

WESTAMERICA BANCORPORATION

Form 10-Q

November 03, 2017

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the quarterly period ended September 30, 2017**

**or**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

**Commission file number: 001-09383**

**WESTAMERICA BANCORPORATION**

**(Exact Name of Registrant as Specified in Its Charter)**

**CALIFORNIA**

**94-2156203**

(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

**1108 FIFTH AVENUE, SAN RAFAEL, CALIFORNIA 94901**

(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code (707) 863-6000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer	(Do not check if a smaller reporting company)
Smaller reporting company	Emerging growth company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date:

Title of Class      Shares outstanding as of October 26, 2017

Common Stock, 26,345,570  
No Par Value

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## FORWARD-LOOKING STATEMENTS

This report on Form 10-Q contains forward-looking statements about Westamerica Bancorporation (the “Company”) for which it claims the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, expenses, future credit quality and performance, the appropriateness of the allowance for loan losses, loan growth or reduction, mitigation of risk in the Company’s loan and investment securities portfolios, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans, objectives and expectations of the Company or its management or board of directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes", "anticipates", "expects", “estimates”, "intends", "targeted", "projected", “forecast”, "continue", "remain", "will", "should", "may" and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

These forward-looking statements are based on Management’s current knowledge and belief and include information concerning the Company’s possible or assumed future financial condition and results of operations. A number of factors, some of which are beyond the Company’s ability to predict or control, could cause future results to differ materially from those contemplated. These factors include but are not limited to (1) the length and severity of difficulties in the global, national and California economies and the effects of government efforts to address those difficulties; (2) liquidity levels in capital markets; (3) fluctuations in asset prices including, but not limited to stocks, bonds, real estate, and commodities; (4) the effect of acquisitions and integration of acquired businesses; (5) economic uncertainty created by terrorist threats and attacks on the United States, the actions taken in response, and the uncertain effect of these events on the national and regional economies; (6) changes in the interest rate environment; (7) changes in the regulatory environment; (8) competitive pressure in the banking industry; (9) operational risks including a failure or breach in data processing or security systems or those of third party vendors and other service providers, including as a result of cyber attacks or fraud; (10) volatility of interest rate sensitive loans, deposits and investments; (11) asset/liability management risks and liquidity risks; (12) the effect of natural disasters, including earthquakes, fire, flood, drought, and other disasters, on the uninsured value of the Company’s assets and of loan collateral, the financial condition of debtors and issuers of investment securities, the economic conditions affecting the Company’s market place, and commodities and asset values; (13) changes in the securities markets and (14) the outcome of contingencies, such as legal proceedings. However, the reader should not consider the above-mentioned factors to be a complete set of all potential risks or uncertainties.

Forward-looking statements speak only as of the date they are made. The Company undertakes no obligation to update any forward-looking statements in this Report to reflect circumstances or events that occur after the date forward looking statements are made, except as may be required by law. The reader is directed to the Company's annual report on Form 10-K for the year ended December 31, 2016, for further discussion of factors which could affect the Company's business and cause actual results to differ materially from those expressed in any forward-looking statement made in this report.



**PART I - FINANCIAL INFORMATION****Item 1 Financial Statements**

## WESTAMERICA BANCORPORATION

## CONSOLIDATED BALANCE SHEETS

(unaudited)

	At September 30, 2017	At December 31, 2016
	(In thousands)	
Assets:		
Cash and due from banks	\$561,757	\$462,271
Investment securities available for sale	2,090,477	1,890,758
Investment securities held to maturity, with fair values of: \$1,208,279 at September 30, 2017 and \$1,340,741 at December 31, 2016	1,204,240	1,346,312
Loans	1,284,782	1,352,711
Allowance for loan losses	(23,628 )	(25,954 )
Loans, net of allowance for loan losses	1,261,154	1,326,757
Other real estate owned	1,426	3,095
Premises and equipment, net	35,507	36,566
Identifiable intangibles, net	4,605	6,927
Goodwill	121,673	121,673
Other assets	164,969	171,724
Total Assets	\$5,445,808	\$5,366,083
Liabilities:		
Noninterest-bearing deposits	\$2,128,342	\$2,089,443
Interest-bearing deposits	2,606,238	2,615,298
Total deposits	4,734,580	4,704,741
Short-term borrowed funds	66,337	59,078
Other liabilities	40,934	40,897
Total Liabilities	4,841,851	4,804,716
Contingencies (Note 10)		
Shareholders' Equity:		
Common stock (no par value), authorized - 150,000 shares Issued and outstanding: 26,319 at September 30, 2017 and 25,907 at December 31, 2016	425,655	404,606
Deferred compensation	1,533	1,533

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Accumulated other comprehensive loss	(3,433 )	(10,074 )
Retained earnings	180,202	165,302
Total Shareholders' Equity	603,957	561,367
Total Liabilities and Shareholders' Equity	\$5,445,808	\$5,366,083

See accompanying notes to unaudited consolidated financial statements.

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## WESTAMERICA BANCORPORATION

## CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

	For the Three Months Ended September 30,		For the Nine Months	
	2017	2016	2017	2016
	(In thousands, except per share data)			
<b>Interest and Loan Fee Income:</b>				
Loans	\$15,082	\$16,968	\$46,330	\$52,904
Investment securities available for sale	11,347	8,796	32,305	24,855
Investment securities held to maturity	6,716	7,704	20,997	23,083
<b>Total Interest and Loan Fee Income</b>	<b>33,145</b>	<b>33,468</b>	<b>99,632</b>	<b>100,842</b>
<b>Interest Expense:</b>				
Deposits	461	512	1,395	1,586
Short-term borrowed funds	12	11	34	30
<b>Total Interest Expense</b>	<b>473</b>	<b>523</b>	<b>1,429</b>	<b>1,616</b>
<b>Net Interest and Loan Fee Income</b>	<b>32,672</b>	<b>32,945</b>	<b>98,203</b>	<b>99,226</b>
Reversal of Provision for Loan Losses	-	(3,200)	(1,900)	(3,200)
<b>Net Interest and Loan Fee Income After Reversal of Provision for Loan Losses</b>	<b>32,672</b>	<b>36,145</b>	<b>100,103</b>	<b>102,426</b>
<b>Noninterest Income:</b>				
Service charges on deposit accounts	4,989	5,303	14,857	15,790
Merchant processing services	2,153	1,532	6,080	4,699
Debit card fees	1,784	1,587	4,851	4,724
Trust fees	718	686	2,136	2,004
ATM processing fees	684	600	1,914	1,860
Other service fees	652	671	1,964	1,951
Financial services commissions	148	118	484	411
Other noninterest income	1,420	1,101	4,042	3,590
<b>Total Noninterest Income</b>	<b>12,548</b>	<b>11,598</b>	<b>36,328</b>	<b>35,029</b>
<b>Noninterest Expense:</b>				
Salaries and related benefits	12,816	13,063	38,867	39,067
Occupancy	3,665	3,749	10,807	10,546
Outsourced data processing services	2,383	2,114	6,710	6,375
Furniture and equipment	1,242	1,211	3,764	3,611
Amortization of identifiable intangibles	760	867	2,322	2,642
Professional fees	512	1,693	1,533	3,183
Courier service	451	451	1,310	1,458
Other real estate owned	221	(206)	54	(487)
Other noninterest expense	2,064	3,146	7,758	10,780
<b>Total Noninterest Expense</b>	<b>24,114</b>	<b>26,088</b>	<b>73,125</b>	<b>77,175</b>
<b>Income Before Income Taxes</b>	<b>21,106</b>	<b>21,655</b>	<b>63,306</b>	<b>60,280</b>

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Provision for income taxes	6,089	6,027	17,441	15,880
Net Income	\$15,017	\$15,628	\$45,865	\$44,400
Average Common Shares Outstanding	26,309	25,641	26,260	25,558
Average Diluted Common Shares Outstanding	26,404	25,687	26,379	25,595
Per Common Share Data:				
Basic earnings	\$0.57	\$0.61	\$1.75	\$1.74
Diluted earnings	0.57	0.61	1.74	1.73
Dividends paid	0.39	0.39	1.17	1.17

See accompanying notes to unaudited consolidated financial statements.

## WESTAMERICA BANCORPORATION

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	For the Three Months Ended September 30,		For the Nine Months	
	2017	2016	2017	2016
	(In thousands)			
Net income	\$ 15,017	\$ 15,628	\$ 45,865	\$ 44,400
Other comprehensive income (loss):				
Changes in unrealized gains and losses on securities available for sale	4,179	(4,992 )	11,413	14,319
Deferred tax (expense) benefit	(1,757 )	2,099	(4,799 )	(6,020 )
Changes in unrealized gains and losses on securities available for sale, net of tax	2,422	(2,893 )	6,614	8,299
Post-retirement benefit transition obligation amortization	15	15	45	45
Deferred tax expense	(6 )	(6 )	(18 )	(18 )
Post-retirement benefit transition obligation amortization, net of tax	9	9	27	27
Total other comprehensive income (loss)	2,431	(2,884 )	6,641	8,326
Total comprehensive income	\$ 17,448	\$ 12,744	\$ 52,506	\$ 52,726

See accompanying notes to unaudited consolidated financial statements.

## WESTAMERICA BANCORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(unaudited)

	Common Shares Outstanding (In thousands)	Common Stock	Deferred Compensation	Accumulated Other Comprehensive Income (loss)	Retained Earnings	Total
Balance, December 31, 2015	25,528	\$378,858	\$ 2,578	\$ 675	\$150,094	\$532,205
Net income for the period					44,400	44,400
Other comprehensive income				8,326		8,326
Exercise of stock options	258	11,588				11,588
Tax benefit increase upon exercise and expiration of stock options		199				199
Restricted stock activity	15	1,798	(1,045 )			753
Stock based compensation		1,142				1,142
Stock awarded to employees	1	75				75
Retirement of common stock	(137 )	(2,059 )			(3,721 )	(5,780 )
Dividends					(29,912 )	(29,912 )
Balance, September 30, 2016	25,665	\$391,601	\$ 1,533	\$ 9,001	\$160,861	\$562,996
Balance, December 31, 2016	25,907	\$404,606	\$ 1,533	\$ (10,074 )	\$165,302	\$561,367
Net income for the period					45,865	45,865
Other comprehensive income				6,641		6,641
Exercise of stock options	403	18,988				18,988
Restricted stock activity	13	707				707
Stock based compensation		1,368				1,368
Stock awarded to employees	2	76				76
Retirement of common stock	(6 )	(90 )			(224 )	(314 )
Dividends					(30,741 )	(30,741 )
Balance, September 30, 2017	26,319	\$425,655	\$ 1,533	\$ (3,433 )	\$180,202	\$603,957

See accompanying notes to unaudited consolidated financial statements.

## WESTAMERICA BANCORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	For the Nine Months Ended September 30,	
	2017	2016
	(In thousands)	
Operating Activities:		
Net income	\$45,865	\$44,400
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,807	14,211
Reversal of provision for loan losses	(1,900 )	(3,200 )
Net amortization of deferred loan cost (fees)	34	(281 )
Decrease in interest income receivable	713	475
Life insurance premiums paid	(126 )	(126 )
Increase in other assets	(2,088 )	(627 )
Increase in income taxes payable	2,461	403
Decrease in net deferred tax asset	895	3,258
Tax benefit increase upon exercise and expiration of stock options	-	(199 )
Stock option compensation expense	1,368	1,142
Decrease in interest expense payable	(8 )	(19 )
(Decrease) increase in other liabilities	(1,142 )	143
Net writedown of premises and equipment	60	21
Net gain on sale of foreclosed assets	(72 )	(1,182 )
Writedown of foreclosed assets	219	759
Net Cash Provided by Operating Activities	65,086	59,178
Investing Activities:		
Net repayments of loans	69,319	171,573
Net (payments) receipts under FDIC <sup>(1)</sup> indemnification agreements	(63 )	3,180
Purchases of investment securities available for sale	(433,525)	(812,697)
Proceeds from sale/maturity/calls of securities available for sale	238,888	632,795
Purchases of investment securities held to maturity	-	(246,956)
Proceeds from maturity/calls of securities held to maturity	135,208	141,770
Purchases of premises and equipment	(1,980 )	(1,299 )
Net change in FRB <sup>(2)</sup> stock	1	-
Proceeds from sale of foreclosed assets	1,521	7,143
Net Cash Provided by (Used in) Investing Activities	9,369	(104,491)
Financing Activities:		
Net change in deposits	29,839	104,211
Net change in short-term borrowings	7,259	3,330
Exercise of stock options	18,988	11,588
Tax benefit increase upon exercise and expiration of stock options	-	199

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Retirement of common stock	(314 )	(5,780 )
Common stock dividends paid	(30,741 )	(29,912 )
Net Cash Provided by Financing Activities	25,031	83,636
Net Change In Cash and Due from Banks	99,486	38,323
Cash and Due from Banks at Beginning of Period	462,271	433,044
Cash and Due from Banks at End of Period	\$561,757	\$471,367

Supplemental Cash Flow Disclosures:

Supplemental disclosure of non cash activities:

Loan collateral transferred to other real estate owned	\$-	\$488
Securities purchases pending settlement	811	171

Supplemental disclosure of cash flow activities:

Interest paid for the period	1,437	1,635
Income tax payments for the period	14,657	14,032

See accompanying notes to unaudited consolidated financial statements.

(1) Federal Deposit Insurance Corporation ("FDIC")

(2) Federal Reserve Bank ("FRB")

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

### Note 1: Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission and follow general practices within the banking industry. The results of operations reflect interim adjustments, all of which are of a normal recurring nature and which, in the opinion of Management, are necessary for a fair presentation of the results for the interim periods presented. The interim results for the three and nine months ended September 30, 2017 are not necessarily indicative of the results expected for the full year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes as well as other information included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

### Note 2: Accounting Policies

The most significant accounting policies followed by the Company are presented in Note 1 to the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, Management has identified the allowance for loan losses accounting to be the accounting area requiring the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available. A discussion of the factors affecting accounting for the allowance for loan losses is included in the "Provision for Loan Losses," "Loan Portfolio Credit Risk" and "Allowance for Loan Losses" discussion below. Certain amounts in prior periods have been reclassified to conform to the current presentation.

Application of these principles requires the Company to make certain estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain accounting policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a

decline in the value of an asset not carried on the financial statements at fair value warrants an impairment writedown or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available.

#### Recently Adopted Accounting Standards

FASB Accounting Standards Update (ASU) 2016-09, *Improvements to Employee Share-Based Payment Accounting*, was issued March 30, 2016. The provisions of the new standard changes several aspects of the accounting for share-based payment award transactions, including: (1) Accounting and Cash Flow Classification for Excess Tax Benefits, (2) Forfeitures, and (3) Tax Withholding Requirements and Cash Flow Classification. The Company adopted the ASU provisions effective January 1, 2017, which has the potential to create volatility in the book tax provision at the time nonqualified stock options are exercised or expire. During the first nine months of 2017, 403 thousand shares were issued due to the exercise of nonqualified stock options resulting in a tax deduction exceeding related share based compensation by \$1.6 million. The first nine months of 2017 income tax provision was \$688 thousand lower than would have been under accounting standards prior to the adoption of ASU 2016-09. The Company elected to account for forfeitures as they occur.

#### Recently Issued Accounting Standards

FASB ASU 2014-09, *Revenue (Topic 606): Revenue from Contracts with Customers*, was issued May 2014. The ASU specifies a standardized approach for revenue recognition across industries and transactions. The scope of the ASU does not include revenue streams covered by other ASU topics; thus, Topic 606 does not apply to revenue related to financial instruments, guarantees and leases, such as the Company's net interest income.



Approximately 73% of our revenue, including all of our net interest income and a portion of our noninterest income, is out of scope of the guidance. The contracts that are in scope of the guidance are primarily related to service charges and fees on deposit accounts, merchant processing fees, trust fees and other service charges, commissions and fees. We have created an implementation team that is analyzing the individual contracts in scope to determine if our current accounting will change. This review is expected to be completed in the fourth quarter of 2017.

The Company will be required to adopt the ASU on January 1, 2018. The Company intends to adopt the accounting standard during the first quarter of 2018, as required. The Company has not yet selected a transition method. The Company's preliminary analysis suggests that the adoption of this accounting standard is not expected to have a material impact on the Company's consolidated financial statements.

FASB ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, was issued January 2016. The ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most notably, the ASU changes the income statement impact of equity investments held by the Company and the requirement for the Company to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

The Company will be required to adopt the ASU provisions on January 1, 2018, and for those equity securities with readily determinable fair values, the Company plans to elect the retrospective transition approach with a cumulative effect adjustment to the balance sheet and for those equity securities that do not have readily determinable fair values, the Company plans to elect the prospective transition approach. The adoption of this accounting standard on the Company's consolidated financial statements will be subject to the price volatility of the equity investments.

FASB ASU 2016-02, *Leases (Topic 842)*, was issued February 25, 2016. The provisions of the new standard require lessees to recognize most leases on-balance sheet, increasing reported assets and liabilities. Lessor accounting remains substantially similar to current U.S. GAAP.

The Company will be required to adopt the ASU provisions January 1, 2019, and plans to elect the modified retrospective transition approach. Management is evaluating the impact that the ASU will have on the Company's financial statements. As of December 31, 2016, the Company leased 61 of its operating facilities; the remaining minimum lease payments were \$20.8 million. The Company does not expect a material change in noninterest expenses upon adoption of the new standard.

FASB ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, was issued on June 16, 2016. The ASU significantly changes estimates for credit losses related to financial assets measured at amortized cost and certain other contracts. For estimating credit losses, the FASB is replacing the incurred loss model with the current expected credit loss (CECL) model, which will accelerate

recognition of credit losses. Additionally, credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses under the new standard. The Company will also be required to provide additional disclosures related to the financial assets within the scope of the new standard.

The Company will be required to adopt the ASU provisions on January 1, 2020. Management is evaluating the impact that the ASU will have on the Company's consolidated financial statements. The ultimate adjustment to the allowance for loan losses will be accomplished through an offsetting after-tax adjustment to shareholders' equity. Management expects the Company and the Bank to meet all regulatory capital adequacy requirements to which they are subject following adoption of the new standard. Economic conditions and the composition of the Company's loan portfolio at the time of adoption will influence the extent of the adopting accounting adjustment.

FASB ASU 2017-08, *Receivables – Non-Refundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*, was issued March 2017. The ASU will shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity.

The Company will be required to adopt the ASU provisions on January 1, 2019. Management is evaluating the impact the ASU will have on the Company's financial statements.

**Note 3: Investment Securities**

An analysis of the amortized cost, gross unrealized gains and losses accumulated in other comprehensive income, and fair value of the available for sale investment securities portfolio follows:

Investment Securities Available for Sale At September 30, 2017				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In thousands)				
Securities of U.S. Government sponsored entities	\$122,280	\$ 19	\$ (1,840 )	\$120,459
Agency residential mortgage-backed securities (MBS)	754,138	1,091	(16,011 )	739,218
Non-agency residential MBS	164	1	-	165
Agency commercial MBS	1,916	-	(14 )	1,902
Securities of U.S. Government entities	1,783	-	(14 )	1,769
Obligations of states and political subdivisions	176,182	4,929	(1,610 )	179,501
FHLMC <sup>(1)</sup> and FNMA <sup>(2)</sup> stock	749	8,811	-	9,560
Corporate securities	1,037,173	2,943	(4,027 )	1,036,089
Other securities	2,000	-	(186 )	1,814
Total	\$2,096,385	\$ 17,794	\$ (23,702 )	\$2,090,477

(1) Federal Home Loan Mortgage Corporation

(2) Federal National Mortgage Association

An analysis of the amortized cost, gross unrecognized gains and losses, and fair value of the held to maturity investment securities portfolio follows:

Investment Securities Held to Maturity At September 30, 2017				
	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
(In thousands)				
Agency residential MBS	\$574,017	\$ 949	\$ (6,802 )	\$568,164
Non-agency residential MBS	4,628	67	-	4,695

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Agency commercial MBS	9,114	1	(82	)	9,033
Obligations of states and political subdivisions	616,481	10,999	(1,093	)	626,387
Total	\$1,204,240	\$ 12,016	\$ (7,977	)	\$1,208,279

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An analysis of the amortized cost, gross unrealized gains and losses accumulated in other comprehensive income, and fair value of the available for sale investment securities portfolio follows:

Investment Securities Available for Sale				
At December 31, 2016				
	Amortized	Gross	Gross	
	Cost	Unrealized	Unrealized	
		Gains	Losses	
			Fair	
			Value	
(In thousands)				
Securities of U.S. Government sponsored entities	\$ 141,599	\$ 35	\$(2,974 )	\$ 138,660
Agency residential MBS	711,623	921	(21,045 )	691,499
Non-agency residential MBS	272	-	(1 )	271
Securities of U.S. Government entities	2,041	-	(16 )	2,025
Obligations of states and political subdivisions	182,230	5,107	(3,926 )	183,411
Asset-backed securities	696	-	(1 )	695
FHLMC <sup>(1)</sup> and FNMA <sup>(2)</sup> stock	749	10,120	-	10,869
Corporate securities	866,835	1,690	(7,668 )	860,857
Other securities	2,034	621	(184 )	2,471
Total	\$ 1,908,079	\$ 18,494	\$(35,815 )	\$ 1,890,758

<sup>(1)</sup> Federal Home Loan Mortgage Corporation

<sup>(2)</sup> Federal National Mortgage Association

An analysis of the amortized cost, gross unrecognized gains and losses, and fair value of the held to maturity investment securities portfolio follows:

Investment Securities Held to Maturity				
At December 31, 2016				
	Amortized	Gross	Gross	
	Cost	Unrecognized	Unrecognized	
		Gains	Losses	
			Fair	
			Value	
(In thousands)				
Securities of U.S. Government sponsored entities	\$ 581	\$ 1	\$ -	\$ 582
Agency residential MBS	668,235	1,122	(8,602 )	660,755
Non-agency residential MBS	5,370	76	-	5,446
Agency commercial MBS	9,332	11	(143 )	9,200
Obligations of states and political subdivisions	662,794	6,031	(4,067 )	664,758
Total	\$ 1,346,312	\$ 7,241	\$(12,812 )	\$ 1,340,741

The amortized cost and fair value of investment securities by contractual maturity are shown in the following tables at the dates indicated:

	At September 30, 2017			
	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Maturity in years:				
1 year or less	\$208,391	\$208,764	\$37,548	\$38,399
Over 1 to 5 years	861,895	860,966	278,240	281,577
Over 5 to 10 years	219,648	221,949	290,869	296,357
Over 10 years	45,701	44,370	9,824	10,054
Subtotal	1,335,635	1,336,049	616,481	626,387
MBS	758,001	743,054	587,759	581,892
Other securities	2,749	11,374	-	-
Total	\$2,096,385	\$2,090,477	\$1,204,240	\$1,208,279

	At December 31, 2016			
	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(In thousands)				
Maturity in years:				
1 year or less	\$154,693	\$154,835	\$14,961	\$15,639
Over 1 to 5 years	750,834	745,219	292,024	292,062
Over 5 to 10 years	238,077	239,153	318,580	319,587
Over 10 years	47,756	44,416	37,810	38,052
Subtotal	1,191,360	1,183,623	663,375	665,340
MBS	713,936	693,795	682,937	675,401
Other securities	2,783	13,340	-	-
Total	\$1,908,079	\$1,890,758	\$1,346,312	\$1,340,741

Expected maturities of mortgage-related securities can differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties. In addition, such factors as prepayments and interest rates may affect the yield on the carrying value of mortgage-related securities. At September 30, 2017 and December 31, 2016, the Company had no high-risk collateralized mortgage obligations as defined by regulatory guidelines.

An analysis of the gross unrealized losses of the available for sale investment securities portfolio follows:

	Investment Securities Available for Sale At September 30, 2017							
	No. of	Less than 12 months		No. of	12 months or longer		No. of	Total
	Investment Positions	Fair Value	Unrealized Losses	Investment Positions	Fair Value	Unrealized Losses	Investment Positions	Fair Value
(\$ in thousands)								
Securities of U.S. Government sponsored entities	6	\$89,046	\$(1,169)	2	\$29,328	\$(671)	8	\$118,374
Agency residential MBS	15	336,023	(8,283)	37	202,746	(7,728)	52	538,769
Non-agency residential MBS	1	6	-	-	-	-	1	6
Agency commercial MBS	1	1,902	(14)	-	-	-	1	1,902
Securities of U.S. Government entities	1	896	(6)	2	873	(8)	3	1,769
Obligations of states and political subdivisions	35	28,910	(592)	24	35,329	(1,018)	59	64,239
Corporate securities	36	299,545	(1,672)	26	166,386	(2,355)	62	465,931
Other securities	-	-	-	1	1,814	(186)	1	1,814
Total	95	\$756,328	\$(11,736)	92	\$436,476	\$(11,966)	187	\$1,192,804

An analysis of gross unrecognized losses of the held to maturity investment securities portfolio follows:

Investment Securities Held to Maturity									
At September 30, 2017									
	No. of Investment Positions	Less than 12 months Fair Value	Unrecognized Losses	No. of Investment Positions	12 months or longer Fair Value	Unrecognized Losses	No. of Investment Positions	Total Fair Value	Unrecognized Losses
	(\$ in thousands)								
Agency residential MBS	64	\$494,096	\$(6,320)	8	\$19,092	\$(482)	72	\$513,188	\$(6,802)
Agency commercial MBS	-	-	-	1	7,101	(82)	1	7,101	(82)
Obligations of states and political subdivisions	42	40,023	(417)	26	27,693	(676)	68	67,716	(1,093)
Total	106	\$534,119	\$(6,737)	35	\$53,886	\$(1,240)	141	\$588,005	\$(7,975)



The unrealized losses on the Company's investment securities were caused by market conditions for these types of investments, particularly changes in risk-free interest rates. The Company evaluates securities on a quarterly basis including changes in security ratings issued by rating agencies, changes in the financial condition of the issuer, and, for mortgage-backed and asset-backed securities, delinquency and loss information with respect to the underlying collateral, changes in the levels of subordination for the Company's particular position within the repayment structure and remaining credit enhancement as compared to expected credit losses of the security. Substantially all of these securities continue to be investment grade rated by a major rating agency. In addition to monitoring credit rating agency evaluations, Management performs its own evaluations regarding the credit worthiness of the issuer or the securitized assets underlying asset backed securities.

The Company does not intend to sell any investments and has concluded that it is more likely than not that it will not be required to sell the investments prior to recovery of the amortized cost basis. Therefore, the Company does not consider these investments to be other-than-temporarily impaired as of September 30, 2017.

The fair values of the investment securities could decline in the future if the general economy deteriorates, inflation increases, credit ratings decline, the issuer's financial condition deteriorates, or the liquidity for securities declines. As a result, other than temporary impairments may occur in the future.

As of September 30, 2017, \$771,257 thousand of investment securities were pledged to secure public deposits and short-term borrowed funds. As of December 31, 2016, \$768,845 thousand of investment securities were pledged to secure public deposits and short-term borrowed funds.

An analysis of gross unrealized losses of investment securities available for sale follows:

Investment Securities Available for Sale								
At December 31, 2016								
	No. of	Less than 12 months	No. of	12 months or longer	No. of	Total		
	Investment	Unrealized	Investment	Unrealized	Investment	Total		
	Positions	Losses	Positions	Losses	Positions	Total		
	(\$ in thousands)		(\$ in thousands)		(\$ in thousands)			
Securities of U.S. Government sponsored entities	8	\$ 117,227	0	\$-	8	\$ 117,227		
Agency residential MBS	21	524,269	28	(16,494)	49	647,170		
Non-agency residential MBS	2	246	0	(1)	2	246		
Securities of U.S. Government entities	2	1,253	1	(9)	3	2,025		
Obligations of states and political subdivisions	43	57,989	3	(3,905)	46	59,106		
Asset-backed securities	-	-	1	(1)	1	695		

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Corporate securities	53	385,175	(6,551 )	27	96,145	(1,117)	80	481,320
Other securities	-	-	-	1	1,816	(184 )	1	1,816
Total	129	\$1,086,159	\$(29,934)	61	\$223,446	\$(5,881)	190	\$1,309,600

An analysis of gross unrecognized losses of investment securities held to maturity follows:

Investment Securities Held to Maturity									
At December 31, 2016									
	No. of Investment Positions	Less than 12 months of Investment Fair Value	Unrecognized Losses	No. of Investment Positions	12 months or longer of Investment Fair Value	Unrecognized Losses	No. of Investment Positions	Total Investment Fair Value	Unrecognized Losses
(\$ in thousands)									
Agency residential MBS	66	\$569,876	\$(8,285 )	3	\$10,480	\$(317)	69	\$580,356	\$(8,602)
Agency commercial MBS	-	-	-	1	7,214	(143)	1	7,214	(143)
Obligations of states and political subdivisions	295	272,496	(3,710 )	12	13,126	(357)	307	285,622	(4,067)
Total	361	\$842,372	\$(11,995)	16	\$30,820	\$(817)	377	\$873,192	\$(12,812)

The following table provides information about the amount of interest income earned on investment securities which is fully taxable and which is exempt from regular federal income tax:

	For the Three Months Ended September 30,		For the Nine Months	
	2017	2016	2017	2016
	(In thousands)			
Taxable	\$12,957	\$11,024	\$37,584	\$31,256
Tax-exempt from regular federal income tax	5,106	5,476	15,718	16,682
Total interest income from investment securities	\$18,063	\$16,500	\$53,302	\$47,938

#### Note 4: Loans and Allowance for Loan Losses

A summary of the major categories of loans outstanding is shown in the following tables at the dates indicated.

	At September 30, 2017	At December 31, 2016
	(In thousands)	
Commercial	\$316,891	\$354,697
Commercial Real Estate	573,717	542,171
Construction	4,992	2,555
Residential Real Estate	69,124	87,724
Consumer Installment & Other	320,058	365,564
Total	\$1,284,782	\$1,352,711

Total loans outstanding reported above include loans purchased from the FDIC of \$90,708 thousand and \$121,210 thousand at September 30, 2017 and December 31, 2016, respectively. Loans purchased from the FDIC were separately reported in prior periods and have been reclassified into their respective categories in the current presentation.

Changes in the accretable yield for purchased loans were as follows:

	For the Nine Months Ended September 30, 2017	For the Year Ended December 31, 2016	
Accretable yield:	(In thousands)		
Balance at the beginning of the period	\$ 1,237	\$ 1,259	
Reclassification from nonaccretable difference	1,504	3,912	
Accretion	(1,862 )	(3,934 )	)
Balance at the end of the period	\$ 879	\$ 1,237	
Accretion	\$(1,862 )	\$(3,934 )	)
Change in FDIC indemnification	192	1,053	
(Increase) in interest income	\$(1,670 )	\$(2,881 )	)

The following summarizes activity in the allowance for loan losses:

	Allowance for Loan Losses						Unallocated	Total
	For the Three Months Ended September 30, 2017							
	Commercial Real Estate	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other			
Allowance for loan losses:	(In thousands)							
Balance at beginning of period	\$8,167	\$ 3,545	\$ 160	\$ 1,105	\$ 7,215	\$ 3,911	\$24,103	
Additions:								
(Reversal) provision	(391 )	288	136	(50 )	167	(150 )	-	
Deductions:								
Chargeoffs	(132 )	-	-	-	(886 )	-	(1,018 )	
Recoveries	128	-	-	-	415	-	543	
Net loan losses	(4 )	-	-	-	(471 )	-	(475 )	
Total allowance for loan losses	\$7,772	\$ 3,833	\$ 296	\$ 1,055	\$ 6,911	\$ 3,761	\$23,628	

Allowance for Loan Losses  
For the Nine Months Ended September 30, 2017

	Commercial		Construction	Residential	Consumer	Unallocated	Total
	Commercial	Real Estate		Real Estate	Installment		
	Commercial	Real Estate	Construction	Real Estate	and Other	Unallocated	Total
(In thousands)							
Allowance for loan losses:							
Balance at beginning of period	\$8,327	\$ 3,330	\$ 152	\$ 1,330	\$ 7,980	\$ 4,835	\$25,954
Additions:							
(Reversal) provision	(220 )	415	(1,755 )	(275 )	1,009	(1,074 )	(1,900 )
Deductions:							
Chargeoffs	(961 )	-	-	-	(3,783 )	-	(4,744 )
Recoveries	626	88	1,899	-	1,705	-	4,318
Net loan (losses) recoveries	(335 )	88	1,899	-	(2,078 )	-	(426 )
Total allowance for loan losses	\$7,772	\$ 3,833	\$ 296	\$ 1,055	\$ 6,911	\$ 3,761	\$23,628

Allowance for Loan Losses  
For the Three Months Ended September 30, 2016

	Commercial		Construction	Residential	Consumer	Unallocated	Total
	Commercial	Real Estate		Real Estate	Installment		
	Commercial	Real Estate	Construction	Real Estate	and Other	Unallocated	Total
(In thousands)							
Allowance for loan losses:							
Balance at beginning of period	\$10,402	\$ 3,912	\$ 167	\$ 1,636	\$ 7,651	\$ 5,142	\$28,910
Additions:							
(Reversal) provision	(3,642 )	(822 )	(22 )	(193 )	1,777	(298 )	(3,200 )
Deductions:							
Chargeoffs	(88 )	-	-	-	(1,848 )	-	(1,936 )
Recoveries	1,739	509	-	-	337	-	2,585
Net loan recoveries (losses)	1,651	509	-	-	(1,511 )	-	649
Total allowance for loan losses	\$8,411	\$ 3,599	\$ 145	\$ 1,443	\$ 7,917	\$ 4,844	\$26,359

Allowance for Loan Losses  
For the Nine Months Ended September 30, 2016

	Commercial		Construction	Residential	Consumer	Unallocated	Total
	Commercial	Real Estate		Real Estate	Installment		
	Commercial	Real Estate	Construction	Real Estate	and Other	Unallocated	Total
(In thousands)							
Allowance for loan losses:							

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Allowance for loan losses:							
Balance at beginning of period	\$9,559	\$ 4,212	\$ 235	\$ 1,801	\$ 8,001	\$ 5,963	\$29,771
Additions:							
(Reversal) provision	(2,827)	(1,152 )	(90 )	(358 )	2,346	(1,119 )	(3,200 )
Deductions:							
Chargeoffs	(2,024)	-	-	-	(3,568 )	-	(5,592 )
Recoveries	3,703	539	-	-	1,138	-	5,380
Net loan recoveries (losses)	1,679	539	-	-	(2,430 )	-	(212 )
Total allowance for loan losses	\$8,411	\$ 3,599	\$ 145	\$ 1,443	\$ 7,917	\$ 4,844	\$26,359

The allowance for loan losses and recorded investment in loans evaluated for impairment were as follows:

Allowance for Loan Losses and Recorded Investment in Loans Evaluated for Impairment							
At September 30, 2017							
	Commercial	Residential	Consumer				
	Commercial	Real	Construction	Real	Installment	Unallocated	Total
	Estate	Estate		Estate	and Other		
(In thousands)							
Allowance for loan losses:							
Individually evaluated for impairment	\$4,922	\$154	\$-	\$-	\$-	\$-	\$5,076
Collectively evaluated for impairment	2,850	3,679	296	1,055	6,911	3,761	18,552
Purchased loans with evidence of credit deterioration	-	-	-	-	-	-	-
Total	\$7,772	\$3,833	\$296	\$1,055	\$6,911	\$3,761	\$23,628
Carrying value of loans:							
Individually evaluated for impairment	\$10,749	\$13,973	\$-	\$211	\$-	\$-	\$24,933
Collectively evaluated for impairment	306,113	559,182	4,992	68,913	319,889	-	1,259,089
Purchased loans with evidence of credit deterioration	29	562	-	-	169	-	760
Total	\$316,891	\$573,717	\$4,992	\$69,124	\$320,058	\$-	\$1,284,782

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Allowance for Loan Losses and Recorded Investment in Loans Evaluated for Impairment

At December 31, 2016

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Unallocated	Total
	(In thousands)						
Allowance for loan losses:							
Individually evaluated for impairment	\$5,048	\$-	\$-	\$-	\$-	\$-	\$5,048
Collectively evaluated for impairment	3,279	3,330	152	1,330	7,980	4,835	20,906
Purchased loans with evidence of credit deterioration	-	-	-	-	-	-	-
Total	\$8,327	\$3,330	\$152	\$1,330	\$7,980	\$4,835	\$25,954
Carrying value of loans:							
Individually evaluated for impairment	\$11,174	\$12,706	\$-	\$835	\$-	\$-	\$24,715
Collectively evaluated for impairment	343,494	528,957	2,555	86,889	365,236	-	1,327,131
Purchased loans with evidence of credit deterioration	29	508	-	-	328	-	865
Total	\$354,697	\$542,171	\$2,555	\$87,724	\$365,564	\$-	\$1,352,711

The Bank's customers are small businesses, professionals and consumers. Given the scale of these borrowers, corporate credit rating agencies do not evaluate the borrowers' financial condition. The Bank maintains a Loan Review Department which reports directly to the Board of Directors. The Loan Review Department performs independent evaluations of loans and assigns credit risk grades to evaluated loans using grading standards employed by bank regulatory agencies. Loans judged to carry lower-risk attributes are assigned a "pass" grade, with a minimal likelihood of loss. Loans judged to carry higher-risk attributes are referred to as "classified loans," and are further disaggregated, with increasing expectations for loss recognition, as "substandard," "doubtful," and "loss." Loan Review Department evaluations occur every calendar quarter. If the Bank becomes aware of deterioration in a borrower's performance or financial condition between Loan Review Department examinations, assigned risk grades are re-evaluated promptly. Credit risk grades assigned by the Loan Review Department are subject to review by the Bank's regulatory authorities during regulatory examinations.

The following summarizes the credit risk profile by internally assigned grade:

Credit Risk Profile by Internally Assigned Grade  
At September 30, 2017

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	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Total
(In thousands)						
Grade:						
Pass	\$304,710	\$551,222	\$4,992	\$66,164	\$317,933	\$1,245,021
Substandard	12,181	22,495	-	2,960	1,603	39,239
Doubtful	-	-	-	-	6	6
Loss	-	-	-	-	516	516
Total	\$316,891	\$573,717	\$4,992	\$69,124	\$320,058	\$1,284,782

Credit risk profile reflects internally assigned grade of purchased covered loans without regard to FDIC indemnification.

Credit Risk Profile by Internally Assigned Grade  
At December 31, 2016

	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Total
(In thousands)						
Grade:						
Pass	\$340,973	\$515,045	\$2,555	\$84,384	\$362,597	\$1,305,554
Substandard	13,724	25,830	-	3,340	2,477	45,371
Doubtful	-	1,296	-	-	10	1,306
Loss	-	-	-	-	480	480
Total	\$354,697	\$542,171	\$2,555	\$87,724	\$365,564	\$1,352,711

Credit risk profile reflects internally assigned grade of purchased covered loans without regard to FDIC indemnification.

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The following tables summarize loans by delinquency and nonaccrual status:

Summary of Loans by Delinquency and Nonaccrual Status  
At September 30, 2017

	Current and Accruing	30-59 Days Past Due and Accruing	60-89 Days Past Due and Accruing	Past Due 90 Days or More and Accruing	Nonaccrual	Total Loans
(In thousands)						
Commercial	\$316,150	\$ 404	\$ 66	\$ -	\$ 271	\$316,891
Commercial real estate	565,377	2,820	8	-	5,512	573,717
Construction	4,992	-	-	-	-	4,992
Residential real estate	69,124	-	-	-	-	69,124
Consumer installment and other	315,520	3,351	753	434	-	320,058
Total	\$1,271,163	\$ 6,575	\$ 827	\$ 434	\$ 5,783	\$1,284,782

Summary of Loans by Delinquency and Nonaccrual Status  
At December 31, 2016

	Current and Accruing	30-59 Days Past Due and Accruing	60-89 Days Past Due and Accruing	Past Due 90 Days or More and Accruing	Nonaccrual	Total Loans
(In thousands)						
Commercial	\$353,497	\$ 966	\$ 40	\$ -	\$ 194	\$354,697
Commercial real estate	533,377	1,460	445	-	6,889	542,171
Construction	2,329	226	-	-	-	2,555
Residential real estate	86,098	528	37	-	1,061	87,724
Consumer installment and other	360,549	3,288	989	497	241	365,564
Total	\$1,335,850	\$ 6,468	\$ 1,511	\$ 497	\$ 8,385	\$1,352,711

There were no commitments to lend additional funds to borrowers whose loans were on nonaccrual status at September 30, 2017 and December 31, 2016.

The following summarizes impaired loans:

	Impaired Loans At September 30, 2017			Impaired Loans At December 31, 2016		
	Unpaid Recorded Investmen Balance (In thousands)	Principal Balance	Related Allowance	Unpaid Recorded Investmen Balance (In thousands)	Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial	\$1,246	\$1,308	\$ -	\$1,234	\$1,303	\$ -
Commercial real estate	12,726	14,817	-	13,233	15,610	-
Residential real estate	211	241	-	1,279	1,309	-
Consumer installment and other	169	276	-	569	675	-
Total with no related allowance recorded	14,352	16,642	-	16,315	18,897	-
With an allowance recorded:						
Commercial	9,803	9,803	4,922	10,163	10,172	5,048
Commercial real estate	1,809	1,811	154	-	-	-
Total with an allowance recorded	11,612	11,614	5,076	10,163	10,172	5,048
Total	\$25,964	\$28,256	\$ 5,076	\$26,478	\$29,069	\$ 5,048

Impaired loans include troubled debt restructured loans. Impaired loans at September 30, 2017, included \$12,365 thousand of restructured loans, \$5,044 thousand of which were on nonaccrual status. Impaired loans at December 31, 2016, included \$12,381 thousand of restructured loans, \$5,302 thousand of which were on nonaccrual status.

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	Impaired Loans				For the Nine Months Ended September 30,			
	For the Three Months Ended September 30, 2017		2016		2017		2016	
	Average Recorded Investment	Recognized Interest Income	Average Recorded Investment	Recognized Interest Income	Average Recorded Investment	Recognized Interest Income	Average Recorded Investment	Recognized Interest Income
	(In thousands)							
Commercial	\$11,125	\$ 130	\$12,858	\$ 126	\$11,203	\$ 366	\$13,454	\$ 394
Commercial real estate	14,681	208	14,486	188	14,826	669	17,991	549
Construction	-	-	-	-	-	-	136	-
Residential real estate	365	4	530	4	494	13	693	13
Consumer installment and other	340	3	545	6	466	17	435	18
Total	\$26,511	\$ 345	\$28,419	\$ 324	\$26,989	\$ 1,065	\$32,709	\$ 974

The following table provides information on troubled debt restructurings:

Troubled Debt Restructurings At September 30, 2017				
	Number of	Pre-Modification	Period-End	Period-End Individual
	Continuing	Carrying Value	Carrying Value	Impairment Allowance
	(\$ in thousands)			
Commercial	7	\$ 2,393	\$ 1,140	\$ 49
Commercial real estate	11	11,847	11,014	-
Residential real estate	1	241	211	-
Total	19	\$ 14,481	\$ 12,365	\$ 49

Troubled Debt Restructurings At December 31, 2016				
	Number of	Pre-Modification	Period-End	Period-End Individual
	Continuing	Carrying Value	Carrying Value	Impairment Allowance

	(\$ in thousands)			
Commercial	7	\$ 2,719	\$ 1,489	\$ 113
Commercial real estate	10	11,257	10,673	-
Residential real estate	1	241	219	-
Total	18	\$ 14,217	\$ 12,381	\$ 113

During the three and nine months ended September 30, 2017, the Company modified one loan with a carrying value of \$50 thousand and four loans with a carrying value of \$699 thousand, respectively, that were considered troubled debt restructurings. The four concessions granted in the first nine months of 2017 consisted of modifications of payment terms to extend the maturity date to allow for deferred principal repayment and under-market terms. During the three and nine months ended September 30, 2016, the Company modified zero loans and four loans with a total carrying value of \$4,843 thousand, respectively, that were considered troubled debt restructurings. The concessions granted in the four restructurings completed in the first nine months of 2016 consisted of three modifications of payment terms to extend the maturity date to allow for deferred principal repayment and under-market terms and one court order requiring under-market terms. During the three and nine months ended September 30, 2017, one troubled debt restructured loan with a carrying value of \$58 thousand was charged off. There were no chargeoffs related to troubled debt restructurings made during the three and nine months ended September 30, 2016. During the three and nine months ended September 30, 2017 and 2016, no troubled debt restructured loans defaulted within 12 months of the modification date. A troubled debt restructuring is considered to be in default when payments are ninety days or more past due.

There were no loans restricted due to collateral requirements at September 30, 2017 and December 31, 2016.

There were no loans held for sale at September 30, 2017 and December 31, 2016.

At September 30, 2017 and December 31, 2016, the Company held total other real estate owned (OREO) of \$1,426 thousand net of reserve of \$1,905 thousand and \$3,095 thousand net of reserve of \$1,816 thousand, respectively, of which \$-0- thousand was foreclosed residential real estate properties or covered OREO at both dates. There were no consumer mortgage loans outstanding secured by residential real estate properties for which formal foreclosure proceedings were in process at September 30, 2017 and December 31, 2016.

**Note 5: Concentration of Credit Risk**

Under the California Financial Code, credit extended to any one person owing to a commercial bank at any one time shall not exceed the following limitations: (a) unsecured loans shall not exceed 15 percent of the sum of the shareholders' equity, allowance for loan losses, capital notes, and debentures of the bank, or (b) secured and unsecured loans in all shall not exceed 25 percent of the sum of the shareholders' equity, allowance for loan losses, capital notes, and debentures of the bank. At September 30, 2017, Westamerica Bank did not have credit extended to any one entity exceeding these limits. At September 30, 2017, Westamerica Bank had 38 lending relationships each with aggregate loans exceeding \$5 million. The Company has significant credit arrangements that are secured by real estate collateral. In addition to real estate loans outstanding as disclosed in Note 4, the Company had loan commitments related to real estate loans of \$58,046 thousand and \$57,721 thousand at September 30, 2017 and December 31, 2016, respectively. The Company requires collateral on all real estate loans with loan-to-value ratios at origination generally no greater than 75% on commercial real estate loans and no greater than 80% on residential real estate loans. At September 30, 2017, Westamerica Bank held corporate bonds in 66 issuing entities that exceeded \$5 million for each issuer.

**Note 6: Other Assets**

Other assets consisted of the following:

	At	
	September 30, 2017	At December 31, 2016
	(In thousands)	
Cost method equity investments:		
Federal Reserve Bank stock <sup>(1)</sup>	\$ 14,068	\$ 14,069
Other investments	159	201
Total cost method equity investments	14,227	14,270
Life insurance cash surrender value	53,459	51,535
Net deferred tax asset	49,514	55,417
Limited partnership investments	11,241	12,591
Interest receivable	20,776	21,489
Prepaid assets	3,969	4,825
Other assets	11,783	11,597
Total other assets	\$ 164,969	\$ 171,724

(1) A bank applying for membership in the Federal Reserve System is required to subscribe to stock in the Federal Reserve Bank (FRB) in its district in a sum equal to six percent of the bank's paid-up capital stock and surplus. One-half of the amount of the bank's subscription shall be paid to the FRB and the remaining half will be subject to call when deemed necessary by the Board of Governors of the Federal Reserve System.

The Company invests in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for low-income housing tax credits. At September 30, 2017, this investment totaled \$11,241 thousand and \$2,299 thousand of this amount represents outstanding equity capital commitments that are included in other liabilities. At December 31, 2016, this investment totaled \$12,591 thousand and \$2,299 thousand of this amount represented outstanding equity capital commitments. At September 30, 2017, the \$2,299 thousand of outstanding equity capital commitments are expected to be paid as follows, \$722 thousand in 2020, \$131 thousand in 2023, \$90 thousand in 2024 and \$1,356 thousand in 2025 or thereafter.

The amounts recognized in net income for these investments include:

	For the Three Months Ended September 30, 2017 2016		For the Nine Months Ended 2017 2016	
	(In thousands)			
Investment loss included in pre-tax income	\$450	\$675	\$1,350	\$2,025
Tax credits recognized in provision for income taxes	463	562	1,388	1,723

**Note 7: Goodwill and Identifiable Intangible Assets**

The Company has recorded goodwill and other identifiable intangibles associated with purchase business combinations. Goodwill is not amortized, but is evaluated for impairment at least annually. The Company did not recognize impairment during the three and nine months ended September 30, 2017 and year ended December 31, 2016. Identifiable intangibles are amortized to their estimated residual values over their expected useful lives. Such lives and residual values are also periodically reassessed to determine if any amortization period adjustments are indicated. During the three and nine months ended September 30, 2017 and year ended December 31, 2016, no such adjustments were recorded.

The carrying values of goodwill were:

	At	
	September 30, 2017	At December 31, 2016
	(In thousands)	
Goodwill	\$ 121,673	\$ 121,673

The gross carrying amount of identifiable intangible assets and accumulated amortization was:

	At September 30, 2017		At December 31, 2016	
	Gross	Accumulated	Gross	Accumulated
	Carrying	Amortization	Carrying	Amortization
	Amount	Amount	Amount	Amount
	(In thousands)			
Core Deposit Intangibles	\$56,808	\$ (52,271 )	\$56,808	\$ (50,074 )
Merchant Draft Processing Intangible	10,300	(10,232 )	10,300	(10,107 )
Total Identifiable Intangible Assets	\$67,108	\$ (62,503 )	\$67,108	\$ (60,181 )

As of September 30, 2017, the current period and estimated future amortization expense for identifiable intangible assets was:

	Core Deposit Intangible	Merchant Draft Processing Intangible	Total
	(In thousands)		
For the Nine Months ended September 30, 2017 (actual)	\$2,197	\$ 125	\$2,322
Estimate for the remainder of year ending December 31, 2017	716	39	755
Estimate for year ending December 31, 2018	1,892	29	1,921
2019	538	-	538
2020	287	-	287
2021	269	-	269
2022	252	-	252

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**Note 8: Deposits and Borrowed Funds**

The following table provides additional detail regarding deposits.

	Deposits	
	At	
	September 30, 2017	At December 31, 2016
	(In thousands)	
Noninterest-bearing	\$2,128,342	\$ 2,089,443
Interest-bearing:		
Transaction	873,145	865,701
Savings	1,491,168	1,493,427
Time deposits less than \$100 thousand	124,252	133,712
Time deposits \$100 thousand through \$250 thousand	79,614	84,925
Time deposits more than \$250 thousand	38,059	37,533
Total deposits	\$4,734,580	\$ 4,704,741

Demand deposit overdrafts of \$1,179 thousand and \$2,679 thousand were included as loan balances at September 30, 2017 and December 31, 2016, respectively. Interest expense for aggregate time deposits with individual account balances in excess of \$100 thousand was \$103 thousand and \$314 thousand for the three and nine months ended September 30, 2017, respectively and \$124 thousand and \$395 thousand for the three and nine months ended September 30, 2016, respectively.

The following table provides additional detail regarding short-term borrowed funds.

	Repurchase Agreements (Sweep)	
	Accounted for as Secured Borrowings	
	Remaining Contractual Maturity of the Agreements	
	Overnight and Continuous	
	At September 30, 2017	At December 31, 2016
	(In thousands)	
Repurchase agreements:		
Collateral securing borrowings:		
Securities of U.S. Government sponsored entities	\$ 74,852	\$ 74,031
Agency residential MBS	60,023	63,277
Corporate securities	105,698	90,554
Total collateral carrying value	\$ 240,573	\$ 227,862

Total short-term borrowed funds	\$ 66,337	\$ 59,078
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**Note 9: Fair Value Measurements**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Available for sale investment securities are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as other real estate owned, impaired loans, certain loans held for investment, investment securities held to maturity, and other assets. These nonrecurring fair value adjustments typically involve the lower-of-cost or fair-value accounting of individual assets.

In accordance with the Fair Value Measurement and Disclosure topic of the Codification, the Company bases its fair values on the price that would be received to sell an asset or paid to transfer a liability in the principal market or most advantageous market for an asset or liability in an orderly transaction between market participants on the measurement date under current market conditions. A fair value measurement reflects all of the assumptions that market participants would use in pricing the asset or liability, including assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset, and the risk of nonperformance.

The Company groups its assets and liabilities measured at fair value into a three-level hierarchy, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. When the valuation assumptions used to measure the fair value of the asset or liability are categorized within different levels of the fair value hierarchy, the asset or liability is categorized in its entirety within the lowest level of the hierarchy. These levels are:

Level 1 – Valuation is based upon quoted prices for identical instruments traded in active exchange markets, such as the New York Stock Exchange. Level 1 includes U.S. Treasury and equity securities, which are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. Level 2 includes federal agency securities, mortgage-backed securities, corporate securities, asset-backed securities, and municipal bonds.

Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company’s estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The Company relies on independent vendor pricing services to measure fair value for investment securities available for sale and investment securities held to maturity. The Company employs three pricing services. To validate the pricing of these vendors, the Company compares vendors’ pricing for each of the securities for consistency; significant pricing differences, if any, are evaluated using all available independent quotes with the quote closely affecting the market generally used as the fair value estimate. In addition, the Company conducts “other than temporary impairment (OTTI)” analysis on a quarterly basis; securities selected for OTTI analysis include all securities at a market price below 95 percent of par value. As with any valuation technique used to estimate fair value, changes in underlying assumptions used could significantly affect the results of current and future values. Accordingly, these fair value estimates may not be realized in an actual sale of the securities.

The Company regularly reviews the valuation techniques and assumptions used by its vendors and determines which valuation techniques are utilized based on observable market inputs for the type of securities being measured. The Company uses the information to determine the placement in the fair value hierarchy as level 1, 2 or 3. When the Company changes its valuation assumptions for measuring financial assets and financial liabilities at fair value, either due to changes in current market conditions or other factors, or reevaluates the valuation techniques and assumptions used by its vendors, it may need to transfer those assets or liabilities to another level in the hierarchy based on the new information. The Company recognizes these transfers at the end of the reporting period that the transfers occur. For the nine months ended September 30, 2017 and year ended December 31, 2016, there were no transfers in or out of levels 1, 2 or 3.

#### **Assets Recorded at Fair Value on a Recurring Basis**

The tables below present assets measured at fair value on a recurring basis on the dates indicated.

At September 30, 2017  
Fair Value

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Quoted Prices in Active Markets for Identical Assets (Level 1) Significant Other Observable Inputs (Level 2) Significant Unobservable Inputs (Level 3)

	(In thousands)			
Securities of U.S. Government sponsored entities	\$ 120,459	\$ -	\$ 120,459	\$ -
Agency residential MBS	739,218	-	739,218	-
Non-agency residential MBS	165	-	165	-
Agency commercial MBS	1,902	-	1,902	-
Securities of U.S. Government entities	1,769	-	1,769	-
Obligations of states and political subdivisions	179,501	-	179,501	-
FHLMC and FNMA stock	9,560	13	9,547	-
Corporate securities	1,036,089	-	1,036,089	-
Other securities	1,814	-	1,814	-
Total securities available for sale	\$ 2,090,477	\$ 13	\$ 2,090,464	\$ -

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	At December 31, 2016			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)			
Securities of U.S. Government sponsored entities	\$ 138,660	\$ -	\$ 138,660	\$ -
Agency residential MBS	691,499	-	691,499	-
Non-agency residential MBS	271	-	271	-
Securities of U.S. Government entities	2,025	-	2,025	-
Obligations of states and political subdivisions	183,411	-	183,411	-
Asset-backed securities	695	-	695	-
FHLMC and FNMA stock	10,869	17	10,852	-
Corporate securities	860,857	-	860,857	-
Other securities	2,471	656	1,815	-
Total securities available for sale	\$ 1,890,758	\$ 673	\$ 1,890,085	\$ -

### Assets Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost or fair-value accounting of individual assets. For assets measured at fair value on a nonrecurring basis that were recorded in the balance sheet at September 30, 2017 and December 31, 2016, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at period end.

	At September 30, 2017			For the Nine Months Ended September 30, 2017
Carrying Value	Level 1	Level 2	Level 3	Total Losses

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	(In thousands)				
Other real estate owned	\$1,426	\$ -	\$ -	\$1,426	\$ (219 )
Impaired loans	10,821	-	-	10,821	-
Total assets measured at fair value on a nonrecurring basis	\$12,247	\$ -	\$ -	\$12,247	\$ (219 )

	At December 31, 2016				For the Year Ended December 31, 2016
	Carrying Value	Level 1	Level 2	Level 3	Total Losses
	(In thousands)				
Other real estate owned	\$3,095	\$ -	\$ -	\$3,095	\$ (705 )
Impaired loans	9,525	-	-	9,525	-
Total assets measured at fair value on a nonrecurring basis	\$12,620	\$ -	\$ -	\$12,620	\$ (705 )

Level 3 – Valuation is based upon present value of expected future cash flows, independent market prices, estimated liquidation values of loan collateral or appraised value of the collateral as determined by third-party independent appraisers, less 10% for selling costs, generally. Level 3 includes other real estate owned that has been measured at fair value upon transfer to foreclosed assets and impaired loans collateralized by real property and other business asset collateral where a specific reserve has been established or a chargeoff has been recorded. Losses on other real estate owned represent losses recognized in earnings during the period subsequent to its initial classification as foreclosed assets. The unobservable inputs and qualitative information about the unobservable inputs are not presented as the inputs were not developed by the Company.

## Disclosures about Fair Value of Financial Instruments

The following section describes the valuation methodologies used by the Company for estimating fair value of financial instruments not recorded at fair value in the balance sheet.

**Cash and Due from Banks** Cash and due from banks represent U.S. dollar denominated coin and currency, deposits at the Federal Reserve Bank and correspondent banks, and amounts being settled with other banks to complete the processing of customers' daily transactions. Collectively, the Federal Reserve Bank and financial institutions operate in a market in which cash and due from banks transactions are processed continuously in significant daily volumes honoring the face value of the U.S. dollar.

**Investment Securities Held to Maturity** The fair values of investment securities were estimated using quoted prices as described above for Level 2 valuation.

**Loans** Loans were separated into two groups for valuation. Variable rate loans, except for those described below, which reprice frequently with changes in market rates were valued using historical cost. Fixed rate loans and variable rate loans that have reached their minimum contractual interest rates were valued by discounting the future cash flows expected to be received from the loans using current interest rates charged on loans with similar characteristics. Additionally, the allowance for loan losses of \$23,628 thousand at September 30, 2017 and \$25,954 thousand at December 31, 2016 was applied against the estimated fair values to recognize estimated future defaults of contractual cash flows. The Company does not consider these values to be a liquidation price for the loans.

**Deposit Liabilities** Deposits with no stated maturity such as checking accounts, savings accounts and money market accounts can be readily converted to cash or used to settle transactions at face value through the broad financial system operated by the Federal Reserve Bank and financial institutions. The fair value of deposits with no stated maturity is equal to the amount payable on demand. The fair values of time deposits were estimated by discounting estimated future contractual cash flows using current market rates for financial instruments with similar characteristics.

**Short-Term Borrowed Funds** The carrying amount of securities sold under agreement to repurchase and other short-term borrowed funds approximate fair value due to the relatively short period of time between their origination and their expected realization.

The table below is a summary of fair value estimates for financial instruments and the level of the fair value hierarchy within which the fair value measurements are categorized, excluding financial instruments recorded at fair value on a recurring basis. The values assigned do not necessarily represent amounts which ultimately may be realized for assets or paid to settle liabilities. In addition, these values do not give effect to adjustments to fair value which may occur when financial instruments are sold or settled in larger quantities. The carrying amounts in the following table are recorded in the balance sheet under the indicated captions.

The Company has not included assets and liabilities that are not financial instruments, such as goodwill, long-term relationships with deposit, merchant processing and trust customers, other purchased intangibles, premises and equipment, deferred taxes and other assets and liabilities. The total estimated fair values do not represent, and should not be construed to represent, the underlying value of the Company.

	At September 30, 2017				
	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2 )	Significant Unobservable Inputs (Level 3 )
Financial Assets:	(In thousands)				
Cash and due from banks	\$561,757	\$561,757	\$561,757	\$-	\$-
Investment securities held to maturity	1,204,240	1,208,279	-	1,208,279	-
Loans	1,261,154	1,264,503	-	-	1,264,503
Financial Liabilities:					
Deposits	\$4,734,580	\$4,731,990	\$-	\$4,492,655	\$ 239,335
Short-term borrowed funds	66,337	66,337	-	66,337	-



	At December 31, 2016				
	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2 )	Significant Unobservable Inputs (Level 3 )
Financial Assets:					
(In thousands)					
Cash and due from banks	\$462,271	\$462,271	\$462,271	\$-	\$-
Investment securities held to maturity	1,346,312	1,340,741	-	1,340,741	-
Loans	1,326,757	1,337,774	-	-	1,337,774
Financial Liabilities:					
Deposits	\$4,704,741	\$4,702,797	\$-	\$4,448,571	\$ 254,226
Short-term borrowed funds	59,078	59,078	-	59,078	-

The majority of the Company's standby letters of credit and other commitments to extend credit carry current market interest rates if converted to loans. No premium or discount was ascribed to these commitments because virtually all funding would be at current market rates.

#### Note 10: Commitments and Contingent Liabilities

Loan commitments are agreements to lend to a customer provided there is no violation of any condition established in the agreement. Commitments generally have fixed expiration dates or other termination clauses. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future funding requirements. Loan commitments are subject to the Company's normal credit policies and collateral requirements. Unfunded loan commitments were \$307,269 thousand and \$304,508 thousand at September 30, 2017 and December 31, 2016, respectively. Standby letters of credit commit the Company to make payments on behalf of customers when certain specified future events occur. Standby letters of credit are primarily issued to support customers' short-term financing requirements and must meet the Company's normal credit policies and collateral requirements. Financial and performance standby letters of credit outstanding totaled \$19,956 thousand and \$21,732 thousand at September 30, 2017 and December 31, 2016, respectively. The Company had no commitments outstanding for commercial and similar letters of credit at September 30, 2017 and December 31, 2016. The Company had a reserve for unfunded commitments of \$2,308 thousand at September 30, 2017 and \$2,408 thousand at December 31, 2016, included in other liabilities.

Due to the nature of its business, the Company is subject to various threatened or filed legal cases. Based on the advice of legal counsel, the Company does not expect such cases will have a material, adverse effect on its financial position or results of operations. Legal liabilities are accrued when obligations become probable and the amount can be reasonably estimated.

The Company has determined that it will be obligated to provide refunds of revenue recognized in prior years to some customers. The Company is not yet able to quantify the amount of refunds and has therefore not accrued a liability. The Company will provide additional information and accrue a liability when a determination of the probable amount of these obligations is made.

The October 2017 California wildfires have disrupted operations in the Company's geographic footprint mainly due to temporary power outages, unhealthy air quality, and evacuations affecting some branches and an operations center. The Company maintains secondary power generation capability at its principal operations center. The Company maintains, and regularly tests, disaster recovery plans and protocols to be prepared for disasters such as these wildfires. The Company has not experienced a casualty loss as of the date of this report, but does carry customary casualty insurance to protect against such risk.

Management has performed an initial evaluation of loss exposure caused by the wildfires within the Company's loan portfolio and investment portfolio; Management has not identified any increased risk of loss, however, continuing Management evaluations and further wildfire developments could result in identification of losses which are not currently apparent.

**Note 11: Earnings Per Common Share**

The table below shows earnings per common share and diluted earnings per common share. Basic earnings per common share are computed by dividing net income by the average number of common shares outstanding during the period. Diluted earnings per common share are computed by dividing net income by the average number of common shares outstanding during the period plus the impact of common stock equivalents.

	For the Three Months Ended September 30, 2017		For the Nine Months 2016	
Net income applicable to common equity (numerator)	\$15,017	\$15,628	\$45,865	\$44,400
Basic earnings per common share				
Weighted average number of common shares outstanding - basic (denominator)	26,309	25,641	26,260	25,558
Basic earnings per common share	\$0.57	\$0.61	\$1.75	\$1.74
Diluted earnings per common share				
Weighted average number of common shares outstanding - basic	26,309	25,641	26,260	25,558
Add common stock equivalents for options	95	46	119	37
Weighted average number of common shares outstanding - diluted (denominator)	26,404	25,687	26,379	25,595
Diluted earnings per common share	\$0.57	\$0.61	\$1.74	\$1.73

For the three and nine months ended September 30, 2017, options to purchase 376 thousand and 343 thousand shares of common stock, respectively, were outstanding but not included in the computation of diluted earnings per common share because the option exercise price exceeded the fair value of the stock such that their inclusion would have had an anti-dilutive effect.

For the three and nine months ended September 30, 2016, options to purchase 771 thousand and 948 thousand shares of common stock, respectively, were outstanding but not included in the computation of diluted net income per share because the option exercise price exceeded the fair value of the stock such that their inclusion would have had an anti-dilutive effect.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

## WESTAMERICA BANCORPORATION

## FINANCIAL SUMMARY

	For the Three Months Ended September 30,		For the Nine Months	
	2017	2016	2017	2016
	(In thousands, except per share data)			
Net Interest and Loan Fee Income (FTE) <sup>(1)</sup>	\$35,680	\$36,176	\$107,474	\$109,118
Reversal of Provision for Loan Losses	-	(3,200 )	(1,900 )	(3,200 )
Noninterest Income	12,548	11,598	36,328	35,029
Noninterest Expense	24,114	26,088	73,125	77,175
Income Before Income Taxes (FTE) <sup>(1)</sup>	24,114	24,886	72,577	70,172
Income Tax Provision (FTE) <sup>(1)</sup>	9,097	9,258	26,712	25,772
Net Income	\$15,017	\$15,628	\$45,865	\$44,400
Average Common Shares Outstanding	26,309	25,641	26,260	25,558
Average Diluted Common Shares Outstanding	26,404	25,687	26,379	25,595
Common Shares Outstanding at Period End	26,319	25,665		
Per Common Share:				
Basic Earnings	\$0.57	\$0.61	\$1.75	\$1.74
Diluted Earnings	0.57	0.61	1.74	1.73
Book Value	\$22.95	\$21.94		
Financial Ratios:				
Return on Assets	1.09	% 1.18	% 1.13	% 1.14
Return on Common Equity	9.94	% 11.39	% 10.36	% 11.04
Net Interest Margin (FTE) <sup>(1)</sup>	3.10	% 3.21	% 3.12	% 3.27
Net Loan Losses (Recoveries) to Average Loans	0.15	% (0.19 %)	0.04	% 0.02
Efficiency Ratio <sup>(2)</sup>	50.0	% 54.6	% 50.9	% 53.5
Average Balances:				
Assets	\$5,441,612	\$5,253,502	\$5,407,661	\$5,204,418
Earning Assets	4,587,848	4,489,317	4,601,931	4,448,261
Loans	1,287,740	1,386,186	1,325,128	1,447,061
Deposits	4,714,579	4,588,762	4,692,330	4,552,819
Shareholders' Equity	599,473	545,771	591,691	537,010
Period End Balances:				
Assets	\$5,445,808	\$5,306,778		
Earning Assets	4,579,499	4,537,756		

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Loans	1,284,782		1,364,329	
Deposits	4,734,580		4,644,870	
Shareholders' Equity	603,957		562,996	
Capital Ratios at Period End:				
Total Risk Based Capital	16.71	%	15.16	%
Tangible Equity to Tangible Assets	8.98	%	8.37	%
Dividends Paid Per Common Share	\$0.39		\$0.39	
Common Dividend Payout Ratio	68	%	64	%
			\$1.17	
			\$1.17	
			67	%
			68	%

The above financial summary has been derived from the Company's unaudited consolidated financial statements. This information should be read

in conjunction with those statements, notes and the other information included elsewhere herein. Percentages under the heading "Financial Ratios"

are annualized with the exception of the efficiency ratio.

(1) Yields on securities and certain loans have been adjusted upward to a "fully taxable equivalent" ("FTE") basis in order to reflect the effect of income which is exempt from federal income taxation at the current statutory tax rate.

(2) The efficiency ratio is defined as noninterest expense divided by total revenue (net interest income on an FTE basis and noninterest income).

## Financial Overview

Westamerica Bancorporation and subsidiaries' (the "Company") principal source of revenue is net interest and loan fee income, which represents interest and fees earned on loans and investment securities ("earning assets") reduced by interest paid on deposits and other borrowings ("interest-bearing liabilities"). Market interest rates declined considerably following the recession of 2008 and 2009. Interest rates remained historically low through 2016 as the Federal Open Market Committee's ("FOMC") monetary policy was highly accommodative. During this period, Management avoided originating long-dated, low-yielding loans given the potential impact of such assets on forward earning potential; as a result, loans declined and investment securities increased. The changing composition of the earning assets and low market interest rates has pressured the net interest margin to lower levels. The FOMC's first post-recession increase in the federal funds rate occurred in December 2015, although longer-term rates declined. The FOMC's successive post-recession increases in the federal funds rate occurred between December 2016 and June 2017, although longer-term rates have not increased by a similar magnitude. The more recent increase in rates has resulted in competitive loan yields which are more appealing from a profitability perspective, in Management's opinion.

The funding of the Company's earning assets is primarily customer deposits. The Company's long-term strategy includes maximizing checking and savings deposits as these types of deposits are lower-cost and less sensitive to changes in interest rates compared to time deposits. The first nine months of 2017 average volume of checking and savings deposits was 95 percent of average total deposits.

The Company recognized a reversal of the provision for loan losses of \$1.9 million in the first nine months of 2017. Credit quality improved during the first nine months of 2017 with nonperforming assets declining \$4 million to \$8 million at September 30, 2017. The Company's net losses were \$426 thousand for the first nine months of 2017. These developments were reflected in Management's evaluation of credit quality, the level of the provision for loan losses, and the adequacy of the allowance for loan losses at September 30, 2017.

The Company's long-term strategy also includes controlling operating costs, or "noninterest expense." Noninterest expense of \$73.1 million for the first nine months of 2017 was \$4.1 million lower than for the first nine months of 2016.

The Company presents its net interest margin and net interest income on an FTE basis using the current statutory federal tax rate. Management believes the FTE basis is valuable to the reader because the Company's loan and investment securities portfolios contain a relatively large portion of municipal loans and securities that are federally tax exempt. The Company's tax exempt loans and securities composition may not be similar to that of other banks. Therefore in order to reflect the impact of the federally tax exempt loans and securities on the net interest margin and net interest income for comparability with other banks, the Company presents its net interest margin and net interest

income on an FTE basis.

The Company's significant accounting policies (see Note 1 ("Summary of Significant Accounting Policies") to Financial Statements in the Company's 2016 Form 10-K) are fundamental to understanding the Company's results of operations and financial condition. The Company adopted the FASB ASU 2016-09, Improvements to Employee Share-Based Payment Accounting effective January 1, 2017.

The Company reported net income of \$15.0 million or \$0.57 diluted earnings per common share for the third quarter 2017 and net income of \$45.9 million or \$1.74 diluted earnings per common share for the nine months ended September 30, 2017. Second quarter 2017 results included a \$1.9 million reversal of provision for loan losses which accounted for \$0.04 of the quarter's diluted earnings per common share. Third quarter and first nine months of 2017 results reflect the Company's prospective adoption of ASU 2016-09; first quarter 2017 diluted earnings per common share measured \$0.02 higher than would have been measured under accounting standards applied in 2016. The adoption of ASU 2016-09 did not affect second or third quarter 2017 results by a meaningful amount. Third quarter and first nine months of 2017 results compare to net income of \$15.6 million or \$0.61 diluted earnings per common share for the third quarter 2016 and net income of \$44.4 million or \$1.73 diluted earnings per common share for the nine months ended September 30, 2016.

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**Net Income**

Following is a summary of the components of net income for the periods indicated:

	For the Three Months Ended September 30,		For the Nine Months	
	2017	2016	2017	2016
	(In thousands, except per share data)			
Net interest and fee income (FTE)	\$35,680	\$36,176	\$107,474	\$109,118
Reversal of provision for loan losses	-	3,200	1,900	3,200
Noninterest income	12,548	11,598	36,328	35,029
Noninterest expense	(24,114 )	(26,088 )	(73,125 )	(77,175 )
Income before income taxes (FTE)	24,114	24,886	72,577	70,172
Income tax provision (FTE)	(9,097 )	(9,258 )	(26,712 )	(25,772 )
Net income	\$15,017	\$15,628	\$45,865	\$44,400
Average diluted common shares	26,404	25,687	26,379	25,595
Diluted earnings per common share	\$0.57	\$0.61	\$1.74	\$1.73
Average total assets	\$5,441,612	\$5,253,502	\$5,407,661	\$5,204,418
Net income to average total assets (annualized)	1.09 %	1.18 %	1.13 %	1.14 %
Net income to average common shareholders' equity (annualized)	9.94 %	11.39 %	10.36 %	11.04 %

Net income for the third quarter 2017 was \$611 thousand less than the third quarter 2016, the net result of a reversal of provision for loan losses in the third quarter 2016 and lower net interest and fee income (FTE) in the third quarter 2017, partially offset by higher noninterest income and lower noninterest expense and lower income tax provision (FTE) in the third quarter 2017. The decline in net interest and loan fee income (FTE) in the third quarter 2017 compared with the third quarter 2016 was mostly attributable to lower average balances of loans and lower net yield on those loans, partially offset by higher average balances of investments and higher net yield on those investments. The Company recorded no provision for loan losses in the current quarter and a \$3.2 million reversal of provision for loan losses for the third quarter 2016, reflecting Management's evaluation of losses inherent in the loan portfolio. Noninterest income increased primarily due to higher merchant processing services and debit card fees, partially offset by lower service charges on deposit accounts. Noninterest expense decreased due to reductions in professional fees, limited partnership operating losses, intangible amortization, correspondent service charges, offset in part by higher outsourced data processing and other real estate owned expenses. Third quarter 2017 tax provision (FTE) was lower

than third quarter 2016 primarily due to lower pre-tax income, higher levels of federally tax-exempt income on interest-earning assets relative to pre-tax income. The ASU 2016-09 did not affect third quarter 2017 results by a meaningful amount.

Comparing the first nine months of 2017 with the first nine months of 2016, net income increased \$1.5 million due to higher noninterest income and lower noninterest expense, partially offset by lower net interest and fee income (FTE), a lower reversal of provision for loan losses, and higher income tax provision (FTE). Net interest and loan fee income (FTE) decreased in the first nine months of 2017 compared with first nine months of 2016 mostly attributable to lower average balances of loans and lower net yield on those loans, partially offset by higher average balances of investments. The Company recorded a \$1.9 million reversal of provision for loan losses for the first nine months of 2017 and a \$3.2 million reversal of provision for loan losses for the first nine months of 2016, reflecting Management's evaluation of losses inherent in the loan portfolio. Noninterest income increased primarily due to higher merchant processing services fees, partially offset by lower service charges on deposit accounts. Noninterest expense decreased due to reductions in professional fees, correspondent service charges, insurance premiums, limited partnership operating losses and intangible amortization, partially offset by higher outsourced data processing and other real estate owned expenses. The tax provision (FTE) for the first nine months of 2017 was higher than in the first nine months of 2016 primarily due to higher pre-tax income, reduced levels of federally tax-exempt income on interest-earning assets relative to pre-tax income, and lower tax credits. The first nine months of 2017 income tax provision was \$688 thousand lower than would have been under accounting standards prior to the adoption of ASU 2016-09.

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**Net Interest and Loan Fee Income (FTE)**

Following is a summary of the components of net interest and loan fee income (FTE) for the periods indicated:

	For the Three Months Ended September 30,		For the Nine Months	
	2017	2016	2017	2016
	(\$ in thousands)			
Interest and loan fee income	\$33,145	\$33,468	\$99,632	\$100,842
Interest expense	(473 )	(523 )	(1,429 )	(1,616 )
FTE adjustment	3,008	3,231	9,271	9,892
Net interest and loan fee income (FTE)	\$35,680	\$36,176	\$107,474	\$109,118
Average earning assets	\$4,587,848	\$4,489,317	\$4,601,931	\$4,448,261
Net interest margin (FTE) (annualized)	3.10 %	3.21 %	3.12 %	3.27 %

Net interest and loan fee income (FTE) decreased \$496 thousand in the third quarter 2017 compared with third quarter 2016 mostly attributable to lower average balances of loans (down \$98 million) and lower net yield on those loans (down 0.22%), partially offset by higher average balances of investments (up \$197 million) and higher net yield on those investments (up 0.01%).

Comparing the first nine months of 2017 with the first nine months of 2016, net interest and loan fee income (FTE) decreased \$1.6 million mostly due to lower average balances of loans (down \$122 million) and lower net yield on those loans (down 0.21%), partially offset by higher average balances of investments (up \$276 million).

Yields on interest-earning assets declined due to relatively low interest rates prevailing in the market. The annualized net interest margin (FTE) was 3.10% in the third quarter 2017 and 3.12% in the first nine months of 2017 compared with 3.21% in the third quarter 2016 and 3.27% in the first nine months of 2016. The volume of older-dated higher-yielding loans and municipal bonds declined due to principal maturities and paydowns. The Company, in anticipation of rising interest rates, has been purchasing shorter-duration investment securities with lower yields than longer-duration securities to increase liquidity. The Company's high levels of liquidity will provide an opportunity to invest in higher yielding assets assuming market interest rates increase to levels higher than yields on maturing securities and security paydowns.

The Company has been replacing higher-cost funding sources with low-cost deposits and interest expense has declined to offset some of the decline in interest income. Average balances of time deposits declined \$28 million from the first nine months of 2016 to first nine months of 2017 while lower-cost checking and savings deposits grew 4% in the same period. Average balances of checking and saving deposits accounted for 94.7% of average total deposits in the nine months of 2017 compared with 93.9% in the first nine months of 2016.

### Net Interest Margin (FTE)

The following summarizes the components of the Company's net interest margin (annualized) for the periods indicated:

	For the Three Months Ended September 30,		For the Nine Months	
	2017	2016	2017	2016
Yield on earning assets (FTE)	3.14%	3.26%	3.16%	3.32%
Rate paid on interest-bearing liabilities	0.07%	0.08%	0.07%	0.08%
Net interest spread (FTE)	3.07%	3.18%	3.09%	3.24%
Impact of noninterest-bearing demand deposits	0.03%	0.03%	0.03%	0.03%
Net interest margin (FTE)	3.10%	3.21%	3.12%	3.27%

During 2016 and through the third quarter 2017, the net interest margin (FTE) was affected by historically low market interest rates. The changing composition of interest-earning assets and low market rates has pressured the net interest margin. Rates on interest-bearing liabilities were kept low by reducing the volume of higher-cost time deposits and increasing balances of checking and savings deposits, which earn relatively low interest rates and are less volatile than time deposits during periods of rising market interest rates.

**Summary of Average Balances, Yields/Rates and Interest Differential**

The following tables present information regarding the consolidated average assets, liabilities and shareholders' equity, the amounts of interest income earned from average interest earning assets and the resulting yields, and the amounts of interest expense incurred on average interest-bearing liabilities and the resulting rates. Average loan balances include nonperforming loans. Interest income includes reversal of previously accrued interest on loans placed on non-accrual status during the period and proceeds from loans on nonaccrual status only to the extent cash payments have been received and applied as interest income and accretion of purchased loan discounts. Yields on tax-exempt securities and loans have been adjusted upward to reflect the effect of income exempt from federal income taxation at the current statutory tax rate. Yields, rates and interest margins are annualized.

**Distribution of Assets, Liabilities & Shareholders' Equity and Yields, Rates & Interest Margin**

	For the Three Months Ended September 30, 2017		
	Average Balance (\$ in thousands)	Interest Income/ Expense	Yields/ Rates
<b>Assets</b>			
Investment securities:			
Taxable	\$2,496,470	\$12,957	2.08%
Tax-exempt <sup>(1)</sup>	803,638	7,847	3.91%
Total investments <sup>(1)</sup>	3,300,108	20,804	2.52%
Loans:			
Taxable	1,225,937	14,586	4.72%
Tax-exempt <sup>(1)</sup>	61,803	763	4.90%
Total loans <sup>(1)</sup>	1,287,740	15,349	4.73%
Total Interest-earning assets <sup>(1)</sup>	4,587,848	36,153	3.14%
Other assets	853,764		
Total assets	\$5,441,612		
<b>Liabilities and shareholders' equity</b>			
Noninterest-bearing demand	\$2,103,042	\$-	- %
Savings and interest-bearing transaction	2,367,501	280	0.05%
Time less than \$100,000	135,363	78	0.23%
Time \$100,000 or more	108,673	103	0.38%
Total interest-bearing deposits	2,611,537	461	0.07%
Short-term borrowed funds	76,083	12	0.06%
Total interest-bearing liabilities	2,687,620	473	0.07%
Other liabilities	51,477		
Shareholders' equity	599,473		

Total liabilities and shareholders' equity	\$5,441,612	
Net interest spread <sup>(1) (2)</sup>		3.07%
Net interest and fee income and interest margin <sup>(1) (3)</sup>	\$35,680	3.10%

<sup>(1)</sup> Amounts calculated on an FTE basis using the current statutory federal tax rate.

<sup>(2)</sup> Net interest spread represents the average yield earned on interest-earning assets less the average rate incurred on interest-bearing liabilities.

<sup>(3)</sup> Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets. The net interest margin is greater than the net interest spread due to the benefit of noninterest-bearing demand deposits.

## Distribution of Assets, Liabilities &amp; Shareholders' Equity and Yields, Rates &amp; Interest Margin

	For the Three Months Ended September 30, 2016		
	Average Balance	Interest Income/ Expense	Yields/ Rates
	(\$ in thousands)		
Assets			
Investment securities:			
Taxable	\$2,265,883	\$11,024	1.95%
Tax-exempt <sup>(1)</sup>	837,248	8,415	4.02%
Total investments <sup>(1)</sup>	3,103,131	19,439	2.51%
Loans:			
Taxable	1,320,635	16,424	4.95%
Tax-exempt <sup>(1)</sup>	65,551	836	5.07%
Total loans <sup>(1)</sup>	1,386,186	17,260	4.95%
Total Interest-earning assets <sup>(1)</sup>	4,489,317	36,699	3.26%
Other assets	764,185		
Total assets	\$5,253,502		
Liabilities and shareholders' equity			
Noninterest-bearing demand	\$2,041,045	\$-	- %
Savings and interest-bearing transaction	2,277,462	293	0.05%
Time less than \$100,000	152,142	95	0.25%
Time \$100,000 or more	118,113	124	0.42%
Total interest-bearing deposits	2,547,717	512	0.08%
Short-term borrowed funds	68,640	11	0.06%
Total interest-bearing liabilities	2,616,357	523	0.08%
Other liabilities	50,329		
Shareholders' equity	545,771		
Total liabilities and shareholders' equity	\$5,253,502		
Net interest spread <sup>(1) (2)</sup>			3.18%
Net interest and fee income and interest margin <sup>(1) (3)</sup>		\$36,176	3.21%

(1) Amounts calculated on an FTE basis using the current statutory federal tax rate.

(2) Net interest spread represents the average yield earned on interest-earning assets less the average rate incurred on interest-bearing liabilities.

(3) Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets. The net interest margin is greater than the net interest spread due to the benefit of noninterest-bearing demand deposits.

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## Distribution of Assets, Liabilities &amp; Shareholders' Equity and Yields, Rates &amp; Interest Margin

	For the Nine Months Ended September 30, 2017		
	Average Balance (\$ in thousands)	Interest Income/ Expense	Yields/ Rates
<b>Assets</b>			
Investment securities:			
Taxable	\$2,459,360	\$37,584	2.04 %
Tax-exempt <sup>(1)</sup>	817,443	24,154	3.94 %
Total investments <sup>(1)</sup>	3,276,803	61,738	2.51 %
Loans:			
Taxable	1,261,726	44,777	4.74 %
Tax-exempt <sup>(1)</sup>	63,402	2,388	5.04 %
Total loans <sup>(1)</sup>	1,325,128	47,165	4.76 %
Total Interest-earning assets <sup>(1)</sup>	4,601,931	108,903	3.16 %
Other assets	805,730		
Total assets	\$5,407,661		
<b>Liabilities and shareholders' equity</b>			
Noninterest-bearing demand	\$2,069,521	\$-	- %
Savings and interest-bearing transaction	2,373,814	839	0.05 %
Time less than \$100,000	138,483	242	0.23 %
Time \$100,000 or more	110,512	314	0.38 %
Total interest-bearing deposits	2,622,809	1,395	0.07 %
Short-term borrowed funds	71,976	34	0.06 %
Total interest-bearing liabilities	2,694,785	1,429	0.07 %
Other liabilities	51,664		
Shareholders' equity	591,691		
Total liabilities and shareholders' equity	\$5,407,661		
Net interest spread <sup>(1) (2)</sup>			3.09 %
Net interest and fee income and interest margin <sup>(1) (3)</sup>		\$107,474	3.12 %

<sup>(1)</sup> Amounts calculated on an FTE basis using the current statutory federal tax rate.

<sup>(2)</sup> Net interest spread represents the average yield earned on interest-earning assets less the average rate incurred on interest-bearing liabilities.

<sup>(3)</sup> Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets. The net interest margin is greater than the net interest spread due to the benefit of noninterest-bearing demand deposits.

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## Distribution of Assets, Liabilities &amp; Shareholders' Equity and Yields, Rates &amp; Interest Margin

	For the Nine Months Ended September 30, 2016		
	Average Balance	Interest Income/ Expense	Yields/ Rates
	(\$ in thousands)		
Assets			
Investment securities:			
Taxable	\$2,165,463	\$31,256	1.92%
Tax-exempt <sup>(1)</sup>	835,737	25,632	4.09%
Total investments <sup>(1)</sup>	3,001,200	56,888	2.53%
Loans:			
Taxable	1,378,593	51,150	4.96%
Tax-exempt <sup>(1)</sup>	68,468	2,696	5.26%
Total loans <sup>(1)</sup>	1,447,061	53,846	4.97%
Total Interest-earning assets <sup>(1)</sup>	4,448,261	110,734	3.32%
Other assets	756,157		
Total assets	\$5,204,418		
Liabilities and shareholders' equity			
Noninterest-bearing demand	\$2,010,058	\$-	- %
Savings and interest-bearing transaction	2,265,775	878	0.05%
Time less than \$100,000	156,568	313	0.27%
Time \$100,000 or more	120,418	395	0.44%
Total interest-bearing deposits	2,542,761	1,586	0.08%
Short-term borrowed funds	62,823	30	0.06%
Total interest-bearing liabilities	2,605,584	1,616	0.08%
Other liabilities	51,766		
Shareholders' equity	537,010		
Total liabilities and shareholders' equity	\$5,204,418		
Net interest spread <sup>(1) (2)</sup>			3.24%
Net interest and fee income and interest margin <sup>(1) (3)</sup>		\$109,118	3.27%

<sup>(1)</sup> Amounts calculated on an FTE basis using the current statutory federal tax rate.

<sup>(2)</sup> Net interest spread represents the average yield earned on interest-earning assets less the average rate incurred on interest-bearing liabilities.

<sup>(3)</sup> Net interest margin is computed by calculating the difference between interest income and expense, divided by the average balance of interest-earning assets. The net interest margin is greater than the net interest spread due to the benefit of noninterest-bearing demand deposits.

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### Summary of Changes in Interest Income and Expense due to Changes in Average Asset & Liability Balances and Yields Earned & Rates Paid

The following tables set forth a summary of the changes in interest income and interest expense due to changes in average assets and liability balances (volume) and changes in average interest yields/rates for the periods indicated. Changes not solely attributable to volume or yields/rates have been allocated in proportion to the respective volume and yield/rate components.

#### Summary of Changes in Interest Income and Expense

	For the Three Months Ended September 30, 2017		
	Compared with		
	For the Three Months Ended September 30, 2016		
	Volume	Yield/Rate	Total
	(In thousands)		
Increase (decrease) in interest and loan fee income:			
Investment securities:			
Taxable	\$1,122	\$ 811	\$1,933
Tax-exempt <sup>(1)</sup>	(338 )	(230 )	(568 )
Total investments <sup>(1)</sup>	784	581	1,365
Loans:			
Taxable	(1,154)	(684 )	(1,838)
Tax-exempt <sup>(1)</sup>	(47 )	(26 )	(73 )
Total loans <sup>(1)</sup>	(1,201)	(710 )	(1,911)
Total decrease in interest and loan fee income <sup>(1)</sup>	(417 )	(129 )	(546 )
Increase (decrease) in interest expense:			
Deposits:			
Savings and interest-bearing transaction	12	(25 )	(13 )
Time less than \$100,000	(10 )	(7 )	(17 )
Time \$100,000 or more	(10 )	(11 )	(21 )
Total interest-bearing deposits	(8 )	(43 )	(51 )
Short-term borrowed funds	1	-	1
Total decrease in interest expense	(7 )	(43 )	(50 )
Decrease in net interest and loan fee income <sup>(1)</sup>	\$(410 )	\$ (86 )	\$(496 )

<sup>(1)</sup> Amounts calculated on an FTE basis using the current statutory federal tax rate.

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## Summary of Changes in Interest Income and Expense

	For the Nine Months Ended September 30, 2017		
	Compared with		
	For the Nine Months Ended September 30, 2016		
	Volume	Yield/Rate	Total
	(In thousands)		
Increase (decrease) in interest and loan fee income:			
Investment securities:			
Taxable	\$4,242	\$ 2,086	\$6,328
Tax-exempt <sup>(1)</sup>	(561 )	(917 )	(1,478)
Total investments <sup>(1)</sup>	3,681	1,169	4,850
Loans:			
Taxable	(4,363)	(2,010 )	(6,373)
Tax-exempt <sup>(1)</sup>	(201 )	(107 )	(308 )
Total loans <sup>(1)</sup>	(4,564)	(2,117 )	(6,681)
Total decrease in interest and loan fee income <sup>(1)</sup>	(883 )	(948 )	(1,831)
Increase (decrease) in interest expense:			
Deposits:			
Savings and interest-bearing transaction	42	(81 )	(39 )
Time less than \$100,000	(36 )	(35 )	(71 )
Time \$100,000 or more	(33 )	(48 )	(81 )
Total interest-bearing deposits	(27 )	(164 )	(191 )
Short-term borrowed funds	4	-	4
Total decrease in interest expense	(23 )	(164 )	(187 )
Decrease in net interest and loan fee income <sup>(1)</sup>	\$(860 )	\$(784 )	\$(1,644)

**Provision for Loan Losses**

The Company manages credit costs by consistently enforcing conservative underwriting and administration procedures and aggressively pursuing collection efforts with debtors experiencing financial difficulties. The provision for loan losses reflects Management's assessment of credit risk in the loan portfolio during each of the periods presented.

The Company provided no provision for loan losses in the three months ended September 30, 2017 and recorded a reversal of the provision for loan losses of \$1.9 million in the nine months ended September 30, 2017. The Company

recorded a reversal of the provision for loan losses of \$3.2 million in the three and nine months ended September 30, 2016. During the nine months ended September 30, 2017, classified loans declined \$7.4 million to \$39.8 million (total classified loans included nonperforming loans of \$6.4 million). The Company realized net loan losses of \$426 thousand for the first nine months of 2017; these developments were reflected in Management's evaluation of credit quality, the level of the provision for loan losses, and the adequacy of the allowance for loan losses at September 30, 2017. Management's evaluation of credit quality includes originated and purchased loans. The Company recorded purchased loans at estimated fair value upon the acquisition dates. Such estimated fair values were recognized for individual loans, although small balance homogenous loans were pooled for valuation purposes. The valuation discounts recorded for purchased loans included Management's assessment of the risk of principal loss under economic and borrower conditions prevailing on the dates of purchase. The purchased County Bank loans secured by single-family residential real estate are "covered" through February 6, 2019 by loss-sharing agreements the Company entered with the FDIC which mitigates losses during the term of the agreements. Any deterioration in estimated value related to principal loss subsequent to the acquisition dates requires additional loss recognition through a provision for loan losses. No assurance can be given future provisions for loan losses related to purchased loans will not be necessary. For further information regarding credit risk, net credit losses and the allowance for loan losses, see the "Loan Portfolio Credit Risk" and "Allowance for Loan Losses" sections of this Report.



**Noninterest Income**

The following table summarizes the components of noninterest income for the periods indicated:

	For the Three Months Ended September 30,		For the Nine Months	
	2017	2016	2017	2016
	(In thousands)			
Service charges on deposit accounts	\$4,989	\$5,303	\$14,857	\$15,790
Merchant processing services	2,153	1,532	6,080	4,699
Debit card fees	1,784	1,587	4,851	4,724
Trust fees	718	686	2,136	2,004
ATM processing fees	684	600	1,914	1,860
Other service fees	652	671	1,964	1,951
Financial services commissions	148	118	484	411
Other noninterest income	1,420	1,101	4,042	3,590
Total	\$12,548	\$11,598	\$36,328	\$35,029

Noninterest income for the third quarter 2017 increased by \$950 thousand from the third quarter 2016. Merchant processing services fees increased \$621 thousand primarily due to increased transaction volumes. Service charges on deposit accounts decreased \$314 thousand due to declines in fees charged on overdrawn and insufficient funds accounts (down \$255 thousand) and lower fees on analyzed accounts (down \$60 thousand).

In the first nine months of 2017, noninterest income increased \$1.3 million compared with the first nine months of 2016. Merchant processing services fees increased \$1.4 million primarily due to higher transaction volumes. Trust fees increased \$132 thousand due to successful sales efforts. Offsetting the increase were service charges on deposits which decreased \$933 thousand due to declines in fees charged on overdrawn and insufficient funds accounts (down \$746 thousand) and lower fees on analyzed accounts (down \$212 thousand).

**Noninterest Expense**

The following table summarizes the components of noninterest expense for the periods indicated:

	For the Three Months Ended September 30,		For the Nine Months	
	2017	2016	2017	2016
	(In thousands)			
Salaries and related benefits	\$12,816	\$13,063	\$38,867	\$39,067
Occupancy	3,665	3,749	10,807	10,546
Outsourced data processing services	2,383	2,114	6,710	6,375
Furniture and equipment	1,242	1,211	3,764	3,611
Amortization of identifiable intangibles	760	867	2,322	2,642
Professional fees	512	1,693	1,533	3,183
Courier service	451	451	1,310	1,458
Other real estate owned	221	(206 )	54	(487 )
Other noninterest expense	2,064	3,146	7,758	10,780
Total	\$24,114	\$26,088	\$73,125	\$77,175

Noninterest expense decreased \$2.0 million in the third quarter 2017 compared with the third quarter 2016. Professional fees decreased \$1.2 million due to lower legal fees associated with nonperforming assets. Other noninterest expense decreased \$1.1 million primarily due to decreases in correspondent bank service charges and limited partnership operating losses. Salaries and related benefits decreased \$247 thousand mostly due to attrition. Amortization of intangibles decreased \$107 thousand as assets are amortized on a declining balance method. Offsetting the decrease were higher expenses for other real estate owned and outsourced data processing. Expenses of other real estate owned increased \$427 thousand due to a writedown of a foreclosed property in the current quarter and gains on sale of foreclosed assets in the third quarter 2016.

In the first nine months of 2017, noninterest expense decreased \$4.1 million compared with the first nine months of 2016. Other noninterest expense decreased \$3.0 million primarily due to decreases in correspondent bank service charges, limited partnership operating losses and insurance premiums. Professional fees decreased \$1.7 million due to lower legal fees associated with nonperforming assets. Amortization of intangibles decreased \$320 thousand as assets are amortized on a declining balance method. Salaries and related benefits decreased \$200 thousand mostly due to attrition, partially offset by higher stock option expense. Offsetting the decrease were higher expenses for other real estate owned, outsourced data processing, occupancy and furniture and equipment. Expenses of other real estate owned increased \$541 thousand due to lower gains on sale of foreclosed assets. Expenses for occupancy and furniture and equipment increased due to technology upgrades.

### **Provision for Income Tax**

The Company recorded an income tax provision (FTE) of \$9.1 million for the third quarter 2017 and \$26.7 million for the first nine months of 2017. Effective January 1, 2017, the Company adopted ASU 2016-09 which has the potential to create volatility in the book tax provision at the time nonqualified stock options are exercised or expire. During the first nine months of 2017, 403 thousand shares were issued due to the exercise of nonqualified stock options resulting in a tax deduction exceeding related share based compensation by \$1.6 million. The first nine months of 2017 income tax provision was \$688 thousand lower than would have been under accounting standards prior to the adoption of ASU 2016-09. Third quarter and first nine months of 2017 income tax provision (FTE) compared with \$9.3 million and \$25.8 million for the third quarter and first nine months of 2016, respectively. The effective tax rates (FTE) of 37.7% and 36.8% for the third quarter and first nine months of 2017, respectively, compared with 37.2% and 36.7% for the third quarter and first nine months of 2016, respectively. The third quarter and first nine months of 2017 effective tax rates (FTE) would have been 37.8% and 37.8%, respectively, under accounting rules applied in 2016.

### **Investment Portfolio**

The Company maintains an investment securities portfolio consisting of securities issued by U.S. Government sponsored entities, agency and non-agency mortgage backed securities, state and political subdivisions, corporations, and other securities.

Management has increased the investment securities portfolio in response to deposit growth and loan volume declines. The carrying value of the Company's investment securities portfolio was \$3.3 billion as of September 30, 2017 and \$3.2 billion as of December 31, 2016.

Management continually evaluates the Company's investment securities portfolio in response to established asset/liability management objectives, changing market conditions that could affect profitability, liquidity, and the level of interest rate risk to which the Company is exposed. These evaluations may cause Management to change the level of funds the Company deploys into investment securities and change the composition of the Company's investment securities portfolio. In 2016 Management reduced securities of U.S. Government sponsored entities to reduce call optionality and increased agency residential MBS to develop more reliable cash flows.

As of September 30, 2017, substantially all of the Company's investment securities continue to be investment grade rated by one or more major rating agencies. In addition to monitoring credit rating agency evaluations, Management performs its own evaluations regarding the credit worthiness of the issuer or the securitized assets underlying asset-backed securities. The Company's procedures for evaluating investments in securities are in accordance with guidance issued by the Board of Governors of the Federal Reserve System, "Investing in Securities without Reliance on Nationally Recognized Statistical Rating Agencies" (SR 12-15) and other regulatory guidance. There have been no significant differences in our internal analyses compared with the ratings assigned by the third party credit rating agencies.

During the third quarter 2017, the Atlantic hurricane season caused severe damage within many US States and Territories. Management has evaluated investment security exposures within the counties receiving disaster designations. The Company's exposures are limited to municipal and corporate bond investment securities from issuers within Texas, Florida and Georgia counties. The Company holds municipal bonds of \$19 million issued by seventeen municipalities within Texas counties, \$9 million issued by nine municipalities within Florida counties and \$6 million issued by four municipalities within Georgia counties. The market value of the bonds at September 30, 2017 was \$20 million, \$10 million and \$7 million, respectively. The bonds mature as follows:

	2018	2019	2020	2022	2023	2024	2025	2026	2027	Total
	(In thousands)									
Texas	\$280	\$4,285	\$3,220	\$ -	\$4,460	\$710	\$4,435	\$1,625	\$350	\$19,365
Florida	1,000	2,185	-	-	1,755	1,910	340	635	1,405	9,230
Georgia	-	-	-	-	-	-	1,325	4,880	-	6,205
	\$1,280	\$6,470	\$3,220	\$ -	\$6,215	\$2,620	\$6,100	\$7,140	\$1,755	\$34,800

In Management's judgement, each municipality's financial resources and the availability of federal and state disaster funds mitigates the risk exposure of the bonds, particularly for intermediate-term and longer-term bonds.

In addition, the Company holds one \$12.3 million (market value) corporate bond maturing in 2021 issued by a regulated utility in a Texas county which can recapture capital expenditures through rates charged customers; the market value of this corporate bond at September 30, 2017 was 121.5% of its par value, which reflects the bond's 9.15% coupon rate.

Based on currently available information, Management does not expect any of the bonds affected by the hurricanes to become impaired; Management will continue to monitor the value of these bonds for impairment.

The following tables summarize the total general obligation and revenue bonds issued by states and political subdivisions held in the Company's investment securities portfolios as of the dates indicated, identifying the state in which the issuing government municipality or agency operates.

At September 30, 2017, the Company's investment securities portfolios included securities issued by 662 state and local government municipalities and agencies located within 45 states. None of the Company's investment securities were issued by Puerto Rican government entities. The largest exposure to any one municipality or agency was \$10.1 million (fair value) represented by nine general obligation bonds.

At September 30,  
2017  
Amortized Fair  
Cost Value  
(In thousands)

Obligations of states and political subdivisions:

General obligation bonds:		
California	\$94,536	\$97,251
Texas	66,823	67,200
New Jersey	39,474	40,073
Minnesota	30,558	30,937
Other (36 states)	298,187	302,140
Total general obligation bonds	\$529,578	\$537,601
Revenue bonds:		
California	\$41,261	\$42,389
Kentucky	22,724	23,155
Iowa	17,322	17,472
Colorado	15,512	15,816
Washington	13,523	14,140
Indiana	13,363	13,606
Other (29 states)	139,380	141,709
Total revenue bonds	\$263,085	\$268,287
Total obligations of states and political subdivisions	\$792,663	\$805,888

At December 31, 2016, the Company's investment securities portfolios included securities issued by 698 state and local government municipalities and agencies located within 44 states. None of the Company's investment securities were issued by Puerto Rican government entities. The largest exposure to any one municipality or agency was \$10.0 million (fair value) represented by nine general obligation bonds.

	At December 31, 2016	
	Amortized Fair	
	Cost	Value
	(In thousands)	
Obligations of states and political subdivisions:		
General obligation bonds:		
California	\$ 105,129	\$ 106,391
Texas	69,017	68,671
New Jersey	40,111	40,102
Pennsylvania	37,384	37,543
Minnesota	32,946	32,847
Other (36 states)	280,488	279,571
Total general obligation bonds	\$ 565,075	\$ 565,125
Revenue bonds:		
California	\$ 47,415	\$ 48,429
Kentucky	22,854	22,902
Pennsylvania	18,568	18,683
Iowa	18,086	18,302
Colorado	15,574	15,674
Other (30 states)	157,452	159,054
Total revenue bonds	\$ 279,949	\$ 283,044
Total obligations of states and political subdivisions	\$ 845,024	\$ 848,169

At September 30, 2017 and December 31, 2016, the revenue bonds in the Company's investment securities portfolios were issued by state and local government municipalities and agencies to fund public services such as water utility, sewer utility, recreational and school facilities, and general public and economic improvements. The revenue bonds were payable from 22 revenue sources at September 30, 2017 and 23 revenue sources December 31, 2016. The revenue sources that represent 5% or more individually of the total revenue bonds are summarized in the following tables.

	At September 30, 2017	
	Amortized Fair	
	Cost	Value
	(In thousands)	
Revenue bonds by revenue source:		
Water	\$ 53,416	\$ 55,155
Sewer	34,754	35,600
Sales tax	30,255	31,133
Lease (renewal)	20,991	21,379

College & University	17,705	17,695
Other (17 sources)	105,964	107,325
Total revenue bonds by revenue source	\$263,085	\$268,287

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	At December 31, 2016	
	Amortized Fair Cost	Value
	(In thousands)	
Revenue bonds by revenue source:		
Water	\$55,401	\$56,826
Sewer	37,996	38,497
Sales tax	31,146	31,835
Lease (renewal)	24,242	24,235
College & University	17,856	17,762
Other (18 sources)	113,308	113,889
Total revenue bonds by revenue source	\$279,949	\$283,044

See Note 3 to the unaudited consolidated financial statements for additional information related to the investment securities.

### **Loan Portfolio Credit Risk**

The Company extends loans to commercial and consumer customers which expose the Company to the risk borrowers will default, causing loan losses. The Company's lending activities are exposed to various qualitative risks. All loan segments are exposed to risks inherent in the economy and market conditions. Significant risk characteristics related to the commercial loan segment include the borrowers' business performance and financial condition, and the value of collateral for secured loans. Significant risk characteristics related to the commercial real estate segment include the borrowers' business performance and the value of properties collateralizing the loans. Significant risk characteristics related to the construction loan segment include the borrowers' performance in successfully developing the real estate into the intended purpose and the value of the property collateralizing the loans. Significant risk characteristics related to the residential real estate segment include the borrowers' financial wherewithal to service the mortgages and the value of the property collateralizing the loans. Significant risk characteristics related to the consumer loan segment include the financial condition of the borrowers and the value of collateral securing the loans.

The preparation of the financial statements requires Management to estimate the amount of losses inherent in the loan portfolio and establish an allowance for credit losses. The allowance for credit losses is maintained by assessing or reversing a provision for loan losses through the Company's earnings. In estimating credit losses, Management must exercise judgment in evaluating information deemed relevant, such as financial information regarding individual borrowers, overall credit loss experience, the amount of past due, nonperforming and classified loans, recommendations of regulatory authorities, prevailing economic conditions and other information. The amount of ultimate losses on the loan portfolio can vary from the estimated amounts. Management follows a systematic

methodology to estimate loss potential in an effort to reduce the differences between estimated and actual losses.

The Company closely monitors the markets in which it conducts its lending operations and follows a strategy to control exposure to loans with high credit risk. The Bank's organization structure separates the functions of business development and loan underwriting; Management believes this segregation of duties avoids inherent conflicts of combining business development and loan approval functions. In measuring and managing credit risk, the Company adheres to the following practices.

The Bank maintains a Loan Review Department which reports directly to the Board of Directors. The Loan Review Department performs independent evaluations of loans and assigns credit risk grades to evaluated loans using grading standards employed by bank regulatory agencies. Those loans judged to carry higher risk attributes are referred to as "classified loans." Classified loans receive elevated management attention to maximize collection.

The Bank maintains two loan administration offices whose sole responsibility is to manage and collect classified loans.

Classified loans with higher levels of credit risk are further designated as "nonaccrual loans." Management places classified loans on nonaccrual status when full collection of contractual interest and principal payments is in doubt. Uncollected interest previously accrued on loans placed on nonaccrual status is reversed as a charge against interest income. The Company does not accrue interest income on loans following placement on nonaccrual status. Interest payments received on nonaccrual loans are applied to reduce the carrying amount of the loan unless the carrying amount is well secured by loan collateral.

“Nonperforming assets” include nonaccrual loans, loans 90 or more days past due and still accruing, and repossessed loan collateral (commonly referred to as “Other Real Estate Owned”).

#### Nonperforming Assets

	At September 30,		At December 31,
	2017	2016	2016
	(In thousands)		
Nonperforming nonaccrual loans	\$1,498	\$1,861	\$3,956
Performing nonaccrual loans	4,285	4,432	4,429
Total nonaccrual loans	5,783	6,293	8,385
Accruing loans 90 or more days past due	434	487	497
Total nonperforming loans	6,217	6,780	8,882
Other real estate owned	1,426	3,032	3,095
Total nonperforming assets	\$7,643	\$9,812	\$11,977

Nonperforming assets have declined during 2016 and the first nine months of 2017 due to payoffs, chargeoffs and sale of Other Real Estate Owned. At September 30, 2017, one loan secured by commercial real estate with a balance of \$4.3 million was on nonaccrual status. The remaining four nonaccrual loans held at September 30, 2017 had an average carrying value of \$375 thousand and the largest carrying value was \$573 thousand.

Management believes the overall credit quality of the loan portfolio is reasonably stable; however, classified and nonperforming assets could fluctuate from period to period. The performance of any individual loan can be affected by external factors such as the interest rate environment, economic conditions, and collateral values or factors particular to the borrower. No assurance can be given that additional increases in nonaccrual and delinquent loans will not occur in the future.

#### Allowance for Loan Losses

The Company’s allowance for loan losses represents Management’s estimate of loan losses inherent in the loan portfolio. In evaluating credit risk for loans, Management measures loss potential of the carrying value of loans. As described above, payments received on nonaccrual loans may be applied against the principal balance of the loans until such time as full collection of the remaining recorded balance is expected.

The following table summarizes the allowance for loan losses, chargeoffs and recoveries for the periods indicated:

	For the Three Months Ended September 30,		For the Nine Months		
	2017	2016	2017	2016	
	(\$ in thousands)				
<b>Analysis of the Allowance for Loan Losses</b>					
Balance, beginning of period	\$24,103	\$28,910	\$25,954	\$29,771	
Reversal of provision for loan losses	-	(3,200)	(1,900)	(3,200)	
Loans charged off					
Commercial	(132)	(88)	(961)	(2,024)	
Real estate residential	-	-	-	-	
Consumer installment and other	(886)	(1,848)	(3,783)	(3,568)	
Total chargeoffs	(1,018)	(1,936)	(4,744)	(5,592)	
Recoveries of loans previously charged off					
Commercial	128	1,739	626	3,703	
Commercial real estate	-	509	88	539	
Construction	-	-	1,899	-	
Consumer installment and other	415	337	1,705	1,138	
Total recoveries	543	2,585	4,318	5,380	
Net loan (losses) recoveries	(475)	649	(426)	(212)	
Balance, end of period	\$23,628	\$26,359	\$23,628	\$26,359	
Net loan losses (recoveries) as a percentage of average total loans (annualized)	0.15	% (0.19	%)	0.04	% 0.02

The Company's allowance for loan losses is maintained at a level considered appropriate to provide for losses that can be estimated based upon specific and general conditions. These include conditions unique to individual borrowers, as well as overall loan loss experience, the amount of past due, nonperforming and classified loans, recommendations of regulatory authorities, prevailing economic conditions and other factors. A portion of the allowance is individually allocated to impaired loans whose full collectability of principal is uncertain. Such allocations are determined by Management based on loan-by-loan analyses. The Company evaluates for impairment all loans with outstanding principal balances in excess of \$500 thousand which are classified or on nonaccrual status and all "troubled debt restructured" loans. The remainder of the loan portfolio is collectively evaluated for impairment based in part on quantitative analyses of historical loan loss experience of loan portfolio segments to determine standard loss rates for each segment. The loss rate for each loan portfolio segment reflects both the historical loss experience during a look-back period and a loss emergence period. Liquidating purchased consumer installment loans are evaluated separately by applying historical loss rates to forecasted liquidating principal balances to measure losses inherent in this portfolio segment. The loss rates are applied to segmented loan balances to allocate the allowance to the segments of the loan portfolio.

The remainder of the allowance is considered to be unallocated. The unallocated allowance is established to provide for probable losses that have been incurred as of the reporting date but not reflected in the allocated allowance. The unallocated allowance addresses additional qualitative factors consistent with Management's analysis of the level of risks inherent in the loan portfolio, which are related to the risks of the Company's general lending activity. Included in the unallocated allowance is the risk of losses that are attributable to national or local economic or industry trends which have occurred but have not yet been recognized in loan chargeoff history (external factors). The primary external factor evaluated by the Company and the judgmental amount of unallocated reserve assigned by Management as of September 30, 2017 is economic and business conditions \$0.7 million. Also included in the unallocated allowance is the risk of losses attributable to general attributes of the Company's loan portfolio and credit administration (internal factors). The internal factors evaluated by the Company and the judgmental amount of unallocated reserve assigned by Management are: loan review system \$1.1 million, adequacy of lending Management and staff \$0.4 million and concentrations of credit \$1.3 million.

Allowance for Loan Losses  
For the Three Months Ended September 30, 2017

	Commercial		Construction	Residential		Consumer	Unallocated	Total
	Commercial	Real Estate		Real Estate	Installment	and Other		
	(In thousands)							
Allowance for loan losses:								
Balance at beginning of period	\$8,167	\$ 3,545	\$ 160	\$ 1,105	\$ 7,215	\$ 3,911		\$24,103
Additions:								
(Reversal) provision	(391 )	288	136	(50 )	167	(150 )		-
Deductions:								
Chargeoffs	(132 )	-	-	-	(886 )	-		(1,018 )
Recoveries	128	-	-	-	415	-		543
Net loan losses	(4 )	-	-	-	(471 )	-		(475 )

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Total allowance for loan losses \$7,772 \$ 3,833 \$ 296 \$ 1,055 \$ 6,911 \$ 3,761 \$23,628

Allowance for Loan Losses  
For the Nine Months Ended September 30, 2017

	Commercial Real Estate	Commercial Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Unallocated	Total
(In thousands)							
Allowance for loan losses:							
Balance at beginning of period	\$8,327	\$ 3,330	\$ 152	\$ 1,330	\$ 7,980	\$ 4,835	\$25,954
Additions:							
(Reversal) provision	(220 )	415	(1,755 )	(275 )	1,009	(1,074 )	(1,900 )
Deductions:							
Chargeoffs	(961 )	-	-	-	(3,783 )	-	(4,744 )
Recoveries	626	88	1,899	-	1,705	-	4,318
Net loan (losses) recoveries	(335 )	88	1,899	-	(2,078 )	-	(426 )
Total allowance for loan losses	\$7,772	\$ 3,833	\$ 296	\$ 1,055	\$ 6,911	\$ 3,761	\$23,628

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Allowance for Loan Losses and Recorded Investment in Loans Evaluated  
for Impairment

At September 30, 2017

	Commercial Commercial Estate	Real Estate	Construction	Residential Real Estate	Consumer Installment and Other	Unallocated	Total
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(In thousands)

Allowance for loan losses:

Individually evaluated for impairment	\$4,922	\$154	\$-	\$-	\$-	\$-	\$5,076
Collectively evaluated for impairment	2,850	3,679	296	1,055	6,911	3,761	18,552
Purchased loans with evidence of credit deterioration	-	-	-	-	-	-	-
Total	\$7,772	\$3,833	\$296	\$1,055	\$6,911	\$3,761	\$23,628
Carrying value of loans:							
Individually evaluated for impairment	\$10,749	\$13,973	\$-	\$211	\$-	\$-	\$24,933
Collectively evaluated for impairment	306,113	559,182	4,992	68,913	319,889	-	1,259,0
Purchased loans with evidence of credit deterioration	29	562	-	-	169	-	760
Total	\$316,891	\$573,717	\$4,992	\$69,124	\$320,058	\$-	\$1,284,7

The portion of the allowance for loan losses ascribed to loan segments declined from September 30, 2016 to September 30, 2017 due to declines in classified loans, delinquent loans, and the overall loan portfolio. The decline in the unallocated portion was due to improved economic conditions within the Company's geographic markets.

Management considers the \$23.6 million allowance for loan losses to be adequate as a reserve against loan losses inherent in the loan portfolio as of September 30, 2017.

See Note 4 to the unaudited consolidated financial statements for additional information related to the loan portfolio, loan portfolio credit risk, and allowance for loan losses.

## Asset/Liability and Market Risk Management

Asset/liability management involves the evaluation, monitoring and management of interest rate risk, market risk, liquidity and funding. The fundamental objective of the Company's management of assets and liabilities is to maximize its economic value while maintaining adequate liquidity and a conservative level of interest rate risk.

### **Interest Rate Risk**

Interest rate risk is a significant market risk affecting the Company. Many factors affect the Company's exposure to interest rates, such as general economic and financial conditions, customer preferences, historical pricing relationships, and re-pricing characteristics of financial instruments. Assets and liabilities may mature or re-price at different times. Assets and liabilities may re-price at the same time but by different amounts. Short-term and long-term market interest rates may change by different amounts. The timing and amount of cash flows of various assets or liabilities may shorten or lengthen as interest rates change. In addition, the changing levels of interest rates may have an impact on loan demand, demand for various deposit products, credit losses, and other elements of earnings such as account analysis fees on commercial deposit accounts and correspondent bank service charges.

The Company's earnings are affected not only by general economic conditions, but also by the monetary and fiscal policies of the United States government and its agencies, particularly the Federal Open Market Committee (the "FOMC"). The monetary policies of the FOMC can influence the overall growth of loans, investment securities, and deposits and the level of interest rates earned on assets and paid for liabilities. The nature and impact of future changes in monetary policies are generally not predictable.

Management expects a high level of uncertainty in regard to interest rate levels in the immediate term, and Management's most likely earnings forecast for the twelve months ending September 30, 2018 assumes market interest rates will gradually rise, with short-term rates rising more than long-term rates.

In adjusting the Company's asset/liability position, Management attempts to manage interest rate risk while enhancing the net interest margin and net interest income. At times, depending on expected increases or decreases in general interest rates, the relationship between long and short-term interest rates, market conditions and competitive factors, Management may adjust the Company's interest rate risk position in order to manage its net interest margin and net interest income. The Company's results of operations and net portfolio values remain subject to changes in interest rates and to fluctuations in the difference between long and short-term interest rates.



The Company's asset and liability position was "neutral" to slightly "asset sensitive" at September 30, 2017, depending on the interest rate assumptions applied to the simulation model employed by Management to measure interest rate risk. An "asset sensitive" position results in a slightly larger change in interest income than in interest expense resulting from application of assumed interest rate changes. Simulation estimates depend on, and will change with, the size and mix of the actual and projected balance sheet at the time of each simulation. Management continues to monitor the interest rate environment as well as economic conditions and other factors it deems relevant in managing the Company's exposure to interest rate risk.

The Company does not currently engage in trading activities or use derivative instruments to control interest rate risk, even though such activities may be permitted with the approval of the Company's Board of Directors.

### **Market Risk - Equity Markets**

Equity price risk can affect the Company. As an example, any preferred or common stock holdings, as permitted by banking regulations, can fluctuate in value. Management regularly assesses the extent and duration of any declines in market value, the causes of such declines, the likelihood of a recovery in market value, and its intent to hold securities until a recovery in value occurs. Declines in value of preferred or common stock holdings that are deemed "other than temporary" could result in loss recognition in the Company's income statement.

Fluctuations in the Company's common stock price can impact the Company's financial results in several ways. First, the Company has regularly repurchased and retired its common stock; the market price paid to retire the Company's common stock affects the level of the Company's shareholders' equity, cash flows and shares outstanding. Second, the Company's common stock price impacts the number of dilutive equivalent shares used to compute diluted earnings per share. Third, fluctuations in the Company's common stock price can motivate holders of options to purchase Company common stock through the exercise of such options thereby increasing the number of shares outstanding and potentially adding volatility to the book tax provision. Finally, the amount of compensation expense associated with share based compensation fluctuates with changes in and the volatility of the Company's common stock price.

### **Market Risk - Other**

Market values of loan collateral can directly impact the level of loan chargeoffs and the provision for loan losses. The financial condition and liquidity of debtors issuing bonds and debtors whose mortgages or other obligations are securitized can directly impact the credit quality of the Company's investment securities portfolio requiring the Company to recognize other than temporary impairment charges. Other types of market risk, such as foreign currency exchange risk, are not significant in the normal course of the Company's business activities.

## **Liquidity and Funding**

The objective of liquidity management is to manage cash flow and liquidity reserves so that they are adequate to fund the Company's operations and meet obligations and other commitments on a timely basis and at a reasonable cost. The Company achieves this objective through the selection of asset and liability maturity mixes that it believes best meet its needs. The Company's liquidity position is enhanced by its ability to raise additional funds as needed in the wholesale markets.

In recent years, the Company's deposit base has provided the majority of the Company's funding requirements. This relatively stable and low-cost source of funds, along with shareholders' equity, provided 98 percent of funding for average total assets in the first nine months of 2017 and in 2016. The stability of the Company's funding from customer deposits is in part reliant on the confidence clients have in the Company. The Company places a very high priority in maintaining this confidence through conservative credit and capital management practices and by maintaining an appropriate level of liquidity reserves.

Liquidity is further provided by assets such as balances held at the Federal Reserve Bank, investment securities, and amortizing loans. The Company's investment securities portfolio provides a substantial secondary liquidity reserve. The Company held \$3.3 billion in total investment securities at September 30, 2017. Under certain deposit, borrowing and other arrangements, the Company must hold and pledge investment securities as collateral. At September 30, 2017, such collateral requirements totaled approximately \$771 million.

Liquidity risk can result from the mismatching of asset and liability cash flows, or from disruptions in the financial markets. The Company performs liquidity stress tests on a periodic basis to evaluate the sustainability of its liquidity. Under the stress testing, the Company assumes outflows of funds increase beyond expected levels. Measurement of such heightened outflows considers the composition of the Company's deposit base, including any concentration of deposits, non-deposit funding such as short-term borrowings, and unfunded lending commitments. The Company evaluates its stock of highly liquid assets to meet the assumed higher levels of outflows. Highly liquid assets include cash and amounts due from other banks from daily transaction settlements, reduced by branch cash needs and Federal Reserve Bank reserve requirements, and investment securities based on regulatory risk-weighting guidelines. Based on the results of the most recent liquidity stress test, Management is satisfied with the liquidity condition of the Bank and the Company. However, no assurance can be given the Bank or Company will not experience a period of reduced liquidity.

Management continually monitors the Company's cash levels. Loan demand from credit worthy borrowers will be dictated by economic and competitive conditions. The Company aggressively solicits non-interest bearing demand deposits and money market checking deposits, which are the least sensitive to changes in interest rates. The growth of these deposit balances is subject to heightened competition, the success of the Company's sales efforts, delivery of superior customer service, new regulations and market conditions. The Company does not aggressively solicit higher-costing time deposits; as a result, Management anticipates such deposits will decline. Changes in interest rates, most notably rising interest rates, could impact deposit volumes. Depending on economic conditions, interest rate levels, liquidity management and a variety of other conditions, deposit growth may be used to fund loans or purchase investment securities. However, due to possible volatility in economic conditions, competition and political uncertainty, loan demand and levels of customer deposits are not certain. Shareholder dividends are expected to continue subject to the Board's discretion and continuing evaluation of capital levels, earnings, asset quality and other factors.

Westamerica Bancorporation ("Parent Company") is a separate entity apart from Westamerica Bank ("Bank") and must provide for its own liquidity. In addition to its operating expenses, the Parent Company is responsible for the payment of dividends declared for its shareholders, and interest and principal on any outstanding debt. The Parent Company currently has no debt. Substantially all of the Parent Company's revenues are obtained from subsidiary dividends and service fees.

The Bank's dividends paid to the Parent Company, proceeds from the exercise of stock options, and Parent Company cash balances provided adequate cash for the Parent Company to pay shareholder dividends of \$31 million in the first nine months of 2017 and \$40 million in 2016, and retire common stock in the amount of \$314 thousand in the first nine months of 2017 and \$6 million in 2016. Payment of dividends to the Parent Company by the Bank is limited under California and Federal laws. The Company believes these regulatory dividend restrictions will not have an impact on the Parent Company's ability to meet its ongoing cash obligations.

## Capital Resources

The Company has historically generated high levels of earnings, which provide a means of accumulating capital. The Company's net income as a percentage of average shareholders' equity ("return on equity" or "ROE") has been 10.4% in the first nine months of 2017 and 10.9% in 2016. The Company also raises capital as employees exercise stock options. Capital raised through the exercise of stock options was \$19 million in the first nine months of 2017 and \$24 million in 2016.

The Company paid common dividends totaling \$31 million in the first nine months of 2017 and \$40 million in 2016, which represent dividends per common share of \$1.17 and \$1.56, respectively. The Company's earnings have historically exceeded dividends paid to shareholders. The amount of earnings in excess of dividends provides the Company resources to finance growth and maintain appropriate levels of shareholders' equity. In the absence of profitable growth opportunities, the Company has repurchased and retired its common stock as another means to return earnings to shareholders. The Company repurchased and retired 6 thousand shares valued at \$314 thousand in the first nine months of 2017 and 137 thousand shares valued at \$6 million in 2016.

The Company's primary capital resource is shareholders' equity, which was \$604 million at September 30, 2017 compared with \$561 million at December 31, 2016. The Company's ratio of equity to total assets was 11.09% at September 30, 2017 and 10.46% at December 31, 2016.

The Company performs capital stress tests on a periodic basis to evaluate the sustainability of its capital. Under the stress testing, the Company assumes various scenarios such as deteriorating economic and operating conditions, unanticipated asset devaluations, and significant operational lapses. The Company measures the impact of these scenarios on its earnings and capital. Based on the results of the most recent stress tests, Management is satisfied with the capital condition of the Bank and the Company. However, no assurance can be given the Bank or Company will not experience a period of reduced earnings or a reduction in capital from unanticipated events and circumstances.

### Capital to Risk-Adjusted Assets

On July 2, 2013, the Federal Reserve Board approved a final rule that implements changes to the regulatory capital framework for all banking organizations. The rule's provisions which most affected the regulatory capital requirements of the Company and the Bank:

- Introduced a new "Common Equity Tier 1" capital measurement,
- Established higher minimum levels of capital,
- Introduced a "capital conservation buffer,"
- Increased the risk-weighting of certain assets, and
- Established limits on the amount of deferred tax assets with any excess treated as a deduction from Tier 1 capital.

Under the final rule, a banking organization that is not subject to the "advanced approaches rule" may make a one-time election not to include most elements of Accumulated Other Comprehensive Income, including net-of-tax unrealized gains and losses on available for sale investment securities, in regulatory capital. Neither the Company nor the Bank is subject to the "advanced approaches rule" and both made the election not to include most elements of Accumulated Other Comprehensive Income in regulatory capital.

Banking organizations that are not subject to the "advanced approaches rule" began complying with the final rule on January 1, 2015; on such date, the Company and the Bank became subject to the revised definitions of regulatory capital, the new minimum regulatory capital ratios, and various regulatory capital adjustments and deductions according to transition provisions and timelines. All banking organizations began calculating standardized total risk-weighted assets on January 1, 2015. The transition period for the capital conservation buffer for all banking organizations began on January 1, 2016 and will end January 1, 2019. Any bank subject to the rule which is unable to maintain its "capital conservation buffer" will be restricted in the payment of discretionary executive compensation and shareholder distributions, such as dividends and share repurchases.

The final rule did not supersede provisions of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) requiring federal banking agencies to take prompt corrective action (PCA) to resolve problems of insured depository institutions. The final rule revised the PCA thresholds to incorporate the higher minimum levels of capital, including the "common equity tier 1" ratio.

The capital ratios for the Company and the Bank under the new capital framework are presented in the table below, on the dates indicated.

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	At September 30, 2017				Required for Capital Adequacy Purposes Effective January 1, 2017				Effective		To Be Well-capitalized Under Prompt Corrective Action Regulations (Bank)	
	Company	Bank							January 1, 2019			
Common Equity Tier I Capital	15.73	%	12.59	%	5.75	% <sup>(1)</sup>	7.00	% <sup>(2)</sup>	6.50		%	
Tier I Capital	15.73	%	12.59	%	7.25	% <sup>(1)</sup>	8.50	% <sup>(2)</sup>	8.00		%	
Total Capital	16.71	%	13.78	%	9.25	% <sup>(1)</sup>	10.50	% <sup>(2)</sup>	10.00		%	
Leverage Ratio	9.03	%	7.18	%	4.00	%	4.00	%	5.00		%	

<sup>(1)</sup> Includes 1.25% capital conservation buffer.

<sup>(2)</sup> Includes 2.5% capital conservation buffer.

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	At December 31, 2016				Required for Capital Adequacy Purposes				To Be Well-capitalized Under Prompt Corrective Action	
	Company		Bank		Effective January 1, 2016		Effective January 1, 2019		Regulations (Bank)	
Common Equity Tier I Capital	14.85	%	11.70	%	5.125	% <sup>(3)</sup>	7.00	% <sup>(4)</sup>	6.50	%
Tier I Capital	14.85	%	11.70	%	6.625	% <sup>(3)</sup>	8.50	% <sup>(4)</sup>	8.00	%
Total Capital	15.95	%	13.02	%	8.625	% <sup>(3)</sup>	10.50	% <sup>(4)</sup>	10.00	%
Leverage Ratio	8.46	%	6.63	%	4.000	%	4.00	%	5.00	%

<sup>(3)</sup> Includes 0.625% capital conservation buffer.

<sup>(4)</sup> Includes 2.5% capital conservation buffer.

The Company and the Bank routinely project capital levels by analyzing forecasted earnings, credit quality, securities valuations, shareholder dividends, asset volumes, share repurchase activity, stock option exercise proceeds, and other factors. Based on current capital projections, the Company and the Bank expect to maintain regulatory capital levels exceeding the highest effective regulatory standard and pay quarterly dividends to shareholders. No assurance can be given that changes in capital management plans will not occur.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company does not currently engage in trading activities or use derivative instruments to control interest rate risk, even though such activities may be permitted with the approval of the Company's Board of Directors.

Credit risk and interest rate risk are the most significant market risks affecting the Company, and equity price risk can also affect the Company's financial results. These risks are described in the preceding sections regarding "Loan Portfolio Credit Risk," and "Asset/Liability and Market Risk Management." Other types of market risk, such as foreign currency exchange risk and commodity price risk, are not significant in the normal course of the Company's business activities.

#### **Item 4. Controls and Procedures**

The Company's principal executive officer and principal financial officer have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended, as of September 30, 2017.

Based upon their evaluation, the principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective to ensure that material information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported as and when required and that such information is communicated to the Company's management, including the principal executive officer and the principal financial officer, to allow for timely decisions regarding required disclosures. The evaluation did not identify any change in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2017 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

Neither the Company nor any of its subsidiaries is a party to any material pending legal proceeding, nor is their property the subject of any material pending legal proceeding, other than ordinary routine legal proceedings arising in the ordinary course of the Company's business. None of these proceedings is expected to have a material adverse impact upon the Company's business, financial position or results of operations.



**Item 1A. Risk Factors**

The Company's Form 10-K as of December 31, 2016 includes detailed disclosure about the risks faced by the Company's business; such risks have not materially changed since the Form 10-K was filed.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(a) Previously reported on Form 8-K.

(b) None

(c) Issuer Purchases of Equity Securities

The table below sets forth the information with respect to purchases made by or on behalf of Westamerica Bancorporation or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of common stock during the quarter ended September 30, 2017 (in thousands, except per share data).

Period	2017		(c) Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
	(a) Total Number of shares Purchased	(b) Average Price Paid per Share		
	(In thousands, except price paid)			
July 1 through July 31	-	\$ -	-	1,750
August 1 through August 31	-	-	-	1,750
September 1 through September 30	-	-	-	1,750

Total - \$ - - 1,750

The Company repurchases shares of its common stock in the open market on a discretionary basis to optimize the Company's use of equity capital and enhance shareholder value and with the intention of lessening the dilutive impact of issuing new shares under stock option plans, and other ongoing requirements.

No shares were repurchased during the period from July 1, 2017 through September 30, 2017. A replacement program approved by the Board of Directors on July 28, 2017 authorizes the purchase of up to 1,750 thousand shares of the Company's common stock from time to time prior to September 1, 2018.

### **Item 3. Defaults upon Senior Securities**

None

### **Item 4. Mine Safety Disclosures**

Not applicable.

### **Item 5. Other Information**

None

### **Item 6. Exhibits**

The exhibit list required by this item is incorporated by reference to the Exhibit Index filed with this report.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

WESTAMERICA BANCORPORATION

(Registrant)

/s/ JOHN "ROBERT" THORSON

John "Robert" Thorson

Senior Vice President and Chief Financial Officer

(Chief Financial and Accounting Officer)

Date: November 3, 2017

## EXHIBIT INDEX

Exhibit 31.1: Certification of Chief Executive Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)

Exhibit 31.2: Certification of Chief Financial Officer pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)

Exhibit 32.1: Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32.2: Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 101: Pursuant to Rule 405 of Regulation S-T, the following financial information from the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2017, is formatted in XBRL interactive data files: (i) Consolidated Statements of Income for the three and nine months ended September 30, 2017 and 2016; (ii) Consolidated Balance Sheets at September 30, 2017, and December 31, 2016; (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2017 and 2016, (iv) Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2017 and 2016; (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2017 and 2016; and (vi) Notes to the Unaudited Consolidated Financial Statements.

