

**SOUTHPOINT BANCSHARES, INC.
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2017 AND 2016

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
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DECEMBER 31, 2017 AND 2016

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INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders
SouthPoint Bancshares, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of SouthPoint Bancshares, Inc. and Subsidiaries as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SouthPoint Bancshares, Inc. and Subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information

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

Warren Averett, LLC

Birmingham, Alabama
March 19, 2018

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2017 AND 2016

ASSETS	2017	2016
CASH AND CASH EQUIVALENTS		
Cash and due from banks	\$ 2,164,005	\$ 2,184,828
Interest bearing deposits in other banks	963,127	4,306,778
Federal funds sold	-	410
Total cash and cash equivalents	3,127,132	6,492,016
Securities available-for-sale	41,163,147	40,830,760
Loans held-for-sale	5,540,422	9,526,830
Loans, net of allowance for loan losses	240,803,868	208,232,199
Premises and equipment, net	11,479,123	5,580,204
Other real estate	265,882	802,091
Bank-owned life insurance	3,192,086	3,113,210
Deferred tax assets	528,971	1,023,587
Other assets	3,074,400	1,723,084
TOTAL ASSETS	\$ 309,175,031	\$ 277,323,981
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS		
Interest bearing	\$ 219,542,681	\$ 218,931,050
Noninterest bearing	29,641,047	28,831,357
Total deposits	249,183,728	247,762,407
FHLB advances	28,000,000	4,000,000
Federal funds purchased	1,249,000	50,000
Accounts payable and accrued liabilities	2,241,985	1,123,996
Line-of-credit	1,737,952	1,696,646
TOTAL LIABILITIES	282,412,665	254,633,049
SHAREHOLDERS' EQUITY		
Preferred stock, \$1 par value; 10,000,000 shares authorized and none issued or outstanding	-	-
Common stock, \$1 par value; 10,000,000 shares authorized; 2,124,000 and 2,101,001 shares issued at December 31, 2017 and 2016, respectively, and 1,987,835 and 1,964,834 shares outstanding at December 31, 2017 and 2016, respectively	2,124,000	2,101,001
Additional paid-in capital	20,300,070	19,925,876
Retained earnings	5,792,895	2,695,878
Accumulated other comprehensive income (loss)	126,941	(450,260)
Treasury stock, 136,165 and 136,167 shares at cost at December 31, 2017 and 2016, respectively	(1,581,540)	(1,581,563)
Total shareholders' equity	26,762,366	22,690,932
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 309,175,031	\$ 277,323,981

See notes to the consolidated financial statements.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
INTEREST INCOME		
Interest and fees on loans	\$ 11,913,509	\$ 9,816,503
Interest on investment securities	1,282,374	1,258,334
Total interest income	<u>13,195,883</u>	<u>11,074,837</u>
INTEREST EXPENSE		
Interest on deposits	1,548,767	1,347,857
Interest on borrowed funds	291,655	336,028
Total interest expense	<u>1,840,422</u>	<u>1,683,885</u>
NET INTEREST INCOME	11,355,461	9,390,952
PROVISION FOR LOAN LOSSES	<u>300,000</u>	<u>175,000</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>11,055,461</u>	<u>9,215,952</u>
NONINTEREST INCOME		
Service charges, fees and commissions	486,788	419,694
Mortgage origination and servicing-release premium fees	4,952,624	4,986,924
Net gain (loss) on sale of available-for-sale securities	(20,039)	37,646
Other	118,214	572,089
Total noninterest income	<u>5,537,587</u>	<u>6,016,353</u>
NONINTEREST EXPENSES		
Salaries and employee benefits	7,432,399	6,688,484
Net occupancy expenses	683,787	643,967
Other real estate costs (recoveries)	(44,421)	9,723
Operating expenses	3,358,160	3,790,382
Total noninterest expenses	<u>11,429,925</u>	<u>11,132,556</u>
INCOME BEFORE INCOME TAXES	5,163,123	4,099,749
INCOME TAX EXPENSE	<u>(2,045,217)</u>	<u>(1,126,055)</u>
NET INCOME	<u>\$ 3,117,906</u>	<u>\$ 2,973,694</u>

See notes to the consolidated financial statements.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
NET INCOME	<u>\$ 3,117,906</u>	<u>\$ 2,973,694</u>
OTHER COMPREHENSIVE INCOME (LOSS)		
Net change in unrealized gains (losses) on available-for-sale securities, net of tax	569,538	(879,976)
Reclassification of certain tax effects to accumulated other comprehensive income	20,889	-
Reclassification adjustment for gains (losses) on securities available-for-sale realized in net income, net of taxes	<u>(13,226)</u>	<u>20,209</u>
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)	<u>577,201</u>	<u>(859,767)</u>
TOTAL COMPREHENSIVE INCOME	<u><u>\$ 3,674,218</u></u>	<u><u>\$ 2,113,927</u></u>

See notes to the consolidated financial statements.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	Common Stock	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
BALANCE AT DECEMBER 31, 2015	\$ 2,101,001	\$ 19,923,169	\$ (277,816)	\$ 409,507	\$ -	\$ 22,155,861
Net income	-	-	2,973,694	-	-	2,973,694
Other comprehensive income	-	-	-	(859,767)	-	(859,767)
Share-based compensation	-	2,707	-	-	-	2,707
Treasury stock purchase	-	-	-	-	(1,581,563)	(1,581,563)
BALANCE AT DECEMBER 31, 2016	2,101,001	19,925,876	2,695,878	(450,260)	(1,581,563)	22,690,932
Net income	-	-	3,117,906	-	-	3,117,906
Other comprehensive income	-	-	-	556,312	-	556,312
Reclassification of certain tax effects to accumulated other comprehensive income	-	-	(20,889)	20,889	-	-
Share-based compensation	-	167,203	-	-	-	167,203
Stock options exercised	22,999	206,991	-	-	-	229,990
Treasury stock sold	-	-	-	-	23	23
BALANCE AT DECEMBER 31, 2017	\$ 2,124,000	\$ 20,300,070	\$ 5,792,895	\$ 126,941	\$ (1,581,540)	\$ 26,762,366

See notes to the consolidated financial statements.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 3,117,906	\$ 2,973,694
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	255,427	268,501
Proceeds from loans held-for-sale	112,855,606	115,683,293
Origination of loans held-for-sale	(108,869,198)	(118,337,380)
Provision for loan losses	300,000	175,000
Net realized loss (gain) on investments	20,039	(37,646)
Realized gains on disposition and write down of other real estate, net	(50,163)	(13,502)
Amortization of premiums and discounts on securities available-for-sale	228,828	262,947
Share-based compensation	167,203	2,707
Proceeds from bank owned life insurance	-	(352,292)
Deferred income expense	473,727	85,196
Decrease (increase) in cash surrender value of life insurance	(78,876)	497,865
Decrease (increase) in FHLB stock	(1,064,600)	700,900
Change in other assets	(552,413)	(153,325)
Change in accounts payable and accrued liabilities	1,117,989	332,165
Net cash provided by operating activities	<u>\$ 7,921,475</u>	<u>\$ 2,088,123</u>

See notes to the consolidated financial statements.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of premises and equipment	\$ (93,414)	\$ (129,913)
Payments for construction-in-progress	(6,060,932)	(3,046,525)
Net change in loans	(33,063,832)	(44,792,085)
Pay downs, calls and maturities of available-for-sale securities	1,023,813	1,910,341
Purchase of available-for-sale securities	(7,830,928)	(14,829,665)
Sales of available-for-sale securities	7,068,759	10,733,913
Federal funds purchased	1,199,000	50,000
Net proceeds from disposition of foreclosed real estate	<u>778,535</u>	<u>655,388</u>
Net cash used in investing activities	<u>(36,978,999)</u>	<u>(49,448,546)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Net change in deposits	1,421,321	62,950,361
Sale (purchase) of treasury stock	23	(1,581,563)
Net change in line-of-credit	41,306	1,696,646
Advances (payments) on FHLB advance line	24,000,000	(16,000,000)
Proceeds from exercise of stock options	<u>229,990</u>	<u>-</u>
Net cash provided by financing activities	<u>25,692,640</u>	<u>47,065,444</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	<u>(3,364,884)</u>	<u>(294,979)</u>
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>6,492,016</u>	<u>6,786,995</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 3,127,132</u>	<u>\$ 6,492,016</u>

See notes to the consolidated financial statements.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

1. ORGANIZATION

SouthPoint Bancshares, Inc. (the Company), an Alabama corporation, operates primarily in the domestic commercial banking industry. The Company's subsidiary, SouthPoint Bank (the Bank), was formed and incorporated in 2005 as a state-chartered bank under the Code of Alabama 1975, as amended. The Bank provides full-service banking to customers primarily located in central Alabama. The Bank is subject to regulation by the State of Alabama Banking Department and the Federal Deposit Insurance Corporation (FDIC). The Bank operates from its four branch locations in and around Birmingham, Alabama, and four loan production offices located throughout the State of Alabama. SPB Properties, LLC holds certain assets of the Bank and is a wholly-owned subsidiary of the Bank.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation

The consolidated financial statements include the accounts of the Company and the Bank, and its wholly owned subsidiary. All significant intercompany balances and transactions have been eliminated. Unless otherwise indicated herein, the financial results of the Company refer to the Company and the Bank and its subsidiary on a consolidated basis. The consolidated financial statements of the Company are presented in accordance with accounting principles generally accepted in the United States of America (GAAP).

During May 2016, a holding company was created named SouthPoint Bancshares, Inc. The transaction was effected by the exchanging of the holding company shares for the outstanding shares of SouthPoint Bank. As the transaction was an exchange and the entities are under common control, the transaction is accounted for similar to the pooling-of-interests method. As comparative financial statements are presented, the prior years have been retrospectively adjusted to furnish comparative information.

Cash and Cash Equivalents

For the purpose of cash flows, the Company considers cash on hand and cash or cash equivalents on deposit with other banks, due from banks and federal funds sold to be cash equivalents. The Company maintains various correspondent or other bank accounts, which may, at times, have balances that exceed the FDIC insurance coverage. The amount by which cash and cash equivalents exceeded FDIC insurance coverage at December 31, 2017, was approximately \$1,281,456. The Company has not and does not expect to incur losses with these bank accounts.

Securities Available-for-Sale

Securities available-for-sale represent those securities which the Company has designated for sale. Such securities are carried at fair value with unrealized gains and losses reported as accumulated other comprehensive income (loss), net of any related deferred taxes, in a separate component of shareholders' equity until realized. Gains or losses realized on disposition are based on the net proceeds and the adjusted carrying amount on the securities sold, using the specific identification method, and are included in noninterest income or expense in the accompanying consolidated financial statements.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Estimated fair values are provided by security dealers who have obtained quoted prices (Note 17). Securities may be pledged as collateral for customer deposits and to the FHLB (Note 3).

Loans

The Company grants commercial, real estate, and consumer loans to customers. A substantial portion of the loan portfolio is represented by commercial and real estate loans throughout Alabama. Loans are stated at unpaid principal balances, less the allowance for loan losses and net deferred loan fees.

Loan origination or commitment fees are deferred and accreted using the interest method over the life of the loan. Direct loan origination costs are capitalized and amortized over the life of the loan as a reduction of the loan yield as an offset to interest and fees on loans. Amortization of deferred loan fees is discontinued if a loan is placed on nonaccrual status.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the collectability of a loan balance is remote. Subsequent recoveries, if any, are credited to the allowance.

As part of management's assessment of the allowance for loan losses, management segregates the loan portfolio into the following segments: commercial, financial and agricultural; real estate – construction; real estate – mortgage; consumer and other. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as information becomes available and as economic conditions change.

The allowance for loan losses consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance for losses is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors, which includes trend assessments in delinquent and nonaccrual loans, unanticipated charge-offs, prevailing economic conditions, changes in lending personnel experience, changes in lending policies or procedures and other influencing factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance for loan losses reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due.

Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed.

Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent. Generally, impaired loans include loans on nonaccrual status, loans that have been assigned a specific allowance for credit losses, loans that have been partially charged off and loans designated as troubled debt restructurings.

While management believes that it has established the allowance for loan losses in accordance with generally accepted accounting principles in the United States of America (GAAP) and has taken into account the views of its regulators and the current economic environment, there can be no assurance that in the future the Bank's regulators or its economic environment will not require further increases in the allowance for losses.

Income Recognition on Impaired and Nonaccrual Loans

Loans, including impaired loans, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-collateralized and in the process of collection. If a loan or a portion of a loan is classified as doubtful or is partially charged off, the loan is generally classified as nonaccrual.

Loans that are on a current payment status or past due less than 90 days may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt. Loans may be returned to accrual status when all principal and interest amounts contractually due are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower, in accordance with the contractual terms of principal and interest.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

While a loan is classified as nonaccrual, and the future collectability of the recorded loan balance is doubtful, collections of principal and interest are generally applied as a reduction to principal outstanding. When the future collectability of the recorded loan balance is expected, interest income may be recognized. In the case where a nonaccrual loan has been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

Mortgage loans held-for-sale and mortgage banking derivatives

Prior to 2017, mortgage loans held for sale were carried at the lower of cost or market value, as these mortgage loans were delivered to investors on a “best efforts” basis. During 2017 the Company, through the Bank, began entering into mandatory delivery of a portion of its residential mortgage loans originated for sale in the secondary market. In connection with mandatory delivery, mortgage loans held-for-sale are carried at fair value under the fair value option with changes in fair value recognized in current period earnings.

Fair value of mortgage loans held for sale is typically calculated using observable market information including pricing from actual market transactions, investor commitment prices, or broker quotations. Fair value for mortgage loans covered by investor commitments is generally based on commitment prices and the value for uncommitted loans is generally based on current delivery prices.

In connection with its mortgage banking activities, the Company enters into loan commitments, considered derivative instruments, to fund residential mortgage loans with applicants. These interest rate lock commitments (IRLC) represent an agreement to extend credit to a mortgage loan applicant whereby the interest rate on the loan is set prior to funding. The loan commitment binds the Company (subject to the loan approval process) to fund the loan at a specified rate, regardless of whether interest rates have changed between the commitment date through the funding date or expiration date. The loan commitments generally range between 15 and 60 days; however, the borrower is not obligated to obtain the loan. The Company is subject to fallout risk related to IRLCs, which is realized if approved borrowers choose not to close on the loans within the terms of the IRLCs. Forward delivery commitments on mortgage-backed securities are used to manage the interest rate risk and price risk. Historical commitment-to-closing ratios are considered to estimate the quantity of mortgage loans that will fund within the terms of the IRLCs.

Gains and losses from the sale of mortgages are recognized based upon the difference between the sales proceeds and carrying value of the related loans upon sale, and are recorded in gain on sale of mortgage loans held for sale in the statements of income. The sales proceeds reflect the cash received. Gain on sale of mortgage loans held for sale also includes the unrealized gains and losses associated with the mortgage loans held for sale and the realized and unrealized gains and losses from derivatives.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Other Real Estate

Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at the fair value less estimated selling costs at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. No write-downs occurred in 2017 or 2016.

After foreclosure, valuations are periodically performed by management, and property held-for-sale is carried at the lower of the new cost basis or fair value less estimated costs to sell. Impairment losses on property to be held and used are measured as the amount by which the carrying amount of a property exceeds its fair value. Costs of significant property improvements are capitalized (up to fair value less estimated selling costs), whereas costs relating to holding property are expensed.

Any subsequent write-downs of amounts recorded as other real estate are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less estimated costs to sell.

Bank-Owned Life Insurance

The Bank purchased life insurance policies on certain employees. These policies are recorded at their cash surrender value or the amount that can be realized. Income from these policies and changes in the cash surrender value are recorded in noninterest income. The Bank is the named beneficiary for each policy.

Premises and Equipment

Land is carried at cost. Other premises and equipment are stated at cost less accumulated depreciation. Expenditures for additions and improvements that extend the useful life of an asset are capitalized. Expenditures for repairs and maintenance are charged to expense when incurred. Assets which are disposed of are removed from the accounts, and the resulting gains or losses are recorded in other operating income or expenses. Depreciation is computed by the straight-line method based on the depreciable lives of individual assets, ranging from three to 30 years.

FHLB Stock and Borrowings (Advances)

The Company is a member and has purchased stock in the Federal Home Loan Bank of Atlanta (FHLB). The stock consists of Subclass B1 membership stock and Subclass B2 activity (advance-based) stock, which is determined based on the amount of advances outstanding.

Borrowings represent advances under an advance and security agreement with the FHLB, as well as secured borrowings with the Federal Reserve Bank of Atlanta (FRB) Discount Window under a similar security agreement. Under the terms of the agreements, the Company is required to maintain qualifying collateral, consisting primarily of investment securities and loans, which are based on collateral rates set by the FHLB and the FRB.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Advertising

Advertising costs are expensed as incurred.

Income Taxes

The Company files a consolidated federal income tax return and separate State of Alabama excise tax returns. The subsidiaries provide for income taxes on a separate basis and remit to the Company amounts determined to be currently payable. These returns are filed using the accrual basis of accounting. Provisions for income taxes are based on amounts reported in the statements of income (after exclusion of nontaxable income, such as interest on state and municipal securities) and include deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes.

Stock Options

The Board of Directors approved the 2015 Stock Incentive Plan (Stock Plan), which amended, restated, and replaced the 2005 Stock Incentive Plan, which expired in October 2015. The 2015 Stock Plan permitted the granting of nonstatutory (nonqualified), incentive and restricted stock option awards, to enhance shareholder investment by attracting, retaining and motivating key employees and directors of the Company and to align the interests of management with those of shareholders. The maximum number of shares to be issued under the Stock Plan are 315,150. See Note 14 for activity of the 2015 Stock Plan.

The option price is determined by the Board of Directors or a committee appointed by the Board of Directors to administer the Stock Plan, who may use the latest stock trade information or an independent valuation. Options granted are generally subject to vesting in equal increments over a vesting period of at least three years.

The Company uses a stock valuation model for stock awards issued pursuant to the 2015 Stock Plan, which results in share-based compensation expense. The Company uses the Black-Scholes fair value model for determining option value and share-based payments, which includes such factors as expected term, interest rate, forfeiture estimates, volatility and dividend yield, to estimate compensation expense associated with the stock option awards.

Financial Instruments

The Company uses fair value methods and measurements to determine fair value for certain assets and liabilities for recording and disclosure purposes. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined by quoted market prices. The fair value guidance established three categories within a fair value hierarchy, which are presented below:

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

- Level 1 – Valuations based on quoted prices in active markets for identical assets or liabilities that the Bank has the ability to access.
- Level 2 – Valuations based on observable inputs, including quoted prices (other than Level 1) in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, such as interest rates, yield curves, volatilities and default rates, and inputs that are derived principally from or corroborated by observable market data.
- Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Additional guidance is available for estimating fair value when the volume and level of activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability, including guidance on circumstances that may indicate that a transaction is not orderly and requires additional disclosures about fair value measurements.

The Company also reports fair value measurement of nonfinancial assets and liabilities. These measurements occur on a nonrecurring basis, and recognition at fair value occurs when nonfinancial assets and liabilities are deemed to be other-than-temporarily impaired.

Statements of Cash Flows

The following is supplemental disclosure to the consolidated statements of cash flows for the years ended December 31:

	<u>2017</u>	<u>2016</u>
Cash paid during the year for interest	\$ 1,797,149	\$ 1,674,468
Noncash disclosures:		
Loans transferred to foreclosed real estate during the year	305,459	-
Sales of foreclosed real estate financed through loans	113,296	23,500
Net increase (decrease) in unrealized gains and losses on securities available-for-sale, net of deferred taxes of \$265,696 for 2017 and \$292,321 for 2016	577,201	(859,767)

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Investment in securities available-for-sale is exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities and that the values of the Bank's investments are sensitive to changes in economic and regulatory conditions, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the value of those investments reported.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic and regulatory environment and local market conditions. The Bank's loans are generally secured by specific items of collateral, including real property, consumer and business assets. In connection with the determination of the estimated losses on loans, Management obtains independent appraisals for significant collateral.

Although the Company has a diversified loan portfolio, and management uses available information to recognize losses on loans, further reduction in the carrying amounts of loans may be necessary based on changes in local economic conditions or other factors.

In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans and may require the Company to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Retirement Plan

The Company participates in the SouthPoint Bank Retirement Plan. The Plan is a 401(k) Plan and is designed to follow the regulations under the Internal Revenue Code (IRC). The Company's expense related to the plan for the years ended December 31, 2017 and 2016, amounted to approximately \$95,000 and \$84,000, respectively, and is included in salaries and employee benefits expense on the consolidated statements of income.

Subsequent Events

Management has evaluated subsequent events and their potential effects on these consolidated financial statements through March 19, 2018, the date that the consolidated financial statements were available to be issued.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Reclassifications

Certain reclassifications were made to the 2016 financial statement presentation to conform to the 2017 financial statement presentation. Reclassification adjustments included in net income were not considered material for each period presented.

Recently Adopted and Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09 and in August 2015 issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, a comprehensive new revenue recognition standard that will supersede nearly all existing revenue recognition guidance under U.S. generally accepted accounting principles. The standard's core principle is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. The guidance may be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initial application recognized at the date of initial application for fiscal years beginning after December 15, 2018, and early application is permitted. The Company is in the process of reviewing the potential impact the adoption of this guidance will have on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The amendments in this ASU, among other things: a) requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; b) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and c) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). The effective date of this ASU for the Company is January 1, 2019. The new guidance permits early adoption of the own credit provision. In addition, the new guidance permits early adoption of the provision that exempts private companies and not-for-profit organizations from having to disclose fair value information about financial instruments measured at amortized cost. The Company is reviewing the impact that the adoption of this ASU may have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The amendments in this ASU, affect all companies and other organizations that lease assets. This ASU will require organizations that lease assets, referred to as "leases", to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The accounting by organizations that own the assets leased by the lessee, known as lessor accounting, will remain largely unchanged from current GAAP (Topic 840). For non-public companies this ASU is effective for fiscal year beginning after December 15, 2019 for January 1, 2020 for the Company. The Company is reviewing the impact that the adoption of this ASU may have on its consolidated financial statements.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The areas for simplification in this ASU involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Some of the areas for simplification apply only to nonpublic entities. For non-public companies, this ASU is effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early adoption is permitted for any entity in any interim or annual period. The Company is reviewing the impact that the adoption of this ASU may have on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments in this ASU cover two areas: assets measured at amortized cost and available-for-sale debt securities. For assets measured at amortized cost, the amendments in this ASU require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. For available-for-sale debt securities, credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. Available-for-sale accounting recognizes that value may be realized either through collection of contractual cash flows or through sale of the security. Therefore, the amendments limit the amount of the allowance for credit losses to the amount by which fair value is below amortized cost because the classification as available-for-sale is premised on an investment strategy that recognizes that the investment could be sold at fair value, if cash collection would result in the realization of an amount less than fair value. For non-public entities, the amendments in this ASU are effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. All entities may adopt the amendments in this ASU earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is reviewing the impact that the adoption of this ASU may have on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, *Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. The amendments in this ASU 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. For non-public entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity should apply the amendments in ASU 2017-08 on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is reviewing the impact that the adoption of this ASU may have on its consolidated financial statements.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

In February 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income* (Topic 220); *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The amendments in this ASU require a reclassification from / to accumulated other comprehensive and to / from retained earnings for stranded tax effects resulting from the change in the newly enacted federal corporate income tax rate. Consequently, the amendments in this ASU eliminates the stranded tax effects associated with the change in the federal corporate income tax rate in the Tax Cuts and Jobs Act of 2017. The amendments in this ASU are effective for all entities for fiscal year beginning after December 15, 2018, with early adoption allowed. The Company has elected to early adopt this ASU as of December 31, 2017. The effect of the adoption of this ASU was to increase comprehensive income by \$20,889 with the offset to retained earnings as recorded in the statement of changes in stockholders' equity. This represents the difference between the historical corporate tax rate and the newly enacted 21% corporate income tax rate.

In February 2018, the FASB issued 2018-03 – Technical Corrections and Improvement to Financial Instruments – Overall (Topic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities*. The amendments in this ASU clarify certain aspects of the guidance issued in ASU 2016-01, in the areas of: (1) equity securities without a readily determinable fair value – discontinuation, (2) equity securities without a readily determinable fair value – adjustments, (3) forward contracts and purchased options, (4) presentation requirements for certain fair value option liabilities, (5) fair value option liabilities dominated in a foreign currency, and (6) transition guidance for equity securities without a readily determinable fair value. For non-public companies, the effective date of this ASU is the same as the effective date of ASU 2016-01, which is January 1, 2019. Early adoption is permitted, including adoption in an interim period. The Bank is reviewing the impact that the adoption of this ASU may have on its financial statements.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

3. SECURITIES AVAILABLE-FOR-SALE

Investment securities available-for-sale consisted of the following at December 31, 2017 and 2016:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
As of December 31, 2017:				
Mortgage-backed securities	\$ 7,891,959	\$ -	\$ (81,752)	\$ 7,810,207
State, county and municipal securities	32,110,503	463,982	(221,544)	32,352,941
Trust preferred security	1,000,000	-	-	1,000,000
	<u>\$ 41,002,462</u>	<u>\$ 463,982</u>	<u>\$ (303,297)</u>	<u>\$ 41,163,147</u>
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
As of December 31, 2016:				
Mortgage-backed securities	\$ 9,648,650	\$ -	\$ (223,862)	\$ 9,424,788
State, county and municipal securities	30,864,323	243,890	(702,241)	30,405,972
Trust preferred security	1,000,000	-	-	1,000,000
	<u>\$ 41,512,973</u>	<u>\$ 243,890</u>	<u>\$ (926,103)</u>	<u>\$ 40,830,760</u>

At December 31, 2017, the Company had 15 investment securities in an unrealized loss position for less than 12 months with a fair value of \$8,899,212 and unrealized losses totaling \$139,731, and 12 investment securities in an unrealized loss position for 12 months or more with a fair value of \$8,988,526 and unrealized losses totaling \$163,566.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

3. SECURITIES AVAILABLE-FOR-SALE – CONTINUED

At December 31, 2016, the Company had 50 investment securities in an unrealized loss position for less than 12 months with a fair value of \$29,411,520 and unrealized losses totaling \$926,103, and no investment securities in an unrealized loss position for 12 months or more.

The unrealized losses are considered by management to be temporary since the Company does not have the intent to sell any of these securities prior to recovery and it is more likely than not that the Bank will not have to sell the debt securities prior to recovery of fair value at a minimum up to the cost of the investment.

The net unrealized gain of \$126,941 is shown net of related deferred tax of \$33,744 as of December 31, 2017 (loss of \$450,260 is shown net of related deferred tax of \$231,952 in 2016), and is reported as accumulated other comprehensive income (net of tax) in the accompanying consolidated financial statements.

There were no held-to-maturity or trading investments at December 31, 2017 or 2016.

The amortized cost and estimated fair value of securities available-for-sale at December 31, 2017, by contractual maturity, are as follows:

	<u>Amortized Cost</u>	<u>Fair Value</u>
Amounts maturing:		
After five years through 10 years	\$ 2,397,651	\$ 2,380,455
After 10 years through 15 years	10,856,698	10,854,934
After 15 years	<u>27,748,113</u>	<u>27,927,758</u>
	<u>\$ 41,002,462</u>	<u>\$ 41,163,147</u>

Expected maturities of mortgage-backed securities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Investment securities with an approximate fair value of \$20,336,399 and \$24,345,000 were pledged as collateral for deposits held under the State of Alabama's Security for Alabama Funds Enhancement (SAFE) Program as of December 31, 2017 and 2016, respectively. The Company also pledged investments with fair values of approximately \$5,890,000 and \$14,230,000 for FHLB advances and \$-0- and \$502,000 for Federal Fund lines of credit as of December 31, 2017 and 2016, respectively. The Company also holds certain restrictive investments in FHLB stock (Note 7).

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

4. LOANS

The composition of loans by primary loan classification and by performing and impaired loan status as of December 31, 2017 and 2016 are as follows:

	<u>Commercial, Financial and Agricultural</u>	<u>Real Estate Construction</u>	<u>Real Estate Mortgage</u>	<u>Consumer and Other</u>	<u>Subtotal</u>	<u>Allowance for Loan Losses</u>	<u>Net Loans</u>
2017							
Performing loans	\$ 51,534,027	\$ 29,229,468	\$ 153,502,622	\$ 8,720,562	\$ 242,986,679	\$ (2,922,071)	\$ 240,064,608
Impaired loans	1,151,518	-	232,032	-	1,383,550	(644,290)	739,260
	<u>\$ 52,685,545</u>	<u>\$ 29,229,468</u>	<u>\$ 153,734,654</u>	<u>\$ 8,720,562</u>	<u>\$ 244,370,229</u>	<u>\$ (3,566,361)</u>	<u>\$ 240,803,868</u>
2016							
Performing loans	\$ 47,253,533	\$ 19,992,725	\$ 134,734,545	\$ 7,432,121	\$ 209,412,924	\$ (2,541,776)	\$ 206,871,148
Impaired loans	1,196,162	-	897,679	-	2,093,841	(732,790)	1,361,051
	<u>\$ 48,449,695</u>	<u>\$ 19,992,725</u>	<u>\$ 135,632,224</u>	<u>\$ 7,432,121</u>	<u>\$ 211,506,765</u>	<u>\$ (3,274,566)</u>	<u>\$ 208,232,199</u>

Changes in the allowance for loan losses for the years ended December 31 were as follows:

	<u>2017</u>	<u>2016</u>
Balance at beginning of year	\$ 3,274,566	\$ 3,096,089
Charge-offs	(109,985)	(9,560)
Recoveries	101,780	13,037
Net recoveries (charge-offs)	(8,205)	3,477
Provision	300,000	175,000
Ending balance	<u>\$ 3,566,361</u>	<u>\$ 3,274,566</u>

At December 31, 2017 and 2016, there were no loans classified as nonaccrual that were not deemed to be impaired. At the date such loans were placed on nonaccrual status, the Bank reversed all previously accrued interest income against current year earnings. Had such nonaccrual loans been on accrual status, interest income would have been greater by approximately \$5,000 for the year ended December 31, 2017 and \$15,000 for the year ended December 31, 2016.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

4. LOANS – CONTINUED

The allocation and changes in the allowance for loan losses, by loan classification, as of and for the years ended December 31, 2017 and 2016, are as follows:

	Commercial, Financial and Agricultural	Real Estate Construction	Real Estate Mortgage	Consumer and Other	Unallocated	Total
Balance at December 31, 2016	\$ 1,185,402	\$ 405,925	\$ 1,636,800	\$ 34,187	\$ 12,252	\$ 3,274,566
Charge-offs	(88,417)	-	(17,130)	(4,438)	-	(109,985)
Recoveries	6,514	-	94,333	933	-	101,780
Net charge-offs	(81,903)	-	77,203	(3,505)	-	(8,205)
Provision	91,805	(87,644)	(31,363)	32,131	295,071	300,000
Balance at December 31, 2017	<u>\$ 1,195,304</u>	<u>\$ 318,281</u>	<u>\$ 1,682,640</u>	<u>\$ 62,813</u>	<u>\$ 307,323</u>	<u>\$ 3,566,361</u>
	Commercial, Financial and Agricultural	Real Estate Construction	Real Estate Mortgage	Consumer and Other	Unallocated	Total
Balance at December 31, 2015	\$ 561,367	\$ 197,050	\$ 1,812,708	\$ 39,441	\$ 485,523	\$ 3,096,089
Charge-offs	-	-	-	(9,560)	-	(9,560)
Recoveries	-	-	12,300	737	-	13,037
Net charge-offs	-	-	12,300	(8,823)	-	3,477
Provision	624,035	208,875	(188,208)	3,569	(473,271)	175,000
Balance at December 31, 2016	<u>\$ 1,185,402</u>	<u>\$ 405,925</u>	<u>\$ 1,636,800</u>	<u>\$ 34,187</u>	<u>\$ 12,252</u>	<u>\$ 3,274,566</u>

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

4. LOANS – CONTINUED

Risk ratings are categorized as pass, special mention, substandard, substandard-impaired or doubtful. Management believes that the categories follow those outlined by the Bank's primary regulator. Pass rated loans include all risk rated credits other than those included in special mention, substandard and doubtful, which are defined as follows:

- Special Mention loans have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date.
- Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.
- Substandard-impaired loans are substandard loans that may have been placed on nonaccrual, may have an associated allowance for loan losses and may have a partial charge off for the loan.
- Doubtful loans have all the characteristics of substandard loans with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The Bank considers all doubtful loans to be impaired and places all such loans on nonaccrual status.

The following table outlines the amount of each loan classification based on internally assigned risk ratings as of December 31, 2017 and 2016:

2017	Commercial, Financial and Agricultural	Real Estate Construction	Real Estate Mortgage	Consumer and Other	Total
Grade:					
Pass	\$ 49,972,081	\$ 29,229,468	\$ 153,502,621	\$ 8,720,562	\$ 241,424,732
Special mention	1,561,947	-	-	-	1,561,947
Substandard	1,151,517	-	139,277	-	1,290,794
Substandard – impaired	-	-	92,756	-	92,756
Total	<u>\$ 52,685,545</u>	<u>\$ 29,229,468</u>	<u>\$ 153,734,654</u>	<u>\$ 8,720,562</u>	<u>\$ 244,370,229</u>

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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4. LOANS – CONTINUED

2016	Commercial, Financial and Agricultural	Real Estate Construction	Real Estate Mortgage	Consumer and Other	Total
Grade:					
Pass	\$ 43,906,822	\$ 19,992,725	\$ 134,734,545	\$ 7,432,121	\$ 206,066,213
Special mention	3,346,711	-	-	-	3,346,711
Substandard	1,196,162	-	665,597	-	1,861,759
Substandard – impaired	-	-	232,082	-	232,082
Total	\$ 48,449,695	\$ 19,992,725	\$ 135,632,224	\$ 7,432,121	\$ 211,506,765

Past due balances and loans on nonaccrual status at December 31, 2017 and 2016, by loan classification, are as follows:

2017	Past Due 30-89 Days and Still Accruing	Total Past Due and Performing	Loans on Nonaccrual Status	Current	Total Loans
Commercial, financial and agricultural	\$ 1,374,433	\$ 1,374,433	\$ -	\$ 51,311,112	\$ 52,685,545
Real estate – construction	243,008	243,008	-	28,986,460	29,229,468
Real estate – mortgage	928,975	928,975	92,756	152,712,923	153,734,654
Consumer and other	-	-	-	8,720,562	8,720,562
	\$ 2,546,416	\$ 2,546,416	\$ 92,756	\$ 241,731,057	\$ 244,370,229

2016	Past Due 30-89 Days and Still Accruing	Total Past Due and Performing	Loans on Nonaccrual Status	Current	Total Loans
Commercial, financial and agricultural	\$ 869,283	\$ 869,283	\$ -	\$ 47,580,412	\$ 48,449,695
Real estate – construction	-	-	-	19,992,725	19,992,725
Real estate – mortgage	875,340	875,340	232,082	134,524,802	135,632,224
Consumer and other	10,432	10,432	-	7,421,689	7,432,121
	\$ 1,755,055	\$ 1,755,055	\$ 232,082	\$ 209,519,628	\$ 211,506,765

There were no loans past due 90 days or more and still accruing at December 31, 2017 or 2016.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

4. LOANS – CONTINUED

The following tables provide details on impaired loans as of December 31, 2017 and 2016, including the average recorded investment of impaired loans and interest income recognized for the years ended December 31, 2017 and 2016:

	<u>At December 31, 2017</u>			<u>For the Year Ended December 31, 2017</u>	
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Impaired loans with no recorded allowance:					
Commercial, financial and agricultural	\$ 140,430	\$ 139,823	\$ -	\$ 144,766	\$ 8,808
Real estate – mortgage	233,702	232,033	-	237,039	13,991
	<u>374,132</u>	<u>371,856</u>	<u>-</u>	<u>381,805</u>	<u>22,799</u>
Impaired loans with a recorded allowance:					
Commercial, financial and agricultural	1,028,892	1,011,694	644,290	1,022,198	68,323
Real estate – mortgage	-	-	-	-	-
	<u>1,028,892</u>	<u>1,011,694</u>	<u>644,290</u>	<u>1,022,198</u>	<u>68,323</u>
Total impaired loans	<u>\$ 1,403,024</u>	<u>\$ 1,383,550</u>	<u>\$ 644,290</u>	<u>\$ 1,404,003</u>	<u>\$ 91,122</u>
	<u>At December 31, 2016</u>			<u>For the Year Ended December 31, 2016</u>	
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Impaired loans with no recorded allowance:					
Commercial, financial and agricultural	\$ 168,299	\$ 163,723	\$ -	\$ 166,126	\$ 17,594
Real estate – mortgage	837,615	830,055	-	836,052	32,739
	<u>1,005,914</u>	<u>993,778</u>	<u>-</u>	<u>1,002,178</u>	<u>50,333</u>
Impaired loans with a recorded allowance:					
Commercial, financial and agricultural	1,039,736	1,032,439	665,166	1,042,667	67,256
Real estate – mortgage	67,835	67,624	67,624	67,725	2,381
	<u>1,107,571</u>	<u>1,100,063</u>	<u>732,790</u>	<u>1,110,392</u>	<u>69,637</u>
Total impaired loans	<u>\$ 2,113,485</u>	<u>\$ 2,093,841</u>	<u>\$ 732,790</u>	<u>\$ 2,112,570</u>	<u>\$ 119,970</u>

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

4. LOANS – CONTINUED

The following table details the number of troubled debt restructurings by loan classification as of December 31, 2017 and 2016:

<u>2017 Troubled Debt Restructurings</u>	<u>Number of Contracts</u>	<u>Premodification Outstanding Recorded Investment</u>	<u>Postmodification Outstanding Recorded Investment</u>
Real estate – mortgage	0	\$ -	\$ -
	0	\$ -	\$ -

<u>2016 Troubled Debt Restructurings</u>	<u>Number of Contracts</u>	<u>Premodification Outstanding Recorded Investment</u>	<u>Postmodification Outstanding Recorded Investment</u>
Real estate – mortgage	1	\$ 342,067	\$ 231,093
	1	\$ 342,067	\$ 231,093

There were no new troubled debt restructurings during 2017 or 2016. There were also no debt restructurings during 2016 that subsequently defaulted during 2017.

Impaired loans also include loans that the Company may elect to formally restructure due to the weakening credit status of a borrower such that the restructuring may facilitate a repayment plan that minimizes the potential losses, if any, that the Company may have to otherwise incur. These loans are classified as impaired loans and, if on nonaccrual status as of the date of restructuring, the loans are included in the nonperforming loan balances noted above.

The Company entered into the mortgage loan resale market during 2007 and executed investor agreements for the sale of certain mortgage loans originated and any related servicing. The agreements vary by investor but may include recourse provisions based on conditions specified in the agreements, such as early payment default or early payoff. All agreements are subject to breach of contract clauses. Total mortgage loans sold to investors subject to recourse provisions were approximately \$33,260,000 and \$36,486,000 as of December 31, 2017 and 2016, respectively. The Company recorded an estimate of the potential recourse liability at December 31, 2017 and 2016.

The Company has elected to hold certain mortgage loans originated by the mortgage division of the Bank, and contracts with a third-party service provider for servicing. Mortgage loans held by the Company and serviced by a third-party were approximately \$11,481,000 and \$9,572,000 as of December 31, 2017 and 2016, respectively, and are reported in loans in the consolidated balance sheets.

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5. PREMISES AND EQUIPMENT

Major classifications of premises and equipment at December 31 are summarized below:

	<u>2017</u>	<u>2016</u>
Land	\$ 263,469	\$ 263,469
Buildings and improvements	2,142,949	2,142,949
Equipment	1,804,665	1,714,264
Furniture and fixtures	304,476	304,476
Software	80,104	74,154
Vehicles	74,157	74,157
Construction-in-progress	<u>9,107,457</u>	<u>3,046,525</u>
	13,777,277	7,619,994
Less accumulated depreciation	<u>2,298,154</u>	<u>2,039,790</u>
	<u>\$ 11,479,123</u>	<u>\$ 5,580,204</u>

Construction-in-progress of \$9,107,457 at December 31, 2017, consists of land cost, building construction cost, equipment cost, and furniture and fixtures cost related to the construction of the Company's new headquarters. The remaining budget for the project at December 31, 2017 is approximately \$1,500,000. Subsequent to year end, construction was substantially completed and the new building opened for business on January 29, 2018, merging three existing offices into one location.

6. DEPOSITS

The Company has approximately \$23,864,000 of time deposits greater than the FDIC insurance limit of \$250,000 at December 31, 2017 (\$24,768,000 at December 31, 2016). The maturity schedule for all outstanding time deposits as of December 31, 2017, is as follows:

2018	\$ 79,274,012
2019	8,617,680
2020	3,967,429
2021	1,709,691
2022	<u>2,184,997</u>
	<u>\$ 95,753,809</u>

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7. FHLB STOCK AND BORROWINGS

During 2017, the Company held Subclass B1 membership stock and Subclass B2 activity-based stock with the FHLB for a total cost of \$1,439,600 (\$375,000 in 2016). The Bank earns quarterly dividends on the stock. The stock is a restricted investment reported at cost and included in other assets. These investments were not evaluated for impairment as the Company did not identify any events or changes in circumstances that may have a significant adverse effect on the fair value of these investments. The Company estimated that the fair value was equal to cost and not impaired.

There was one advance under the FHLB agreement totaling \$28,000,000 as of December 31, 2017 (one for \$4,000,000 as of December 31, 2016). The advance is for \$28,000,000 with a variable daily rate credit interest rate (1.59% at December 31, 2017) which matures on July 9, 2018. The Bank also has an \$18,000,000 FHLB letter of credit in favor of the State of Alabama to provide additional collateral for public deposits held for customers under the SAFE Program.

Certain investment securities are held as collateral for the FHLB advances (Note 3). Additional qualifying collateral for the FHLB advances and letter of credit is determined using loan advance rates specified in the agreement and consisted of certain commercial and real estate loans totaling approximately \$60,650,000 and \$53,535,000 as of December 31, 2017 and 2016, respectively.

The Company has several unsecured correspondent bank federal funds lines of credit and one secured repurchase agreement line of credit with total commitments of \$32,600,000 and \$35,600,000 as of December 31, 2017 and 2016, respectively, which are subject to renewal on various dates. The Company also has access to borrow funds from the Federal Reserve Bank discount window of approximately \$237,000 and \$266,000, which is determined based on available bank collateral and secured by loans of \$365,000 and \$425,000 at December 31, 2017 and 2016, respectively (no borrowings outstanding for 2017 or 2016).

8. LINE-OF-CREDIT

Under the terms of a line-of-credit agreement, the Company has granted NobleBank & Trust a security interest in the common stock of the Bank. Under terms of the agreement, the Company may borrow up to \$2,000,000 at prime rate (with a minimum of 4.0%). At December 31, 2017, the interest rate was 4.5% and the outstanding balance was \$1,737,952. The line-of-credit agreement matures in October 2025.

During January 2018, the Company obtained an increase on the line-of-credit agreement to \$4,000,000, at prime rate, with an interest rate of 4.5% and a floor of 4.0% and a maturity date of January 21, 2020.

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9. LEASES

The Company leases certain office space and equipment under various operating leases. The approximate future minimum values of lease payments under these leases are as follows as of December 2017:

2018	\$ 221,750
2019	205,015
2020	201,236
2021	204,112
2022	183,129
Thereafter	<u>2,175,385</u>
	<u>\$ 3,190,627</u>

Total rent expense, net of rental income, was approximately \$428,360 and \$372,379 for 2017 and 2016, respectively.

10. INCOME TAXES

Provisions for federal and state income taxes are based on amounts reported in the statements of income (after exclusion of nontaxable income items such as interest earned on tax-exempt municipal securities and bank-owned life insurance) and include deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes.

The components of income tax expense for the years ended December 31, 2017 and 2016, were as follows:

	<u>2017</u>	<u>2016</u>
Current:		
Federal	\$ 1,597,474	\$ 856,249
State	<u>239,713</u>	<u>184,610</u>
	1,837,187	1,040,859
Deferred:		
Federal	212,829	90,884
State	<u>(4,799)</u>	<u>(5,688)</u>
	<u>208,030</u>	<u>85,196</u>
Income tax expense	<u>\$ 2,045,217</u>	<u>\$ 1,126,055</u>

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10. INCOME TAXES – CONTINUED

The components of the net deferred tax asset (liability) included in other assets as of December 31, 2017 and 2016, are as follows:

	<u>2017</u>	<u>2016</u>
Deferred tax asset:		
Federal	\$ 766,553	\$ 1,299,723
State	148,078	134,728
	<u>914,631</u>	<u>1,434,451</u>
Deferred tax liability:		
Federal	332,711	366,466
State	57,753	46,239
	<u>390,464</u>	<u>412,705</u>
Net operating loss carryforward	<u>4,804</u>	<u>1,841</u>
Net deferred tax asset	<u>\$ 528,971</u>	<u>\$ 1,023,587</u>

The tax effects of each type of income and expense item that gave rise to deferred taxes as of December 31 were as follows:

	<u>2017</u>	<u>2016</u>
Allowance for loan losses	\$ 506,029	\$ 658,411
Net unrealized losses (gains) on securities available-for-sale	(33,744)	231,952
Deferred compensation	35,995	178,496
Depreciation	(142,649)	(256,084)
Deferred loan fees	135,291	188,620
Deferred loan costs	(68,035)	(109,906)
Net operating loss carryforwards	4,803	1,841
Other real estate owned reserve	78,355	140,300
Interest rate lock commitments and forward contracts	(99,902)	-
Organizational Costs	3,964	-
Other	108,864	(10,043)
Net deferred tax asset	<u>\$ 528,971</u>	<u>\$ 1,023,587</u>

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10. INCOME TAXES – CONTINUED

Income taxes for financial reporting purposes differ from the amount computed by applying the statutory federal income tax rate of 34% for the years ended December 31, 2017 and 2016, for the reasons below:

	2017	2016
Tax expense on income computed at statutory federal income tax rate	\$ 1,755,462	\$ 1,393,915
Increase (decrease) in taxes resulting from:		
State income tax, net of federal income tax benefit	147,940	116,157
Taxable exempt interest	(274,624)	(266,552)
Miscellaneous non-deductible items	20,834	12,928
Enacted tax rate change	274,041	-
Change in cash surrender value of bank owned life insurance	(24,351)	(165,321)
Other	145,915	34,928
Income tax expense	\$ 2,045,217	\$ 1,126,055

Pursuant to ASC 740-10-30-2, deferred tax assets and liabilities are measured using enacted tax rates applicable to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. On December 22, 2017, the President of the United States signed the “Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018” (referred to as the “Tax Cuts and Jobs Act”). The Act provides for a reduction in the corporate tax rate from a maximum tax rate of 35% to a flat tax rate of 21% effective for tax years beginning after December 31, 2017. As a result, the Company revalued its deferred tax assets and liabilities as of December 31, 2017, and recorded the effect of this change as a component of tax expense. The tax expense recorded related to the change in the enacted federal tax rate as of December 31, 2017 is \$274,041. The current tax expense rate of 21% will be effective beginning January 1, 2018. Additionally, deferred tax assets and liabilities are subject to a more likely than not test. Management believes that it is more likely than not that the net deferred tax assets or liabilities will be realized based on future operations of the Company and Bank.

The Company measures and recognizes tax positions taken or expected to be taken in a tax return that directly or indirectly affects amounts reported in the Company’s consolidated financial statements and reviews its income tax positions to determine if each position meets a “more likely than not” threshold of expectation of prevailing. As of December 31, 2017 and 2016, the Company has no uncertain tax positions that qualify for either recognition or disclosure in the consolidated financial statements under the current guidance. Under statute, the Company is subject to Internal Revenue Service and state taxing authority review for tax years 2014 through 2016. The Company has filed tax returns through 2016.

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11. CONCENTRATION OF CREDIT RISK

Most of the Company's deposit and lending activities are with customers located within Alabama. The Company grants commercial, residential and consumer loans primarily to customers in Alabama. The concentrations of loans by type are set forth in Note 4.

12. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other parties to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The Company may require collateral or other security to support financial instruments with credit risk. The total collateral values, which consisted primarily of real estate, accounts receivable, inventory and equipment and may be cross-collateralized for loans, was greater than the secured letters of credit. There was no liability recorded for these guarantees at December 31, 2017 or 2016.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

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12. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK - CONTINUED

Performance and financial letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extended loan facilities to customers. The approximate outstanding notional amount of off-balance sheet risk at December 31 is as follows:

	<u>2017</u>	<u>2016</u>
Performance and financial letters of credit	\$ 118,000	\$ 120,000
Unused lines of credit	<u>51,408,000</u>	<u>32,213,000</u>
	<u>\$ 51,526,000</u>	<u>\$ 32,333,000</u>

13. REGULATORY CAPITAL

The Company is subject to various regulatory capital requirements administered by its primary federal regulator, the FDIC. Failure to meet the minimum regulatory capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank and the consolidated financial statements. Under the regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines involving quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices.

The Company's capital amounts and classification under the prompt corrective action guidelines are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total risk-based capital and Tier 1 capital to risk-weighted assets (as defined in the regulations) and Tier 1 capital to adjusted total assets (as defined).

In July 2013, the banking regulators published Final Rules establishing a new comprehensive capital framework for U.S. banking organizations (the Final Rules). The Final Rules implement the Basel Committee of Banking Supervision's framework known as Basel III, as well as certain provisions of the Dodd-Frank Act. The Final Rules, which define the components of capital and also address risk weights, became effective on January 1, 2015. The Final Rules include a new capital ratio designated as Common Equity Tier 1 ratio, which is a tighter definition of tier 1 capital, an increase in tier one capital ratio from 4.0% to 6.0%; a framework for countercyclical buffers; adjustments to prompt corrective action thresholds; short and medium term quantitative liquidity ratios and establishes criteria that instruments must meet in order to be considered regulatory capital.

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13. REGULATORY CAPITAL – CONTINUED

The required minimum conservation buffer will be phased in incrementally starting at 0.625% on January 1, 2016, increasing to 1.25% on January 1, 2017, increasing to 1.85% on January 1, 2018, and increasing to 2.50% on January 1, 2019. When the new capital rule is fully phased in, the minimum capital requirements plus the conservation buffer will exceed the Prompt Corrective Action well-capitalized thresholds.

The Company's and the Bank's actual and required capital amounts and ratios under the new guidance are as follows (dollars in thousands):

	Actual		For Capital Adequacy Purposes (includes the conservation buffer for the Bank only)		To Be Well – Capitalized Under the Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2017						
Common equity tier 1 capital (to risk-weighted assets)						
Consolidated	\$ 26,635	9.49%	\$ 12,630	4.50%	N/A	N/A
Bank	28,122	10.02%	16,139	5.75%	\$ 18,244	6.50%
Tier 1 Capital Ratio (to risk-weighted assets)						
Consolidated	26,635	9.49%	16,840	6.00%	N/A	N/A
Bank	28,122	10.02%	20,350	7.25%	22,455	8.00%
Total Capital Ratio (to risk-weighted assets)						
Consolidated	30,144	10.74%	22,453	8.00%	N/A	N/A
Bank	31,631	11.27%	25,963	9.25%	28,068	10.00%
Tier 1 Leverage Ratio (to average assets)						
Consolidated	26,635	8.75%	12,188	4.00%	N/A	N/A
Bank	28,122	9.23%	12,187	4.00%	15,233	5.00%
As of December 31, 2016						
Common equity tier 1 capital (to risk-weighted assets)						
Consolidated	\$ 23,141	9.73%	\$ 10,705	4.50%	N/A	N/A
Bank	24,847	10.45%	12,191	5.125%	\$ 15,461	6.50%
Tier 1 Capital Ratio (to risk-weighted assets)						
Consolidated	23,141	9.73%	14,274	6.00%	N/A	N/A
Bank	24,847	10.45%	15,759	6.625%	19,029	8.00%
Total Capital Ratio (to risk-weighted assets)						
Consolidated	26,118	10.98%	19,032	8.00%	N/A	N/A
Bank	27,824	11.70%	20,516	8.625%	23,787	10.00%
Tier 1 Leverage Ratio (to average assets)						
Consolidated	23,141	8.58%	10,788	4.00%	N/A	N/A
Bank	24,847	9.21%	10,787	4.00%	13,484	5.00%

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13. REGULATORY CAPITAL – CONTINUED

As of December 31, 2017 and 2016, the Company was categorized as well-capitalized under the regulatory framework for prompt corrective action. To remain categorized as well-capitalized, the Bank will have to maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as disclosed in the above table. There are no conditions or events since the most recent notification that management believes have changed the Company's prompt corrective action category.

14. STOCK OPTIONS

The Bank established the 2015 Stock Incentive Plan (Stock Plan), which is an incentive stock plan for key employees and directors. The Stock Plan permits the granting of three types of awards which are non-statutory stock options, incentive stock options and restricted stock awards.

Incentive Stock Options

The Board of Directors granted stock options under the employee stock incentive plan to certain employees and directors of the Bank in previous years. 77,001 stock options issued in 2015 are still outstanding and vest over a 4 or 3 year period. During 2017 stock options for 80,000 shares were issued to certain employees and directors. The 2017 stock option awards vest immediately or annually over a 3 year period. There were no stock options issued in 2016.

Restricted Stock Awards

During 2017, the Company issued 2,500 restricted stock grants, to directors, that are held in escrow and will vest the business day immediately prior to the day on which the Company holds the 2018 Annual Meeting of Shareholders. At the vesting date the individuals will receive the awards.

The Company uses the Black-Scholes option pricing model to calculate the fair value of stock options issued. The Bank obtained an independent valuations to determine the stock option valuations for stock options related to the issuance of 2017 and 2015 stock options. The option price for the 2017 and 2015 stock options were equal to the estimated valuation of the Company's stock at the date of grant. Total share-based compensation related to the 2015 Stock Plan remaining to be expensed at December 31, 2017 is approximately \$30,000 and will be recorded annually over the service or vesting period of the options. There was \$167,203 in share-based compensation recorded for 2017 (\$2,707 for 2016).

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14. STOCK OPTIONS – CONTINUED

The following table summarizes the weighted average assumptions and calculated value of the stock options using the Black-Scholes option pricing model:

Risk-free interest rate	2.9%
Expected volatility	19.8%
Expected life in years	3.00
Service period in years	10.00
Weighted average fair value of options granted	\$1.95

The following table summarizes the activity related to options during 2017 and 2016:

	<u>Number of Shares</u>	<u>Weighted- Average Exercise Price</u>
Options outstanding, December 31, 2015:	111,000	\$10.00
Grants in 2016	-	
Exercises in 2016	-	
Cancellations and forfeitures in 2016	-	
Options expired in 2016	-	
Options outstanding, December 31, 2016:	111,000	\$10.00
Grants in 2017	82,500	
Exercises in 2017	(22,999)	
Cancellations and forfeitures in 2017	-	
Options expired in 2017	(11,000)	
Options outstanding, December 31, 2017	<u>159,501</u>	\$10.76

The maximum number of shares to be issued under the 2015 Stock Plan is 315,150 shares of common stock. At December 31, 2017, 135,150 shares were available to be issued.

	<u>2017</u>	<u>2016</u>
Options exercisable, December 31	115,167	56,583
Weighted average remaining contractual life-		
Options granted in 2015	7.6 years	8.6 years
Options granted in 2017	9.5 years	-

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15. RELATED PARTY AND PARTY-IN-INTEREST TRANSACTIONS

The Company issued overdraft lines of credit for executive officers and directors of the Company. As of December 31, 2017, loans outstanding to executive officers, directors, principal shareholders and their affiliates totaled approximately \$3,374,000 (\$2,833,000 in 2016) under loan commitments totaling \$3,533,000 (\$3,368,000 in 2016) (including the overdraft lines of credit).

The Company holds interest-bearing and noninterest-bearing deposits from executive officers, directors, principal shareholders and their affiliates of approximately \$2,990,000 and \$2,494,000 as of December 31, 2017 and 2016, respectively.

16. OTHER EXPENSES

Other expenses that exceed 1.0% of the aggregate of total interest income and other income for the years ended December 31 are as follows:

	<u>2017</u>	<u>2016</u>
Data processing	\$ 685,976	734,264
Professional fees	294,274	\$ 745,502
Supervisory assessments	209,565	187,134
Communications	174,251	206,351
Prepayment fees	-	345,523

17. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company reports fair value using the established categories within the fair value hierarchy (Note 2). The valuation methodologies used to determine the fair values of assets and liabilities reflect market participant assumptions and are based on the application of the fair value hierarchy that prioritizes observable market inputs over unobservable inputs. The Company determines the fair values of financial assets and financial liabilities based on quoted market prices, where available.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash Equivalents and Short-Term Investments – For those short-term instruments, the carrying amount is a reasonable estimate of fair value.

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17. FAIR VALUE OF FINANCIAL INSTRUMENTS – CONTINUED

Securities – For securities available-for-sale, fair values are based on quoted market prices or dealer quotes. For other investments, fair value is estimated to be approximately the carrying amount.

Loans and Loans Held-for-Sale – For certain homogeneous categories of loans, such as some residential mortgage and other consumer loans, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics. The fair value of other types of loans is estimated by discounting the future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and maturities.

Derivatives – The Bank estimates the fair value of IRLCs based on the value of the underlying mortgage loan, quoted Agency mortgage back security (“MBS”) prices and the probability that the mortgage loan will fund within the terms of the IRLC. The Bank estimates the fair value of forward sales commitments on quoted MBS prices.

Bank-owned Life Insurance – Bank-owned life insurance is valued at the underlying cash surrender value of the policies, which represents the current value of the policies.

Deposits – The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The recorded value of fixed-maturity certificates of deposit approximates the fair value as interest rates approximate market rates.

Borrowings – Rates currently available to the Bank for debt with similar terms and remaining maturities are used to estimate fair value of existing borrowings.

Commitments to Extend Credit, Standby Letters of Credit and Financial Guarantees Written – The fair value of commitments, letters of credit and financial guarantees is estimated to be approximately the fees charged for these arrangements.

Impaired Loans – Nonrecurring fair value adjustments to impaired loans reflect full or partial write-downs that are based on the loan’s observable market price or current appraised value of the underlying collateral.

Other Real Estate – Other real estate consists primarily of commercial or residential property or land. The fair values of other real estate are primarily based on independent appraisals of the underlying properties, net of any estimated selling costs. Nonrecurring fair value adjustments to other real estate reflect full or partial write-downs that are based on the real estate’s observable market price or current appraised value of the underlying collateral.

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17. FAIR VALUE OF FINANCIAL INSTRUMENTS – CONTINUED

Items Measured at Fair Value on a Recurring Basis

The following fair value hierarchy table presents information about the Bank's assets and liabilities measured at fair value on a recurring basis:

		Fair Value Measurement at Report Date Using		
		Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
As of December 31, 2017	Fair Value			
Securities available-for-sale				
Mortgage-backed securities	\$ 7,810,207	\$ -	\$ 7,810,207	\$ -
State, county and municipal securities	32,352,941	-	32,352,941	-
Trust preferred security	1,000,000	-	-	1,000,000
	41,163,147	-	40,163,147	1,000,000
Loans held-for-sale	5,540,422	-	5,540,422	-
Derivative asset	173,470	-	173,470	-
Total assets	<u>\$ 46,877,039</u>	<u>\$ -</u>	<u>\$ 45,877,039</u>	<u>\$ 1,000,000</u>
As of December 31, 2016	Fair Value	Level 1	Level 2	Level 3
Securities available-for-sale				
Mortgage-backed securities	\$ 9,424,788	\$ -	\$ 9,424,788	\$ -
State, county and municipal securities	30,405,972	-	30,405,972	-
Trust preferred security	1,000,000	-	-	1,000,000
	40,830,760	-	39,830,760	1,000,000
Loans held-for-sale	9,526,830	-	9,526,830	-
Total assets	<u>\$ 50,357,590</u>	<u>\$ -</u>	<u>\$ 49,357,590</u>	<u>\$ 1,000,000</u>

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17. FAIR VALUE OF FINANCIAL INSTRUMENTS – CONTINUED

The table below sets forth a summary of changes in the fair value of the Company's Level 3 investment assets for the years ended December 31, 2017 and 2016:

	Trusted Preferred Security
Beginning balance – December 31, 2015	\$ 1,000,000
Total purchases, sales, issuances and settlements (net) or gains related to instruments still held	-
Ending balance – December 31, 2016	1,000,000
Total purchases, sales, issuances and settlements (net) or gains or losses (realized and unrealized)	-
Ending balance – December 31, 2017	\$ 1,000,000

The Bank has one Level 3 investment in a trust preferred security that is reported at cost. Cost approximates fair value of this security at the reported date.

Items Measured at Fair Value on a Nonrecurring Basis

The following fair value hierarchy table presents information about the Bank's assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2017 and 2016:

		Fair Value Measurement at Report Date Using		
		Quoted Prices in Active Markets	Significant Other Observable Inputs	Significant Unobservable Inputs
	Fair Value	Level 1	Level 2	Level 3
December 31, 2017				
Impaired loans, net	\$ 739,260	\$ -	\$ -	\$ 739,260
Other real estate	265,882	-	-	265,882
Total assets	\$ 1,005,142	\$ -	\$ -	\$ 1,005,142
December 31, 2016				
Impaired loans, net	\$ 1,361,051	\$ -	\$ -	\$ 1,361,051
Other real estate	802,091	-	-	802,091
Total assets	\$ 2,163,142	\$ -	\$ -	\$ 2,163,142

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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17. FAIR VALUE OF FINANCIAL INSTRUMENTS – CONTINUED

The estimated fair values of the Bank's financial instruments as of December 31 are as follows:

	2017		2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in Thousands)			
Financial assets:				
Cash and short-term investments	\$ 3,127	\$ 3,127	\$ 6,492	\$ 6,492
Bank-owned life insurance	3,192	3,192	3,113	3,113
Loans and loans held-for-sale	246,344	244,675	217,759	210,208
Financial liabilities:				
Deposits	249,166	243,424	247,762	247,973
Long-term debt	28,000	27,984	4,000	4,017
Unrecognized financial instruments:				
Commitments to extend credit	51,526	514	32,333	323

18. MORTGAGE BANKING ACTIVITY

During 2017, the Company, through the Bank, began entering into interest rate lock commitments (IRLCs) with customers who have applied for residential mortgage loans and meet certain credit and underwriting criteria. These commitments expose the Company to market risk if interest rates change, and the loan is not economically hedged or committed to an investor. Commitments to originate loans do not necessarily reflect future cash requirements as some commitments are expected to expire without being drawn upon. Total commitments to originate loans carried a notional amount of \$5,244,000 at December 31, 2017. The related interest rate lock commitment derivative asset was approximately \$170,000 at December 31, 2017. The amount of the gain, net of the fair value of the mortgage backed securities TBAs was approximately \$173,000 for the year ended December 31, 2017 and is included in the statement of income in other noninterest income.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
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DECEMBER 31, 2017 AND 2016

19. CONDENSED PARENT COMPANY INFORMATION

Statement of Financial Condition at December 31:

ASSETS	2017	2016
	2017	2016
Cash and due from banks – eliminated upon consolidation	\$ 172,304	\$ 954
Investment in subsidiary (equity method) – eliminated upon consolidation	28,249,122	24,396,419
Deferred tax asset	44,762	8,345
Other assets	34,130	23,199
TOTAL ASSETS	\$ 28,500,318	\$ 24,428,917
LIABILITIES AND SHAREHOLDERS' EQUITY		
Line-of-credit	\$ 1,737,952	\$ 1,696,646
Other liabilities	-	41,339
TOTAL LIABILITIES	1,737,952	1,737,985
TOTAL SHAREHOLDERS' EQUITY	26,762,366	22,690,932
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 28,500,318	\$ 24,428,917

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

19. CONDENSED PARENT COMPANY INFORMATION – CONTINUED

Statement of Income for the Years Ended December 31:

	<u>2017</u>	<u>2016</u>
INCOME		
Dividends	\$ -	\$ 2,000
TOTAL INCOME	<u>-</u>	<u>2,000</u>
EXPENSES		
Interest on line-of-credit	73,099	15,783
Other expenses	168,411	134,842
TOTAL EXPENSES	<u>241,510</u>	<u>150,625</u>
Loss before income taxes and equity in undistributed earnings of subsidiary	(241,510)	(148,625)
Income tax benefit	63,027	21,994
Loss before equity in undistributed earnings of subsidiary	(178,483)	(126,631)
Equity in undistributed earnings of subsidiary	3,296,389	3,100,325
NET INCOME	<u><u>\$ 3,117,906</u></u>	<u><u>\$ 2,973,694</u></u>

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017 AND 2016

19. CONDENSED PARENT COMPANY INFORMATION – CONTINUED

Statement of Cash Flows for the Years Ended December 31:

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 3,117,906	\$ 2,973,694
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed earnings of subsidiaries	(3,296,389)	(3,100,325)
Share-based compensation match	167,203	2,707
Deferred income expense	(36,417)	(8,345)
Other, net	(52,272)	18,140
NET CASH USED BY OPERATING ACTIVITIES	<u>(99,969)</u>	<u>(114,129)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from line-of-credit	41,306	1,696,646
Treasury stock sold (purchased)	23	(1,581,563)
Common stock	22,999	-
Stock options exercised	206,991	-
NET CASH PROVIDED BY FINANCING ACTIVITIES	<u>271,319</u>	<u>115,083</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(171,350)	954
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>954</u>	<u>-</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 172,304</u>	<u>\$ 954</u>
Cash paid during the year for interest	\$ 73,099	\$ 15,283

SUPPLEMENTARY INFORMATION

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET
DECEMBER 31, 2017

	<u>SouthPoint Bancshares, Inc.</u>	<u>SouthPoint Bank</u>	<u>Eliminations</u>	<u>Consolidation</u>
ASSETS				
CASH AND CASH EQUIVALENTS				
Cash and due from banks	\$ 172,304	\$ 2,164,005	\$ (172,304)	\$ 2,164,005
Interest-bearing deposits with other banks	-	963,127	-	963,127
Federal funds sold	-	-	-	-
TOTAL CASH AND CASH EQUIVALENTS	<u>172,304</u>	<u>3,127,132</u>	<u>(172,304)</u>	<u>3,127,132</u>
Investment in subsidiary – SouthPoint Bank	28,249,122	-	(28,249,122)	-
Securities available-for-sale	-	41,163,147	-	41,163,147
Loans held-for sale	-	5,540,422	-	5,540,422
Loans, net of allowance for loan losses	-	240,803,868	-	240,803,868
Premises and equipment, net	-	11,479,123	-	11,479,123
Other real estate	-	265,882	-	265,882
Bank-owned life insurance	-	3,192,086	-	3,192,086
Deferred tax assets	44,762	484,209	-	528,971
Other assets	34,130	3,040,270	-	3,074,400
TOTAL ASSETS	<u>\$ 28,500,318</u>	<u>\$ 309,096,139</u>	<u>\$ (28,421,426)</u>	<u>\$ 309,175,031</u>
LIABILITIES AND STOCKHOLDERS' EQUITY				
DEPOSITS				
Interest bearing	\$ -	\$ 219,542,681	\$ -	\$ 219,542,681
Noninterest bearing	-	29,813,351	(172,304)	29,641,047
TOTAL DEPOSITS	<u>-</u>	<u>249,356,032</u>	<u>(172,304)</u>	<u>249,183,728</u>
FHLB advances	-	28,000,000	-	28,000,000
Federal funds purchased	-	1,249,000	-	1,249,000
Accounts payable and accrued liabilities	-	2,241,985	-	2,241,985
Line-of-credit	1,737,952	-	-	1,737,952
TOTAL LIABILITIES	<u>1,737,952</u>	<u>280,847,017</u>	<u>(172,304)</u>	<u>282,412,665</u>
SHAREHOLDERS' EQUITY				
Preferred stock, \$1 par value; 10,000,000 shares authorized and none issued or outstanding	-	-	-	-
Common stock, \$1 par value; 10,000,000 shares authorized; 2,124,000 and 2,101,001 shares issued at December 31, 2017 and 2016, respectively, and 1,987,835 and 1,964,834 shares outstanding at December 31, 2017 and 2016, respectively	2,124,000	2,101,001	(2,101,001)	2,124,000
Additional paid-in capital	20,300,070	19,923,169	(19,923,169)	20,300,070
Retained earnings	5,792,895	6,098,011	(6,098,011)	5,792,895
Accumulated other comprehensive loss:				
Unrealized losses on securities, net of taxes	126,941	126,941	(126,941)	126,941
Treasury stock, 136,165 and 136,167 shares at cost at December 31, 2017 and 2016, respectively	(1,581,540)	-	-	(1,581,540)
TOTAL SHAREHOLDERS' EQUITY	<u>26,762,366</u>	<u>28,249,122</u>	<u>(28,249,122)</u>	<u>26,762,366</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 28,500,318</u>	<u>\$ 309,096,139</u>	<u>\$ (28,421,426)</u>	<u>\$ 309,175,031</u>

See independent auditors' report.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2017

	<u>SouthPoint Bancshares, Inc.</u>	<u>SouthPoint Bank</u>	<u>Eliminations</u>	<u>Consolidation</u>
INTEREST INCOME				
Interest and fees on loans	\$ -	\$ 11,913,509	\$ -	\$ 11,913,509
Interest on investment securities	-	1,282,374	-	1,282,374
TOTAL INTEREST INCOME	<u>-</u>	<u>13,195,883</u>	<u>-</u>	<u>13,195,883</u>
INTEREST EXPENSE				
Interest expense on deposits	-	1,548,767	-	1,548,767
Interest on borrowed funds	73,099	218,556	-	291,655
TOTAL INTEREST EXPENSE	<u>73,099</u>	<u>1,767,323</u>	<u>-</u>	<u>1,840,422</u>
NET INTEREST INCOME (EXPENSE)	(73,099)	11,428,560	-	11,355,461
Provision for loan losses	-	300,000	-	300,000
NET INTEREST INCOME (EXPENSE) AFTER PROVISION FOR LOAN LOSSES	<u>(73,099)</u>	<u>11,128,560</u>	<u>-</u>	<u>11,055,461</u>
NONINTEREST INCOME				
Service charges, fees and commissions	-	486,788	-	486,788
Mortgage origination and servicing-release premium fees	-	4,952,624	-	4,952,624
Net loss on sale of available-for-sale securities	-	(20,039)	-	(20,039)
Other	-	118,214	-	118,214
TOTAL NONINTEREST INCOME	<u>-</u>	<u>5,537,587</u>	<u>-</u>	<u>5,537,587</u>
NONINTEREST EXPENSES				
Salaries and employee benefits	167,203	7,265,196	-	7,432,399
Net occupancy expenses	-	683,787	-	683,787
Other real estate costs	-	(44,421)	-	(44,421)
Operating expenses	1,210	3,356,950	-	3,358,160
TOTAL NONINTEREST EXPENSES	<u>168,413</u>	<u>11,261,512</u>	<u>-</u>	<u>11,429,925</u>
Equity in subsidiary undistributed earnings – SouthPoint Bank	3,296,391	-	(3,296,391)	-
INCOME BEFORE INCOME TAXES	3,054,879	5,404,635	(3,296,391)	5,163,123
Income tax (benefit) expense	(63,027)	2,108,244	-	2,045,217
NET INCOME	<u>\$ 3,117,906</u>	<u>\$ 3,296,391</u>	<u>\$ (3,296,391)</u>	<u>\$ 3,117,906</u>

See independent auditors' report.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2017

	<u>SouthPoint Bancshares, Inc.</u>	<u>SouthPoint Bank</u>	<u>Eliminations</u>	<u>Consolidation</u>
COMMON STOCK				
2,101,001 shares issued and 1,964,834 shares outstanding	\$ 2,124,000	\$ 2,101,001	\$ (2,101,001)	\$ 2,124,000
ADDITIONAL PAID-IN CAPITAL	20,300,070	19,923,169	(19,923,169)	20,300,070
RETAINED EARNINGS (DEFICIT)				
Balance at December 31, 2016	2,695,878	2,822,509	(2,822,509)	2,695,878
Reclassification of certain tax effects to accumulated other comprehensive income	(20,889)	(20,889)	20,889	(20,889)
Net income for the year	<u>3,117,906</u>	<u>3,296,391</u>	<u>(3,296,391)</u>	<u>3,117,906</u>
Balance at December 31, 2017	5,792,895	6,098,011	(6,098,011)	5,792,895
ACCUMULATED OTHER COMPREHENSIVE LOSS				
Unrealized losses on securities, net	106,052	106,052	(106,052)	106,052
Reclassification of certain tax effects to accumulated other comprehensive income	20,889	20,889	(20,889)	20,889
TREASURY STOCK				
136,165 shares at cost	<u>(1,581,540)</u>	<u>-</u>	<u>-</u>	<u>(1,581,540)</u>
TOTAL SHAREHOLDERS' EQUITY	<u>\$ 26,762,366</u>	<u>\$ 28,249,122</u>	<u>\$ (28,249,122)</u>	<u>\$ 26,762,366</u>

See independent auditors' report.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET
DECEMBER 31, 2016

	<u>SouthPoint Bancshares, Inc.</u>	<u>SouthPoint Bank</u>	<u>Eliminations</u>	<u>Consolidation</u>
ASSETS				
CASH AND CASH EQUIVALENTS				
Cash and due from banks	\$ 954	\$ 2,184,828	\$ (954)	\$ 2,184,828
Interest-bearing deposits with other banks	-	4,306,778	-	4,306,778
Federal funds sold	-	410	-	410
TOTAL CASH AND CASH EQUIVALENTS	<u>954</u>	<u>6,492,016</u>	<u>(954)</u>	<u>6,492,016</u>
Investment in subsidiary – SouthPoint Bank	24,396,419	-	(24,396,419)	-
Securities available-for-sale	-	40,830,760	-	40,830,760
Loans held-for sale	-	9,526,830	-	9,526,830
Loans, net of allowance for loan losses	-	208,232,199	-	208,232,199
Premises and equipment, net	-	5,580,204	-	5,580,204
Other real estate	-	802,091	-	802,091
Bank-owned life insurance	-	3,113,210	-	3,113,210
Deferred tax assets	8,345	1,015,242	-	1,023,587
Other assets	23,199	1,699,885	-	1,723,084
TOTAL ASSETS	<u>\$ 24,428,917</u>	<u>\$ 277,292,437</u>	<u>\$ (24,397,373)</u>	<u>\$ 277,323,981</u>
LIABILITIES AND SHAREHOLDERS' EQUITY				
DEPOSITS				
Interest bearing	\$ -	\$ 218,931,050	\$ -	\$ 218,931,050
Noninterest bearing	-	28,832,311	(954)	28,831,357
TOTAL DEPOSITS	<u>-</u>	<u>247,763,361</u>	<u>(954)</u>	<u>247,762,407</u>
FHLB advances	-	4,000,000	-	4,000,000
Federal funds purchased	-	50,000	-	50,000
Accounts payable and accrued liabilities	41,339	1,082,657	-	1,123,996
Line-of-credit	1,696,646	-	-	1,696,646
TOTAL LIABILITIES	<u>1,737,985</u>	<u>252,896,018</u>	<u>(954)</u>	<u>254,633,049</u>
SHAREHOLDERS' EQUITY				
Preferred stock, \$1 par value; 10,000,000 shares authorized and none issued or outstanding	-	-	-	-
Common stock – par value \$1 per share; 10,000,000 shares authorized, 2,101,001 shares issued and 1,964,834 shares outstanding	2,101,001	2,101,001	(2,101,001)	2,101,001
Additional paid-in capital	19,925,876	19,923,169	(19,923,169)	19,925,876
Retained earnings	2,695,878	2,822,509	(2,822,509)	2,695,878
Accumulated other comprehensive loss:				
Unrealized losses on securities, net of taxes	(450,260)	(450,260)	450,260	(450,260)
Treasury stock, 136,167 shares at cost	(1,581,563)	-	-	(1,581,563)
TOTAL SHAREHOLDERS' EQUITY	<u>22,690,932</u>	<u>24,396,419</u>	<u>(24,396,419)</u>	<u>22,690,932</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 24,428,917</u>	<u>\$ 277,292,437</u>	<u>\$ (24,397,373)</u>	<u>\$ 277,323,981</u>

See independent auditors' report.

SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2016

	<u>SouthPoint Bancshares, Inc.</u>	<u>SouthPoint Bank</u>	<u>Eliminations</u>	<u>Consolidation</u>
INTEREST INCOME				
Interest and fees on loans	\$ -	\$ 9,816,503	\$ -	\$ 9,816,503
Interest on investment securities	-	1,258,334	-	1,258,334
TOTAL INTEREST INCOME	-	11,074,837	-	11,074,837
INTEREST EXPENSE				
Interest expense on deposits	-	1,347,857	-	1,347,857
Interest on borrowed funds	15,783	320,245	-	336,028
TOTAL INTEREST EXPENSE	15,783	1,668,102	-	1,683,885
NET INTEREST INCOME (EXPENSE)	(15,783)	9,406,735	-	9,390,952
Provision for loan losses	-	175,000	-	175,000
NET INTEREST INCOME (EXPENSE) AFTER PROVISION FOR LOAN LOSSES	(15,783)	9,231,735	-	9,215,952
NONINTEREST INCOME				
Service charges, fees and commissions	-	419,694	-	419,694
Mortgage origination and servicing-release premium fees	-	4,986,924	-	4,986,924
Net gain on sale of available-for-sale securities	-	37,646	-	37,646
Other	2,000	572,089	(2,000)	572,089
TOTAL NONINTEREST INCOME	2,000	6,016,353	(2,000)	6,016,353
NONINTEREST EXPENSES				
Salaries and employee benefits	2,707	6,685,777	-	6,688,484
Net occupancy expenses	-	643,967	-	643,967
Other real estate costs	-	9,723	-	9,723
Operating expenses	132,135	3,658,247	-	3,790,382
TOTAL NONINTEREST EXPENSES	134,842	10,997,714	-	11,132,556
Equity in subsidiary undistributed earnings – SouthPoint Bank	3,100,325	-	(3,100,325)	-
INCOME BEFORE INCOME TAXES	2,951,700	4,250,374	(3,102,325)	4,099,749
Income tax expense	(21,994)	1,148,049	-	1,126,055
NET INCOME	\$ 2,973,694	\$ 3,102,325	\$ (3,102,325)	\$ 2,973,694

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SOUTHPOINT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2016

	<u>SouthPoint Bancshares, Inc.</u>	<u>SouthPoint Bank</u>	<u>Eliminations</u>	<u>Consolidation</u>
COMMON STOCK				
2,101,001 shares issued and 2,101,001 shares outstanding	\$ 2,101,001	\$ 2,101,001	\$ (2,101,001)	\$ 2,101,001
ADDITIONAL PAID-IN CAPITAL	19,925,876	19,923,169	(19,923,169)	19,925,876
RETAINED EARNINGS (DEFICIT)				
Balance at December 31, 2015	(277,816)	(277,816)	277,816	(277,816)
Net income for the year	2,973,694	3,102,325	(3,102,325)	2,973,694
Dividends paid	-	(2,000)	2,000	-
Balance at December 31, 2015	<u>2,695,878</u>	<u>2,822,509</u>	<u>(2,822,509)</u>	<u>2,695,878</u>
ACCUMULATED OTHER COMPREHENSIVE GAIN				
Unrealized gains on securities, net	(450,260)	(450,260)	450,260	(450,260)
Treasury Stock				
136,167 shares at cost	<u>(1,581,563)</u>	<u>-</u>	<u>-</u>	<u>(1,581,563)</u>
TOTAL SHAREHOLDERS' EQUITY	<u>\$ 22,690,932</u>	<u>\$ 24,396,419</u>	<u>\$ (24,396,419)</u>	<u>\$ 22,690,932</u>

See independent auditors' report.