The financial information above was derived from quarterly FFIEC Call Report filings to the Federal Reserve and is unaudited.

(Dollars in Thousands)

	2016	2015
<b>Assets</b>		
Cash and due from banks	\$ 18,550	\$ 25,741
Interest-bearing deposits in banks	12,809	8,741
Securities available for sale	194,981	169,469
Restricted investment securities	2,670	1,807
Loans - net of allowance for loan losses of \$3,788 (2,956 in 2015)	344,230	309,407
Premises and equipment - net	29,768	29,671
Accrued interest receivable	1,584	1,491
Intangible assets - net	2,939	3,147
Prepaid expenses and other assets	3,363	1,903
Cash surrender value of life insurance	5,180	5,043
<b>Total assets</b>	<b>616,074</b>	<b>556,420</b>
<b>Liabilities</b>		
Deposits:		
Noninterest-bearing	155,341	133,859
Interest-bearing	397,121	361,548
<b>Total deposits</b>	<b>552,462</b>	<b>495,407</b>
Federal Home Loan Bank borrowings	1,081	1,213
Accrued interest payable and other liabilities	3,313	1,607
<b>Total liabilities</b>	<b>556,856</b>	<b>498,227</b>
Commitments and contingencies (notes 7 and 13)		
<b>Stockholders' Equity</b>		
Common stock - \$1 par value; 20,000,000 shares authorized; 4,796,947 shares issued, 4,781,518 shares outstanding (4,796,947 shares outstanding in 2015)	4,797	4797
Surplus	53,212	53,091
Retained earnings	3,665	802
Treasury stock - 15,429 shares at cost	(309)	0
Accumulated other comprehensive income (loss)	(2,147)	(497)
<b>Total Stockholders' Equity</b>	<b>59,218</b>	<b>58,193</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 616,074</b>	<b>\$ 556,420</b>

(Dollars in Thousands)

	<b>2016</b>	2015
Interest income:		
Interest and fees on loans	\$ 19,100	\$ 16,978
Interest on investment securities	3,624	2,701
Interest on interest-bearing deposits in banks	157	132
	<hr/>	<hr/>
Total interest income	22,881	19,811
Interest expense	2,610	2,071
	<hr/>	<hr/>
Net interest income	20,271	17,740
Provision for loan losses	1,399	1,045
	<hr/>	<hr/>
Net interest income after provision for loan losses	18,872	16,695
	<hr/>	<hr/>
Noninterest income:		
Service charges and fees	2,063	1,809
Wealth management fees	2,316	1,977
Other	290	312
	<hr/>	<hr/>
	4,669	4,098
	<hr/>	<hr/>
Noninterest expenses:		
Salaries and employee benefits	11,400	11,075
Occupancy and equipment expenses	2,600	2,128
Other operating expenses	6,234	4,881
	<hr/>	<hr/>
Total noninterest expenses	20,234	18,084
	<hr/>	<hr/>
Income before federal income tax expense	3,307	2,709
Federal income tax expense	444	625
	<hr/>	<hr/>
Net income	\$ 2,863	\$ 2,084
	<hr/> <hr/>	<hr/> <hr/>



To the Board of Directors and Stockholders  
Texas State Bankshares, Inc. and Subsidiary

## **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Texas State Bankshares, Inc. and Subsidiary, which comprise the consolidated balance sheet as of December 31, 2016; the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended; and the related notes to the consolidated financial statements.

## **Management's Responsibility for the Financial Statements**

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 internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

## **Auditor's Responsibility**

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

An audit 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 entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

## **Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Texas State Bankshares, Inc. and Subsidiary as of December 31, 2016, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## **Other Matter**

The consolidated financial statements of Texas State Bankshares, Inc. and Subsidiary as of and for the year ended December 31, 2015, were audited by other auditors, whose report dated April 11, 2016, expressed an unmodified opinion on those statements.

*RSM US LLP*

Austin, Texas  
April 20, 2017

\*Audited financial statements available to Shareholders upon request.



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Texas State Bankshares, Inc. and Subsidiary  
Consolidated Annual Financial Report  
December 31, 2016 and 2015

To request a copy of report, please contact Adriana McElrath:  
[amcelrath@texasregionalbank.com](mailto:amcelrath@texasregionalbank.com) | 956-972-5421

## CORPORATE HEADQUARTERS

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In 2016, the Board of Directors announced plans to construct a new Texas Regional Bank Headquarters, several years ahead of schedule. Building a corporate headquarters anchored by a TRB retail bank has been a vision of the founders since the beginning. “Our goal was to be building a facility like this by 2020,” said Michael Scaief, Chairman.

Work on the four-story building is expected to commence in the summer of 2017. It will be part of the large commercial development now underway at Stuart Place Road and I-2/Expressway 83 in Harlingen.

Our strong growth is driving the need for more office space and an additional banking center in Harlingen. The building’s first floor will be devoted to a full-service bank with a drive-through. It also will feature a TRB Room, and Wealth Management and Mortgage offices. Offices on the second floor will house the TRB Marketing, Finance, and Credit departments, along with team members who provide essential services and redundancy for operating systems. The TRB Executive team will occupy the fourth floor.

We are excited to move forward on this major project. It represents yet another milestone for Texas Regional Bank.



**COMING SOON** 6770 W EXPRESSWAY 83, HARLINGEN, TEXAS

# NEW LOAN PRODUCTION OFFICES

Shortly after announcing the Blanco National Bank acquisition, we began looking at ways to further extend the TRB brand in the fast-growing area west of I-35 and north of I-10. Sticking with our business plan of recruiting seasoned bankers with strong community ties, we built teams to open new loan production offices in Lakeway (just west of Austin) and San Marcos.

Both locations are working closely to bring our style of relationship banking into these very competitive areas. The Lakeway team is lead by David DeStefano; the San Marcos team by Lance Spruiell. Both are influential leaders who have more than 25 years of banking experience.

We urge you to reach out to your personal and professional contacts in and around Lakeway and San Marcos and encourage them to give Texas Regional Bank an opportunity to earn their business.

## LAKEWAY TEAM



## SAN MARCOS TEAM



**Texas Economy Expands Broadly**

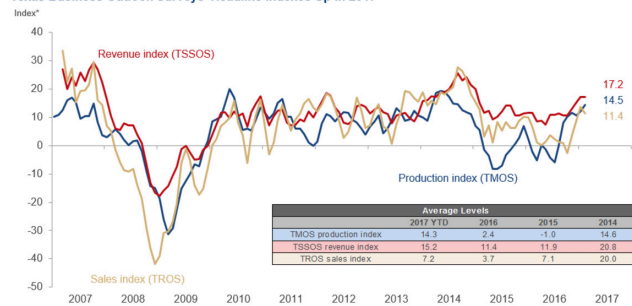
Economic growth continues to accelerate in Texas across sectors and metropolitan areas. Respondents to the Federal Reserve Bank of Dallas’ Texas Business Outlook Surveys (TBOS) indicate strengthening activity in 2017. Employment surged 4.9 percent in January.

The Dallas Fed’s 2017 Texas job growth forecast stands at 2.7 percent, higher than the state’s long-run 2.1 percent average and the 1.7 percent expansion in 2016. Downside risks for the state economy include an appreciating dollar, which makes exports more expensive, and potential new U.S. trade policies disrupting economic ties with Mexico.

**Economic Activity Exceeds Recent Levels**

TBOS headline indexes indicate robust expansion in February. The three-month moving averages of the three indexes are well above the average levels of the past two years (Chart 1). The Texas Service Sector Outlook Survey (TSSOS) revenue index remained elevated in February, and the Texas Retail Outlook Survey (TROS) sales index has remained positive since November 2016, suggesting upward momentum. The Texas Manufacturing Outlook Survey (TMOS) production index pushed higher in February to near 2014 levels, when manufacturing boomed with high oil prices and a thriving state economy.

**Chart 1**  
Texas Business Outlook Surveys’ Headline Indexes Up in 2017



\*Seasonally adjusted, three-month moving average. NOTE: The last data point is February 2017. SOURCES: Federal Reserve Bank of Dallas’ Texas Manufacturing Outlook Survey (TMOS), Texas Service Sector Outlook Survey (TSSOS) and Texas Retail Outlook Survey (TROS).

The Texas manufacturing sector’s return to growth, which began late last year, mirrors trends seen across the nation. Federal Reserve and Institute for Supply Management manufacturing surveys’ new orders indexes indicate a recent rebound following uneven performances in 2015 and 2016 (Chart 2).

**Chart 2**  
Other Surveys Show Strength in Manufacturing Across Nation

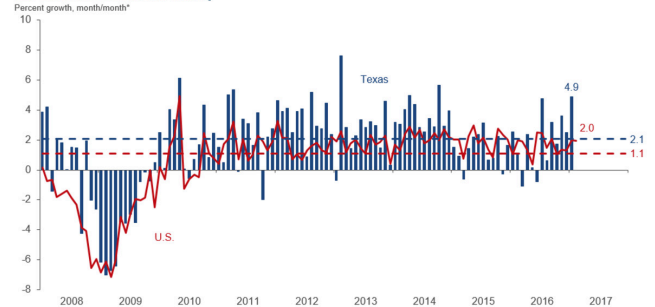


\*Seasonally adjusted, three-month moving average. NOTES: Average series include all Federal Reserve Bank surveys with new orders indexes. Data are through February 2017. SOURCES: Federal Reserve Bank of Dallas; Federal Reserve Bank of New York; Federal Reserve Bank of Kansas City; Federal Reserve Bank of Philadelphia; Federal Reserve Bank of Richmond; Institute for Supply Management.

**Year Begins with Broad-Based Employment Gains**

Texas’ annualized employment growth rate of 4.9 percent in January was the highest since October 2014 (Chart 3). The expansion was broad based, covering every sector except information. The goods sector’s recent rebound into positive territory—which began in fourth quarter 2016 after seven consecutive quarters of decline—reached an annualized 5.6 percent job growth rate in January. Oil and gas employment grew 9.0 percent in January but remained more than 30 percent below its pre-oil-bust peak. Service sector growth was led by professional and business services (8.0 percent), government (7.1 percent) and financial activities (5.9 percent).

**Chart 3**  
Job Growth Accelerates in January



\*Seasonally adjusted, annualized rate. NOTES: Data are through February 2017 for U.S. and January 2017 for Texas. Dotted lines represent the annual average growth rate from 1996 to 2016. SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

The January job expansion was also geographically broad based, with Texas’ major metros all improving. Gains were strongest in Dallas–Fort Worth and weakest in Houston.

Looking ahead, TBOS respondents expressed more optimism about hiring plans than they had in recent years. Forty-seven percent of TMOS and TSSOS respondents said they plan to increase employment in the next six to 12 months—8 percentage points more than a year ago. Manufacturers were particularly bullish, with 57 percent of firms expecting head-count additions this year. This share equals or exceeds figures in 2011, 2012 and 2014, when state manufacturing employment expanded well above a healthy 2.0 percent.

Recent headline unemployment rates of 4.8 percent in Texas and 4.7 percent in the U.S. are slightly below prerecession levels. However, a broader unemployment measure that includes discouraged, marginally attached and part-time workers seeking full-time work remains above prerecession levels in Texas and the U.S.

Average hourly wages ticked up 1.2 percent in Texas in January, exceeding the 2016 monthly trend rate of 0.2 percent. Additionally, some manufacturing and staffing services contacts reported instances of upward wage pressure in February.

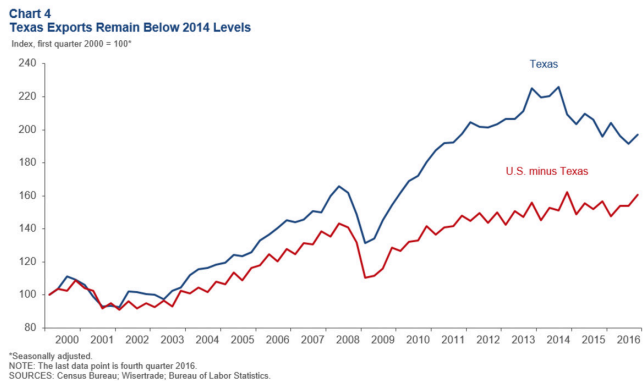


## Energy Production Expands Beyond Permian to Eagle Ford

While the Texas rig count began rising in mid-2016, the increases have been largely confined to the Permian Basin. Eagle Ford rig counts have increased monthly since November, with the largest jump occurring in February. Dallas Fed energy industry contacts indicate that growing oil production in the U.S. and heightened uncertainty cloud the outlook for oil prices. Additionally, even as the rig count rises in Texas, oil patch employment likely will not return to pre-bust levels because of higher operational efficiency and increased automation.

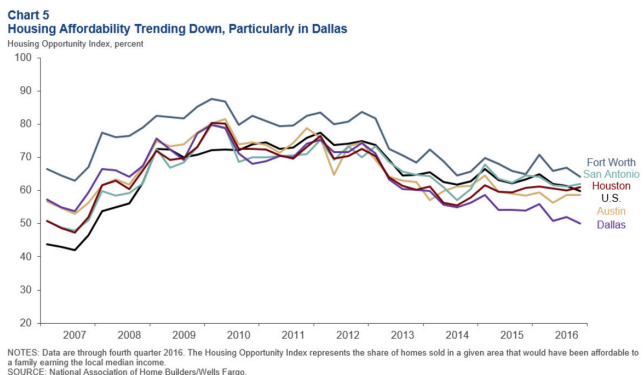
## Exports Increase, Remain Below 2014 Level

Texas exports rose 2.9 percent in the fourth quarter, finishing the year at a level similar to the end of 2015 but still well below 2014 levels (Chart 4)—before the value of the dollar began its dramatic rise. Monthly data show a 5.7 percent rise in exports in January. Exports to Mexico, Latin America and the European Union were largely unchanged from fourth quarter 2015. Exports to Asia surged 17.0 percent (including a sharp rise in exports to China), while exports to Canada declined 8.4 percent.



## Housing Affordability Slips, Construction Contract Values Fall

Housing affordability—the share of homes sold that were affordable to a median-income family in the area—has fallen in most major Texas metros (Chart 5). Houston is an exception, the result of the oil bust slowing home appreciation.

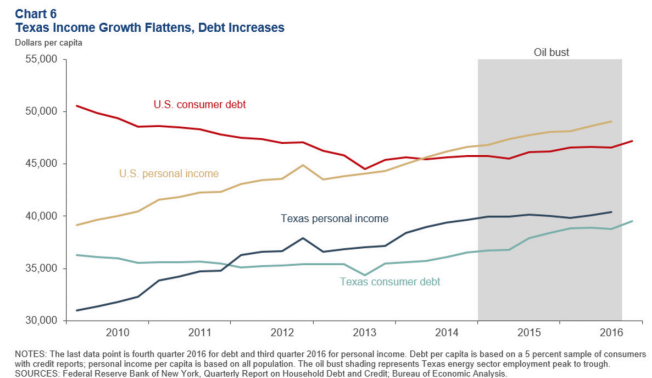


Apartment demand and occupancy rates generally remain high. Contacts expect rent growth to moderate this year. Austin and DFW office markets remain strong, and industrial availability is tight in most major metros. Again, Houston is an exception, experiencing apartment oversupply and a relatively weak office market.

Nominal Texas construction contract values (aggregated as five-month moving averages) fell 1.4 percent year over year in January but remained 1 percent above their five-year average.

## Household Debt-to-Income Ratio Increase Reflects Oil-Bust Impact

The debt-to-income ratio began rising in Texas in second quarter 2015, while it has trended lower nationally. Texas consumer debt has increased, driven largely by higher mortgage debt from a still-booming housing market—home sales and valuations are both rising faster than they are nationally (Chart 6). Also, high-wage energy and manufacturing jobs declined precipitously during the oil bust, damping income growth in Texas as income continued rising in the U.S.



Texas also has the highest auto loan balance of any state, accounting for 11.8 percent of U.S. auto loans in fourth quarter 2016. Additionally, 8.6 percent of Texas auto loans were 30 or more days past due (including severe derogatory), the seventh-highest percentage among the states. Dallas Fed contacts noted in January that, as a result of increased delinquencies, auto companies are easing away from the subprime market. This could affect auto sales, which have already weakened this year.



## About the Authors

Gullo and Abraham are research assistants and Kerr is a business economist in the Research Department at the Federal Reserve Bank of Dallas.



L to R: Michael Fallek, Bobby Farris, Bill Elliff, Tudor Uhlhorn, Michael Scaief, Brad Wolfe, Paul Moxley, Mark Richards, Carlos Varela

**OPERATIONS**

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Rolando Carrasco - Chief Compliance Officer  
 Dixie Hall - Operations  
 Ronda Johnson - Chief Information Officer

**Senior Vice President**

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 Jane Jansen - Compliance  
 Adalia Moreno - Human Resources Director  
 George Mukhar - Security & Central Operations Manager  
 Sylvia Shives - Regional Branch Manager

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 Sylvia Huerta - Merchant Services Sales Manager  
 Adriana McElrath - Corporate Administration  
 Ricardo Morales - Branch Administration

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 Ramona Covey - Bookkeeping Operations  
 Mary Espinoza - Electronic Banking Manager  
 Penny Lieck - Operations  
 Cindy Mancha - Banking Center Operations Manager  
 Nelda Rodriguez - Executive Assistant  
 Jackie Russell - Texas Freedom Club Director  
 Kay Smith - Branch Manager  
 Norma L. Trevino - Banking Center Operations Manager  
 Felicia Villarreal - Business Development

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 Kimberly Boren - Branch Manager  
 Rosalinda Castillo - Finance Accounting  
 Diana Garza - BSA  
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 Lori Lopez - Banking Center Operations Manager  
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 Melissa Seymour - Teller Operations  
 Yvette Vasquez - Banking Center Operations Manager

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 Corina S. Garcia - New Accounts Representative  
 Elizabeth M. Garcia - Teller Supervisor  
 Donna F. Martin - Teller Supervisor  
 Andy Roca - IT Officer  
 Kevin Schach - Teller Supervisor  
 Veronica Tarango - Teller Supervisor





L to R: Brent Baldree, Michael Scaief, Paul Moxley, Mark Ramirez, Michael Lamon

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Mark Tidwell - Blanco Market President

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Margie Karst - Loan Administration  
Paul Motes - Senior Credit Officer  
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Michele Robinson - Harlingen Market President  
Carlos A. Rodriguez - Brownsville Market President  
Lance Spruiell - San Marcos Market President  
Cesar Suarez - Mission Market President  
Lincoln Talbert - Weslaco Market President  
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Mario Ysaguirre - Loan Officer

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Rachelle Cisneros - Mortgage Services  
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Olivia Garza - Loan Officer  
Kimberley Gilbert - Loan Officer  
Sherry Hawkins - Loan Servicing  
Jason Hendrix - Loan Officer  
Michael Smith - Loan Officer  
Laura Villarreal - Loan Officer

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Nora L. Koite - Lending Assistant  
Jake Mann - Retail Lending  
Janie Martinez - Lending Assistant  
Tayde Miller - Lending Assistant  
Margarita Rebollar - Lending Assistant  
Annette Salinas - Loan Officer  
Joshua A Smith - Loan Officer  
Betty Yargo - Loan Servicing

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Nydia Bravo - Collateral Management Officer  
Olivia Contreras - Lending Assistant  
Danielle Horna - Lending Assistant  
Miriam Lozano - Lending Assistant



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