

REFINITIV

DELTA REPORT

10-Q

STEL - STELLAR BANCORP, INC.
10-Q - SEPTEMBER 30, 2023 COMPARED TO 10-Q - JUNE 30, 2023

The following comparison report has been automatically generated

TOTAL DELTAS	911
CHANGES	561
DELETIONS	175
ADDITIONS	175

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE SEPTEMBER 30, 2023
OR

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

FOR THE TRANSITION PERIOD FROM TO
COMMISSION FILE NUMBER: 001-38280

Stellar Bancorp, Inc.
(Exact name of registrant as specified in its charter)

Texas
(State or other jurisdiction of incorporation or organization)

20-8339782
(I.R.S. Employer Identification No.)

9 Greenway Plaza, Suite 110
Houston, Texas 77046
(Address of principal executive offices, including zip code)
(713) 210-7600
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value, \$0.01 per share	STEL	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes **S** No **£**

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes **S** No **£**

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

Large accelerated filer	£	Accelerated filer	S
Non-accelerated filer	£	Smaller reporting company	£
		Emerging growth company	£

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes **£** No **S**

As of July 26, 2023 November 2, 2023, the registrant had 53,308,244 53,262,213 shares common stock, \$0.01 par value per share, outstanding.

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INDEX TO FORM 10-Q
June September 30, 2023

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PART I—FINANCIAL INFORMATION

ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS

STELLAR BANCORP, INC. CONSOLIDATED BALANCE SHEETS (Unaudited)						
		June 30, 2023	December 31, 2022			
		(In thousands, except shares and par value)				
ASSETS	ASSETS			ASSETS		
Cash and due from banks	Cash and due from banks	\$ 105,913	\$ 67,063	Cash and due from banks	\$ 94,970	\$ 67,063
Interest-bearing deposits at other financial institutions	Interest-bearing deposits at other financial institutions	198,176	304,642	Interest-bearing deposits at other financial institutions	207,302	304,642
Total cash and cash equivalents	Total cash and cash equivalents	304,089	371,705	Total cash and cash equivalents	302,272	371,705
Available for sale securities, at fair value	Available for sale securities, at fair value	1,478,222	1,807,586	Available for sale securities, at fair value	1,414,952	1,807,586
Loans held for investment	Loans held for investment	8,068,718	7,754,751	Loans held for investment	8,004,528	7,754,751
Less: allowance for credit losses on loans	Less: allowance for credit losses on loans	(100,195)	(93,180)	Less: allowance for credit losses on loans	(93,575)	(93,180)
Loans, net	Loans, net	7,968,523	7,661,571	Loans, net	7,910,953	7,661,571
Accrued interest receivable	Accrued interest receivable	42,051	44,743	Accrued interest receivable	43,536	44,743
Premises and equipment, net	Premises and equipment, net	119,142	126,803	Premises and equipment, net	119,332	126,803
Federal Home Loan Bank stock	Federal Home Loan Bank stock	24,478	15,058	Federal Home Loan Bank stock	29,022	15,058
Bank-owned life insurance	Bank-owned life insurance	104,148	103,094	Bank-owned life insurance	104,699	103,094
Goodwill	Goodwill	497,260	497,260	Goodwill	497,318	497,260

Core deposit intangibles, net	Core deposit intangibles, net	129,805	143,525	Core deposit intangibles, net	122,944	143,525
Other assets	Other assets	110,633	129,092	Other assets	120,432	129,092
TOTAL ASSETS	TOTAL ASSETS	\$ 10,778,351	\$ 10,900,437	TOTAL ASSETS	\$ 10,665,460	\$ 10,900,437
LIABILITIES AND SHAREHOLDERS' EQUITY	LIABILITIES AND SHAREHOLDERS' EQUITY			LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:	LIABILITIES:			LIABILITIES:		
Deposits:	Deposits:			Deposits:		
Noninterest-bearing	Noninterest-bearing	\$ 3,713,536	\$ 4,230,169	Noninterest-bearing	\$ 3,656,288	\$ 4,230,169
Interest-bearing	Interest-bearing			Interest-bearing		
Demand	Demand	1,437,509	1,591,828	Demand	1,397,492	1,591,828
Money market and savings	Money market and savings	2,174,073	2,575,923	Money market and savings	2,128,950	2,575,923
Certificates and other time	Certificates and other time	1,441,251	869,712	Certificates and other time	1,503,891	869,712
Total interest-bearing deposits	Total interest-bearing deposits	5,052,833	5,037,463	Total interest-bearing deposits	5,030,333	5,037,463
Total deposits	Total deposits	8,766,369	9,267,632	Total deposits	8,686,621	9,267,632
Accrued interest payable	Accrued interest payable	4,555	2,098	Accrued interest payable	7,612	2,098
Borrowed funds	Borrowed funds	369,963	63,925	Borrowed funds	323,981	63,925
Subordinated debt	Subordinated debt	109,566	109,367	Subordinated debt	109,665	109,367
Other liabilities	Other liabilities	69,218	74,239	Other liabilities	76,735	74,239
Total liabilities	Total liabilities	9,319,671	9,517,261	Total liabilities	9,204,614	9,517,261
COMMITMENTS AND CONTINGENCIES (See Note 14)	COMMITMENTS AND CONTINGENCIES (See Note 14)			COMMITMENTS AND CONTINGENCIES (See Note 14)		
SHAREHOLDERS' EQUITY:	SHAREHOLDERS' EQUITY:			SHAREHOLDERS' EQUITY:		
Preferred stock, \$0.01 par value; 10,000,000 shares authorized; no shares issued or outstanding at June 30, 2023 and December 31, 2022		—	—			
Common stock, \$0.01 par value; 140,000,000 shares authorized; 53,302,734 shares issued and outstanding at June 30, 2023 and 52,954,985 shares issued and outstanding at December 31, 2022		533	530			
Preferred stock, \$0.01 par value; 10,000,000 shares authorized; no shares issued or outstanding at September 30, 2023 and December 31, 2022				Preferred stock, \$0.01 par value; 10,000,000 shares authorized; no shares issued or outstanding at September 30, 2023 and December 31, 2022	—	—
Common stock, \$0.01 par value; 140,000,000 shares authorized; 53,321,541 shares issued and outstanding at September 30, 2023 and 52,954,985 shares issued and outstanding at December 31, 2022				Common stock, \$0.01 par value; 140,000,000 shares authorized; 53,321,541 shares issued and outstanding at September 30, 2023 and 52,954,985 shares issued and outstanding at December 31, 2022	533	530
Capital surplus	Capital surplus	1,228,532	1,222,761	Capital surplus	1,231,686	1,222,761
Retained earnings	Retained earnings	361,619	303,146	Retained earnings	385,600	303,146
Accumulated other comprehensive loss	Accumulated other comprehensive loss	(132,004)	(143,261)	Accumulated other comprehensive loss	(156,973)	(143,261)
Total shareholders' equity	Total shareholders' equity	1,458,680	1,383,176	Total shareholders' equity	1,460,846	1,383,176
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 10,778,351	\$ 10,900,437	TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 10,665,460	\$ 10,900,437

See condensed notes to interim consolidated financial statements.

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STELLAR BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

		Three Months Ended June 30,		Six Months Ended June 30,		Three Months Ended September 30,		Nine Months Ended September 30,	
		2023	2022	2023	2022	2023	2022	2023	2022
		(Dollars in thousands, except per share data)				(Dollars in thousands, except per share data)			
INTEREST INCOME:	INTEREST INCOME:					INTEREST INCOME:			
Loans, including fees	Loans, including fees	\$ 133,931	\$ 53,835	\$ 259,660	\$ 106,205	Loans, including fees	\$ 138,948	\$ 58,025	\$ 398,608
Securities:	Securities:					Securities:			
Taxable	Taxable	9,726	5,571	19,379	10,639	Taxable	9,493	6,655	28,872
Tax-exempt	Tax-exempt	436	2,557	1,698	5,082	Tax-exempt	437	2,594	2,135
Deposits in other financial institutions	Deposits in other financial institutions	2,865	877	6,636	1,217	Deposits in other financial institutions	2,391	608	9,027
Total interest income	Total interest income	146,958	62,840	287,373	123,143	Total interest income	151,269	67,882	438,642
INTEREST EXPENSE:	INTEREST EXPENSE:					INTEREST EXPENSE:			
Demand, money market and savings deposits	Demand, money market and savings deposits	20,708	1,859	38,745	3,206	Demand, money market and savings deposits	23,557	3,527	62,302
Certificates and other time deposits	Certificates and other time deposits	9,622	1,922	12,929	4,078	Certificates and other time deposits	13,282	1,664	26,211
Borrowed funds	Borrowed funds	6,535	114	7,852	300	Borrowed funds	5,801	499	13,653
Subordinated debt	Subordinated debt	1,812	1,463	3,739	2,905	Subordinated debt	1,908	1,502	5,647
Total interest expense	Total interest expense	38,677	5,358	63,265	10,489	Total interest expense	44,548	7,192	107,813
NET INTEREST INCOME	NET INTEREST INCOME	108,281	57,482	224,108	112,654	NET INTEREST INCOME	106,721	60,690	330,829
Provision for credit losses	Provision for credit losses	1,915	2,143	5,581	3,957	Provision for credit losses	2,315	1,962	7,896
Net interest income after provision for credit losses	Net interest income after provision for credit losses	106,366	55,339	218,527	108,697	Net interest income after provision for credit losses	104,406	58,728	322,933
NONINTEREST INCOME:	NONINTEREST INCOME:					NONINTEREST INCOME:			
Nonsufficient funds fees	Nonsufficient funds fees	418	126	824	242	Nonsufficient funds fees			
Nonsufficient funds and overdraft charges	Nonsufficient funds and overdraft charges					Nonsufficient funds and overdraft charges	291	145	1,115
Service charges on deposit accounts	Service charges on deposit accounts	1,157	560	2,100	1,087	Service charges on deposit accounts	1,329	527	3,429
(Loss) gain on sale of assets	(Loss) gain on sale of assets	(6)	(17)	192	(17)	(Loss) gain on sale of assets			
Gain on sale of assets	Gain on sale of assets					Gain on sale of assets	—	42	192

Bank-owned life insurance income	Bank-owned life insurance income	532	342	1,054	475	Bank-owned life insurance income	551	135	1,605	610
Debit card and ATM card income		1,821	880	3,519	1,699					
Debit card and ATM income						Debit card and ATM income	935	869	4,454	2,568
Other	Other	1,561	813	5,292	3,236	Other	1,589	1,277	6,881	4,513
Total noninterest income	Total noninterest income	5,483	2,704	12,981	6,722	Total noninterest income	4,695	2,995	17,676	9,717
NONINTEREST EXPENSE:	NONINTEREST EXPENSE:					NONINTEREST EXPENSE:				
Salaries and employee benefits	Salaries and employee benefits	37,300	21,864	77,075	44,592	Salaries and employee benefits	39,495	22,013	116,570	66,605
Net occupancy and equipment	Net occupancy and equipment	3,817	2,220	7,905	4,425	Net occupancy and equipment	4,455	2,129	12,360	6,554
Depreciation	Depreciation	1,841	1,012	3,677	2,045	Depreciation	1,952	1,003	5,629	3,048
Data processing and software amortization	Data processing and software amortization	4,674	2,522	9,728	5,020	Data processing and software amortization	4,798	2,541	14,526	7,561
Professional fees	Professional fees	1,564	662	3,091	800	Professional fees	997	485	4,088	1,285
Regulatory assessments and FDIC insurance	Regulatory assessments and FDIC insurance	2,755	1,256	4,049	2,517	Regulatory assessments and FDIC insurance	1,814	1,134	5,863	3,651
Amortization of intangibles	Amortization of intangibles	6,881	751	13,760	1,502	Amortization of intangibles	6,876	750	20,636	2,252
Communications	Communications	689	363	1,390	704	Communications	663	359	2,053	1,063
Advertising	Advertising	907	483	1,746	945	Advertising	877	385	2,623	1,330
Acquisition and merger-related expenses	Acquisition and merger-related expenses	2,897	1,667	9,062	2,118	Acquisition and merger-related expenses	3,421	10,551	12,483	12,669
Other	Other	5,882	5,104	10,322	7,753	Other	5,400	2,681	15,722	10,434
Total noninterest expense	Total noninterest expense	69,207	37,904	141,805	72,421	Total noninterest expense	70,748	44,031	212,553	116,452
INCOME BEFORE INCOME TAXES	INCOME BEFORE INCOME TAXES	42,642	20,139	89,703	42,998	INCOME BEFORE INCOME TAXES	38,353	17,692	128,056	60,690
Provision for income taxes	Provision for income taxes	7,467	3,702	17,380	7,904	Provision for income taxes	7,445	3,406	24,825	11,310
NET INCOME	NET INCOME	\$ 35,175	\$ 16,437	\$ 72,323	\$ 35,094	NET INCOME	\$ 30,908	\$ 14,286	\$ 103,231	\$ 49,380
EARNINGS PER SHARE:	EARNINGS PER SHARE:					EARNINGS PER SHARE:				
Basic	Basic	\$ 0.66	\$ 0.57	\$ 1.36	\$ 1.22	Basic	\$ 0.58	\$ 0.51	\$ 1.94	\$ 1.72
Diluted	Diluted	\$ 0.66	\$ 0.56	\$ 1.36	\$ 1.21	Diluted	\$ 0.58	\$ 0.50	\$ 1.94	\$ 1.71
DIVIDENDS PER SHARE	DIVIDENDS PER SHARE	\$ 0.13	\$ 0.10	\$ 0.26	\$ 0.20	DIVIDENDS PER SHARE	\$ 0.13	\$ 0.10	\$ 0.39	\$ 0.30

See condensed notes to interim consolidated financial statements.

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STELLAR BANCORP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
	(In thousands)			
Net income	\$ 35,175	\$ 16,437	\$ 72,323	\$ 35,094
Other comprehensive (loss) income:				
Unrealized gain (loss) on securities:				
Change in unrealized holding (loss) gain on available for sale securities during the period	(23,717)	(65,648)	14,249	(169,269)
Reclassification of loss (gain) realized on securities	—	17	(234)	17
Total other comprehensive (loss) income	(23,717)	(65,631)	14,015	(169,252)
Deferred tax benefit (expense) related to other comprehensive loss	4,994	13,782	(2,758)	35,543
Other comprehensive (loss) income, net of tax	(18,723)	(51,849)	11,257	(133,709)
Comprehensive income (loss)	\$ 16,452	\$ (35,412)	\$ 83,580	\$ (98,615)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
	(In thousands)			
Net income	\$ 30,908	\$ 14,286	\$ 103,231	\$ 49,380
Other comprehensive loss:				
Unrealized loss on securities:				
Change in unrealized holding loss on available for sale securities during the period	(31,638)	(60,618)	(17,390)	(229,887)
Reclassification of gain realized on securities	—	(42)	(234)	(25)
Total other comprehensive loss	(31,638)	(60,660)	(17,624)	(229,912)
Deferred tax benefit related to other comprehensive loss	6,669	12,739	3,912	48,282
Other comprehensive loss, net of tax	(24,969)	(47,921)	(13,712)	(181,630)
Comprehensive income (loss)	\$ 5,939	\$ (33,635)	\$ 89,519	\$ (132,250)

See condensed notes to interim consolidated financial statements.

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STELLAR BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)

	(Continued)															
	Common Stock				Accumulated Other Comprehensive Income (Loss)			Total Shareholders' Equity	Common Stock				Accumulated Other Comprehensive Income (Loss)			Total Shareholders' Equity
	Shares	Amount	Capital Surplus	Retained Earnings	Comprehensive Income (Loss)	Share	Equity				Capital Surplus	Retained Earnings	Comprehensive Income (Loss)	Shareholders' Equity		
															Amount	Surplus
(Dollars in thousands, except per share data)								(Dollars in thousands, except per share data)								
BALANCE AT MARCH 31, 2022	28,903,910	\$ 290	\$ 532,372	\$ 282,896	\$ (63,618)	\$	751,940									
BALANCE AT JUNE 30, 2022								BALANCE AT JUNE 30, 2022	28,586,426	\$ 286	\$ 524,033	\$ 296,477	\$ (115,467)	\$	705,329	
Net income	Net income	—	—	—	16,437	—	16,437	Net income	—	—	—	14,286	—		14,286	
Other comprehensive loss	Other comprehensive loss	—	—	—	—	(51,849)	(51,849)	Other comprehensive loss	—	—	—	—	(47,921)		(47,921)	
Cash dividends declared, \$0.10 per share	Cash dividends declared, \$0.10 per share	—	—	—	(2,856)	—	(2,856)	Cash dividends declared, \$0.10 per share	—	—	—	(2,788)	—		(2,788)	

Common stock issued in connection with the exercise of stock options and restricted stock awards	Common stock issued in connection with the exercise of stock options and restricted stock awards	32,789	—	416	—	—	416	Common stock issued in connection with the exercise of stock options and restricted stock awards	31,823	—	343	—	—	34
Repurchase of common stock	Repurchase of common stock	(350,273)	(4)	(9,686)	—	—	(9,690)	Repurchase of common stock	(481,638)	(5)	(13,911)	—	—	(13,911)
Stock-based compensation expense	Stock-based compensation expense	—	—	931	—	—	931	Stock-based compensation expense	—	—	969	—	—	969
BALANCE AT JUNE 30, 2022		28,586,426	\$ 286	\$ 524,033	\$296,477	\$ (115,467)	\$ 705,329	BALANCE AT SEPTEMBER 30, 2022		28,136,611	\$281	\$ 511,434	\$307,975	\$ (163,388)
														\$ 656,300
BALANCE AT MARCH 31, 2023		53,296,038	\$ 533	\$1,225,596	\$333,368	\$ (113,281)	\$ 1,446,216							
BALANCE AT JUNE 30, 2023								BALANCE AT JUNE 30, 2023		53,302,734	\$533	\$1,228,532	\$361,619	\$ (132,004)
Net income	Net income	—	—	—	35,175	—	35,175	Net income	—	—	—	30,908	—	30,908
Other comprehensive loss	Other comprehensive loss	—	—	—	—	(18,723)	(18,723)	Other comprehensive loss	—	—	—	—	(24,969)	(24,969)
Cash dividends declared, \$0.13 per share	Cash dividends declared, \$0.13 per share	—	—	—	(6,924)	—	(6,924)	Cash dividends declared, \$0.13 per share	—	—	—	(6,927)	—	(6,927)
Common stock issued in connection with the exercise of stock options and restricted stock awards	Common stock issued in connection with the exercise of stock options and restricted stock awards	6,696	—	94	—	—	94	Common stock issued in connection with the exercise of stock options and restricted stock awards	18,807	—	342	—	—	342
Stock-based compensation expense	Stock-based compensation expense	—	—	2,842	—	—	2,842	Stock-based compensation expense	—	—	2,812	—	—	2,812
BALANCE AT JUNE 30, 2023		53,302,734	\$ 533	\$1,228,532	\$361,619	\$ (132,004)	\$ 1,458,680	BALANCE AT SEPTEMBER 30, 2023		53,321,541	\$533	\$1,231,686	\$385,600	\$ (156,973)
BALANCE AT SEPTEMBER 30, 2023														\$ 1,460,840
BALANCE AT DECEMBER 31, 2021		28,845,903	\$ 289	\$ 530,845	\$267,092	\$ 18,242	\$ 816,468	BALANCE AT DECEMBER 31, 2021		28,845,903	\$289	\$ 530,845	\$267,092	\$ 18,242
Net income	Net income	—	—	—	35,094	—	35,094	Net income	—	—	—	49,380	—	49,380
Other comprehensive loss	Other comprehensive loss	—	—	—	—	(133,709)	(133,709)	Other comprehensive loss	—	—	—	—	(181,630)	(181,630)
Cash dividends declared \$0.20 per share		—	—	—	(5,709)	—	(5,709)							
Cash dividends declared \$0.30 per share								Cash dividends declared \$0.30 per share		—	—	—	(8,497)	—
Common stock issued in connection with the exercise of stock options and restricted stock awards	Common stock issued in connection with the exercise of stock options and restricted stock awards	90,796	1	984	—	—	985	Common stock issued in connection with the exercise of stock options and restricted stock awards	122,619	1	1,327	—	—	1,327
Repurchase of common stock	Repurchase of common stock	(350,273)	(4)	(9,686)	—	—	(9,690)	Repurchase of common stock	(831,911)	(9)	(23,597)	—	—	(23,600)

Stock-based compensation expense	Stock-based compensation expense	—	—	1,890	—	—	1,890	Stock-based compensation expense	—	—	2,859	—	—	2,85
BALANCE AT JUNE 30, 2022		28,586,426	\$ 286	\$ 524,033	\$296,477	\$ (115,467)	\$ 705,329							
BALANCE AT SEPTEMBER 30, 2022								BALANCE AT SEPTEMBER 30, 2022	28,136,611	\$281	\$ 511,434	\$307,975	\$ (163,388)	
														\$ 656,30
BALANCE AT DECEMBER 31, 2022	BALANCE AT DECEMBER 31, 2022	52,954,985	\$ 530	\$1,222,761	\$303,146	\$ (143,261)	\$ 1,383,176	BALANCE AT DECEMBER 31, 2022	52,954,985	\$530	\$1,222,761	\$303,146	\$ (143,261)	\$ 1,383,17
Net income	Net income	—	—	—	72,323	—	72,323	Net income	—	—	—	103,231	—	103,23
Other comprehensive income		—	—	—	—	11,257	11,257							
Cash dividends declared \$0.26 per share		—	—	—	(13,850)	—	(13,850)							
Other comprehensive loss								Other comprehensive loss	—	—	—	—	(13,712)	(13,71
Cash dividends declared \$0.39 per share								Cash dividends declared \$0.39 per share	—	—	—	(20,777)	—	(20,77
Common stock issued in connection with the exercise of stock options and restricted stock awards	Common stock issued in connection with the exercise of stock options and restricted stock awards	347,749	3	348	—	—	351	Common stock issued in connection with the exercise of stock options and restricted stock awards	366,556	3	690	—	—	69
Stock-based compensation expense	Stock-based compensation expense	—	—	5,423	—	—	5,423	Stock-based compensation expense	—	—	8,235	—	—	8,23
BALANCE AT JUNE 30, 2023		53,302,734	\$ 533	\$1,228,532	\$361,619	\$ (132,004)	\$ 1,458,680							
BALANCE AT SEPTEMBER 30, 2023								BALANCE AT SEPTEMBER 30, 2023	53,321,541	\$533	\$1,231,686	\$385,600	\$ (156,973)	\$ 1,460,84

See condensed notes to interim consolidated financial statements.

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STELLAR BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	(In thousands)					(In thousands)				
	Six Months Ended June 30,					Nine Months Ended September 30,				
	2023		2022			2023		2022		
	(In thousands)					(In thousands)				
CASH FLOWS FROM OPERATING ACTIVITIES:	CASH FLOWS FROM OPERATING ACTIVITIES:				CASH FLOWS FROM OPERATING ACTIVITIES:					
Net income	Net income	\$	72,323	\$	35,094	Net income	\$	103,231	\$	49,380
Adjustments to reconcile net income to net cash provided by operating activities:	Adjustments to reconcile net income to net cash provided by operating activities:				Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and core deposit intangibles amortization	Depreciation and core deposit intangibles amortization		17,437		3,547	Depreciation and core deposit intangibles amortization		26,265		5,300
Provision for credit losses	Provision for credit losses		5,581		3,957	Provision for credit losses		7,896		5,919

Deferred income tax benefit	Deferred income tax benefit	11,961	(97)	Deferred income tax benefit	11,617	(954)
Net amortization of premium on investments	Net amortization of premium on investments	1,564	5,558	Net amortization of premium on investments	5,098	7,903
Excess tax benefit from stock-based compensation	Excess tax benefit from stock-based compensation	(47)	(154)	Excess tax benefit from stock-based compensation	(70)	(312)
Bank-owned life insurance income	Bank-owned life insurance income	(1,054)	(475)	Bank-owned life insurance income	(1,605)	(610)
Net accretion of discount on loans	Net accretion of discount on loans	(22,665)	(139)	Net accretion of discount on loans	(35,065)	(165)
Net amortization of discount on subordinated debt	Net amortization of discount on subordinated debt	59	58	Net amortization of discount on subordinated debt	88	87
Net accretion of discount on certificates of deposit	Net accretion of discount on certificates of deposit	(19)	(31)	Net accretion of discount on certificates of deposit	(21)	(45)
Net (gain) loss on sale of assets		(192)	17			
Net gain on sale of assets				Net gain on sale of assets	(192)	(25)
Federal Home Loan Bank stock dividends	Federal Home Loan Bank stock dividends	(400)	(35)	Federal Home Loan Bank stock dividends	(799)	(64)
Stock-based compensation expense	Stock-based compensation expense	5,423	1,890	Stock-based compensation expense	8,235	2,859
Net change in operating leases	Net change in operating leases	2,088	1,515	Net change in operating leases	3,055	2,178
Decrease (increase) in accrued interest receivable and other assets		6,453	(4,153)			
Decrease in accrued interest payable and other liabilities		(524)	(5,694)			
Increase in accrued interest receivable and other assets				Increase in accrued interest receivable and other assets	(165)	(1,415)
Increase in accrued interest payable and other liabilities				Increase in accrued interest payable and other liabilities	9,319	4,082
Net cash provided by operating activities	Net cash provided by operating activities	97,988	40,858	Net cash provided by operating activities	136,887	74,118
CASH FLOWS FROM INVESTING ACTIVITIES:	CASH FLOWS FROM INVESTING ACTIVITIES:			CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal paydowns of available for sale securities	Proceeds from maturities and principal paydowns of available for sale securities	55,312	2,283,396	Proceeds from maturities and principal paydowns of available for sale securities	685,707	2,320,157
Proceeds from sales and calls of available for sale securities	Proceeds from sales and calls of available for sale securities	320,691	5,056	Proceeds from sales and calls of available for sale securities	320,691	12,056

Purchase of available for sale securities	Purchase of available for sale securities	(33,287)	(2,398,416)	Purchase of available for sale securities	(633,287)	(2,414,630)
Net change in total loans	Net change in total loans	(291,730)	(129,096)	Net change in total loans	(223,256)	(371,904)
Purchase of bank premises and equipment	Purchase of bank premises and equipment	(2,479)	(395)	Purchase of bank premises and equipment	(5,621)	(668)
Proceeds from sale of bank premises, equipment and other real estate	Proceeds from sale of bank premises, equipment and other real estate	3,652	—	Proceeds from sale of bank premises, equipment and other real estate	3,685	—
Net (purchase) redemption of Federal Home Loan Bank stock		(9,020)	5,315			
Net purchase of Federal Home Loan Bank stock				Net purchase of Federal Home Loan Bank stock	(13,165)	(7,421)
Net cash provided by (used in) investing activities	Net cash provided by (used in) investing activities	43,139	(234,140)	Net cash provided by (used in) investing activities	134,754	(462,410)
CASH FLOWS FROM FINANCING ACTIVITIES:	CASH FLOWS FROM FINANCING ACTIVITIES:			CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in noninterest-bearing deposits	Net (decrease) increase in noninterest-bearing deposits	(516,633)	151,634	Net (decrease) increase in noninterest-bearing deposits	(573,881)	222,754
Net increase (decrease) in interest-bearing deposits		15,389	(318,610)			
Net decrease in interest-bearing deposits				Net decrease in interest-bearing deposits	(7,109)	(609,629)
Net change in short-term other borrowed funds	Net change in short-term other borrowed funds	306,000	(90,000)	Net change in short-term other borrowed funds	260,000	167,000
Dividends paid to common shareholders	Dividends paid to common shareholders	(13,850)	(5,709)	Dividends paid to common shareholders	(20,777)	(8,497)
Proceeds from the issuance of common stock and stock option exercises	Proceeds from the issuance of common stock and stock option exercises	351	985	Proceeds from the issuance of common stock and stock option exercises	693	1,328
Repurchase of common stock	Repurchase of common stock	—	(9,690)	Repurchase of common stock	—	(23,606)
Net cash used in financing activities	Net cash used in financing activities	(208,743)	(271,390)	Net cash used in financing activities	(341,074)	(250,650)
NET CHANGE IN CASH AND CASH EQUIVALENTS	NET CHANGE IN CASH AND CASH EQUIVALENTS	(67,616)	(464,672)	NET CHANGE IN CASH AND CASH EQUIVALENTS	(69,433)	(638,942)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	371,705	757,509	CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	371,705	757,509
CASH AND CASH EQUIVALENTS, END OF PERIOD	CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 304,089	\$ 292,837	CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 302,272	\$ 118,567

SUPPLEMENTAL CASH FLOW INFORMATION:	SUPPLEMENTAL CASH FLOW INFORMATION:			SUPPLEMENTAL CASH FLOW INFORMATION:						
Income taxes paid	Income taxes paid	\$	—	\$	6,900	Income taxes paid	\$	7,500	\$	10,550
Interest paid	Interest paid		60,808		10,742	Interest paid		102,299		16,761
Cash paid for operating lease liabilities	Cash paid for operating lease liabilities		2,230		1,723	Cash paid for operating lease liabilities		3,372		2,559
SUPPLEMENTAL NONCASH DISCLOSURE:	SUPPLEMENTAL NONCASH DISCLOSURE:					SUPPLEMENTAL NONCASH DISCLOSURE:				
Lease right-of-use asset obtained in exchange for lessee operating lease liabilities	Lease right-of-use asset obtained in exchange for lessee operating lease liabilities	\$	—	\$	76					
Branch assets transferred to assets held for sale	Branch assets transferred to assets held for sale		3,819		2,137	Branch assets transferred to assets held for sale	\$	3,819	\$	2,137

See condensed notes to interim consolidated financial statements.

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STELLAR BANCORP, INC.
CONDENSED NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
June September 30, 2023
(Unaudited)

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

Nature of Operations-Stellar Bancorp, Inc. ("Stellar") through its wholly-owned subsidiary, Stellar Bank, (the "Bank"), and together with Stellar, collectively referred to herein as "we," "us," "our" and the "Company"), provides a diversified range of commercial banking services primarily to small- to medium-sized businesses. Stellar derives substantially all of its revenues and income from the operation of the Bank.

We refer to the Houston-The Woodlands-Sugar Land metropolitan statistical area ("MSA"), as the Houston region ("Houston region") and the Beaumont-Port Arthur MSA, as the Beaumont region ("Beaumont region"). The Company is focused on delivering a wide variety of relationship-driven commercial banking products and community-oriented services tailored to meet the needs of small-to medium-sized businesses, professionals and individuals through its 55 banking centers with 38 banking centers in the Houston region, 16 banking centers in the Beaumont region and one banking center in Dallas, Texas, which we collectively refer to as our markets.

Basis of Presentation-The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and in accordance with guidance provided by the Securities and Exchange Commission ("SEC"). Accordingly, the condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments considered necessary for a fair presentation of the financial position, results of operations and cash flows of the Company on a consolidated basis, and all such adjustments are of a normal recurring nature. Transactions between Stellar and the Bank have been eliminated. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2022. Operating results for the three and six nine months ended June 30, 2023 September 30, 2023 are not necessarily indicative of the results that may be expected for the year ending December 31, 2023.

Merger of Equals-The merger of equals (the "Merger") between Allegiance Bancshares, Inc. ("Allegiance") and CBTX, Inc. ("CBTX"), was effective on October 1, 2022, with CBTX as the surviving corporation that was renamed Stellar Bancorp, Inc. At the effective time of the Merger, each outstanding share of Allegiance common stock, par value of \$1.00 per share, was converted into the right to receive 1.4184 shares of common stock of the Company. Immediately following the Merger, CommunityBank of Texas, N.A. ("CommunityBank"), a national banking association and a wholly-owned subsidiary of CBTX, merged with and into Allegiance Bank, a wholly owned subsidiary of Allegiance, with Allegiance Bank as the surviving bank. In connection with the operational conversion during the first quarter of 2023, Allegiance Bank changed its name to Stellar Bank on February 18, 2023, in connection with the operational conversion.

The Merger constituted a business combination and was accounted for as a reverse merger using the acquisition method of accounting. As a result, Allegiance was the accounting acquirer and CBTX was the legal acquirer and the accounting acquiree. Accordingly, the historical financial statements of Allegiance became the historical financial statements of the combined company for all periods prior to October 1, 2022 (the "Merger Date"). In addition, the assets and liabilities of CBTX have been recorded at their estimated fair values and added to those of Allegiance as of October 1, 2022. The determination of fair value required management to make estimates about discount rates, expected future cash flows, market conditions and other future events that are subjective and subject to change, subjective.

The Company's results of operations for the three and **six nine** months ended **June 30, 2022** **September 30, 2022** reflect Allegiance's historical results and do not include the historical results of CBTX. The Company has substantially completed its valuations of CBTX's assets and liabilities. The Merger had a significant impact on all aspects of the Company's financial statements, and financial results for periods after the Merger are not comparable to financial results for periods prior to the Merger. The number of shares issued and outstanding, earnings per share, capital surplus, dividends paid and all references to share quantities of the Company have been retrospectively

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adjusted to reflect the equivalent number of shares issued to holders of

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Allegiance common stock in the Merger. See Note 2 – Acquisitions in the accompanying notes to the consolidated financial statements for the impact of the Merger.

Significant Accounting and Reporting Policies

The Company's significant accounting and reporting policies can be found in Note 1 of the Company's annual financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2022.

Adoption of New Accounting Standards

ASU 2022-02, "Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures." became effective for the Company for the first quarter of 2023 and did not have a significant impact on the Company's financial statements. ASU 2022-02 eliminates the troubled debt restructuring ("TDR") accounting model for creditors that have already adopted Topic 326, which is commonly referred to as the current expected credit loss model. In lieu of the TDR accounting model, the Company applies the general loan modification guidance in Subtopic 310-20 to all loan modifications, including modifications made for borrowers experiencing financial difficulty on a prospective basis. Under the general loan modification guidance, a modification is treated as a new loan only if the following two conditions are met: (1) the terms of the new loan are at least as favorable to the lender as the terms for comparable loans to other customers with similar collection risks; and (2) modifications to the terms of the original loan are more than minor. If either condition is not met, the modification is accounted for as the continuation of the old loan with any effect of the modification treated as a prospective adjustment to the loan's effective interest rate.

2. ACQUISITIONS

Merger of Equals

As described in Note 1 – Nature of Operations and Summary of Significant Accounting and Reporting Policies, the Merger was completed on October 1, 2022.

Allegiance merged with and into CBTX with the surviving corporation renamed Stellar Bancorp, Inc. At the effective date of the Merger, each outstanding share of Allegiance common stock was converted into the right to receive 1.4184 shares of common stock of the Company.

The Company issued 28.1 million shares of its common stock to Allegiance shareholders in connection with the Merger, which represented 54.0% of the voting interests in the Company upon completion of the Merger. In accordance with FASB ASC 805-40-30-2, the purchase price in a reverse acquisition is determined based on the number of equity interests the legal acquirer would have had to issue to give the owners of the legal acquirer the same percentage equity interest in the combined entity that results from the reverse acquisition.

The table below summarizes the ownership of the combined company following the Merger, for each shareholder group, using shares of CBTX and Allegiance common stock outstanding at September 30, 2022 and Allegiance's closing price on September 30, 2022 (shares in thousands).

	Stellar Bancorp, Inc. Ownership	
	Number of CBTX Outstanding Shares	Percentage Ownership
CBTX shareholders	24,015	46.0 %
Allegiance shareholders	28,137	54.0 %
Total	52,152	100.0 %

The Merger was accounted for as a reverse merger using the acquisition method of accounting, which means that for accounting and financial reporting purposes, Allegiance was deemed to have acquired CBTX in the Merger, even though CBTX was the legal acquirer. Accordingly, Allegiance's historical financial statements are the historical financial statements of the combined company for all periods prior to **the Merger Date, October 1, 2022.**

Total acquisition and merger-related expenses recognized for the three months ended **June 30, 2023** **September 30, 2023** and 2022 were **\$2.9** **\$3.4** million and **\$1.7** **\$10.6** million, respectively, and **\$9.1** **\$12.5** million and **\$2.1** **\$12.7** million for the **six nine** months ended **June 30, 2023** **September 30, 2023** and 2022, respectively.

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3. GOODWILL AND OTHER INTANGIBLE ASSETS

Changes in the carrying amount of the Company's goodwill and core deposit intangible assets were as follows:

		Core Deposit				Core Deposit		
		Goodwill	Intangibles	Servicing Assets		Goodwill	Intangibles	Servicing Assets
		(In thousands)				(In thousands)		
Balance as of December 31, 2021	Balance as of December 31, 2021	\$ 223,642	\$ 14,658	\$ —	Balance as of December 31, 2021	\$ 223,642	\$ 14,658	\$ —
Acquired intangibles	Acquired intangibles	273,618	138,150	329	Acquired intangibles	273,618	138,150	329
Amortization	Amortization	—	(9,283)	(20)	Amortization	—	(9,283)	(20)
Balance as of December 31, 2022	Balance as of December 31, 2022	497,260	143,525	309	Balance as of December 31, 2022	497,260	143,525	309
Amortization	Amortization	—	(13,720)	(40)	Amortization	—	(20,581)	(55)
Measurement period adjustment					Measurement period adjustment	58	—	—
Decrease due to payoff of serviced loans	Decrease due to payoff of serviced loans	—	—	(18)	Decrease due to payoff of serviced loans	—	—	(27)
Balance as of June 30, 2023		\$ 497,260	\$ 129,805	\$ 251				
Balance as of September 30, 2023					Balance as of September 30, 2023	\$ 497,318	\$ 122,944	\$ 227

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired recorded on the acquisition date of an entity. During the measurement period, the Company may record subsequent adjustments to goodwill for provisional amounts recorded at the acquisition date. During the third quarter of 2023, the Company completed the final tax returns related to CBTX's business and operations through September 30, 2022. After completion of these tax returns, the Company increased income tax balances and goodwill in the amount of \$58 thousand which finalized all purchase accounting adjustments for the Merger.

Management performs an Goodwill is subject to impairment evaluation testing, which must be conducted at least annually or upon the occurrence of a triggering event. Various factors, such as the Company's results of operations, the trading price of the Company's common stock relative to the book value per share, macroeconomic conditions and more frequently if conditions in the banking sector, inform whether a triggering event occurs, for an interim goodwill impairment test has occurred. Goodwill is recorded and evaluated for impairment at its reporting unit, the Company. The Company's policy is to test goodwill for impairment annually as of October 1st, or on an interim basis if an event triggering an impairment assessment is determined to have occurred.

Testing of goodwill impairment comprises a two-step process. First, the Company performs a qualitative assessment to evaluate relevant events or circumstances to determine whether any it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the Company determines that it is more likely than not that an impairment has occurred, it proceeds to the quantitative impairment test, whereby it calculates the fair value of the reporting unit and compares it with its carrying amount, including goodwill. In its performance of impairment testing, the Company has the unconditional option to proceed directly to the quantitative impairment test, bypassing the qualitative assessment. If the carrying amount of the reporting unit exceeds the fair value, the amount by which the carrying amount exceeds fair value, up to the carrying value of goodwill, is recorded through earnings as an impairment charge. If the results of the qualitative assessment indicate that it is not more likely than not that an impairment has occurred, or if the quantitative impairment test results in a fair value of the reporting unit that is greater than the carrying amount, then no impairment charge is recorded.

During the nine months ended September 30, 2023, economic uncertainty and other market volatility resulting from the rising interest rate environment and the recent banking crisis resulted in a decrease in the Company's stock price and market capitalization. Management believed such decrease was a triggering event requiring an interim goodwill impairment quantitative analysis for the third quarter 2023. As a result, the Company performed a qualitative assessment and quantitative impairment test on its only reporting unit as of September 30, 2023 and determined that there was no impairment as the fair value exceeded the carrying amount of the Company. If the Company had deemed intangible assets has occurred. If any to be impaired, a non-cash charge for the amount of such impairment is determined, a write-down is recorded. As would be recorded through earnings and would have no impact on tangible capital or our regulatory capital.

[Table of June 30, 2023, there were no impairments recorded on goodwill and other intangible assets.](#) [Contents](#)

The estimated aggregate future amortization expense for core deposit intangible assets remaining as of June 30, 2023 September 30, 2023 is as follows (in thousands):

Remaining 2023	Remaining 2023	\$ 13,093	Remaining 2023	\$ 6,232
2024	2024	24,166	2024	24,166
2025	2025	21,528	2025	21,528
2026	2026	18,896	2026	18,896

Thereafter	Thereafter	52,122	Thereafter	52,122
Total	Total	\$ 129,805	Total	\$ 122,944

4. SECURITIES

The amortized cost and fair value of investment securities were as follows:

June 30, 2023				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In thousands)				
Available for Sale				
U.S. government and agency securities	\$ 420,321	\$ 156	\$ (15,595)	\$ 404,882
Municipal securities	259,423	2,177	(32,402)	229,198
Agency mortgage-backed pass-through securities	385,780	272	(41,671)	344,381
Agency collateralized mortgage obligations	455,153	1	(66,382)	388,772
Corporate bonds and other	124,626	53	(13,690)	110,989
Total	\$ 1,645,303	\$ 2,659	\$ (169,740)	\$ 1,478,222

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September 30, 2023				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In thousands)				
Available for Sale				
U.S. government and agency securities	\$ 409,152	\$ 129	\$ (15,873)	\$ 393,408
Municipal securities	258,901	545	(40,330)	219,116
Agency mortgage-backed pass-through securities	378,573	22	(50,401)	328,194
Agency collateralized mortgage obligations	444,234	—	(78,356)	365,878
Corporate bonds and other	122,812	29	(14,485)	108,356
Total	\$ 1,613,672	\$ 725	\$ (199,445)	\$ 1,414,952

December 31, 2022				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In thousands)				
Available for Sale				
U.S. government and agency securities	\$ 433,417	\$ 90	\$ (19,227)	\$ 414,280
Municipal securities	580,076	4,319	(43,826)	540,569
Agency mortgage-backed pass-through securities	370,471	362	(42,032)	328,801
Agency collateralized mortgage obligations	461,760	—	(67,630)	394,130
Corporate bonds and other	143,192	2	(13,388)	129,806
Total	\$ 1,988,916	\$ 4,773	\$ (186,103)	\$ 1,807,586

As of **June 30, 2023** **September 30, 2023**, no allowance for credit losses has been recognized on available for sale securities in an unrealized loss position as management does not believe any of the securities are impaired due to reasons of credit quality. This **belief** is based upon our analysis of the underlying risk characteristics, including credit ratings, and other qualitative factors related to our available for sale securities and in consideration of our historical credit loss experience and internal forecasts. The issuers of these securities continue to make timely principal and interest payments under the contractual terms of the securities. Furthermore, management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that we will not have to sell any such securities before a recovery of cost. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline.

The amortized cost and fair value of investment securities at **June 30, 2023** **September 30, 2023**, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations at any time with or without call or prepayment penalties.

	Amortized Cost	Fair Value
(In thousands)		
Due in one year or less	\$ 77,538	\$ 76,185
Due after one year through five years	179,555	167,715
Due after five years through ten years	133,247	121,458
Due after ten years	414,030	379,711
Subtotal	804,370	745,069
Agency mortgage-backed pass-through securities and collateralized mortgage obligations	840,933	733,153
Total	\$ 1,645,303	\$ 1,478,222

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	Amortized Cost	Fair Value
(In thousands)		
Due in one year or less	\$ 77,562	\$ 77,026
Due after one year through five years	185,518	174,016
Due after five years through ten years	141,625	125,892
Due after ten years	386,160	343,946
Subtotal	790,865	720,880
Agency mortgage-backed pass-through securities and collateralized mortgage obligations	822,807	694,072
Total	\$ 1,613,672	\$ 1,414,952

Securities with unrealized losses segregated by length of time such securities have been in a continuous loss position are as follows:

		June 30, 2023							September 30, 2023					
		Less than 12 Months		More than 12 Months		Total			Less than 12 Months		More than 12 Months		Total	
		Estimated	Unrealized	Estimated	Unrealized	Estimated	Unrealized		Estimated	Unrealized	Estimated	Unrealized	Estimated	Unrealized
		Fair Value	Losses	Fair Value	Losses	Fair Value	Losses		Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
(In thousands)														
Available for Sale	Available for Sale							Available for Sale						
U.S. government and agency securities	U.S. government and agency securities	\$114,612	\$ (1,871)	\$ 260,133	\$ (13,724)	\$ 374,745	\$ (15,595)	U.S. government and agency securities	\$111,573	\$ (3,328)	\$ 261,872	\$ (12,545)	\$ 373,445	\$ (15,873)
Municipal securities	Municipal securities	9,423	(193)	173,602	(32,209)	183,025	(32,402)	Municipal securities	18,062	(640)	166,011	(39,690)	184,073	(40,331)
Agency mortgage-backed pass-through securities	Agency mortgage-backed pass-through securities	73,644	(2,529)	247,615	(39,142)	321,259	(41,671)	Agency mortgage-backed pass-through securities	79,012	(3,829)	248,186	(46,572)	327,197	(50,401)
Agency collateralized mortgage obligations	Agency collateralized mortgage obligations	11,239	(36)	374,339	(66,346)	385,578	(66,382)	Agency collateralized mortgage obligations	13,881	(168)	351,996	(78,188)	365,878	(78,356)
Corporate bonds and other	Corporate bonds and other	33,323	(2,830)	60,977	(10,860)	94,300	(13,690)	Corporate bonds and other	11,314	(1,249)	81,556	(13,236)	92,870	(14,485)

Total	Total	\$242,241	\$ (7,459)	\$1,116,666	\$(162,281)	\$1,358,907	\$(169,740)	Total	\$233,842	\$ (9,214)	\$1,109,621	\$(190,231)	\$1,343,463	\$(199,441)
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		December 31, 2022										
		Less than 12 Months		More than 12 Months		Total						
	Estimated Fair Value	Unrealized Losses		Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses					
(In thousands)												
Available for Sale												
U.S. government and agency securities	\$	99,732	\$	(1,427)	\$	305,256	\$	(17,800)	\$	404,988	\$	(19,227)
Municipal securities		228,192		(14,473)		134,640		(29,353)		362,832		(43,826)
Agency mortgage-backed pass-through securities		95,291		(7,612)		199,836		(34,420)		295,127		(42,032)
Agency collateralized mortgage obligations		117,147		(14,426)		276,925		(53,204)		394,072		(67,630)
Corporate bonds and other		72,913		(5,704)		49,893		(7,684)		122,806		(13,388)
Total	\$	613,275	\$	(43,642)	\$	966,550	\$	(142,461)	\$	1,579,825	\$	(186,103)

During the six nine months ended June 30, 2023 September 30, 2023, the Company sold \$320.4 million had sales and calls of securities of \$320.5 million of securities recording gross gains of \$234 thousand. There were no securities sold during During the six nine months ended June 30, 2022, September 30, 2022, the Company sold \$12.1 million of securities recording a gross gain of \$42 thousand on the sale of those securities. At June 30, 2023 September 30, 2023 and December 31, 2022, the Company did not own securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of consolidated shareholders' equity at such respective dates.

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The carrying value of pledged securities was \$1.07 billion \$711.8 million at June 30, 2023 September 30, 2023 and \$978.9 million at December 31, 2022. The majority of the securities in each case were pledged to collateralize public fund deposits.

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5. LOANS AND ALLOWANCE FOR CREDIT LOSSES

The loan portfolio balances, net of unearned income and fees, consist of various types of loans primarily made to borrowers located within Texas and are segregated by class of loan as follows:

		June 30, 2023	December 31, 2022			September 30, 2023	December 31, 2022
		(In thousands)				(In thousands)	
Commercial and industrial	Commercial and industrial	\$ 1,512,476	\$ 1,455,795	Commercial and industrial	\$ 1,474,600	\$ 1,455,795	
Paycheck Protection Program (PPP)	Paycheck Protection Program (PPP)	8,027	13,226	Paycheck Protection Program (PPP)	5,968	13,226	
Real estate:	Real estate:			Real estate:			
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	4,038,487	3,931,480	Commercial real estate (including multi-family residential)	4,076,606	3,931,480	
Commercial real estate construction and land development	Commercial real estate construction and land development	1,136,124	1,037,678	Commercial real estate construction and land development	1,078,265	1,037,678	
1-4 family residential (including home equity)	1-4 family residential (including home equity)	1,009,439	1,000,956	1-4 family residential (including home equity)	1,024,945	1,000,956	
Residential construction	Residential construction	311,208	268,150	Residential construction	289,553	268,150	

Consumer and other	Consumer and other	52,957	47,466	Consumer and other	54,591	47,466
Total loans	Total loans	8,068,718	7,754,751	Total loans	8,004,528	7,754,751
Allowance for credit losses on loans	Allowance for credit losses on loans	(100,195)	(93,180)	Allowance for credit losses on loans	(93,575)	(93,180)
Loans, net	Loans, net	\$ 7,968,523	\$ 7,661,571	Loans, net	\$ 7,910,953	\$ 7,661,571

Nonaccrual and Past Due Loans

An aging analysis of the recorded investment in past due loans, segregated by class of loans, is included below. The Company defines recorded investment as the outstanding loan balances including net deferred loan fees, and excluding accrued interest receivable of \$35.1 million \$36.4 million and \$34.1 million as of June 30, 2023 September 30, 2023 and December 31, 2022, respectively, due to immateriality.

		June 30, 2023							September 30, 2023					
		Loans Past Due and Still							Loans Past Due and Still					
		Accruing							Accruing					
		Total							Total					
		90 or	Past						90 or	Past				
30-89	More	Due	Nonaccrual	Current	30-	Total	30-89	More	Due	Nonaccrual	Current			
Days	Days	Loans	Loans	Loans	Days	Loans	Days	Days	Loans	Loans	Loans			
		(In thousands)												
Commercial and industrial	Commercial and industrial	\$ 2,210	\$ —	\$ 2,210	\$ 22,800	\$ 1,487,466	\$ 1,512,476	Commercial and industrial	\$ 3,535	\$—	\$ 3,535	\$ 14,971	\$ 1,456,094	\$
Paycheck Protection Program (PPP)	Paycheck Protection Program (PPP)	56	—	56	168	7,803	8,027	Paycheck Protection Program (PPP)	85	—	85	20	5,863	
Real estate:	Real estate:							Real estate:						
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	3,302	—	3,302	8,221	4,026,964	4,038,487	Commercial real estate (including multi-family residential)	19,649	—	19,649	13,563	4,043,394	
Commercial real estate construction and land development	Commercial real estate construction and land development	4,573	—	4,573	388	1,131,163	1,136,124	Commercial real estate construction and land development	4,405	—	4,405	170	1,073,690	
1-4 family residential (including home equity)	1-4 family residential (including home equity)	8,332	—	8,332	10,880	990,227	1,009,439	1-4 family residential (including home equity)	4,742	—	4,742	8,442	1,011,761	
Residential construction	Residential construction	662	—	662	665	309,881	311,208	Residential construction	3,389	—	3,389	635	285,529	
Consumer and other	Consumer and other	142	—	142	227	52,588	52,957	Consumer and other	215	—	215	490	53,886	
Total loans	Total loans	\$19,277	\$ —	\$19,277	\$ 43,349	\$8,006,092	\$8,068,718	Total loans	\$36,020	\$—	\$36,020	\$ 38,291	\$7,930,217	\$

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December 31, 2022													
Loans Past Due and Still Accruing													
		30-89 Days	90 or More Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans						
(In thousands)													
Commercial and industrial		\$ 1,591	\$ —	\$ 1,591	\$ 25,297	\$ 1,428,907	\$ 1,455,795						
Paycheck Protection Program (PPP)		517	—	517	105	12,604	13,226						
Real estate:													

Commercial real estate (including multi-family residential)	3,222	—	3,222	9,970	3,918,288	3,931,480
Commercial real estate construction and land development	851	—	851	—	1,036,827	1,037,678
1-4 family residential (including home equity)	3,385	—	3,385	9,404	988,167	1,000,956
Residential construction	—	—	—	—	268,150	268,150
Consumer and other	192	—	192	272	47,002	47,466
Total loans	\$ 9,758	\$ —	\$ 9,758	\$ 45,048	\$ 7,699,945	\$ 7,754,751

Credit Quality Indicators

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt. The Company utilizes a risk rating matrix to assign a risk rating to each of its loans. Loans are rated on a scale of 10 to 90. Risk ratings are updated on an ongoing basis and are subject to change by continuous loan monitoring processes including lending management monitoring, executive management and board committee oversight, and independent credit review. As part of the ongoing monitoring of the credit quality of the Company's loan portfolio and methodology for calculating the allowance for credit losses, management assigns and tracks certain risk ratings to be used as credit quality indicators including trends related to (1) the weighted-average risk grade of loans, (2) the level of classified loans, (3) the delinquency status of loans, (4) nonperforming loans and (5) the general economic conditions in the our markets. Individual bankers, under the oversight of credit administration, review updated financial information for all pass grade commercial loans to reassess the risk grade on at least an annual basis. When a loan reaches a set of internally designated criteria, including Substandard or higher, a special assets officer will be involved in the monitoring of the loan on an on-going basis.

The following is a general description of the risk ratings used by the Company:

Pass—Credits in this category contain an acceptable amount of risk.

Special Mention—Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Substandard—Loans classified as substandard have well-defined weaknesses on a continuing basis and are inadequately protected by the current net worth and paying capacity of the borrower, declining collateral values, or a continuing downturn in their industry which is reducing their profits to below zero and having a significantly negative impact on their cash flow. These loans so classified are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful—Loans classified as doubtful have all the weaknesses inherent in those classified as substandard 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.

Loss—Loans classified as loss are to be charged-off or charged-down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. "Loss" is not intended to imply that the loan or some portion of it will never be paid, nor does it in any way imply that there has been a forgiveness of debt.

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The following table presents risk ratings by category and the gross charge-offs by primary loan type and year of origination or renewal. Generally, current period renewals of credit are re-underwritten at the point of renewal and considered current period originations for purposes of the table below. The following summarizes the amortized cost basis of loans by year of origination/renewal and credit quality indicator by class of loan as of June 30, 2023 September 30, 2023 and December 31, 2022:

	As of June 30, 2023								As of December 31, 2022	
	Term Loans Amortized Cost Basis by Origination Year						Revolving Loans	Revolving Loans Converted to Term Loans	Total	Total
	2023	2022	2021	2020	2019	Prior	Revolving Loans	Revolving Loans Converted to Term Loans	Total	Total
	(In thousands)									
Commercial and industrial										
Pass	\$ 179,607	\$ 330,548	\$ 202,720	\$ 61,221	\$ 42,300	\$ 31,586	\$ 558,826	\$ 50,630	\$ 1,457,438	\$ 1,400,191
Special Mention	—	349	492	446	381	2	8,173	836	10,679	18,982
Substandard	510	5,279	18,110	1,197	12,511	344	5,263	1,094	44,308	36,568
Doubtful	—	51	—	—	—	—	—	—	51	54
Total commercial and industrial loans	\$ 180,117	\$ 336,227	\$ 221,322	\$ 62,864	\$ 55,192	\$ 31,932	\$ 572,262	\$ 52,560	\$ 1,512,476	\$ 1,455,795

Current-period gross charge-offs	\$ —	\$ 95	\$ 126	\$ 456	\$ —	\$ —	\$ 373	\$ 434	\$ 1,484	
Paycheck Protection Program (PPP)										
Pass	\$ —	\$ —	\$ 4,858	\$ 3,169	\$ —	\$ —	\$ —	\$ —	\$ 8,027	\$ 13,226
Special Mention	—	—	—	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—	—	—	—
Doubtful	—	—	—	—	—	—	—	—	—	—
Total PPP loans	\$ —	\$ —	\$ 4,858	\$ 3,169	\$ —	\$ —	\$ —	\$ —	\$ 8,027	\$ 13,226
Current-period gross charge-offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
Commercial real estate (including multi-family residential)										
Pass	\$ 283,360	\$ 1,304,844	\$ 844,501	\$ 473,336	\$ 356,126	\$ 549,716	\$ 131,751	\$ 20,950	\$ 3,964,584	\$ 3,844,951
Special Mention	942	135	7,005	7,269	796	12,611	587	—	29,345	18,183
Substandard	1,903	4,711	11,580	7,274	5,048	13,855	187	—	44,558	68,346
Doubtful	—	—	—	—	—	—	—	—	—	—
Total commercial real estate (including multi-family residential) loans	\$ 286,205	\$ 1,309,690	\$ 863,086	\$ 487,879	\$ 361,970	\$ 576,182	\$ 132,525	\$ 20,950	\$ 4,038,487	\$ 3,931,480
Current-period gross charge-offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
Commercial real estate construction and land development										
Pass	\$ 154,065	\$ 522,070	\$ 299,038	\$ 35,881	\$ 33,778	\$ 10,070	\$ 62,503	\$ 658	\$ 1,118,063	\$ 1,025,141
Special Mention	—	3,814	1,945	142	303	209	—	—	6,413	832
Substandard	—	581	10,477	89	82	270	—	149	11,648	11,705
Doubtful	—	—	—	—	—	—	—	—	—	—
Total commercial real estate construction and land development	\$ 154,065	\$ 526,465	\$ 311,460	\$ 36,112	\$ 34,163	\$ 10,549	\$ 62,503	\$ 807	\$ 1,136,124	\$ 1,037,678
Current-period gross charge-offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	

	September 30, 2023							December 31, 2022			
	Term Loans Amortized Cost Basis by Origination Year						Revolving Loans	Converted to		Total	
	2023	2022	2021	2020	2019	Prior	Revolving Loans	Term Loans	Total	Total	Total
(In thousands)											
Commercial and industrial	\$ 249,626	\$ 299,874	\$ 194,032	\$ 47,217	\$ 31,150	\$ 23,062	\$ 528,399	\$ 63,180	\$ 1,436,540	\$ 1,400,191	
Special Mention	2,786	403	508	438	861	—	3,054	102	8,152	18,982	
Substandard	1,250	3,925	9,303	1,140	12,131	281	1,057	771	29,858	36,568	
Doubtful	—	50	—	—	—	—	—	—	50	54	
Total commercial and industrial loans	\$ 253,662	\$ 304,252	\$ 203,843	\$ 48,795	\$ 44,142	\$ 23,343	\$ 532,510	\$ 64,053	\$ 1,474,600	\$ 1,455,795	

Current period gross charge-offs	\$	—	\$	130	\$	4,264	\$	456	\$	129	\$	—	\$	4,143	\$	531	\$	9,653		
Paycheck Protection Program (PPP)																				
Pass	\$	—	\$	—	\$	3,218	\$	2,750	\$	—	\$	—	\$	—	\$	—	\$	5,968	\$	13,226
Special Mention		—		—		—		—		—		—		—		—		—		—
Substandard		—		—		—		—		—		—		—		—		—		—
Doubtful		—		—		—		—		—		—		—		—		—		—
Total PPP loans	\$	—	\$	—	\$	3,218	\$	2,750	\$	—	\$	—	\$	—	\$	—	\$	5,968	\$	13,226
Current period gross charge-offs	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—		
Commercial real estate (including multi-family residential)																				
Pass	\$	366,601	\$	1,327,957	\$	863,078	\$	467,867	\$	348,105	\$	480,980	\$	128,848	\$	11,052	\$	3,994,488	\$	3,844,951
Special Mention		934		508		7,756		8,409		1,716		12,414		305		—		32,042		18,183
Substandard		3,906		5,050		16,003		6,832		5,009		12,890		286		100		50,076		68,346
Doubtful		—		—		—		—		—		—		—		—		—		—
Total commercial real estate (including multi-family residential) loans	\$	371,441	\$	1,333,515	\$	886,837	\$	483,108		354,830	\$	506,284	\$	129,439	\$	11,152	\$	4,076,606	\$	3,931,480
Current period gross charge-offs	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—		
Commercial real estate construction and land development																				
Pass	\$	211,096	\$	518,943	\$	227,438	\$	29,351	\$	9,689	\$	6,189	\$	58,463	\$	693	\$	1,061,862	\$	1,025,141
Special Mention		—		2,222		2,062		139		—		202		—		—		4,625		832
Substandard		22		1,016		10,406		88		80		17		—		149		11,778		11,705
Doubtful		—		—		—		—		—		—		—		—		—		—
Total commercial real estate construction and land development	\$	211,118	\$	522,181	\$	239,906	\$	29,578	\$	9,769	\$	6,408	\$	58,463	\$	842	\$	1,078,265	\$	1,037,678
Current period gross charge-offs	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—	\$	—		

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		As of June 30, 2023										As of December 31, 2022				
		Term Loans Amortized Cost Basis by Origination						Revolving Loans								
		Year						Converted								
		Revolving to Term						Term Loans Amortized Cost Basis by Origination								
		2023	2022	2021	2020	2019	Prior	Loans	Loans	Total	Total	2023	2022	2021		
		(In thousands)														
1-4 family residential (including home equity)	1-4 family residential (including home equity)												1-4 family residential (including home equity)			
Pass	Pass	\$ 85,495	\$ 245,898	\$ 227,583	\$ 119,543	\$ 75,722	\$ 109,646	\$ 107,781	\$ 8,692	\$ 980,360	\$ 969,396	Pass	\$ 132,680	\$ 252,160	\$ 224,560	
Special Mention	Special Mention	—	57	—	1,614	—	196	—	190	2,057	3,714	Special Mention	499	569	—	
Substandard	Substandard	722	2,410	2,526	2,302	4,039	5,289	7,076	2,658	27,022	27,846	Substandard	1,940	2,399	3,100	
Doubtful	Doubtful	—	—	—	—	—	—	—	—	—	—	Doubtful	—	—	—	

Total 1-4 family residential (including home equity)	Total 1-4 family residential (including home equity)	\$ 86,217	\$ 248,365	\$ 230,109	\$ 123,459	\$ 79,761	\$ 115,131	\$ 114,857	\$ 11,540	\$ 1,009,439	\$ 1,000,956	Total 1-4 family residential (including home equity)	\$ 135,119	\$ 255,128	\$ 227,66
Current-period gross charge-offs		\$ —	\$ —	\$ —	\$ —	\$ —	\$ 23	\$ —	\$ —	\$ 23					
Current period gross charge-offs												Current period gross charge-offs	\$ —	\$ —	\$ —
Residential construction	Residential construction											Residential construction			
Pass	Pass	\$ 75,514	\$ 177,850	\$ 16,576	\$ 7,682	\$ 661	\$ 1,378	\$ 27,385	\$ —	\$ 307,046	\$ 266,943	Pass	\$ 116,508	\$ 136,500	\$ 6,34
Special Mention	Special Mention	—	—	—	—	—	—	—	—	—	421	Special Mention	—	634	—
Substandard	Substandard	868	665	2,629	—	—	—	—	—	4,162	786	Substandard	—	635	1,95
Doubtful	Doubtful	—	—	—	—	—	—	—	—	—	—	Doubtful	—	—	—
Total residential construction	Total residential construction	\$ 76,382	\$ 178,515	\$ 19,205	\$ 7,682	\$ 661	\$ 1,378	\$ 27,385	\$ —	\$ 311,208	\$ 268,150	Total residential construction	\$ 116,508	\$ 137,769	\$ 8,29
Current-period gross charge-offs		\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —				
Current period gross charge-offs												Current period gross charge-offs	\$ —	\$ —	\$ —
Consumer and other	Consumer and other											Consumer and other			
Pass	Pass	\$ 20,268	\$ 10,715	\$ 4,645	\$ 2,248	\$ 791	\$ 619	\$ 12,716	\$ 633	\$ 52,635	\$ 47,062	Pass	\$ 23,489	\$ 9,146	\$ 4,13
Special Mention	Special Mention	—	30	1	—	—	—	—	—	31	43	Special Mention	—	26	—
Substandard	Substandard	—	67	37	—	71	5	4	107	291	361	Substandard	—	312	3
Doubtful	Doubtful	—	—	—	—	—	—	—	—	—	—	Doubtful	—	—	—
Total consumer and other	Total consumer and other	\$ 20,268	\$ 10,812	\$ 4,683	\$ 2,248	\$ 862	\$ 624	\$ 12,720	\$ 740	\$ 52,957	\$ 47,466	Total consumer and other	\$ 23,489	\$ 9,484	\$ 4,16
Current-period gross charge-offs		\$ —	\$ 38	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 38					
Current period gross charge-offs												Current period gross charge-offs	\$ —	\$ 44	\$ —
Total loans	Total loans											Total loans			
Pass	Pass	\$ 798,309	\$ 2,591,925	\$ 1,599,921	\$ 703,080	\$ 509,378	\$ 703,015	\$ 900,962	\$ 81,563	\$ 7,888,153	\$ 7,566,910	Pass	\$ 1,100,000	\$ 2,544,580	\$ 1,522,79
Special Mention	Special Mention	942	4,385	9,443	9,471	1,480	13,018	8,760	1,026	48,525	42,175	Special Mention	4,219	4,362	10,32
Substandard	Substandard	4,003	13,713	45,359	10,862	21,751	19,763	12,530	4,008	131,989	145,612	Substandard	7,118	13,337	40,80
Doubtful	Doubtful	—	51	—	—	—	—	—	—	51	54	Doubtful	—	50	—
Total loans	Total loans	\$ 803,254	\$ 2,610,074	\$ 1,654,723	\$ 723,413	\$ 532,609	\$ 735,796	\$ 922,252	\$ 86,597	\$ 8,068,718	\$ 7,754,751	Total loans	\$ 1,111,337	\$ 2,562,329	\$ 1,573,92
Total current-period gross charge-offs		\$ —	\$ 133	\$ 126	\$ 456	\$ —	\$ 23	\$ 373	\$ 434	\$ 1,545					
Current period gross charge-offs												Current period gross charge-offs	\$ —	\$ 174	\$ 4,26

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The following table presents the activity in the allowance for credit losses on loans by portfolio type for the three and **six** nine months ended **June 30, 2023** September 30, 2023 and 2022:

Commercial and industrial	Paycheck Protection Program (PPP)	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total	Commercial and industrial	Paycheck Protection Program (PPP)	Commercial real estate (including multi-family residential)	Commercial real estate construction and land development	1-4 family residential (including home equity)	Residential construction	Consumer and other	Total
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	(In thousands)																
Allowance for credit losses on loans:	Allowance for credit losses on loans:	Allowance for credit losses on loans:															
Three Months Ended	Three Months Ended	Three Months Ended															
Balance March 31, 2023	\$ 39,516	\$ —	\$ 37,700	\$ 13,579	\$ 2,832	\$ 2,089	\$ 472	\$ 96,188									
Balance June 30, 2023									Balance June 30, 2023	\$ 38,505	\$ —	\$ 38,963	\$ 14,500	\$ 4,757	\$ 3,080	\$ 390	
Provision for credit losses on loans	Provision for credit losses on loans	(814)	—	1,263	921	1,946	991	(64)	4,243	Provision for credit losses on loans	2,173	—	58	(791)	34	(221)	243
Charge-offs	Charge-offs	(1,058)	—	—	—	(23)	—	(30)	(1,111)	Charge-offs	(8,169)	—	—	—	—	—	(7)
Recoveries	Recoveries	861	—	—	—	2	—	12	875	Recoveries	55	—	2	—	—	—	3
Net charge-offs	Net charge-offs	(197)	—	—	—	(21)	—	(18)	(236)	Net charge-offs	(8,114)	—	2	—	—	—	(4)
Balance June 30, 2023	\$ 38,505	\$ —	\$ 38,963	\$ 14,500	\$ 4,757	\$ 3,080	\$ 390	\$100,195									
Six Months Ended																	
Balance September 30, 2023									Balance September 30, 2023	\$ 32,564	\$ —	\$ 39,023	\$ 13,709	\$ 4,791	\$ 2,859	\$ 629	
Nine Months Ended									Nine Months Ended								
Balance December 31, 2022	Balance December 31, 2022	\$ 41,236	\$ —	\$ 32,970	\$ 14,121	\$ 2,709	\$ 1,796	\$ 348	\$ 93,180	Balance December 31, 2022	\$ 41,236	\$ —	\$ 32,970	\$ 14,121	\$ 2,709	\$ 1,796	\$ 348
Provision for credit losses on loans	Provision for credit losses on loans	(2,316)		5,979	379	2,062	1,284	55	7,443	Provision for credit losses on loans	(143)	—	6,037	(412)	2,096	1,063	298
Charge-offs	Charge-offs	(1,484)	—	—	—	(23)	—	(38)	(1,545)	Charge-offs	(9,653)	—	—	—	(23)	—	(45)
Recoveries	Recoveries	1,069	—	14	—	9	—	25	1,117	Recoveries	1,124	—	16	—	9	—	28
Net charge-offs	Net charge-offs	(415)	—	14	—	(14)	—	(13)	(428)	Net charge-offs	(8,529)	—	16	—	(14)	—	(17)
Balance June 30, 2023	\$ 38,505	\$ —	\$ 38,963	\$ 14,500	\$ 4,757	\$ 3,080	\$ 390	\$100,195									
Balance September 30, 2023									Balance September 30, 2023	\$ 32,564	\$ —	\$ 39,023	\$ 13,709	\$ 4,791	\$ 2,859	\$ 629	
Three Months Ended	Three Months Ended	Three Months Ended															
Balance March 31, 2022	\$ 16,295	\$ —	\$ 24,877	\$ 6,147	\$ 752	\$ 1,093	\$ 51	\$ 49,215									
Balance June 30, 2022									Balance June 30, 2022	\$ 16,701	\$ —	\$ 24,000	\$ 7,399	\$ 1,036	\$ 1,048	\$ 58	
Provision for credit losses on loans	Provision for credit losses on loans	1,010	—	(855)	1,197	284	(45)	7	1,598	Provision for credit losses on loans	(1,091)	—	1,606	952	(9)	188	14
Charge-offs	Charge-offs	(615)	—	(72)	—	—	—	—	(687)	Charge-offs	(2)	—	(56)	—	—	—	(17)
Recoveries	Recoveries	11	—	50	55	—	—	—	116	Recoveries	319	—	—	—	—	—	1
Net charge-offs		(604)	—	(22)	55	—	—	—	(571)								
Balance June 30, 2022	\$ 16,701	\$ —	\$ 24,000	\$ 7,399	\$ 1,036	\$ 1,048	\$ 58	\$ 50,242									
Six Months Ended																	
Net recoveries									Net recoveries	317	—	(56)	—	—	—	—	(16)
Balance September 30, 2022	\$ 15,927	\$ —	\$ 25,550	\$ 8,351	\$ 1,027	\$ 1,236	\$ 56										
Nine Months Ended									Nine Months Ended								

Balance December 31, 2021	Balance December 31, 2021	\$ 16,629	\$ —	\$ 23,143	\$ 6,263	\$ 847	\$ 975	\$ 83	\$ 47,940	Balance December 31, 2021	\$ 16,629	\$ —	\$ 23,143	\$ 6,263	\$ 847	\$ 975	\$ 83
Provision for credit losses on loans	Provision for credit losses on loans	627	—	1,134	1,144	189	73	23	3,190	Provision for credit losses on loans	(464)	—	2,740	2,096	180	261	37
Charge-offs	Charge-offs	(956)	—	(327)	(63)	—	—	(48)	(1,394)	Charge-offs	(958)	—	(383)	(63)	—	—	(65)
Recoveries	Recoveries	401	—	50	55	—	—	—	506	Recoveries	720	—	50	55	—	—	1
Net charge-offs	Net charge-offs	(555)	—	(277)	(8)	—	—	(48)	(888)	Net charge-offs	(238)	—	(333)	(8)	—	—	(64)
Balance June 30, 2022		\$ 16,701	\$ —	\$ 24,000	\$ 7,399	\$ 1,036	\$ 1,048	\$ 58	\$ 50,242								
Balance September 30, 2022										Balance September 30, 2022	\$ 15,927	\$ —	\$ 25,550	\$ 8,351	\$ 1,027	\$ 1,236	\$ 56

Allowance for Credit Losses on Unfunded Commitments

In addition to the allowance for credit losses on loans, the Company has established an allowance for credit losses on unfunded commitments, classified in other liabilities and adjusted as a provision for credit loss expense. The allowance represents estimates of expected credit losses over the contractual period in which there is exposure to credit risk via a contractual obligation to extend credit, unless that obligation is unconditionally cancellable by the Company. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on the commitments expected to fund. The estimate of commitments expected to fund is informed by historical analysis looking at utilization rates. The expected credit loss rates applied to the commitments expected to fund is informed by the general valuation allowance utilized for outstanding balances with the same underlying assumptions and drivers. The allowance for credit losses on unfunded commitments as of **June 30, 2023** September 30, 2023 and December 31, 2022 was **\$10.1** **\$10.9** million and \$12.0 million, respectively. This reserve is maintained at a level management believes to be sufficient to absorb losses arising from unfunded loan commitments. The Company recorded a **\$2.3 million reversal of an \$818 thousand provision** on unfunded commitments during the three months ended **June 30, 2023** September 30, 2023 compared to a provision of **\$544** **\$302** thousand for the three months ended **June 30, 2022** September 30, 2022 and recorded a **\$1.9** **\$1.0** million reversal of provision on unfunded commitments for the **six** **nine** months ended **June 30, 2023** September 30, 2023 compared to a provision of **\$767 thousand** **\$1.1 million** for the **six** **nine** months ended **June 30, 2022** September 30, 2022.

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Collateral dependent loans are secured by real estate assets, accounts receivable, inventory and equipment. For a collateral dependent loan, the Company's evaluation process includes a valuation by appraisal or other collateral analysis adjusted for selling costs, when appropriate. This valuation is compared to the remaining outstanding principal balance of the loan. If a loss is determined to be probable, the loss is included in the allowance for credit losses on loans as a specific allocation.

The following tables present the amortized cost basis of collateral dependent loans, which are individually evaluated to determine expected credit losses as of **June 30, 2023** September 30, 2023 and December 31, 2022:

		As of June 30, 2023					September 30, 2023											
							Business											
		Real Estate	Business Assets	Other	Total		Real Estate	Assets	Other	Total								
		(In thousands)					(In thousands)											
Commercial and industrial	Commercial and industrial	\$	—	\$	15,718	\$	—	\$	15,718	Commercial and industrial	\$	—	\$	7,476	\$	—	\$	7,476
Real estate:	Real estate:									Real estate:								
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)		4,715		—		—		4,715	Commercial real estate (including multi-family residential)		3,411		—		—		3,411
Commercial real estate construction and land development	Commercial real estate construction and land development		174		—		—		174	Commercial real estate construction and land development				—		—		—
1-4 family residential (including home equity)	1-4 family residential (including home equity)		2,093		—		—		2,093	1-4 family residential (including home equity)		—		—		—		—
Residential construction	Residential construction		665		—		—		665	Residential construction		—		—		—		—

Consumer and other	Consumer and other	—	—	—	—	Consumer and other	—	—	—	—
Total	Total	\$ 7,647	\$ 15,718	\$ —	\$ 23,365	Total	\$ 3,411	\$ 7,476	\$ —	\$ 10,887
		As of December 31, 2022					December 31, 2022			
		Real Estate	Business Assets	Other	Total		Real Estate	Business Assets	Other	Total
		(In thousands)					(In thousands)			
Commercial and industrial	Commercial and industrial	\$ —	\$ 18,411	\$ 30	\$ 18,441	Commercial and industrial	\$ —	\$ 18,411	\$ 30	\$ 18,441
Real estate:	Real estate:					Real estate:				
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	1,612	—	—	1,612	Commercial real estate (including multi-family residential)	1,612	—	—	1,612
Commercial real estate construction and land development	Commercial real estate construction and land development	—	—	—	—	Commercial real estate construction and land development	—	—	—	—
1-4 family residential (including home equity)	1-4 family residential (including home equity)	3,478	—	—	3,478	1-4 family residential (including home equity)	3,478	—	—	3,478
Residential construction	Residential construction	—	—	—	—	Residential construction	—	—	—	—
Consumer and other	Consumer and other	—	—	—	—	Consumer and other	—	—	—	—
Total	Total	\$ 5,090	\$ 18,411	\$ 30	\$ 23,531	Total	\$ 5,090	\$ 18,411	\$ 30	\$ 23,531

The following tables present additional information regarding nonaccrual loans. No interest income was recognized on nonaccrual loans as of [June 30, 2023](#) [September 30, 2023](#) and December 31, 2022.

		As of June 30, 2023				September 30, 2023		
		Nonaccrual Loans with No Related Allowance	Nonaccrual Loans with Related Allowance	Total Nonaccrual Loans		Nonaccrual Loans with No Related Allowance	Nonaccrual Loans with Related Allowance	Total Nonaccrual Loans
		(In thousands)				(In thousands)		
Commercial and industrial	Commercial and industrial	\$ 1,487	\$ 21,313	\$ 22,800	Commercial and industrial	\$ 10,337	\$ 4,634	\$ 14,971
Paycheck Protection Program (PPP)	Paycheck Protection Program (PPP)	168	—	168	Paycheck Protection Program (PPP)	20	—	20
Real estate:	Real estate:				Real estate:			
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	6,983	1,238	8,221	Commercial real estate (including multi-family residential)	10,820	2,743	13,563
Commercial real estate construction and land development	Commercial real estate construction and land development	388	—	388	Commercial real estate construction and land development	170	—	170
1-4 family residential (including home equity)	1-4 family residential (including home equity)	7,300	3,580	10,880	1-4 family residential (including home equity)	6,849	1,593	8,442

Residential construction	Residential construction	665	—	665	Residential construction	635	—	635
Consumer and other	Consumer and other	60	167	227	Consumer and other	81	409	490
Total loans	Total loans	\$ 17,051	\$ 26,298	\$ 43,349	Total loans	\$ 28,912	\$ 9,379	\$ 38,291

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		As of December 31, 2022				December 31, 2022		
		Nonaccrual Loans with No Related Allowance	Nonaccrual Loans with Related Allowance	Total Nonaccrual Loans		Nonaccrual Loans with No Related Allowance	Nonaccrual Loans with Related Allowance	Total Nonaccrual Loans
		(In thousands)				(In thousands)		
Commercial and industrial	Commercial and industrial	\$ 2,776	\$ 22,521	\$ 25,297	Commercial and industrial	\$ 2,776	\$ 22,521	\$ 25,297
Paycheck Protection Program (PPP)	Paycheck Protection Program (PPP)	105	—	105	Paycheck Protection Program (PPP)	105	—	105
Real estate:	Real estate:				Real estate:			
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	8,704	1,266	9,970	Commercial real estate (including multi-family residential)	8,704	1,266	9,970
Commercial real estate construction and land development	Commercial real estate construction and land development	—	—	—	Commercial real estate construction and land development	—	—	—
1-4 family residential (including home equity)	1-4 family residential (including home equity)	4,856	4,548	9,404	1-4 family residential (including home equity)	4,856	4,548	9,404
Residential construction	Residential construction	—	—	—	Residential construction	—	—	—
Consumer and other	Consumer and other	94	178	272	Consumer and other	94	178	272
Total loans	Total loans	\$ 16,535	\$ 28,513	\$ 45,048	Total loans	\$ 16,535	\$ 28,513	\$ 45,048

Loan Modifications and Troubled Debt Restructurings

Effective January 1, 2023, under ASU 2022-02, loan modifications are reported if concessions have been granted to borrowers that are experiencing financial difficulty. Information on these loan modifications originated after the effective date is presented according to the new accounting guidance. Reporting periods prior to the adoption of ASU 2022-02 present information on troubled debt restructurings ("TDRs") under the previous disclosure requirements. The percentage of loans modified comprised less than 1% of their respective classes of loan portfolios at **June 30, 2023** **September 30, 2023**.

The following tables present information regarding loans that were modified due to the borrowers experiencing financial difficulty during the three and **six** nine months ended **June 30, 2023** **September 30, 2023**:

Three Months Ended June 30, 2023							Three Months Ended September 30, 2023				
				Combination Term Extension and Principal Forgiveness	Combination Term Extension and Payment Delay	Total					Combination Term Extension and Principal Forgiveness
Interest Rate Reduction	Term Extension	Payment Delay	Principal forgiveness	Principal Forgiveness	Payment Delay	Total	Interest Rate Reduction	Term Extension	Payment Delay	Principal forgiveness	Principal Forgiveness
(In thousands)							(In thousands)				

Commercial and industrial	Commercial and industrial	\$	—	\$	—	\$	—	\$	—	\$	—	\$	260	\$	260	Commercial and industrial	\$	—	\$	—	\$	—	\$	—	\$	—	\$
Real estate:	Real estate:															Real estate:											
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)		—		—		—		—		—		1,710		1,710	Commercial real estate (including multi-family residential)		—		1,890		—		—		—	
Commercial real estate construction and land development	Commercial real estate construction and land development		—		6,950		—		—		—		—		6,950	Commercial real estate construction and land development		—				—		—		—	
1-4 family residential (including home equity)	1-4 family residential (including home equity)		—		—		—		—		—		—		—	1-4 family residential (including home equity)		—		322		99		—		—	
Residential construction	Residential construction		—		—		—		—		—		—		—	Residential construction		—		—		—		—		—	
Consumer and other	Consumer and other		—		96		—		—		—		—		96	Consumer and other		—		—		—		—		—	
Total	Total	\$	—	\$	7,046	\$	—	\$	—	\$	—	\$	1,970	\$	\$9,016	Total	\$	—	\$	2,212	\$	—	\$	—	\$	—	

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		Six Months Ended June 30, 2023								Nine Months Ended September 30, 2023							
		Interest				Combination Term Extension and Principal Forgiveness				Interest				Combination Term Extension and Principal Forgiveness			
		Rate Reduction	Term Extension	Payment Delay	Principal forgiveness	Principal Forgiveness	Payment Delay	Total		Rate Reduction	Term Extension	Payment Delay	Principal forgiveness	Principal Forgiveness	Payment Delay	Total	
		(In thousands)								(In thousands)							
Commercial and industrial	Commercial and industrial	\$	92	\$	2,251	\$	—	\$	—	\$	89	\$	2,185	\$	—	\$	—
Real estate:	Real estate:																
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)		—		—		790		—		—		2,670		—		—
Commercial real estate construction and land development	Commercial real estate construction and land development		—		6,950		—		—		—		6,850		—		—
1-4 family residential (including home equity)	1-4 family residential (including home equity)		—		721		—		—		—		1,037		99		—
Residential construction	Residential construction		—		—		—		—		—		—		—		—
Consumer and other	Consumer and other		—		96		—		—		—		94		—		—
Total	Total	\$	92	\$	10,018	\$	790	\$	—	\$	89	\$	12,836	\$	99	\$	—

The following table summarizes, by loan portfolio, the financial effect of the Company's loan modifications for the three and **six** **nine** months ended **June 30, 2023** **September 30, 2023**:

		Three Months Ended June 30, 2023				Six Months Ended June 30, 2023				Three Months Ended September 30, 2023				Nine Months Ended September 30, 2023			
		Weighted Average Interest Rate Reduction		Weighted Average Term Extension (months)		Weighted Average Interest Rate Reduction		Weighted Average Term Extension (months)		Weighted Average Interest Rate Reduction		Weighted Average Term Extension (months)		Weighted Average Interest Rate Reduction		Weighted Average Term Extension (months)	
Commercial and industrial ⁽¹⁾	Commercial and industrial ⁽¹⁾	—	%	12		2.0	%	12		—	%	—		2.0	%	12	
Real estate:	Real estate:																
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	—	%	12		—	%	12		—	%	6		—	%	9	
Commercial real estate construction and land development	Commercial real estate construction and land development	—	%	12		—	%	12		—	%	—		—	%	12	
1-4 family residential (including home equity)	1-4 family residential (including home equity)	—	%	—		—	%	12		1.5	%	24		1.5	%	16	
Residential construction	Residential construction	—	%	—		—	%	—		—	%	—		—	%	—	
Consumer and other	Consumer and other	—	%	4		—	%	4		—	%	—		—	%	7	

(1) No financial effect as a result of the loan modification reducing the interest rate as the loan was on nonaccrual.

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The following table summarizes loans that had a payment default within the past twelve months that were modified due to the borrowers experiencing financial difficulty during the three and six nine months ended June 30, 2023 September 30, 2023:

		Interest Rate Reduction				Term Extension				Payment Delay				Principal forgiveness			
		(In thousands)				(In thousands)				(In thousands)				(In thousands)			
Commercial and industrial	Commercial and industrial	\$	92	\$	670	\$	—	\$	—								
Real estate:	Real estate:																
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	—		—		—		—		—		—		—		—	
Commercial real estate construction and land development	Commercial real estate construction and land development	—		—		—		—		—		—		—		—	
1-4 family residential (including home equity)	1-4 family residential (including home equity)	—		721		—		—		—		715		99		—	
Residential construction	Residential construction	—		—		—		—		—		—		—		—	

Consumer and other	Consumer and other					Consumer and other				
		—	—	—	—		—	—	—	—
		\$ 92	\$ 1,391	\$ —	\$ —		\$ 89	\$ 1,385	\$ 99	\$ —

The following table presents information regarding loans modified in a troubled debt restructuring during the three and six nine months ended June 30, 2022 September 30, 2022:

		Three Months Ended June 30, 2022								Six Months Ended June 30, 2022								Three Months Ended September 30, 2022											
																		2022					Nine Months Ended						
		Pre-		Post-		Pre-		Post-		Pre-		Post-		Pre-		Post-		Pre-		Post-		Pre-		Post-		Pre-		Post-	
		modifications		modifications		modifications		modifications		modifications		modifications		modifications		modifications		modifications		modifications		modifications		modifications		modifications		modifications	
		of		of		of		of		of		of		of		of		of		of		of		of		of		of	
Number	Outstanding	Outstanding	Number	Outstanding	Outstanding	Number	Outstanding	Outstanding	Number	Outstanding	Outstanding	Number	Outstanding	Outstanding	Number	Outstanding	Outstanding	Number	Outstanding	Outstanding	Number	Outstanding	Outstanding	Number	Outstanding	Outstanding	Number	Outstanding	Outstanding
of	Recorded	Recorded	of	Recorded	Recorded	of	Recorded	Recorded	of	Recorded	Recorded	of	Recorded	Recorded	of	Recorded	Recorded	of	Recorded	Recorded	of	Recorded	Recorded	of	Recorded	Recorded	of	Recorded	Recorded
Contracts	Investment	Investment	Contracts	Investment	Investment	Contracts	Investment	Investment	Contracts	Investment	Investment	Contracts	Investment	Investment	Contracts	Investment	Investment	Contracts	Investment	Investment	Contracts	Investment	Investment	Contracts	Investment	Investment	Contracts	Investment	Investment
(Dollars in thousands)										(Dollars in thousands)																			
Troubled Debt Restructurings	Troubled Debt Restructurings											Troubled Debt Restructurings																	
Commercial and industrial	Commercial and industrial	3	\$	544	\$	544	3	\$	544	\$	544	Commercial and industrial	1	\$	224	\$	224	4	\$										
Real estate:	Real estate:											Real estate:																	
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	—		—		—	4		1,207		1,207	Commercial real estate (including multi-family residential)	—		—		—	4											
Consumer and other	Consumer and other											Consumer and other																	
Total	Total	3	\$	544	\$	544	7	\$	1,751	\$	1,751	Total	2	\$	269	\$	269	9	\$										

Troubled debt restructurings resulted in no charge-offs during the six nine months ended June 30, 2022 September 30, 2022. There were no loans modified under a trouble debt restructuring during the previous twelve-month period that subsequently defaulted during the six-month nine-month period ended June 30, 2022 September 30, 2022. Default is determined to be at 90 or more days past due. The trouble debt restructurings related to extending the amortization periods of the loans. The Company did not grant principal reductions on any restructured loans during the six nine months ended June 30, 2022 September 30, 2022. There were no commitments to lend additional amounts to borrowers with trouble debt restructured loans for the three and six nine months ended June 30, 2022 September 30, 2022.

6. LEASES

Lease payments over the expected term are discounted using the Company's incremental borrowing rate for borrowings of similar terms. Generally, the Company cannot be reasonably certain about whether or not it will renew a lease until such time as the lease is within the last two years of the existing lease term. When the Company is reasonably certain that a renewal option will be exercised, it measures/remeasures the right-of-use asset and related lease liability using the lease payments specified for the renewal period or, if such amounts are unspecified, the Company generally assumes an increase (evaluated on a case-by-case basis in light of prevailing market conditions) in the lease payment over the final period of the existing lease term.

There were no sale and leaseback transactions, leveraged leases or lease transactions with related parties during the six nine months ended June 30, 2023 September 30, 2023 and 2022.

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At June 30, 2023 September 30, 2023, the Company had 32 31 leases consisting of branch locations and office space. On the June 30, 2023 September 30, 2023 balance sheet, the right-of-use asset is classified within premises and equipment and the lease liability is included in other liabilities. The Company also owns certain office facilities which it leases to outside parties under operating lessor leases; however, such leases are not significant. All leases were classified as operating leases. Leases with an initial term of 12 months or less are not recorded on the balance sheet and the related lease expense is recognized on a straight-line basis over the lease term.

Certain leases include options to renew, with renewal terms that can extend the lease term from one to five years. Lease assets and liabilities include related options that are reasonably certain of being exercised. The depreciable life of leased assets are limited by the expected lease term.

Supplemental lease information at the dates indicated is as follows:

	June 30, 2023		December 31, 2022			September 30, 2023		December 31, 2022	
	(Dollars in thousands)					(Dollars in thousands)			
Balance Sheet:	Balance Sheet:				Balance Sheet:				

Operating lease right of use asset classified as premises and equipment	Operating lease right of use asset classified as premises and equipment	\$	21,451	\$	23,538	Operating lease right of use asset classified as premises and equipment	\$	20,483	\$	23,538
Operating lease liability classified as other liabilities	Operating lease liability classified as other liabilities	\$	21,098	\$	23,136	Operating lease liability classified as other liabilities	\$	20,225	\$	23,136
Weighted average lease term, in years	Weighted average lease term, in years		7.99		8.18	Weighted average lease term, in years		7.91		8.18
Weighted average discount rate	Weighted average discount rate		4.10 %		4.00 %	Weighted average discount rate		4.14 %		4.00 %

Lease costs for the dates indicated is as follows:

		Three Months Ended June 30,		Six Months Ended June 30,		Three Months Ended September 30,		Nine Months Ended September 30,		
		2023	2022	2023	2022	2023	2022	2023	2022	
		(In thousands)								
Income Statement:	Income Statement:					Income Statement:				
Operating lease cost	Operating lease cost	\$ 1,579	\$ 831	\$ 3,393	\$ 1,723	Operating lease cost	\$ 1,885	\$ 836	\$ 5,280	\$ 2,559
Short-term lease cost	Short-term lease cost	10	—	15	—	Short-term lease cost	8	—	21	—
Total operating lease costs	Total operating lease costs	\$ 1,589	\$ 831	\$ 3,408	\$ 1,723	Total operating lease costs	\$ 1,893	\$ 836	\$ 5,301	\$ 2,559

A maturity analysis of the Company's lease liabilities is as follows:

	June 30, 2023		December 31, 2022		September 30, 2023		December 31, 2022	
	(In thousands)				(In thousands)			
Lease payments due:	Lease payments due:				Lease payments due:			
Within one year	Within one year	\$ 2,296		\$ 4,634	Within one year	\$ 1,171		\$ 4,634
After one but within two years	After one but within two years	4,121		4,121	After one but within two years	4,137		4,121
After two but within three years	After two but within three years	3,684		3,684	After two but within three years	3,681		3,684
After three but within four years	After three but within four years	3,130		3,132	After three but within four years	3,125		3,132
After four but within five years	After four but within five years	2,918		2,918	After four but within five years	2,914		2,918
After five years	After five years	9,303		9,303	After five years	9,279		9,303
Total lease payments	Total lease payments	25,452		27,792	Total lease payments	24,307		27,792
Less: discount on cash flows	Less: discount on cash flows	4,354		4,656	Less: discount on cash flows	4,082		4,656
Total lease liability	Total lease liability	\$ 21,098		\$ 23,136	Total lease liability	\$ 20,225		\$ 23,136

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7. FAIR VALUE

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value represents the exchange price that would be received from selling an asset or paid to transfer a liability, otherwise known as an "exit price," in the principal or most advantageous market available to the entity in an orderly transaction between market participants on the measurement date.

Fair Value Hierarchy

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company groups financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1—Quoted prices for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2—Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3—Significant unobservable inputs that reflect management's judgment and assumptions that market participants would use in pricing an asset or liability that are supported by little or no market activity.

The carrying amounts and estimated fair values of financial instruments that are reported on the balance sheet are as follows:

		As of June 30, 2023						September 30, 2023				
		Carrying Amount	Estimated Fair Value					Carrying Amount	Estimated Fair Value			
			Level 1	Level 2	Level 3	Total			Level 1	Level 2	Level 3	Total
(In thousands)												
Financial assets	Financial assets						Financial assets					
Cash and cash equivalents	Cash and cash equivalents	\$ 304,089	\$ 304,089	\$ —	\$ —	\$ 304,089	Cash and cash equivalents	\$ 302,272	\$ 302,272	\$ —	\$ —	\$ 302,272
Available for sale securities	Available for sale securities	1,478,222	—	1,478,222	—	1,478,222	Available for sale securities	1,414,952	—	1,414,952	—	1,414,952
Loans held for investment, net of allowance	Loans held for investment, net of allowance	7,968,523	—	—	7,713,018	7,713,018	Loans held for investment, net of allowance	7,910,953	—	—	7,615,073	7,615,073
Accrued interest receivable	Accrued interest receivable	42,051	163	6,745	35,143	42,051	Accrued interest receivable	43,536	176	6,947	36,413	43,536
Financial liabilities	Financial liabilities						Financial liabilities					
Deposits	Deposits	\$ 8,766,369	\$ —	\$ 8,754,102	\$ —	\$ 8,754,102	Deposits	\$ 8,686,621	\$ —	\$ 8,677,026	\$ —	\$ 8,677,026
Accrued interest payable	Accrued interest payable	4,555	—	4,555	—	4,555	Accrued interest payable	7,612	—	7,612	—	7,612
Borrowed funds	Borrowed funds	369,963	—	369,990	—	369,990	Borrowed funds	323,981	—	323,998	—	323,998
Subordinated debt	Subordinated debt	109,566	—	108,029	—	108,029	Subordinated debt	109,665	—	107,469	—	107,469

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		As of December 31, 2022					December 31, 2022				
		Estimated Fair Value					Estimated Fair Value				
Carrying Amount		Level 1	Level 2	Level 3	Total	Carrying Amount		Level 1	Level 2	Level 3	Total
(In thousands)											
Financial assets	Financial assets						Financial assets				

Cash and cash equivalents	Cash and cash equivalents	\$ 371,705	\$ 371,705	\$ —	\$ —	\$ 371,705	Cash and cash equivalents	\$ 371,705	\$ 371,705	\$ —	\$ —	\$ 371,705
Available for sale securities	Available for sale securities	1,807,586	—	1,807,586	—	1,807,586	Available for sale securities	1,807,586	—	1,807,586	—	1,807,586
Loans held for investment, net of allowance	Loans held for investment, net of allowance	7,661,571	—	—	7,555,602	7,555,602	Loans held for investment, net of allowance	7,661,571	—	—	7,555,602	7,555,602
Accrued interest receivable	Accrued interest receivable	44,743	25	10,585	34,133	44,743	Accrued interest receivable	44,743	25	10,585	34,133	44,743
Financial liabilities	Financial liabilities						Financial liabilities					
Deposits	Deposits	\$ 9,267,632	\$ —	\$ 9,256,141	\$ —	\$ 9,256,141	Deposits	\$ 9,267,632	\$ —	\$ 9,256,141	\$ —	\$ 9,256,141
Accrued interest payable	Accrued interest payable	2,098	—	2,098	—	2,098	Accrued interest payable	2,098	—	2,098	—	2,098
Borrowed funds	Borrowed funds	63,925	—	63,999	—	63,999	Borrowed funds	63,925	—	63,999	—	63,999
Subordinated debt	Subordinated debt	109,367	—	107,910	—	107,910	Subordinated debt	109,367	—	107,910	—	107,910

The following tables present fair values for assets and liabilities measured at fair value on a recurring basis. There were no liabilities measured at fair value on a recurring basis as of **June 30, 2023** **September 30, 2023**.

		June 30, 2023				September 30, 2023			
		Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
(In thousands)									
Financial assets	Financial assets								
Available for sale securities:	Available for sale securities:								
U.S. government and agency securities	U.S. government and agency securities	\$ —	\$ 404,882	\$ —	\$ 404,882	\$ —	\$ 393,408	\$ —	\$ 393,408
Municipal securities	Municipal securities	—	229,198	—	229,198	—	219,116	—	219,116
Agency mortgage-backed pass-through securities	Agency mortgage-backed pass-through securities	—	344,381	—	344,381	—	328,194	—	328,194
Agency collateralized mortgage obligations	Agency collateralized mortgage obligations	—	388,772	—	388,772	—	365,878	—	365,878
Corporate bonds and other	Corporate bonds and other	—	110,989	—	110,989	—	108,356	—	108,356
Interest rate swaps	Interest rate swaps	—	—	8,841	8,841	—	—	10,218	10,218
Credit risk participation agreements	Credit risk participation agreements	—	—	23	23	—	—	10	10

Total fair value of financial assets	Total fair value of financial assets	\$ —	\$ 1,478,222	\$ 8,864	\$ 1,487,086	Total fair value of financial assets	\$ —	\$ 1,414,952	\$ 10,228	\$ 1,425,180
Financial liabilities	Financial liabilities					Financial liabilities				
Interest rate swaps	Interest rate swaps	\$ —	\$ —	\$ 8,841	\$ 8,841	Interest rate swaps	\$ —	\$ —	\$ 10,218	\$ 10,218
Total fair value of financial liabilities	Total fair value of financial liabilities	\$ —	\$ —	\$ 8,841	\$ 8,841	Total fair value of financial liabilities	\$ —	\$ —	\$ 10,218	\$ 10,218

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	December 31, 2022				
	Level 1	Level 2	Level 3	Total	
	(In thousands)				
Financial assets					
Available for sale securities:					
U.S. government and agency securities	\$ —	\$ 414,280	\$ —	\$ 414,280	
Municipal securities	—	540,569	—	540,569	
Agency mortgage-backed pass-through securities	—	328,801	—	328,801	
Agency collateralized mortgage obligations	—	394,130	—	394,130	
Corporate bonds and other	—	129,806	—	129,806	
Interest rate swaps	—	—	9,263	9,263	
Credit risk participation agreements	—	—	27	27	
Total fair value of financial assets	\$ —	\$ 1,807,586	\$ 9,290	\$ 1,816,876	
Financial liabilities					
Interest rate swaps	\$ —	\$ —	\$ 9,263	\$ 9,263	
Total fair value of financial liabilities	\$ —	\$ —	\$ 9,263	\$ 9,263	

There were no transfers between levels during the **six nine** months ended **June 30, 2023** **September 30, 2023** or 2022.

Assets measured at fair value on a nonrecurring basis are summarized in the table below. There were no liabilities measured at fair value on a nonrecurring basis at **June 30, 2023** **September 30, 2023** and December 31, 2022.

		June 30, 2023			September 30, 2023			
		Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	
(In thousands)								
Loans:	Loans:							
Commercial and industrial	Commercial and industrial	\$ —	\$ —	\$ 11,991	Commercial and industrial	\$ —	\$ —	\$ 13,830
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	—	—	2,752	Commercial real estate (including multi-family residential)	—	—	7,706
Commercial real estate construction and land development	Commercial real estate construction and land development	—	—	6,751	Commercial real estate construction and land development	—	—	6,654
1-4 family residential (including home equity)	1-4 family residential (including home equity)	—	—	2,045	1-4 family residential (including home equity)	—	—	2,776

Consumer and other					Consumer and other	—	—	88
Branch assets held for sale	Branch assets held for sale	5,852	—	—	Branch assets held for sale	5,852	—	—
		\$ 5,852	\$ —	\$ 23,539		\$ 5,852	\$ —	\$ 31,054

December 31, 2022			
Level 1	Level 2	Level 3	
(In thousands)			
Loans:			
Commercial and industrial	\$ —	\$ —	\$ 21,948
Commercial real estate (including multi-family residential)	—	—	11,566
1-4 family residential (including home equity)	—	—	2,883
Branch assets held for sale	5,165	—	—
	\$ 5,165	\$ —	\$ 36,397

Branch assets held for sale include banking centers that have closed and are for sale.

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8. DEPOSITS

Time deposits that met or exceeded the Federal Deposit Insurance Corporation ("FDIC") insurance limit of \$250 \$250,000 thousand at June 30, 2023 September 30, 2023 and December 31, 2022 were \$502.1 million \$560.2 million and \$432.9 million, respectively.

Scheduled maturities of time deposits for the next five years are as follows (in thousands):

Within one year	\$ 1,325,868	1,399,265
After one but within two years	88,265	85,040
Over three years	27,118	19,586
Total	\$ 1,441,251	1,503,891

The Company had \$537.8 million \$579.0 million and \$72.5 million of brokered deposits as of June 30, 2023 September 30, 2023 and December 31, 2022, respectively. There were no concentrations of deposits with any one depositor at June 30, 2023 September 30, 2023 and December 31, 2022.

9. DERIVATIVE INSTRUMENTS

Financial derivatives are reported at fair value in other assets or other liabilities. The accounting for changes in the fair value of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship.

Derivatives not designated as hedges

The Company has outstanding interest rate swap contracts with certain customers and equal and offsetting interest rate swaps with other financial institutions entered into at the same time. These interest rate swap contracts are not designated as hedging instruments for mitigating interest rate risk. The objective of the transactions is to allow customers to effectively convert a variable rate loan to a fixed rate.

In connection with each swap transaction, the Company agreed to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a similar notional amount at a fixed interest rate. At the same time, the Company agreed to pay a third-party financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. Because the Company acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts are designed to offset each other and do not significantly impact the Company's operating results except in certain situations where there is a significant deterioration in the customer's credit worthiness or that of the counterparties. At June 30, 2023 September 30, 2023, management determined there was no such deterioration.

At June 30, 2023 September 30, 2023 and December 31, 2022, the Company had 15 and 14 interest rate swap agreements outstanding with borrowers and financial institutions, respectively. These derivative instruments are not designated as accounting hedges and changes in the net fair value are recognized in other noninterest income. Fair value amounts are included in other assets and other liabilities.

At June 30, 2023 September 30, 2023 and December 31, 2022, the Company had three credit risk participation agreements with another financial institution that are associated with interest rate swaps related to loans for which the Company is the lead agent bank and the other financial institution provides credit protection to the Company

should the borrower fail to perform under the terms of the interest rate swap agreements. The fair value of the agreements is determined based on the market value of the underlying interest rate swaps adjusted for credit spreads and recovery rates.

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Derivative instruments not designated as hedges outstanding as of **June 30, 2023** **September 30, 2023** were as follows (dollars in thousands):

	Weighted Average Maturity							Weighted Average Maturity						
			Notional	Fair						Notional	Fair			
	Classification	Amounts	Value	Fixed Rate	Floating Rate	(Years)		Classification	Amounts	Value	Fixed Rate	Floating Rate	(Years)	
Interest rate swaps:	Interest rate swaps:							Interest rate swaps:						
Financial institutions	Financial institutions	Other assets	\$112,077	\$8,425	3.25% - 5.58%	SOFR CME 1M + 2.50% - 3.00%	4.99	Financial institutions	Other assets	\$110,946	\$9,758	3.25% - 6.25%	SOFR CME 1M + 2.50% - 3.00%	4.74
Financial institutions	Financial institutions	Other assets	4,970	416	4.99%	U.S. Prime	4.46	Financial institutions	Other assets	4,940	460	4.99%	U.S. Prime	4.21
Customers	Customers	Other liabilities	4,970	(416)	4.99%	U.S. Prime	4.46	Customers	Other liabilities	4,940	(460)	4.99%	U.S. Prime	4.21
Customers	Customers	Other liabilities	112,077	(8,425)	3.25% - 5.58%	SOFR CME 1M + 2.50% - 3.00%	4.99	Customers	Other liabilities	110,946	(9,758)	3.25% - 6.25%	SOFR CME 1M + 2.50% - 3.00%	4.74
Credit risk participations:	Credit risk participations:							Credit risk participations:						
Financial institutions	Financial institutions	Other assets	21,159	23	3.50% - 5.40%	SOFR CME 1M + 2.50%	7.86	Financial institutions	Other assets	20,958	10	3.50% - 5.40%	SOFR CME 1M + 2.50%	7.58

Derivative instruments not designated as hedges outstanding as of December 31, 2022 were as follows (dollars in thousands):

			Classification	Notional Amounts	Fair Value	Fixed Rate	Floating Rate	Weighted Average Maturity (Years)
Interest rate swaps:								
Financial institutions		Other assets		\$ 109,242	\$ 8,856	3.25% - 5.58%	SOFR CME 1M + 2.50% - 3.00%	5.49
Financial institutions		Other assets		5,029	407	4.99%	U.S. Prime	4.96
Customers		Other liabilities		5,029	(407)	4.99%	U.S. Prime	4.96
Customers		Other liabilities		109,242	(8,856)	3.25% - 5.58%	SOFR CME 1M + 2.50%	5.49
Credit risk participations:								
Financial institutions		Other assets		13,028	2	3.50%	LIBOR 1M + 2.50%	7.24
Financial institutions		Other assets		8,485	25	5.35% - 5.40%	SOFR CME 1M + 2.50%	9.97

10. BORROWINGS AND BORROWING CAPACITY

The Company has an available line of credit with the Federal Home Loan Bank ("FHLB") of Dallas, which allows the Company to borrow on a collateralized basis. FHLB advances are used to manage liquidity as needed. The advances are secured by a blanket lien on certain loans. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At **June 30, 2023** **September 30, 2023**, the Company had a total borrowing capacity with the FHLB of **\$4.10 billion** **\$3.82 billion**, of which **\$2.90 billion** **\$2.28 billion** was available and **\$1.20 billion** **\$1.54 billion** was outstanding in/through FHLB advances and letters of credit. There were **\$370.0 million** **\$324.0 million** of FHLB short-term advances outstanding at **June 30, 2023** **September 30, 2023** at a weighted-average rate of **5.45%** **5.62%**. Letters of credit were **\$831.3 million** **\$1.22 billion** at **June 30, 2023** **September 30, 2023**, of which **\$91.0 million** **\$50.8 million** will expire during the remaining months of 2023, **\$45.0 million** **\$72.8 million** will expire in 2024, **\$148.0 million** **\$494.5 million** will expire in 2025, **\$52.3 million** **\$57.3 million** will expire in 2026, **\$453.0 million** **\$448.0 million** will expire in 2027, **\$15.0 million** **\$40.0 million** will expire in 2028, and **\$27.0 million** will expire in **2029**, **2029** and **\$30.0 million** will expire in **2031**.

On December 13, 2022, the Company entered into a loan agreement with another financial institution, or the Loan Agreement, that provides for a \$75.0 million revolving line of credit. At **June 30, 2023** **September 30, 2023**, there were no outstanding borrowings on this line of credit and the Company did not draw on this line of credit during 2023 or 2022. The Company can make draws on the line of

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of credit for a period of 24 months, which began on December 13, 2022, after which the Company will not be permitted to make further draws. Interest accrues on outstanding borrowings at a per annum rate equal to the prime rate quoted by The Wall Street Journal and with a floor rate of 3.50% calculated in accordance with the terms of the revolving promissory note and payable quarterly through the first 24 months. The entire outstanding balance and unpaid interest is payable in full on December 13, 2024.

The Company may prepay the principal amount of the line of credit without premium or penalty. The obligations of the Company under the Loan Agreement are secured by a pledge of all the issued and outstanding shares of capital stock of Stellar Bank.

Covenants made under the Loan Agreement include, among other things, while there any obligations outstanding under Loan Agreement, the Company shall maintain a cash flow to debt service (as defined in the Loan Agreement) of not less than 1.25, the Bank's Texas Ratio (as defined in the Loan Agreement) not to exceed 25.0%, and the Bank shall maintain a Tier 1 Leverage Ratio (as defined under the Loan Agreement) of at least 7.0% and restrictions on the ability of the Company and its subsidiaries to incur certain additional debt. As of June 30, 2023 September 30, 2023, the Company believes it was in compliance with all such debt covenants and had not been made aware of any noncompliance by the lender.

11. SUBORDINATED DEBT

Junior Subordinated Debentures

In connection with the acquisition of F&M Bancshares, Inc., the Company assumed Farmers & Merchants Capital Trust II and Farmers & Merchants Capital Trust III. Each of these trusts is a capital or statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds in the Company's junior subordinated debentures. The preferred trust securities of each trust represent preferred beneficial interests in the assets of the respective trusts and are subject to mandatory redemption upon payment of the junior subordinated debentures held by the trust. The common securities of each trust are wholly owned by the Company. Each trust's ability to pay amounts due on the trust preferred securities is solely dependent upon the Company making payment on the related junior subordinated debentures. The debentures, which are the only assets of each trust, are subordinate and junior in right of payment to all of the Company's present and future senior indebtedness. The Company has fully and unconditionally guaranteed each trust's obligations under the trust securities issued by such trust to the extent not paid or made by such trust, provided such trust has funds available for such obligations. The junior subordinated debentures are included in Tier 1 capital under current regulatory guidelines and interpretations. Under the provisions of each issue of the debentures, the Company has the right to defer payment of interest on the debentures at any time, or from time to time, for periods not exceeding five years. If interest payments on either issue of the debentures are deferred, the distributions on the applicable trust preferred securities and common securities will also be deferred.

A summary of pertinent information related to the Company's issues of junior subordinated debentures outstanding at June 30, 2023 September 30, 2023 is set forth in the table below:

Description			Trust	Interest	Junior			
	Description	Issuance	Preferred		Subordinated		Maturity	Issuance
		Date	Securities		Debt Owed			
			Outstanding	Rate(1)	to Trusts			
(Dollars in thousands)								
Farmers & Merchants Capital Trust II	Farmers & Merchants Capital Trust II	November 13, 2003	\$ 7,500	3 month LIBOR + 3.00%	\$ 7,732	November 8, 2033	Farmers & Merchants Capital Trust II	November 13, 2003
Farmers & Merchants Capital Trust III	Farmers & Merchants Capital Trust III	June 30, 2005	3,500	3 month LIBOR + 1.80%	3,609	July 7, 2035	Farmers & Merchants Capital Trust III	June 30, 2005
					\$ 11,341			

(1) The 3-month LIBOR in effect as of June 30, 2023 was 5.07%. Transitions to an alternative benchmark rate plus a comparable spread adjustment in the event that 30-day LIBOR is no longer published on a future adjustment date.

(2) All debentures are currently callable.

Subordinated Notes

In December 2017, the Bank completed the issuance, through a private placement, of \$40.0 million \$40.0 million aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes (the "Bank Notes") due December 15, 2027. As of December 15, 2022, the Bank Notes bear bore a floating rate of interest equal to 3-Month LIBOR + plus 3.03%, which transitions transitioned to an alternative benchmark rate 3-Month SOFR plus a comparable spread adjustment in the event that 30-day LIBOR is no longer published on a future adjustment date, immediately after June 30, 2023, until the Bank Notes mature on December 15, 2027, or such earlier redemption date, payable quarterly in arrears. The Bank Notes are redeemable by the Bank, in whole or in part, on or after December 15, 2022 or, in whole but not in part, upon the occurrence of certain specified tax

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events, capital events or investment company events. Any redemption will be at a redemption price equal to 100% of the principal amount of Bank Notes being redeemed, plus accrued and unpaid interest, and will be subject to, and require, prior regulatory approval. The Bank Notes are not subject to redemption at the

option of the holders. The Bank Notes are eligible for Tier 2 capital treatment, however, during the last five years of the instrument, the amount eligible must be reduced by 20% of the original amount annually and that no amount of the instrument is eligible for inclusion in Tier 2 capital when the remaining maturity of the instrument is less than one year. As the Bank Notes were within five years of maturity, only 80% of the notes are eligible for Tier 2 capital treatment at **June 30, 2023** **September 30, 2023**.

In September 2019, the Company completed the issuance of \$60.0 million aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes (the "Company Notes") due October 1, 2029. The Company Notes bear a fixed interest rate of 4.70% per annum until (but excluding) October 1, 2024, payable semi-annually in arrears on April 1 and October 1, commencing on April 1, 2020. Thereafter, from October 1, 2024 through the maturity date, October 1, 2029, or earlier redemption date, the Company Notes will bear interest at a floating rate equal to the then-current three-month LIBOR, 3-Month SOFR, plus 313 basis points (3.13%) 3.13%, which transitions to an alternative benchmark rate plus a comparable spread adjustment in the event that 30-day transitioned from LIBOR is no longer published on a future adjustment date, immediately after June 30, 2023, for each quarterly interest period, (subject to certain provisions set forth under "Description of the Notes—Interest Rates and Interest Payment Dates" included in the Prospectus Supplement for the Company Notes), payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year. Any redemption will be at a redemption price equal to 100% of the principal amount of Company Notes being redeemed, plus accrued and unpaid interest, and will be subject to, and require, prior regulatory approval. The Company Notes are not subject to redemption at the option of the holders.

12. INCOME TAXES

The amount of the Company's federal and state income tax expense is influenced by the amount of pre-tax income, the amount of tax-exempt income and the amount of other nondeductible items.

		Three Months Ended		Six Months Ended				Three Months Ended		Nine Months Ended	
		June 30, 2023	June 30, 2022	June 30, 2023	June 30, 2022			September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Income tax expense	Income tax expense	\$ 7,467	\$ 3,702	\$ 17,380	\$ 7,904	Income tax expense	\$ 7,445	\$ 3,406	\$ 24,825	\$ 11,310	
Effective income tax rate	Effective income tax rate	17.5 %	18.4 %	19.4 %	18.4 %	Effective income tax rate	19.4 %	19.3 %	19.4 %	18.6 %	

Interest and penalties related to tax positions are recognized in the period in which they begin accruing or when the entity claims the position that does not meet the minimum statutory thresholds. The Company does not have any uncertain tax positions and does not have any interest or penalties recorded in the income statement for the three or **six nine** months ended **June 30, 2023** **September 30, 2023**.

13. STOCK BASED COMPENSATION

In connection with the closing of the Merger on October 1, 2022, the 2022 Omnibus Incentive Plan (the "2022 Plan") approved by the Company's shareholders at the special meeting of shareholders on May 23, 2022 became effective. Under the 2022 Plan, the Company is authorized to issue a maximum aggregate of 2,000,000 shares of common stock. All restricted stock and performance share awards outstanding at **June 30, 2023** **September 30, 2023** were issued under the 2022 Plan. At **June 30, 2023** **September 30, 2023**, there were **1,103,050** **1,017,319** shares reserved and available for issuance under the 2022 Plan.

The Company accounts for stock based employee compensation plans using the fair value-based method of accounting. The Company recognized total stock based compensation expense of **\$2.8 million** **\$2.8 million** and **\$931** **\$969** thousand for the three months ended **June 30, 2023** **September 30, 2023** and 2022, respectively, and **\$5.4 million** **\$8.2 million** and **\$1.9 million** **\$2.9 million** for the **six nine** months ended **June 30, 2023** **September 30, 2023** and 2022, respectively.

Stock Options

Stock options outstanding at **June 30, 2023** **September 30, 2023**, were issued prior to the Merger under three equity compensation plans **with awards outstanding** (1) the Allegiance 2015 Stock Awards and Incentive Plan, (2) the Allegiance 2019 Amended and Restated Stock Awards and Incentive Plan and (3) the CBTX 2014 Stock Option Plan. No additional shares may be issued under these compensation plans.

No options to purchase Company stock were granted during the **six nine** months ended **June 30, 2023** **September 30, 2023**. Options are exercisable for up to 10 years from the date of the grant and, dependent on the terms of the applicable award agreement generally vest three to four years after the date of grant. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model.

A summary of the activity in the stock option plans during the **six nine** months ended **June 30, 2023** **September 30, 2023** is set forth below:

		Number of Options (Shares in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (Dollars in thousands)		Number of Options (Shares in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (Dollars in thousands)
Options outstanding, January 1, 2023	Options outstanding, January 1, 2023	368	\$ 17.89	2.72	\$ 4,256	Options outstanding, January 1, 2023	368	\$ 17.89	2.72	\$ 4,256
Options granted	Options granted	—	—			Options granted	—	—		
Options exercised	Options exercised	(25)	13.95			Options exercised	(49)	14.19		
Options forfeited	Options forfeited	(33)	20.49			Options forfeited	(36)	20.67		
Options outstanding, June 30, 2023		310	\$ 17.94	2.31	\$ 1,656					
Options vested and exercisable, June 30, 2023		310	\$ 17.94	2.31	\$ 1,656					
Options outstanding, September 30, 2023						Options outstanding, September 30, 2023	283	\$ 18.18	2.17	\$ 1,036
Options vested and exercisable, September 30, 2023						Options vested and exercisable, September 30, 2023	283	\$ 18.18	2.17	\$ 1,036

Restricted Stock Awards

The fair value of the Company's restricted stock awards is estimated based on the market value of the Company's common stock at the date of grant, which is the closing price of the Company's common stock on the day before the grant date. The shares of restricted stock granted during 2023 generally vest over a period of two or three years from the date of grant and the Company accounts for shares of restricted stock by recording the fair value of the grant on the award date as compensation expense over the vesting period.

Shares of restricted stock are considered outstanding at the date of issuance as the grantee becomes the record owner of the restricted stock and has voting, dividend and other shareholder rights. The shares of restricted stock awards are non-transferable and subject to forfeiture until the restricted stock awards vest and any dividends with respect to the restricted stock awards are subject to the same restrictions, including the risk of forfeiture.

A summary of the activity of the nonvested shares of restricted stock during the six nine months ended June 30, 2023 September 30, 2023 is as follows:

		Number of Shares (Shares in thousands)	Weighted Average Grant Date Fair Value		Number of Shares (Shares in thousands)	Weighted Average Grant Date Fair Value
Nonvested share awards outstanding, January 1, 2023	Nonvested share awards outstanding, January 1, 2023	501	\$ 32.84	Nonvested share awards outstanding, January 1, 2023	501	\$ 32.84
Share awards granted	Share awards granted	253	25.71	Share awards granted	262	25.67
Share awards vested	Share awards vested	(14)	25.99	Share awards vested	(14)	25.99
Unvested share awards forfeited or cancelled	Unvested share awards forfeited or cancelled	(50)	31.11	Unvested share awards forfeited or cancelled	(64)	31.03
Nonvested share awards outstanding, June 30, 2023		690	30.49			

Nonvested share awards outstanding, September 30, 2023	Nonvested share awards outstanding, September 30, 2023	685	30.41
--	--	-----	-------

As of June 30, 2023 September 30, 2023, there was \$5.8 million \$13.1 million of total unrecognized compensation cost related to the restricted stock awards which is expected to be recognized over a weighted-average period of 1.89 1.70 years.

Performance Share Awards ("PSAs")

PSAs are generally earned subject to certain performance goals being met after the two-year performance period and will be settled in shares of Company common stock following a one-year service period. There were 119,845 PSAs awarded during the six nine months ended June 30, 2023 September 30, 2023. The grant date fair value of the PSAs is based on the probable outcome of the applicable performance conditions and is calculated at target based on a combination of the closing market price of our common stock on the grant date and a Monte Carlo simulated fair value in accordance with ASC 718. At June 30, 2023 September 30, 2023, there was \$1.2 million \$2.0 million of unrecognized compensation expense related to the PSAs, which is expected to be recognized over a weighted-average period of 2.1 2.0 years.

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14. OFF-BALANCE SHEET ARRANGEMENTS, COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in the Company's consolidated balance sheets. The Company

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enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby and commercial letters of credit, which involve to varying degrees elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Company uses the same credit policies in making commitments and conditional obligations as it does for on balance sheet instruments.

The contractual amounts of financial instruments with off-balance sheet risk are as follows:

		June 30, 2023		December 31, 2022				September 30, 2023		December 31, 2022	
		Fixed Rate	Variable Rate	Fixed Rate	Variable Rate			Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
		(In thousands)						(In thousands)			
Commitments to extend credit ⁽¹⁾	Commitments to extend credit ⁽¹⁾	\$ 513,423	\$ 1,403,262	\$ 673,098	\$ 1,686,627	Commitments to extend credit ⁽¹⁾		\$ 432,498	\$ 1,454,648	\$ 673,098	\$ 1,686,627
Standby letters of credit	Standby letters of credit	14,818	23,670	10,310	25,190	Standby letters of credit		14,507	23,249	10,310	25,190
Total	Total	\$ 528,241	\$ 1,426,932	\$ 683,408	\$ 1,711,817	Total		\$ 447,005	\$ 1,477,897	\$ 683,408	\$ 1,711,817

- 1) At June 30, 2023 September 30, 2023 and December 31, 2022, the Company had FHLB Letters of Credit in the amount of \$831.3 million \$1.22 billion and \$1.08 billion, respectively, pledged as collateral for public and other deposits of state and local government agencies. For more information on FHLB borrowings, see Note 10 – Borrowings and Borrowing Capacity.

Commitments to Extend Credit

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 of the commitments are expected to expire without being fully drawn upon, the total commitment amounts disclosed do not necessarily represent future cash funding requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for credit losses. The amount and type of collateral, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer.

Commitments to make loans are generally made for an approval period of 120 days or fewer. As of June 30, 2023 September 30, 2023, the fixed rate loan commitments had interest rates ranging from 1.40% 1.70% to 13.25% 13.50% with a weighted average maturity and rate of 2.50 2.46 years and 5.89% 6.28%, respectively.

Standby Letters of Credit

Standby letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. In the event of nonperformance by the customer, the Company has the rights to the underlying collateral. The credit risk to the Company in issuing letters of credit is substantially similar to that involved in extending loan facilities to its customers. The Company's policy for obtaining collateral, and the nature of such collateral, is substantially similar to that involved in making commitments to extend credit.

Litigation

The Company is subject to claims and lawsuits which arise primarily in the ordinary course of business. Based on information presently available and advice received from legal counsel representing the Company, it is the opinion of management that the disposition or ultimate determination of such claims and lawsuits will not have a material adverse effect on the financial position or results of operations of the Company.

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15. REGULATORY CAPITAL MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines, and for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities and certain off balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings and other factors. Failure to meet minimum capital requirements can cause regulators to initiate actions that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. The final rules implementing Basel Committee on Banking Supervision's capital guideline for U.S.

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Banks (Basel III Rules) were fully phased in when the capital conservation buffer reached 2.5%. Management believes as of **June 30, 2023**, **September 30, 2023** and December 31, 2022, the Company and the Bank met all capital adequacy requirements to which they were then subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If less than well capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required.

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The following is a summary of the Company's and the Bank's actual and required capital ratios as of **June 30, 2023**, **September 30, 2023** and December 31, 2022:

		To Be Categorized As Well-Capitalized								To Be Categorized As Well-Capitalized									
		Actual		Minimum Required for Capital Adequacy Purposes		Minimum Required Plus Capital Conservation Buffer		Under Prompt Corrective Action Provisions		Actual		Minimum Required for Capital Adequacy Purposes		Minimum Required Plus Capital Conservation Buffer		Under Prompt Corrective Action Provisions			
		Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio		
		(Dollars in thousands)								(Dollars in thousands)									
STELLAR BANCORP, INC.	STELLAR BANCORP, INC.									STELLAR BANCORP, INC.									
(Consolidated)	(Consolidated)									(Consolidated)									
As of June 30, 2023																			
September 30, 2023										September 30, 2023									
Total Capital (to risk-weighted assets)	Total Capital (to risk-weighted assets)	\$ 1,175,829	13.03 %	\$ 722,193	8.00 %	\$ 947,878	10.50 %	N/A	N/A	Total Capital (to risk-weighted assets)	\$ 1,201,404	13.42 %	\$ 716,402	8.00 %	\$ 940,278	10.50 %	N/A	N/A	
Common Equity Tier 1 Capital (to risk-weighted assets)	Common Equity Tier 1 Capital (to risk-weighted assets)	963,620	10.67 %	406,234	4.50 %	631,919	7.00 %	N/A	N/A	Common Equity Tier 1 Capital (to risk-weighted assets)	997,556	11.14 %	402,976	4.50 %	626,852	7.00 %	N/A	N/A	
Tier 1 Capital (to risk-weighted assets)	Tier 1 Capital (to risk-weighted assets)	973,518	10.78 %	541,645	6.00 %	767,330	8.50 %	N/A	N/A	Tier 1 Capital (to risk-weighted assets)	1,007,454	11.25 %	537,302	6.00 %	761,177	8.50 %	N/A	N/A	

Tier 1 Leverage (to average tangible assets)	Tier 1 Leverage (to average tangible assets)	973,518	9.51 %	409,420	4.00 %	409,420	4.00 %	N/A	N/A	Tier 1 Leverage (to average tangible assets)	1,007,454	9.82 %	410,344	4.00 %	410,344	4.00 %	N/A	N/A
As of December 31, 2022																		
December 31, 2022										December 31, 2022								
Total Capital (to risk-weighted assets)	Total Capital (to risk-weighted assets)	\$ 1,092,618	12.39 %	\$705,765	8.00 %	\$926,317	10.50 %	N/A	N/A	Total Capital (to risk-weighted assets)	\$ 1,092,618	12.39 %	\$705,765	8.00 %	\$926,317	10.50 %	N/A	N/A
Common Equity Tier 1 Capital (to risk-weighted assets)	Common Equity Tier 1 Capital (to risk-weighted assets)	885,652	10.04 %	396,993	4.50 %	617,545	7.00 %	N/A	N/A	Common Equity Tier 1 Capital (to risk-weighted assets)	885,652	10.04 %	396,993	4.50 %	617,545	7.00 %	N/A	N/A
Tier 1 Capital (to risk-weighted assets)	Tier 1 Capital (to risk-weighted assets)	895,520	10.15 %	529,324	6.00 %	749,876	8.50 %	N/A	N/A	Tier 1 Capital (to risk-weighted assets)	895,520	10.15 %	529,324	6.00 %	749,876	8.50 %	N/A	N/A
Tier 1 Leverage (to average tangible assets)	Tier 1 Leverage (to average tangible assets)	895,520	8.55 %	418,720	4.00 %	418,720	4.00 %	N/A	N/A	Tier 1 Leverage (to average tangible assets)	895,520	8.55 %	418,720	4.00 %	418,720	4.00 %	N/A	N/A
STELLAR BANK										STELLAR BANK								
As of June 30, 2023																		
September 30, 2023										September 30, 2023								
Total Capital (to risk-weighted assets)	Total Capital (to risk-weighted assets)	\$ 1,153,970	12.80 %	\$721,471	8.00 %	\$946,931	10.50 %	\$901,839	10.00 %	Total Capital (to risk-weighted assets)	\$ 1,174,693	13.13 %	\$715,650	8.00 %	\$939,290	10.50 %	\$894,562	10.00 %
Common Equity Tier 1 Capital (to risk-weighted assets)	Common Equity Tier 1 Capital (to risk-weighted assets)	1,011,659	11.22 %	405,827	4.50 %	631,287	7.00 %	586,195	6.50 %	Common Equity Tier 1 Capital (to risk-weighted assets)	1,040,743	11.63 %	402,553	4.50 %	626,193	7.00 %	581,465	6.50 %
Tier 1 Capital (to risk-weighted assets)	Tier 1 Capital (to risk-weighted assets)	1,011,659	11.22 %	541,103	6.00 %	766,563	8.50 %	721,471	8.00 %	Tier 1 Capital (to risk-weighted assets)	1,040,743	11.63 %	536,737	6.00 %	760,378	8.50 %	715,650	8.00 %
Tier 1 Leverage (to average tangible assets)	Tier 1 Leverage (to average tangible assets)	1,011,659	9.89 %	409,051	4.00 %	409,051	4.00 %	511,313	5.00 %	Tier 1 Leverage (to average tangible assets)	1,040,743	10.15 %	409,957	4.00 %	409,957	4.00 %	512,446	5.00 %
As of December 31, 2022																		
December 31, 2022										December 31, 2022								
Total Capital (to risk-weighted assets)	Total Capital (to risk-weighted assets)	\$ 1,059,313	12.02 %	\$705,120	8.00 %	\$925,470	10.50 %	\$881,400	10.00 %	Total Capital (to risk-weighted assets)	\$ 1,059,313	12.02 %	\$705,120	8.00 %	\$925,470	10.50 %	\$881,400	10.00 %
Common Equity Tier 1 Capital (to risk-weighted assets)	Common Equity Tier 1 Capital (to risk-weighted assets)	921,714	10.46 %	396,630	4.50 %	616,980	7.00 %	572,910	6.50 %	Common Equity Tier 1 Capital (to risk-weighted assets)	921,714	10.46 %	396,630	4.50 %	616,980	7.00 %	572,910	6.50 %
Tier 1 Capital (to risk-weighted assets)	Tier 1 Capital (to risk-weighted assets)	921,714	10.46 %	528,840	6.00 %	749,190	8.50 %	705,120	8.00 %	Tier 1 Capital (to risk-weighted assets)	921,714	10.46 %	528,840	6.00 %	749,190	8.50 %	705,120	8.00 %

Tier 1 Leverage (to average tangible assets)	Tier 1 Leverage (to average tangible assets)									Tier 1 Leverage (to average tangible assets)									
		921,714	8.81 %	418,388	4.00 %	418,388	4.00 %	522,984	5.00 %		921,714	8.81 %	418,388	4.00 %	418,388	4.00 %	522,984	5.00 %	

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16. EARNINGS PER COMMON SHARE

Diluted earnings per common share is computed using the weighted-average number of common shares determined for the basic earnings per common share computation plus the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock using the treasury stock method. Outstanding stock options issued by the Company represent the only dilutive effect reflected in diluted weighted average shares. Restricted shares and performance share awards are considered outstanding at the date of grant, accounted for as participating securities and included in basic and diluted weighted average common shares outstanding.

		Three Months Ended June 30,				Six Months Ended June 30,					Three Months Ended September 30,				Nine Months E	
		2023		2022		2023		2022			2023		2022		2023	
		Per		Per		Per		Per			Per		Per		Pe	
		Share		Share		Share		Share			Share		Share		Sha	
		Amount	Amount	Amount	Amount	Amount	Amount	Amount	Amount		Amount	Amount	Amount	Amount	Amount	Amount
		(Amounts in thousands, except per share data)									(Amounts in thousands, except per share data)					
Net income attributable to shareholders	Net income attributable to shareholders	\$35,175		\$16,437		\$72,323		\$35,094		Net income attributable to shareholders	\$30,908		\$14,286		\$103,231	
Basic:	Basic:									Basic:						
Weighted average shares outstanding	Weighted average shares outstanding	53,297	\$ 0.66	28,874	\$ 0.57	53,160	\$ 1.36	28,879	\$ 1.22	Weighted average shares outstanding	53,313	\$ 0.58	28,286	\$ 0.51	53,211	\$ 1.
Diluted:	Diluted:									Diluted:						
Add incremental shares for:	Add incremental shares for:									Add incremental shares for:						
Dilutive effect of stock option exercises and performance share units	Dilutive effect of stock option exercises and performance share units	78		246		101		229		Dilutive effect of stock option exercises and performance share units	67		244		89	
Total	Total	53,375	\$ 0.66	29,120	\$ 0.56	53,261	\$ 1.36	29,108	\$ 1.21	Total	53,380	\$ 0.58	28,530	\$ 0.50	53,300	\$ 1.

There were 30,074, 28,372 and 22,411 no antidilutive shares as of June 30, 2023, September 30, 2023 and 2022, respectively.

The basic and diluted weighted average number of shares issued and earnings per share have been retrospectively adjusted to reflect the equivalent number of shares issued to holders of Allegiance common stock in the Merger.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except where the context otherwise requires or where otherwise indicated in this Quarterly Report on Form 10-Q, the term "Stellar" refers to Stellar Bancorp, Inc., the terms "we," "us," "our," "Company" and "our business" refer to Stellar Bancorp, Inc. and our wholly owned banking subsidiary, Stellar Bank, a Texas banking association.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements. These forward-looking statements reflect the Company's current views with respect to, among other things, future events and the Company's financial performance. These statements are often, but not always, made through the use of words or phrases such as "may," "should," "could," "predict," "potential," "believe," "will likely result," "expect," "continue," "will," "anticipate," "seek," "estimate," "intend," "plan," "projection," "would" and "outlook,"

or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about the Company's industry, management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond the Company's control. Accordingly, the Company cautions that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions and uncertainties that are difficult to predict. Although the Company believes that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements.

There are or will be important factors that could cause the Company's actual results to differ materially from those indicated in these forward-looking statements, including, but not limited to, the risks described in "Part I—Item 1A.—Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2022 and the following:

- disruptions to the economy and the U.S. banking system caused by recent bank failures;
- risks associated with uninsured deposits and responsive measures by federal or state governments or banking regulators, including increases in our deposit insurance assessments and other actions of the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Texas Department of Banking and legislative and regulatory actions and reforms;
- the effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board;
- inflation, interest rate, capital and securities markets and monetary fluctuations;
- changes in the interest rate environment, the value of Stellar's assets and obligations and the availability of capital and liquidity;
- general competitive, economic, political and market conditions and other factors that may affect future results of the Company including changes in asset quality and credit risk; the inability to sustain revenue and earnings growth;
- local, regional, national and international economic conditions and the impact they may have on the Company and our customers and the Company's assessment of that impact;
- the inability to sustain revenue and earnings growth;
- impairment of the Company's goodwill or other intangible assets;
- the composition of the Company's loan portfolio and the concentration of loans in commercial real estate and commercial real estate construction;
- the geographic concentration of the Company's markets;
- the accuracy and sufficiency of the assumptions and estimates the Company makes in establishing reserves for potential loan losses and other estimates;
- the amount of nonperforming and classified assets that the Company holds and the time and effort necessary to resolve nonperforming assets;
- deterioration of asset quality;
- customer borrowing, repayment, investment and deposit practices;
- the Company's ability to maintain important deposit customer relationships;
- changes in the value of collateral securing the Company's loans;
- the risk that the expected cost savings and any revenue synergies from the Merger may not be fully realized or may take longer than anticipated to be realized;
- the amount of the costs, fees, expenses and charges related to the Merger;

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- reputational risk and the reaction of our customers, suppliers, employees or other business partners to the Merger;
- natural disasters and adverse weather on the Company's market area;
- the potential impact of climate change;
- the impact of pandemics, epidemics or any other health-related crisis;
- acts of terrorism, an outbreak of hostilities, such as the conflict in Ukraine or the Middle East, or other international or domestic calamities;
- the Company's ability to maintain effective internal control over financial reporting;
- the cost and effects of cyber incidents or other failures, interruptions or security breaches of the Company's systems or those of the Company's customers or third-party providers;
- the failure of certain third- or fourth-party vendors to perform;
- the impact, extent and timing of technological changes;
- the institution and outcome of litigation and other legal proceedings against the Company or to which it may become subject;
- the costs, effects and results of regulatory examinations, investigations, or reviews or the ability to obtain required regulatory approvals or meet conditions associated with the same;
- changes in the laws, rules, regulations, interpretations or policies relating to financial institution, accounting, tax, trade, monetary and fiscal matters;
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters; and
- other risks, uncertainties, and factors that are discussed from time to time in the Company's reports and documents filed with the SEC.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this Quarterly Report on Form 10-Q. If one or more events related to these or other risks or uncertainties materialize, or if the Company's underlying assumptions prove to be incorrect, actual results may differ materially from what is anticipated. Undue reliance should not be placed on any such forward-looking statements. Any forward-looking statement speaks only as of the date made, and the Company does not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise. New factors emerge from time to time, and it is not possible to predict which will arise. In addition, the Company cannot assess the impact of each factor on its business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Overview

We generate most of our income from interest income on loans, interest income from investments in securities and service charges on customer accounts. We incur interest expense on deposits and other borrowed funds and noninterest expenses such as salaries and employee benefits and occupancy expenses. Net interest income is the difference between interest income on earning assets such as loans and securities and interest expense on liabilities such as deposits and borrowings that are used to fund those assets. Net interest income is our largest source of revenue. To evaluate net interest income, we measure and monitor (1) yields on our loans and other interest-earning assets, (2) the interest expenses of our deposits and other funding sources, (3) our net interest spread and (4) our net interest margin. Net interest spread is the difference between rates earned on interest-earning assets and rates paid on interest-bearing liabilities. Net interest margin is calculated as net interest income divided by average interest-earning assets. Because noninterest-bearing sources of funds, such as noninterest-bearing deposits and shareholders' equity, also fund interest-earning assets, net interest margin includes the benefit of these noninterest-bearing sources.

Our net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as a "volume change." Periodic changes in the volume and types of loans in our loan portfolio are affected by, among other factors, economic and competitive conditions in Texas and specifically in our markets, as well as developments affecting the real estate, technology, financial services, insurance, transportation, manufacturing and energy sectors within our **target market markets** and throughout the state of Texas.

Our net interest income is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and borrowed funds, referred to as a "rate change." Fluctuations in market interest rates are driven by many factors, including governmental monetary policies, inflation, deflation, macroeconomic developments, changes in unemployment, the money supply, political and international conditions and conditions in domestic and foreign financial markets.

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Completion of Merger of Equals

Allegiance Bancshares, Inc. ("Allegiance") merged with and into CBTX, Inc. ("CBTX") with the surviving corporation renamed Stellar Bancorp, Inc. **and at the effective date time** of the Merger, each outstanding share of Allegiance common stock, par value of \$1.00 per share, was converted into the right to receive 1.4184 shares of common stock of the Company. Immediately following the Merger, CommunityBank merged with and into Allegiance Bank with Allegiance Bank as the surviving bank. **In connection with the operational conversion during the first quarter of 2023**, Allegiance Bank changed its name to Stellar Bank on February 18, 2023, **in connection with the operational conversion**. After the Merger, Stellar became one of the largest banks based in Houston, Texas.

The Merger constituted a business combination and was accounted for as a reverse merger using the acquisition method of accounting. As a result, Allegiance was the accounting acquirer and CBTX was the legal acquirer and the accounting acquiree. Accordingly, the historical financial statements of Allegiance became the historical financial statements of the combined company. In addition, the assets and liabilities of CBTX have been recorded at their estimated fair values and added to those of Allegiance as of October 1, 2022. The determination of fair value required management to make estimates about discount rates, expected future cash flows, market conditions and other future **events that are subjective events**. During the third quarter of 2023, the Company completed the final tax returns related to CBTX's business and **subject to change**, operations through September 30, 2022. After completion of these tax returns, the Company increased income tax balances and goodwill in the amount of \$58 thousand which finalized all purchase accounting adjustments for the Merger.

The Company's results of operations for the three and **six nine months ended June 30, 2022 September 30, 2022** reflect Allegiance results, while the results for the three and **six nine months ended June 30, 2023 September 30, 2023** set forth the results of operations for Stellar. **The Company has substantially completed its valuations of CBTX's assets and liabilities but may refine those valuations for up to a year from the date of the Merger, Company**. The Merger had a significant impact on all aspects of the Company's financial statements, and financial results for periods after the Merger are not comparable to financial results for periods prior to the Merger. The number of shares issued and outstanding, earnings per share, additional paid-in capital, dividends paid and all references to share quantities of the Company prior to the Merger have been retrospectively adjusted to reflect the equivalent number of shares issued to holders of Allegiance common stock in the Merger. See Note 2 – Acquisitions in the accompanying notes to the consolidated financial statements for the impact of the Merger.

Critical Accounting Policies

Certain of our accounting estimates are important to the portrayal of our financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates are susceptible to material changes as a result of changes in facts and circumstances. Facts and circumstances that could affect these judgments include, but are not limited to, changes in interest rates, changes in the performance of the economy and changes in the financial condition of borrowers. Management believes that determining the allowance for credit losses is its most critical accounting estimate. Our accounting policies are discussed in detail in Note 1 – Nature of Operations and Summary of Significant Accounting and Reporting Policies in our Annual Report on Form 10-K for the year ended December 31, 2022.

Allowance for Credit Losses

The allowance for credit losses is a valuation account which represents management's best estimate of lifetime expected losses based on reasonable and supportable forecasts, historical loss experience, and other qualitative considerations. The Company bases its estimates of credit losses on three primary components: (1) estimates of expected losses that exist in various segments of performing loans over the remaining life of the loan portfolio using a reasonable and supportable economic forecast, (2) specifically identified losses in individually analyzed credits which are collateral-dependent, which generally include loans internally graded as impaired and purchased credit deteriorated ("PCD") loans and (3) qualitative factors related to economic conditions, portfolio concentrations, regulatory policy updates, and other relevant factors that address estimates of expected losses not fully addressed based upon management's judgment of portfolio conditions. One of the most significant judgments used in determining the allowance for credit losses is the reasonable and supportable economic forecast. Estimating the timing and amounts of future losses is subject to significant management judgment as these projected cash flows rely upon the estimates discussed above and factors that are reflective of current or future expected conditions. The processes we use to estimate expected credit losses, calculate our allowance for credit losses and measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other measures of our financial condition and results of operations, depend upon the use of analytical and forecasting models and tools. These models and tools reflect assumptions made by management. Volatility in certain credit metrics and differences between expected and actual outcomes are to be expected. Customers may not repay their loans according to the original terms, and the collateral securing the payment of those loans may be insufficient to pay any remaining loan balance.

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The allowance for credit losses includes the allowance for credit losses on loans, which is deducted from the loans' amortized cost basis to present the net amount expected to be collected on loans, and the allowance for credit losses on unfunded commitments reported in other liabilities. The amount of the allowance for credit losses is affected by the following: (1) charge-offs of loans that decrease the allowance, (2) subsequent recoveries on loans previously charged off that increase the allowance and (3) provisions for (or reversal of) credit losses charged to income that increase or decrease the allowance. Management considers the policies related to the allowance for credit losses as the most critical to the financial statement presentation. The total allowance for credit losses includes

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activity related to allowances calculated in accordance with Accounting Standards Codification ("ASC") 326 – Measurement of Credit Losses on Financial Instruments.

In addition, various regulatory agencies, as an integral part of the examination process, periodically review the allowance for credit losses. Such agencies may require the Bank to recognize adjustments to the allowance based on their judgments of the information available to them at the time of their examination.

The allowance for credit losses could be affected by significant downturns in circumstances relating to loan quality and economic conditions and as such may not be sufficient to cover expected losses in the loan portfolio which could necessitate additional provisions or a reduction in the allowance for credit losses if our assumption prove to be incorrect. Unanticipated changes and events could have a significant impact on the financial performance of borrowers and their ability to perform as agreed. We may experience significant credit losses if borrowers experience financial difficulties, which could have a material adverse effect on our operating results.

The provision for credit losses for the three and six nine months ended June 30, 2023 September 30, 2023 and 2022, primarily resulted from considerations of a less favorable outlook in the current and forecasted macroeconomic variables such as interest rates, GDP and unemployment as a result of the potential slowdown of economic activity impacted by the FED's tightening policy to control inflation, along with an increase in loans during those periods, policies of the Board of Governors of the Federal Reserve System, among other factors.

Fair value of loans acquired in a business combination

In conjunction with the Merger, the Company recorded \$273.6 million of goodwill, based on the fair value of acquired assets and liabilities of CBTX. The fair value often involved third-party estimates utilizing input assumptions by management which may be complex or uncertain. The fair value of acquired loans is based on a discounted cash flow methodology that considers factors such as type of loan and related collateral, and requires management's judgement on estimates about discount rates, expected future cash flows, market conditions and other future events.

For purchased financial loans with credit deterioration, PCD loans, an estimate of expected credit losses was made for loans with similar risk characteristics and was added to the purchase price to establish the initial amortized cost basis of the PCD loans. Any difference between the unpaid principal balance and the amortized cost basis is considered to relate to noncredit factors and results in a discount or premium. Discounts and premiums are recognized through interest income on a level-yield method over the life of the loans. For acquired loans not deemed PCD at acquisition, the differences between the initial fair value and the unpaid principal balance are recognized as interest income on a level-yield basis over the lives of the related loans.

Management relied on economic forecasts, internal valuations, or other relevant factors which were available at the time of the Merger in the determination of the assumptions used to calculate the fair value of the acquired loans. The estimates about discount rates, expected future cash flows, market conditions and other future events are subjective and may differ from estimates. The estimate of fair values on acquired loans contributed to the recorded goodwill from the Merger. In future income statement periods, interest income on loans will include the amortization and accretion of any premiums and discounts resulting from the fair value of acquired loans. Additionally, the provision for credit losses on acquired individually analyzed PCD loans may be impacted due to changes in the assumptions used to calculate expected cash flows.

Merger and goodwill

The acquisition method of accounting requires that assets acquired and liabilities assumed in business combinations are recorded at their fair values. This often involves estimates based on third-party or internal valuations based on discounted cash flow analyses or other valuation techniques, which are inherently subjective. Business combinations also typically result in goodwill, which is subject to ongoing periodic impairment tests based on the fair values of the reporting units to which the goodwill relates. The amortization of intangible assets with definite useful lives is based upon the estimated economic benefits to be received, which is also subjective. Provisional estimates of fair

values may be adjusted for a period of up to one year from the acquisition date if new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the

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measurement of the amounts recognized as of that date. Adjustments recorded during this period are recognized in the current reporting period.

Management uses various valuation methodologies to estimate the fair value of these assets and liabilities, and often involves a significant degree of judgment, particularly when liquid markets do not exist for the particular item being valued. Examples of such items include loans, deposits, identifiable intangible assets and certain other assets and liabilities. Management uses significant estimates and assumptions to value such items, including projected cash flows, repayment rates, default rates and losses assuming default, discount rates, and realizable collateral values. The allowance for credit losses on PCD loans is recognized within business

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combination accounting. The allowance for credit losses for non-purchased credit deteriorated ("non-PCD") assets is recognized as provision expense in the same reporting period as the business combination. The valuation of other identifiable intangible assets, including core deposit intangibles and other intangibles, requires assumptions such as projected attrition rates, expected revenue and costs, discount rates and other forward-looking factors. The purchase date valuations and any subsequent adjustments also determine the amount of goodwill recognized in connection with the business combination. Our estimates of the fair value of assets acquired and liabilities assumed are based upon assumptions that we believe to be reasonable, and whenever necessary, include assistance from independent third-party appraisal and valuation firms.

Goodwill

Goodwill represents the excess of the consideration paid over the fair value of the net assets acquired in a business combination. During the measurement period, the Company may record subsequent adjustments to goodwill for provisional amounts recorded at the acquisition date. During the third quarter of 2023, the Company completed the final tax returns related to CBTX's business and operations through September 30, 2022. After completion of these tax returns, the Company increased income tax balances and goodwill in the amount of \$58 thousand which finalized all purchase accounting adjustments for the Merger.

Goodwill is subject to impairment testing, which must be conducted at least annually or upon the occurrence of a triggering event. Goodwill is recorded and evaluated for impairment at its reporting unit, the Company. The Company assesses its policy is to test goodwill for impairment at the reporting unit level annually as of October 1st, or on an annual interim basis or more often if an event occurs or circumstances change which indicate there may be impairment. triggering an impairment assessment is determined to have occurred. Various factors, such as the Company's results of operations, the trading price of the Company's common stock relative to the book value per share, macroeconomic conditions and conditions in the banking sector, inform whether a triggering event for an interim goodwill impairment test has occurred. The impairment test compares the estimated fair value of each reporting unit with its net book value. The fair value of the reporting unit is estimated using valuation techniques that market participants would use in an acquisition of the whole reporting unit, such as estimated discounted cash flows, the quoted market price of our common stock adjusted for a control premium, and observable average price-to-forward-earnings and price-to-tangible book multiples of observed transactions. If the unit's fair value is less than its carrying value, an estimate of the implied fair value of the goodwill is compared to the goodwill's carrying value and any impairment recognized.

During the nine months ended September 30, 2023, economic uncertainty and market volatility resulting from the rising interest rate environment and the recent banking crisis resulted in a decrease in the Company's stock price and market capitalization. Management believed such decrease was a triggering event requiring an interim goodwill impairment quantitative analysis for third quarter 2023. The Company engaged an independent third-party service provider to assist management with the determination of the fair value of the Company as of September 30, 2023. A combination of a risk-weighted income valuation methodology, comprising a discounted cash flow analysis and a market valuation methodology, comprising the guideline public company method, was employed.

In performing the discount cash flow analysis, the Company utilized multi-year cash projections that rely on internal forecasts of loan and deposit growth, bond mix, financing composition, market pricing of securities, credit performance, forward interest rates, future returns driven by net interest margin, fee generation and expense incurrence, industry and economic trends, and other relevant considerations.

The discount rate was calculated as the cost of equity capital using the modified capital asset pricing model, which includes variables including the risk-free interest rate, beta, equity risk premium, size premium, and company-specific risk premium.

The market approach considers a combination of price to book value and price to earnings, adjusted based on companies similar to the reporting unit and adjusted for selected multiples, along with a control premium based on a review of transactions in the banking industry in order to calculate the indicated value of the Company's equity on a control, marketable basis. The analysis resulted in the Company's fair value exceeding its carrying value resulting in no impairment charge for the period.

Significant judgment is necessary in the determination of the fair value of a reporting unit. Future events could cause the Company to conclude that the Company's goodwill has become impaired, which would result in recording an impairment loss. Any resulting impairment loss could have a material adverse impact on the Company's financial condition and results of operations. Management will continue evaluating the economic conditions at future reporting periods for triggering events.

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See Note 3 – Goodwill and Other Intangible Assets to the consolidated financial statements for additional information on the Company's goodwill balances and Note 2 – Acquisitions to the consolidated financial statements for goodwill and intangibles recorded in related to the Merger.

Recently Issued Accounting Pronouncements

We have evaluated new accounting pronouncements that have recently been issued. Refer to Note 1 of the Company's consolidated financial statements for a discussion of recent accounting pronouncements that have been adopted by the Company or that will require enhanced disclosures in the Company's financial statements in future periods.

Results of Operations

Net income was \$35.2 million \$30.9 million, or \$0.66 \$0.58 per diluted share, for the second third quarter 2023 compared to \$16.4 million \$14.3 million, or \$0.56 \$0.50 per diluted share, for the second third quarter 2022. The increase in net income was primarily due to a \$50.8 million \$46.0 million increase in net interest income and a \$2.8 million \$1.7 million increase in noninterest income, partially offset by a \$31.3 million \$26.7 million increase in noninterest expense and a \$3.8 million \$4.0 million increase in the provision for income taxes, all primarily resulting from the Merger. Acquisition and merger-related expenses totaled \$2.9 million \$3.4 million for the second third quarter of 2023 compared to \$1.7 million \$10.6 million for the second third quarter of 2022.

Annualized returns on average assets, returns on average equity and efficiency ratios were 1.31% 1.14%, 9.67% 8.34% and 60.83% 63.50%, for the three months ended June 30, 2023 September 30, 2023, compared to 0.94% 0.84%, 8.86% 7.90% and 62.96% 69.18%, for the three months ended June 30, 2022 September 30, 2022. The efficiency ratio is calculated by dividing total noninterest expense by the sum of net interest income plus noninterest income, excluding net gains and losses on the sale of loans, securities and assets. Additionally, taxes and provision for loan losses are not part of the efficiency ratio calculation.

Net income was \$72.3 million \$103.2 million, or \$1.36 \$1.94 per diluted share, for the six nine months ended June 30, 2023 September 30, 2023 compared to \$35.1 million \$49.4 million, or \$1.21 \$1.71 per diluted share, for the six nine months ended June 30, 2022 September 30, 2022. The increase in net income was primarily due to a \$111.5 million \$157.5 million increase in net interest income and a \$6.3 million \$8.0 million increase in noninterest income, partially offset by a \$69.4 million \$96.1 million increase in noninterest expense, a \$1.6 million \$2.0 million increase in the provision for credit losses and a \$9.5 million \$13.5 million increase in the provision for income taxes, all primarily resulting from the Merger. Acquisition and merger-related expenses totaled \$9.1 million \$12.5 million for the six nine months ended June 30, 2023 September 30, 2023 compared to \$2.1 million \$12.7 million for the six nine months ended June 30, 2022 September 30, 2022.

Annualized returns on average assets, returns on average equity and efficiency ratios were 1.35% 1.28%, 10.14% 9.52% and 59.86% 61.02%, for the six nine months ended June 30, 2023 September 30, 2023, compared to 0.99% 0.94%, 9.14% 8.74% and 60.66% 63.62%, for the six nine months ended June 30, 2022 September 30, 2022.

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Net Interest Income

Three months ended June 30, 2023 September 30, 2023 compared with three months ended June 30, 2022 September 30, 2022. Net interest income before the provision for credit losses for the three months ended June 30, 2023 September 30, 2023 was \$108.3 million \$106.7 million compared with \$57.5 million \$60.7 million for the three months ended June 30, 2022 September 30, 2022, an increase of \$50.8 million \$46.0 million, or 88.4% 75.8%, primarily due to the increase in average interest-earning assets and interest-bearing liabilities as a result of the Merger.

Interest income was \$147.0 million \$151.3 million for the three months ended June 30, 2023 September 30, 2023, an increase of \$84.1 million \$83.4 million, or 133.9% 122.8%, compared with \$62.8 million \$67.9 million for the three months ended June 30, 2022 September 30, 2022, primarily due to the Merger as average interest-earning assets balances increased along with increased rates, higher-yielding loans and purchase accounting adjustments. Average interest-earning assets increased \$3.08 billion \$3.37 billion, or 46.5% 53.3%, for the three months ended June 30, 2023 September 30, 2023 compared with the three months ended June 30, 2022 September 30, 2022, primarily due to the increase in loans as a result of the Merger. Average loans to average interest earning assets increased to 82.3% 82.9% for the three months ended June 30, 2023 September 30, 2023 compared to 65.0% 70.4% for the same period in the prior year. Additionally, we recorded interest income from purchase accounting adjustments of \$12.6 million was \$12.4 million for the three months ended June 30, 2023 September 30, 2023.

Interest expense was \$38.7 million \$44.5 million for the three months ended June 30, 2023 September 30, 2023, an increase of \$33.3 million \$37.4 million, or 621.9% 519.4%, compared with \$5.4 million \$7.2 million for the three months ended June 30, 2022 September 30, 2022. This increase was primarily due to higher funding costs on interest-bearing deposits due to higher interest rates and an increase in average interest-bearing liabilities. The cost of average interest-bearing liabilities increased to 2.86% 3.22% for the three months ended June 30, 2023 September 30, 2023 compared to 0.56% 0.81% for the same period in 2022. Average interest-bearing liabilities increased \$1.56 billion \$1.95 billion for the three months ended June 30, 2023 September 30, 2023 compared to the three months ended June 30, 2022 September 30, 2022, primarily due to the Merger.

Tax equivalent net interest margin, defined as net interest income adjusted for tax-free income divided by average interest-earning assets, for the three months ended June 30, 2023 September 30, 2023 was 4.49% 4.37%, an increase of 96 52 basis points compared to 3.53% 3.85% for the three months ended June 30, 2022 September 30, 2022. The increase in the net interest margin on a tax equivalent basis was primarily due to the

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Merger and an increase in the average yield on interest-earning assets partially offset by increased funding costs. The average yield on interest-earning assets of 6.08% 6.19% and the average rate paid on interest-bearing liabilities of 2.86% 3.22% for the second third quarter of 2023 increased by 227 193 basis points and 230 241 basis points, respectively, over the same period in 2022. Tax equivalent adjustments to net interest margin are the result of increasing income from tax-free securities and loans by an amount equal to the taxes that would have been paid if the income were fully taxable based on a 21% federal tax rate for the three months ended June 30, 2023 September 30, 2023 and 2022, thus making tax-exempt yields comparable to taxable asset yields.

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The following table presents, for the periods indicated, the total dollar amount of average balances, interest income from average interest-earning assets and the annualized resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates. Any nonaccruing loans have been included in the table as loans carrying a zero yield.

		Three Months Ended June 30,								Three Months Ended September 30,							
		2023			2022					2023			2022				
		Interest Earned/		Average	Interest Earned/		Average			Interest Earned/		Average	Interest Earned/		Average		
		Average	Interest		Average	Interest				Average	Interest		Average				
			Yield/	Yield/		Yield/	Yield/										
		Balance	Paid	Rate	Balance	Paid	Rate			Balance	Paid	Rate	Balance	Paid	Rate		
		(Dollars in thousands)								(Dollars in thousands)							
Assets	Assets							Assets									
Interest-earning Assets:	Interest-earning Assets:							Interest-earning Assets:									
Loans	Loans	\$ 7,980,856	\$ 133,931	6.73 %	\$ 4,303,714	\$ 53,835	5.02 %	Loans	\$ 8,043,706	\$ 138,948	6.85 %	\$ 4,456,174	\$ 58,025	5.17 %			
Securities	Securities	1,502,949	10,162	2.71 %	1,778,745	8,128	1.83 %	Securities	1,471,916	9,930	2.68 %	1,709,470	9,249	2.15 %			
Deposits in other financial institutions	Deposits in other financial institutions	209,722	2,865	5.48 %	535,546	877	0.66 %	Deposits in other financial institutions	181,931	2,391	5.21 %	160,340	608	1.50 %			
Total interest-earning assets	Total interest-earning assets	9,693,527	\$ 146,958	6.08 %	6,618,005	\$ 62,840	3.81 %	Total interest-earning assets	9,697,553	\$ 151,269	6.19 %	6,325,984	\$ 67,882	4.26 %			
Allowance for credit losses on loans	Allowance for credit losses on loans	(96,414)			(49,290)			Allowance for credit losses on loans	(99,892)			(50,609)					
Noninterest-earning assets	Noninterest-earning assets	1,143,025			450,584			Noninterest-earning assets	1,143,634			442,511					
Total assets	Total assets	\$ 10,740,138			\$ 7,019,299			Total assets	\$ 10,741,295			\$ 6,717,886					
Liabilities and Shareholders' Equity	Liabilities and Shareholders' Equity							Liabilities and Shareholders' Equity									
Interest-bearing Liabilities:	Interest-bearing Liabilities:							Interest-bearing Liabilities:									
Interest-bearing demand deposits	Interest-bearing demand deposits	\$ 1,387,604	\$ 9,343	2.70 %	\$ 1,044,493	\$ 927	0.36 %	Interest-bearing demand deposits	\$ 1,400,508	\$ 10,415	2.95 %	\$ 978,531	\$ 2,380	0.96 %			
Money market and savings deposits	Money market and savings deposits	2,220,827	11,365	2.05 %	1,566,376	932	0.24 %	Money market and savings deposits	2,166,610	13,142	2.41 %	1,500,083	1,147	0.30 %			
Certificates and other time deposits	Certificates and other time deposits	1,225,834	9,622	3.15 %	1,088,664	1,922	0.71 %	Certificates and other time deposits	1,400,367	13,282	3.76 %	877,231	1,664	0.75 %			
Borrowed funds	Borrowed funds	479,896	6,535	5.46 %	50,116	114	0.91 %	Borrowed funds	411,212	5,801	5.60 %	68,752	499	2.88 %			
Subordinated debt	Subordinated debt	109,499	1,812	6.64 %	109,045	1,463	5.38 %	Subordinated debt	109,608	1,908	6.91 %	109,177	1,502	5.46 %			
Total interest-bearing liabilities	Total interest-bearing liabilities	5,423,660	\$ 38,677	2.86 %	3,858,694	\$ 5,358	0.56 %	Total interest-bearing liabilities	5,488,305	\$ 44,548	3.22 %	3,533,774	\$ 7,192	0.81 %			
Noninterest-Bearing Liabilities:	Noninterest-Bearing Liabilities:							Noninterest-Bearing Liabilities:									
Noninterest-bearing demand deposits	Noninterest-bearing demand deposits	3,779,594			2,382,230			Noninterest-bearing demand deposits	3,695,592			2,424,884					
Other liabilities	Other liabilities	78,411			34,249			Other liabilities	86,389			41,792					
Total liabilities	Total liabilities	9,281,665			6,275,173			Total liabilities	9,270,286			6,000,450					

Shareholders' equity	Shareholders' equity	1,458,473		744,126		Shareholders' equity	1,471,009		717,436	
Total liabilities and shareholders' equity	Total liabilities and shareholders' equity	\$ 10,740,138		\$ 7,019,299		Total liabilities and shareholders' equity	\$ 10,741,295		\$ 6,717,886	
Net interest rate spread	Net interest rate spread		3.22 %		3.25 %	Net interest rate spread		2.97 %		3.45 %
Net interest income and margin ⁽¹⁾	Net interest income and margin ⁽¹⁾	\$ 108,281	4.48 %	\$ 57,482	3.48 %	Net interest income and margin ⁽¹⁾	\$ 106,721	4.37 %	\$ 60,690	3.81 %
Net interest income and margin (tax equivalent) ⁽²⁾	Net interest income and margin (tax equivalent) ⁽²⁾	\$ 108,509	4.49 %	\$ 58,238	3.53 %	Net interest income and margin (tax equivalent) ⁽²⁾	\$ 106,919	4.37 %	\$ 61,418	3.85 %
Cost of funds	Cost of funds		1.69 %		0.34 %	Cost of funds		1.92 %		0.48 %
Cost of deposits	Cost of deposits		1.41 %		0.25 %	Cost of deposits		1.69 %		0.36 %

(1) The net interest margin is equal to annualized net interest income divided by average interest-earning assets.

(2) Tax-equivalent adjustments have been computed using a federal income tax rate of 21% for the three months ended **June 30, 2023** **September 30, 2023** and 2022.

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Six Nine months ended June 30, 2023 **September 30, 2023** compared with **six nine months ended June 30, 2022** **September 30, 2022**. Net interest income before the provision for credit losses for the **six nine months ended June 30, 2023** **September 30, 2023** was **\$224.1 million** **\$330.8 million**, compared with **\$112.7 million** **\$173.3 million** for the **six nine months ended June 30, 2022** **September 30, 2022**, an increase of **\$111.5 million** **\$157.5 million**, or **98.9%** **90.9%**, primarily due to the increase in average interest-earning assets and interest-bearing liabilities as a result of the Merger.

Interest income was **\$287.4 million** **\$438.6 million** for the **six nine months ended June 30, 2023** **September 30, 2023**, an increase of **\$164.2 million** **\$247.6 million**, or **133.4%** **129.6%**, compared with **\$123.1 million** **\$191.0 million** for the **six nine months ended June 30, 2022** **September 30, 2022**, primarily due to the Merger as average interest-earning assets balances increased along with increased rates and an increase in higher-yielding loans. Average interest-earning assets increased **\$3.01 billion** **\$3.13 billion**, or **44.6%** **47.4%**, for the **six nine months ended June 30, 2023** **September 30, 2023** compared with the **six nine months ended June 30, 2022** **September 30, 2022**, primarily due to the Merger. Average loans to average interest earning assets increased to **81.1%** **81.7%** for the **six nine months ended June 30, 2023** **September 30, 2023** compared to **63.2%** **65.6%** for the same period in the prior year. Additionally, **we recorded** interest income from purchase accounting adjustments **of \$22.7 million** **was \$35.1 million** for the **six nine months ended June 30, 2023** **September 30, 2023**.

Interest expense was **\$63.3 million** **\$107.8 million** for the **six nine months ended June 30, 2023** **September 30, 2023**, an increase of **\$52.8 million** **\$90.1 million**, or **503.2%** **509.8%**, compared with **\$10.5 million** **\$17.7 million** for the **six nine months ended June 30, 2022** **September 30, 2022**. This increase was primarily due to higher funding costs on interest-bearing deposits due to higher interest rates and an increase in average interest-bearing liabilities. The cost of average interest-bearing liabilities increased to **240** **268** basis points for the **six nine months ended June 30, 2023** **September 30, 2023** compared to **53** **62** basis points for the same period in 2022. Average interest-bearing liabilities increased **\$1.34 billion** **\$1.55 billion**, or **33.8%** **40.5%**, for the **six nine months ended June 30, 2023** **September 30, 2023** compared to the **six nine months ended June 30, 2022** **September 30, 2022** primarily due to the Merger.

Tax equivalent net interest margin, defined as net interest income adjusted for tax-free income divided by average interest-earning assets, for the **six nine months ended June 30, 2023** **September 30, 2023** was **4.64%** **4.55%**, an increase of **123** **100** basis points compared to **3.41%** **3.55%** for the **six nine months ended June 30, 2022** **September 30, 2022**. The increase in the net interest margin on a tax equivalent basis was primarily due to the Merger and an increase in the average yield on interest-earning assets partially offset by increased funding costs. The average yield on interest-earning assets of **5.94%** **6.02%** and the average rate paid on interest-bearing liabilities of **2.40%** **2.68%** for the **second quarter of 2023** **nine months ended September 30, 2023** increased by **226** **215** basis points and **187** **206** basis points, respectively, over the same period in 2022. Tax equivalent adjustments to net interest margin are the result of increasing income from tax-free securities and loans by an amount equal to the taxes that would have been paid if the income were fully taxable based on a 21% federal tax rate for the **six nine months ended June 30, 2023** **September 30, 2023** and 2022, thus making tax-exempt yields comparable to taxable asset yields.

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The following table presents, for the periods indicated, the total dollar amount of average balances, interest income from average interest-earning assets and the annualized resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates. Any nonaccruing loans have been included in the table as loans carrying a zero yield.

Six Months Ended June 30,	
2023	2022

		Interest				Interest						
		Average		Earned/	Average		Average	Earned/	Average			
		Balance	Interest		Yield/ Rate	Balance	Interest	Yield/ Rate				
		(Dollars in thousands)										
Assets	Assets											
Loans	Loans	\$	7,914,303	\$	259,660	6.62	%	\$	4,267,810	\$	106,205	5.02
Securities	Securities		1,553,200		21,077	2.74	%		1,807,024		15,721	1.75
Deposits in other financial institutions	Deposits in other financial institutions		286,823		6,636	4.67	%		670,316		1,217	0.37
Total interest-earning assets	Total interest-earning assets		9,754,326	\$	287,373	5.94	%		6,745,150	\$	123,143	3.68
Allowance for credit losses on loans	Allowance for credit losses on loans		(94,881)						(48,819)			
Noninterest-earning assets	Noninterest-earning assets		1,151,497						441,390			
Total assets	Total assets	\$	10,810,942					\$	7,137,721			
Liabilities and Shareholders' Equity	Liabilities and Shareholders' Equity											
Interest-bearing Liabilities:	Interest-bearing Liabilities:											
Interest-bearing demand deposits	Interest-bearing demand deposits	\$	1,518,213	\$	17,725	2.35	%	\$	1,057,678	\$	1,476	0.28
Money market and savings deposits	Money market and savings deposits		2,355,112		21,020	1.80	%		1,575,325		1,730	0.22
Certificates and other time deposits	Certificates and other time deposits		1,044,721		12,929	2.50	%		1,166,490		4,078	0.70
Borrowed funds	Borrowed funds		293,578		7,852	5.39	%		69,868		300	0.87
Subordinated debt	Subordinated debt		109,458		3,739	6.89	%		108,979		2,905	5.38
Total interest-bearing liabilities	Total interest-bearing liabilities		5,321,082	\$	63,265	2.40	%		3,978,340	\$	10,489	0.53
Noninterest-Bearing Liabilities:	Noninterest-Bearing Liabilities:											
Noninterest-bearing demand deposits	Noninterest-bearing demand deposits		3,971,862						2,347,366			
Other liabilities	Other liabilities		79,609						37,767			
Total liabilities	Total liabilities		9,372,553						6,363,473			
Shareholders' equity	Shareholders' equity		1,438,389						774,248			
Total liabilities and shareholders' equity	Total liabilities and shareholders' equity	\$	10,810,942					\$	7,137,721			
Net interest rate spread	Net interest rate spread					3.54	%					3.15

Net interest income and margin ⁽¹⁾	Net interest income and margin ⁽¹⁾	\$	224,108	4.63	%	\$	112,654	3.37
Net interest income and margin (tax equivalent) ⁽²⁾	Net interest income and margin (tax equivalent) ⁽²⁾	\$	224,628	4.64	%	\$	114,160	3.41
Cost of funds	Cost of funds			1.37	%			0.33
Cost of deposits	Cost of deposits			1.17	%			0.24

(1) The net interest margin is equal to annualized net interest income divided by average interest-earning assets.

(2) Tax-equivalent adjustments have been computed using a federal income tax rate of 21% for the six nine months ended June 30, 2023 September 30, 2023 and 2022.

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The following table presents information regarding the dollar amount of changes in interest income and interest expense for the periods indicated for each major component of interest-earnings assets and interest-bearing liabilities and distinguishes between the changes attributable to changes in volume and changes in interest rates. For purposes of this table, changes attributable to both rate and volume that cannot be segregated have been allocated to rate.

		For the Three Months Ended			For the Six Months Ended				Three Months Ended			Nine Months Ended		
		June 30,			June 30,				September 30,			30,		
		2023 vs. 2022			2023 vs. 2022				2023 vs. 2022			2023 vs. 2022		
		Increase (Decrease)			Increase (Decrease)				Increase (Decrease)			Increase (Decrease)		
		Due to Change in			Due to Change in				Due to Change in			Due to Change in		
		Volume	Rate	Total	Volume	Rate	Total		Volume	Rate	Total	Volume	Rate	Total
		(In thousands)							(In thousands)					
Interest-earning Assets:	Interest-earning Assets:							Interest-earning Assets:						
Loans	Loans	\$46,022	\$34,074	\$80,096	\$90,914	\$62,541	\$153,455	Loans	\$46,750	\$34,173	\$80,923	\$137,664	\$96,714	\$234,378
Securities	Securities	(1,258)	3,292	2,034	(2,203)	7,559	5,356	Securities	(1,287)	1,968	681	(3,492)	9,529	6,037
Deposits in other financial institutions	Deposits in other financial institutions	(536)	2,524	1,988	(704)	6,123	5,419	Deposits in other financial institutions	82	1,701	1,783	(905)	8,107	7,202
Total increase in interest income	Total increase in interest income	44,228	39,890	84,118	88,007	76,223	164,230	Total increase in interest income	45,545	37,842	83,387	133,267	114,350	247,617
Interest-bearing Liabilities:	Interest-bearing Liabilities:							Interest-bearing Liabilities:						
Interest-bearing demand deposits	Interest-bearing demand deposits	308	8,108	8,416	639	15,610	16,249	Interest-bearing demand deposits	1,021	7,014	8,035	1,674	22,611	24,285
Money market and savings deposits	Money market and savings deposits	392	10,041	10,433	851	18,439	19,290	Money market and savings deposits	504	11,491	11,995	1,387	29,897	31,284
Certificates and other time deposits	Certificates and other time deposits	243	7,457	7,700	(423)	9,274	8,851	Certificates and other time deposits	989	10,629	11,618	515	19,954	20,469
Borrowed funds	Borrowed funds	975	5,446	6,421	965	6,587	7,552	Borrowed funds	2,486	2,816	5,302	3,038	9,816	12,854
Subordinated debt	Subordinated debt	6	343	349	13	821	834	Subordinated debt	6	400	406	19	1,221	1,240
Total increase in interest expense	Total increase in interest expense	1,924	31,395	33,319	2,045	50,731	52,776	Total increase in interest expense	5,006	32,350	37,356	6,633	83,499	90,132
Increase in net interest income	Increase in net interest income	\$42,304	\$ 8,495	\$50,799	\$85,962	\$25,492	\$111,454	Increase in net interest income	\$40,539	\$ 5,492	\$46,031	\$126,634	\$30,851	\$157,485

Provision for Credit Losses

Our allowance for credit losses is established through charges to income in the form of the provision in order to bring our allowance for credit losses for various types of financial instruments including loans, unfunded commitments and securities to a level deemed appropriate by management. We recorded a provision for credit losses of **\$1.9 million** **\$2.3 million** and **\$2.1 million** **\$2.0 million** for the three months ended **June 30, 2023** **September 30, 2023** and 2022, respectively, and a **\$5.6 million** **\$7.9 million** and **\$4.0 million** **\$5.9 million** provision for credit losses for the **six** **nine** months ended **June 30, 2023** **September 30, 2023** and 2022, respectively. The provision for credit losses for the three and **six** **nine** months ended **June 30, 2023** **September 30, 2023** and 2022, primarily resulted from **an** considerations of a less favorable outlook in the current and forecasted macroeconomic variables such as interest rates, GDP and unemployment as a result of the potential slowdown of economic activity by the FED's tightening policy to control inflation, among other things.

We recorded net charge-offs of \$8.1 million for the three months ended September 30, 2023 compared to net recoveries of \$245 thousand during the three months ended September 30, 2022. Net charge-offs of \$8.5 million were recorded for the nine months ended September 30, 2023 compared to net charge-offs of \$643 thousand for the nine months ended September 30, 2022. The increase in **loans** charge-offs during **those periods, among other factors**. 2023 was primarily due to a single commercial and industrial loan relationship that was placed on nonaccrual status at December 31, 2022 and had an allowance for credit losses of \$5.1 million at June 30, 2023. During the third quarter 2023, the borrower's financial condition further deteriorated, which prompted the charge-off of \$8.0 million on the loan relationship.

Noninterest Income

Our primary sources of noninterest income are debit card and ATM **card** income, service charges on deposit accounts, income earned on bank-owned life insurance and nonsufficient funds **fees**. ("NSF") and **overdraft charges**. Noninterest income does not include loan origination fees which are recognized over the life of the related loan as an adjustment to yield using the interest method.

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Three months ended **June 30, 2023** **September 30, 2023** compared with three months ended **June 30, 2022** **September 30, 2022**. Noninterest income totaled **\$5.5 million** **\$4.7 million** for the three months ended **June 30, 2023** **September 30, 2023** compared with **\$2.7 million** **\$3.0 million** for the same period in 2022, an increase of **\$2.8 million** **\$1.7 million**, or **102.8%** **56.8%**, primarily due to increased debt card and ATM income and service charges due to increased scale as a result of the **Merger**. Merger partially offset by the impact of the Durbin Amendment of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Durbin Amendment") along with a decision made by the Company to no longer charge NSF fees.

Six **Nine** months ended **June 30, 2023** **September 30, 2023** compared with **six** **nine** months ended **June 30, 2022** **September 30, 2022**. Noninterest income totaled **\$13.0 million** **\$17.7 million** for the **six** **nine** months ended **June 30, 2023** **September 30, 2023** compared with **\$6.7 million** **\$9.7 million** for the same period in 2022, an increase of **\$6.3 million** **\$8.0 million**, or **93.1%** **81.9%**, primarily due to increased debt card and ATM income and service charges due to increased scale as a result of the **Merger**.

Table **Merger partially offset by the impact of** **Contents** **the Durbin Amendment along with a decision made by the Company to no longer charge NSF fees.**

The following table presents, for the periods indicated, the major categories of noninterest income:

	For the Three Months Ended June 30,			For the Six Months Ended June 30,			Three Months Ended September 30,			Nine Months Ended September 30,		
			Increase			Increase			Increase			Increase
	2023	2022	(Decrease)	2023	2022	(Decrease)	2022	2022	(Decrease)	2022	2022	(Decrease)
(In thousands)												
Nonsufficient funds fees	\$ 418	\$ 126	\$ 292	\$ 824	\$ 242	\$ 582						
Nonsufficient funds and overdraft charges							\$ 291	\$ 145	\$ 146	\$ 1,115	\$ 387	\$ 728
Service charges on deposit accounts	1,157	560	597	2,100	1,087	1,013	1,329	527	802	3,429	1,614	1,815
(Loss) gain on sale of assets	(6)	(17)	11	192	(17)	209						
Gain (loss) on sale of assets							—	42	(42)	192	25	167
Bank-owned life insurance income	532	342	190	1,054	475	579	551	135	416	1,605	610	995
Debit card and ATM card income	1,821	880	941	3,519	1,699	1,820						
Debit card and ATM income							935	869	66	4,454	2,568	1,886
Other(1)	1,561	813	748	5,292	3,236	2,056	1,589	1,277	312	6,881	4,513	2,368

Total noninterest income	Total noninterest income	\$ 5,483	\$ 2,704	\$ 2,779	\$12,981	\$6,722	\$ 6,259	Total noninterest income	\$4,695	\$2,995	\$ 1,700	\$17,676	\$9,717	\$ 7,959
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(1) Other includes wire transfer and letter of credit fees, among other items.

Noninterest Expense

Three months ended **June 30, 2023** **September 30, 2023** compared with three months ended **June 30, 2022** **September 30, 2022**. Noninterest expense was **\$69.2 million** **\$70.7 million** for the three months ended **June 30, 2023** **September 30, 2023** compared to **\$37.9 million** **\$44.0 million** for the three months ended **June 30, 2022** **September 30, 2022**, an increase of **\$31.3 million** **\$26.7 million**, or **82.6%** **60.7%**, primarily due to increased salaries and employee benefits, amortization of intangibles, data processing and software amortization, net occupancy and equipment and acquisition and merger-related costs.

Six Nine months ended **June 30, 2023** **September 30, 2023** compared with six nine months ended **June 30, 2022** **September 30, 2022**. Noninterest expense was **\$141.8 million** **\$212.6 million** for the six nine months ended **June 30, 2023** **September 30, 2023** compared to **\$72.4 million** **\$116.5 million** for the six nine months ended **June 30, 2022** **September 30, 2022**, an increase of **\$69.4 million** **\$96.1 million**, or **95.8%** **82.5%**, primarily due to increased salaries and employee benefits, amortization of intangibles, data processing and software amortization and net occupancy and equipment and acquisition and merger-related costs, equipment.

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The following table presents, for the periods indicated, the major categories of noninterest expense:

		For the Three Months Ended June 30,			For the Six Months Ended June 30,			Three Months Ended September 30,			Nine Months Ended September 30,			
				Increase			Increase			Increase			Increase	
		2023	2022	(Decrease)	2023	2022	(Decrease)	2022	2022	(Decrease)	2022	2022	(Decrease)	
		(In thousands)												
Salaries and employee benefits ⁽¹⁾	Salaries and employee benefits ⁽¹⁾	\$37,300	\$21,864	\$ 15,436	\$ 77,075	\$44,592	\$ 32,483	Salaries and employee benefits ⁽¹⁾	\$39,495	\$22,013	\$ 17,482	\$116,570	\$ 66,605	\$ 49,965
Net occupancy and equipment	Net occupancy and equipment	3,817	2,220	1,597	7,905	4,425	3,480	Net occupancy and equipment	4,455	2,129	2,326	12,360	6,554	5,806
Depreciation	Depreciation	1,841	1,012	829	3,677	2,045	1,632	Depreciation	1,952	1,003	949	5,629	3,048	2,581
Data processing and software amortization	Data processing and software amortization	4,674	2,522	2,152	9,728	5,020	4,708	Data processing and software amortization	4,798	2,541	2,257	14,526	7,561	6,965
Professional fees	Professional fees	1,564	662	902	3,091	800	2,291	Professional fees	997	485	512	4,088	1,285	2,803
Regulatory assessments and FDIC insurance	Regulatory assessments and FDIC insurance	2,755	1,256	1,499	4,049	2,517	1,532	Regulatory assessments and FDIC insurance	1,814	1,134	680	5,863	3,651	2,212
Amortization of intangibles	Amortization of intangibles	6,881	751	6,130	13,760	1,502	12,258	Amortization of intangibles	6,876	750	6,126	20,636	2,252	18,384
Communications	Communications	689	363	326	1,390	704	686	Communications	663	359	304	2,053	1,063	990
Advertising	Advertising	907	483	424	1,746	945	801	Advertising	877	385	492	2,623	1,330	1,293
Acquisition and merger-related expenses	Acquisition and merger-related expenses	2,897	1,667	1,230	9,062	2,118	6,944	Acquisition and merger-related expenses	3,421	10,551	(7,130)	12,483	12,669	(1,186)
Other	Other	5,882	5,104	778	10,322	7,753	2,569	Other	5,400	2,681	2,719	15,722	10,434	5,288
Total noninterest expense	Total noninterest expense	\$69,207	\$37,904	\$ 31,303	\$141,805	\$72,421	\$ 69,384	Total noninterest expense	\$70,748	\$44,031	\$ 26,717	\$212,553	\$116,452	\$ 96,101

(1) Total salaries and employee benefits includes \$2.8 million and **\$931** **\$969** thousand for the three months ended **June 30, 2023** **September 30, 2023** and 2022 and **\$5.4 million** **\$8.2 million** and **\$1.9 million** **\$2.9 million** for the six nine months ended **June 30, 2023** **September 30, 2023** and 2022, respectively, of stock based compensation expense.

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Salaries and employee benefits. Salaries and benefits increased \$15.4 million \$17.5 million, or 70.6% 79.4%, for the three months ended June 30, 2023 September 30, 2023 and \$32.5 million \$50.0 million, or 72.8% 75.0% for the six nine months ended June 30, 2023 September 30, 2023, compared to the same periods in 2022 primarily due to the Merger.

Acquisition and merger-related expenses. Acquisition and merger-related expenses of \$2.9 million \$3.4 million and \$9.1 million \$12.5 million incurred during the three and six nine months ended June 30, 2023 September 30, 2023, respectively, were primarily related to compensation and legal and advisory fees associated with the Merger.

Amortization of intangibles. Amortization of intangibles increased \$6.1 million for the three months ended June 30, 2023 September 30, 2023 and \$12.3 million \$18.4 million for the six nine months ended June 30, 2023 September 30, 2023 compared to the same periods in 2022 due the \$138.2 million core deposit intangible created as a result of the Merger.

Efficiency Ratio

The efficiency ratio is a supplemental financial measure utilized in management's internal evaluation of our performance. We calculate our efficiency ratio by dividing total noninterest expense by the sum of net interest income and noninterest income, excluding net gains and losses on the sale of loans, securities and assets. Additionally, taxes and provision for credit losses are not part of this calculation. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same volume of income, while a decrease would indicate a more efficient allocation of resources. Our efficiency ratio was 60.83% 63.50% for the three months ended June 30, 2023 September 30, 2023 compared to 62.96% 69.18% for the three months ended June 30, 2022 September 30, 2022 and 59.86% 61.02% for the six nine months ended June 30, 2023 September 30, 2023 compared to 60.66% 63.62% for the six nine months ended June 30, 2022 September 30, 2022, respectively.

We monitor the efficiency ratio in comparison with changes in our total assets and loans, and we believe that maintaining or reducing the efficiency ratio during periods of growth demonstrates the scalability of our operating platform. We expect to continue to benefit from our scalable platform in future periods as we continue to monitor overhead expenses necessary to support our growth.

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Income Taxes

The amount of federal and state income tax expense is influenced by the amount of pre-tax income, tax-exempt income and other nondeductible expenses. Income tax expense increased \$3.8 million \$4.0 million for the three months ended June 30, 2023 September 30, 2023 and \$9.5 million \$13.5 million for the six nine months ended June 30, 2023 September 30, 2023 compared with the same periods in 2022 primarily due to the increase in pre-tax net income. Our effective tax rate was 17.5% 19.4% and 18.4% 19.3% for the three months ended June 30, 2023 September 30, 2023 and 2022 and 19.4% and 18.4% 18.6% for the six nine months ended June 30, 2023 September 30, 2023 and 2022, respectively.

Financial Condition

Loan Portfolio

At June 30, 2023 September 30, 2023, total loans were \$8.07 billion \$8.00 billion, an increase of \$314.0 million \$249.8 million, or 4.0% 3.2%, compared with December 31, 2022, primarily due to organic growth within our loan portfolio during the six nine months ended June 30, 2023 September 30, 2023. Total loans as a percentage of deposits were 92.0% 92.1% and 83.7% as of June 30, 2023 September 30, 2023 and December 31, 2022, respectively. Total loans as a percentage of assets were 74.9% 75.1% and 71.1% as of June 30, 2023 September 30, 2023 and December 31, 2022, respectively.

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The following table summarizes our loan portfolio by type of loan as of the dates indicated:

		June 30, 2023		December 31, 2022				September 30, 2023		December 31, 2022	
		Amount	Percent	Amount	Percent			Amount	Percent	Amount	Percent
		(Dollars in thousands)						(Dollars in thousands)			
Commercial and industrial	Commercial and industrial	\$ 1,512,476	18.7 %	\$ 1,455,795	18.8 %	Commercial and industrial	\$ 1,474,600	18.4 %	\$ 1,455,795	18.8 %	
Paycheck Protection Program (PPP)	Paycheck Protection Program (PPP)	8,027	0.1 %	13,226	0.2 %	Paycheck Protection Program (PPP)	5,968	0.1 %	13,226	0.2 %	
Real estate:	Real estate:					Real estate:					
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	4,038,487	50.0 %	3,931,480	50.7 %	Commercial real estate (including multi-family residential)	4,076,606	50.9 %	3,931,480	50.7 %	

Commercial real estate construction and land development	Commercial real estate construction and land development	1,136,124	14.1 %	1,037,678	13.4 %	Commercial real estate construction and land development	1,078,265	13.5 %	1,037,678	13.4 %
1-4 family residential (including home equity)	1-4 family residential (including home equity)	1,009,439	12.5 %	1,000,956	12.9 %	1-4 family residential (including home equity)	1,024,945	12.8 %	1,000,956	12.9 %
Residential construction	Residential construction	311,208	3.9 %	268,150	3.4 %	Residential construction	289,553	3.6 %	268,150	3.4 %
Consumer and other	Consumer and other	52,957	0.7 %	47,466	0.6 %	Consumer and other	54,591	0.7 %	47,466	0.6 %
Total loans	Total loans	8,068,718	100.0 %	7,754,751	100.0 %	Total loans	8,004,528	100.0 %	7,754,751	100.0 %
Allowance for credit losses on loans	Allowance for credit losses on loans	(100,195)		(93,180)		Allowance for credit losses on loans	(93,575)		(93,180)	
Loans, net	Loans, net	\$ 7,968,523		\$ 7,661,571		Loans, net	\$ 7,910,953		\$ 7,661,571	

Our lending activities originate from the efforts of our bankers with an emphasis on lending to individuals, professionals, small- to medium-sized businesses and commercial companies generally located in our markets. Our strategy for credit risk management generally includes well-defined, centralized credit policies, uniform underwriting criteria and ongoing risk monitoring and review processes for credit exposures. The strategy generally emphasizes regular credit examinations and management reviews of loans. We have certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. We maintain an independent loan review department that reviews and validates the credit risk program on a periodic basis. In addition, an independent third-party loan review is performed on a periodic basis during the year. Results of these reviews are presented to management and the risk committee of the Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by bankers and credit personnel and contained in our policies and procedures.

The principal categories of our loan portfolio are discussed below:

Commercial and Industrial. We make commercial and industrial loans in our market area that are underwritten on the basis of the borrower's ability to service the debt from income. In general, commercial loans involve more credit risk than residential mortgage loans and commercial mortgage loans and therefore typically yield a higher return. The increased risk in commercial loans derives from the expectation that commercial and industrial loans generally are serviced principally from the operations of the business, which may not be successful and from the type of collateral securing these loans. As a result, commercial and industrial loans require more extensive underwriting and servicing than other types of loans. Our commercial and industrial loan portfolio increased by \$56.7 million \$18.8 million, or 3.9% 1.3%, to \$1.51 billion \$1.47 billion as of June 30, 2023 September 30, 2023 from \$1.46 billion as of December 31, 2022.

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Paycheck Protection Program (PPP). The balance of PPP loans decreased \$5.2 million \$7.3 million to \$8.0 million \$6.0 million as of June 30, 2023 September 30, 2023 from \$13.2 million as of December 31, 2022 due to loan forgiveness.

Commercial Real Estate (Including Multi-Family Residential). We make loans collateralized by owner-occupied, nonowner-occupied and multi-family real estate to finance the purchase or ownership of real estate. As of June 30, 2023 September 30, 2023 and December 31, 2022, 45.8% 46.4% and 45.3%, respectively, of our commercial real estate loans were owner-occupied. Our commercial real estate loan portfolio increased \$107.0 million \$145.1 million, or 2.7% 3.7%, to \$4.04 billion \$4.08 billion as of June 30, 2023 September 30, 2023 from \$3.93 billion as of December 31, 2022, primarily as a result of organic loan growth. Included in our commercial real estate portfolio are multi-family residential loans. Our multi-family loans as of June 30, 2023 September 30, 2023 decreased to \$431.3 million \$453.3 million from \$471.6 million as of December 31, 2022. We had 233 multi-family loans with an average loan size of \$2.0 million \$2.1 million as of June 30, 2023 September 30, 2023.

As of June 30, 2023 September 30, 2023, the Company's commercial relate real estate (including multi-family residential) loan portfolio included \$272.5 million \$313.7 million of multifamily community development loans with associated tax credits, which fund Texas-based projects to promote affordable housing, compared to \$287.3 million as of December 31, 2022.

Commercial Real Estate Construction and Land Development. We make commercial real estate construction and land development loans to fund commercial construction, land acquisition and real estate development construction. Construction loans involve additional risks as they often involve the disbursement of funds with the repayment dependent on the ultimate success of the project's completion. Sources of repayment for these loans may be pre-committed permanent financing or sale of the developed

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property. The loans in this portfolio are monitored closely by management. Due to uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often includes the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. As of June 30, 2023 September 30, 2023 and December 31, 2022, 17.3% 29.6% and 18.2%, respectively, of our commercial real estate construction and land development loans were owner-occupied. Commercial real estate construction and land development loans increased \$98.4 million \$40.6 million, or 9.5% 3.9%, to \$1.14 billion \$1.08 billion as of June 30, 2023 September 30, 2023 compared to \$1.04 billion as of December 31, 2022.

As of June 30, 2023 September 30, 2023, the Company's commercial relate real estate construction and land development portfolio included \$161.4 million \$157.3 million of construction and development loans to support multifamily community development loans with associated tax credits, which fund Texas-based projects to promote affordable housing, compared to \$79.7 million as of December 31, 2022.

1-4 Family Residential (Including Home Equity). Our residential real estate loans include the origination of 1-4 family residential mortgage loans (including home equity and home improvement loans and home equity lines of credit) collateralized by owner-occupied residential properties located in our market area, areas. Our residential real estate portfolio (including home equity) increased \$8.5 million \$24.0 million, or 0.8% 2.4%, to \$1.01 billion \$1.02 billion as of June 30, 2023 September 30, 2023 from \$1.00 billion as of December 31, 2022.

Residential Construction. We make residential construction loans to home builders and individuals to fund the construction of single-family residences with the understanding that such loans will be repaid from the proceeds of the sale of the homes by builders or with the proceeds of a mortgage loan. These loans are secured by the real property being built and are made based on our assessment of the value of the property on an as-completed basis. Our residential construction loans portfolio increased \$43.1 million \$21.4 million, or 16.1% 8.0%, to \$311.2 million \$289.6 million as of June 30, 2023 September 30, 2023 from \$268.2 million as of December 31, 2022.

Consumer and Other. Our consumer and other loan portfolio is made up of loans made to individuals for personal purposes and deferred fees and costs on all loan types. Generally, consumer loans entail greater risk than residential real estate loans because they may be unsecured or if secured the value of the collateral, such as an automobile or boat, may be more difficult to assess and more likely to decrease in value than real estate. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan balance. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws may limit the amount which can be recovered on such loans. Our consumer and other loan portfolio increased \$5.5 million \$7.1 million, or 11.6% 15.0%, to \$53.0 million \$54.6 million as of June 30, 2023 September 30, 2023 from \$47.5 million as of December 31, 2022.

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Asset Quality

We have procedures in place to assist us in maintaining the overall quality of our loan portfolio. We have established underwriting guidelines to be followed by our officers and monitor our delinquency levels for any negative or adverse trends.

Nonperforming Assets

Nonperforming assets totaled \$43.3 million, \$38.3 million, or 0.40% 0.48% of total assets, at June 30, 2023 September 30, 2023 compared to \$45.0 million, or 0.41% of total assets, at December 31, 2022. The following table presents information regarding nonperforming assets as of the dates indicated.

		June 30, 2023		December 31, 2022		September 30, 2023		December 31, 2022	
		(Dollars in thousands)				(Dollars in thousands)			
Nonaccrual loans:	Nonaccrual loans:								
Commercial and industrial	Commercial and industrial	\$	22,800	\$	25,297	\$	14,971	\$	25,297
Paycheck Protection Program (PPP)	Paycheck Protection Program (PPP)		168		105		20		105
Real estate:	Real estate:								
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)		8,221		9,970		13,563		9,970
Commercial real estate construction and land development	Commercial real estate construction and land development		388		—		170		—
1-4 family residential (including home equity)	1-4 family residential (including home equity)		10,880		9,404		8,442		9,404
Residential construction	Residential construction		665		—		635		—
Consumer and other	Consumer and other		227		272		490		272
Total nonaccrual loans	Total nonaccrual loans		43,349		45,048		38,291		45,048

Accruing loans 90 or more days past due	Accruing loans 90 or more days past due	—	—	Accruing loans 90 or more days past due	—	—
Total nonperforming loans	Total nonperforming loans	43,349	45,048	Total nonperforming loans	38,291	45,048
Other real estate	Other real estate	—	—	Other real estate	—	—
Total nonperforming assets	Total nonperforming assets	\$ 43,349	\$ 45,048	Total nonperforming assets	\$ 38,291	\$ 45,048
Modified/restructured loans ⁽¹⁾	Modified/restructured loans ⁽¹⁾	\$ 11,291	\$ 35,425	Modified/restructured loans ⁽¹⁾	\$ 13,321	\$ 35,425
Nonperforming assets to total assets	Nonperforming assets to total assets	0.40 %	0.41 %	Nonperforming assets to total assets	0.36 %	0.41 %
Nonperforming loans to total loans	Nonperforming loans to total loans	0.54 %	0.58 %	Nonperforming loans to total loans	0.48 %	0.58 %

- (1) On January 1, 2023, the Company adopted ASU 2022-02, which replaced the troubled debt restructuring classification with a modified loan classification that is assessed in a different manner. Modified/restructured loans represent the balance at the end of the respective period for those loans that are not already presented as a nonperforming loan.

Nonaccrual loans consisted of 107 111 separate credits at June 30, 2023 September 30, 2023 compared to 96 separate credits at December 31, 2022.

Allowance for Credit Losses

The allowance for credit losses is a valuation allowance that is established through charges to earnings in the form of a provision for (or reversal of) credit losses calculated in accordance with ASC 326, that is deducted from the amortized cost basis of certain assets to present the net amount expected to be collected. The amount of each allowance account represents management's best estimate of current expected credit losses on these financial instruments considering available information, from internal and external sources, relevant to assessing exposure to credit loss over the contractual term of the instrument. Relevant available information includes historical credit loss experience, current conditions and reasonable and supportable forecasts. While historical credit loss experience provides the basis for the estimation of expected credit losses, adjustments to historical loss information may be made for differences in current portfolio-specific risk characteristics, environmental conditions or other relevant factors. While management utilizes its best judgment and information available, the ultimate adequacy of our allowance accounts is dependent upon a variety of factors beyond our control, including the performance of our portfolios, the economy, changes in interest rates and the view of the regulatory authorities toward classification of assets. For additional information regarding critical accounting estimates and policies, refer to "Critical Accounting Estimates" in this section, Note 1 – Nature of Operations and Summary of Significant Accounting and Reporting Policies and Note 5 – Loans and Allowance for Credit Losses in the accompanying notes to the consolidated financial statements.

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Allowance for Credit Losses on Loans

The allowance for credit losses on loans represents management's estimates of current expected credit losses in the Company's loan portfolio. Pools of loans with similar risk characteristics are collectively evaluated, while loans that no longer share risk characteristics with loan pools are evaluated individually.

At June September 30, 2023, our allowance for credit losses on loans was \$100.2 million \$93.6 million, or 1.24% 1.17% of total loans, compared with \$93.2 million, or 1.20%, of total loans, as of December 31, 2022. The increase in the allowance for credit losses on loans during the first six nine months of 2023 reflected an increase in loans primarily resulted from changes to the qualitative factors within the allowance for credit losses model, among other factors. things. The following table presents, as of and for the periods indicated, an analysis of the allowance for loan losses and other related data:

	As of and for the Six Months Ended June 30,				September 30,					
	2023		2022		2023		2022			
	(Dollars in thousands)				(Dollars in thousands)					
Average loans outstanding	Average loans outstanding	\$	7,914,303	\$	4,267,810	Average loans outstanding	\$	7,957,911	\$	4,331,288
Gross loans outstanding at end of period	Gross loans outstanding at end of period		8,068,718		4,348,833	Gross loans outstanding at end of period		8,004,528		4,591,912
Allowance for credit losses on loans at beginning of period	Allowance for credit losses on loans at beginning of period		93,180		47,940	Allowance for credit losses on loans at beginning of period		93,180		47,940
Provision for credit losses on loans	Provision for credit losses on loans		7,443		3,190	Provision for credit losses on loans		8,939		4,850
Charge-offs:	Charge-offs:					Charge-offs:				

Commercial and industrial loans	Commercial and industrial loans	(1,484)	(956)	Commercial and industrial loans	(9,653)	(958)
Real estate:	Real estate:			Real estate:		
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	—	(327)	Commercial real estate (including multi-family residential)	—	(383)
Commercial real estate construction and land development	Commercial real estate construction and land development	—	(63)	Commercial real estate construction and land development	—	(63)
1-4 family residential (including home equity)	1-4 family residential (including home equity)	(23)	—	1-4 family residential (including home equity)	(23)	—
Residential construction	Residential construction	—	—			
Consumer and other	Consumer and other	(38)	(48)	Consumer and other	(45)	(65)
Total charge-offs for all loan types	Total charge-offs for all loan types	(1,545)	(1,394)	Total charge-offs for all loan types	(9,721)	(1,469)
Recoveries:	Recoveries:			Recoveries:		
Commercial and industrial loans	Commercial and industrial loans	1,069	401	Commercial and industrial loans	1,124	720
Real estate:	Real estate:			Real estate:		
Commercial real estate (including multi-family residential)	Commercial real estate (including multi-family residential)	14	50	Commercial real estate (including multi-family residential)	16	50
Commercial real estate construction and land development	Commercial real estate construction and land development	—	55	Commercial real estate construction and land development	—	55
1-4 family residential (including home equity)	1-4 family residential (including home equity)	9	—	1-4 family residential (including home equity)	9	—
Consumer and other	Consumer and other	25	—	Consumer and other	28	1
Total recoveries for all loan types	Total recoveries for all loan types	1,117	506	Total recoveries for all loan types	1,177	826
Net charge-offs	Net charge-offs	(428)	(888)	Net charge-offs	(8,544)	(643)
Allowance for credit losses on loans at end of period	Allowance for credit losses on loans at end of period	\$ 100,195	\$ 50,242	Allowance for credit losses on loans at end of period	\$ 93,575	\$ 52,147
Allowance for credit losses on loans to total loans	Allowance for credit losses on loans to total loans	1.24 %	1.16 %	Allowance for credit losses on loans to total loans	1.17 %	1.14 %
Net charge-offs to average loans ⁽¹⁾	Net charge-offs to average loans ⁽¹⁾	0.01 %	0.04 %	Net charge-offs to average loans ⁽¹⁾	0.14 %	0.02 %
Allowance for credit losses on loans to nonperforming loans	Allowance for credit losses on loans to nonperforming loans	231.14 %	178.01 %	Allowance for credit losses on loans to nonperforming loans	244.38 %	241.97 %

(1) Interim periods annualized.

Allowance for Credit Losses on Unfunded Commitments

The allowance for credit losses on unfunded commitments estimates current expected credit losses over the contractual period in which there is exposure to credit risk via a contractual obligation to extend credit, unless that obligation is unconditionally cancellable by us. The allowance for credit losses on unfunded commitments is a liability account reported as a component of other liabilities in our consolidated balance sheets and is adjusted as a provision for credit loss expense. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on the commitments expected to fund. The estimate of commitments expected to fund is affected by historical analysis looking at utilization rates. The expected credit loss rates applied to

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the commitments expected to fund are affected by the general valuation allowance utilized for outstanding balances with the same

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underlying assumptions and drivers. At **June 30, 2023** **September 30, 2023**, our allowance for credit losses on unfunded commitments was **\$10.1 million** **\$10.9 million** compared to \$12.0 million at December 31, 2022.

Available for Sale Securities

We use our securities portfolio to provide a source of liquidity, to provide an appropriate return on funds invested, to manage interest rate risk and to meet pledging and regulatory capital requirements. As of **June 30, 2023** **September 30, 2023**, the carrying amount of investment securities totaled **\$1.48 billion** **\$1.41 billion**, a decrease of **\$329.4 million** **\$392.6 million**, or **18.2%** **21.7%**, compared with \$1.81 billion as of December 31, 2022. Securities represented **13.7%** **13.3%** and 16.6% of total assets as of **June 30, 2023** **September 30, 2023** and December 31, 2022, respectively.

All of the securities in our securities portfolio are classified as available for sale. Securities classified as available for sale are measured at fair value in the financial statements with unrealized gains and losses reported, net of tax, as accumulated comprehensive income or loss until realized. Interest earned on securities is included in interest income. The following table summarizes the amortized cost and fair value of the securities in our securities portfolio as of the dates shown:

		June 30, 2023						September 30, 2023			
		Amortized	Gross	Gross	Fair			Amortized	Gross	Gross	Fair
		Cost	Unrealized	Unrealized	Value			Cost	Unrealized	Unrealized	Value
		(In thousands)						(In thousands)			
Available for Sale	Available for Sale					Available for Sale					
U.S. government and agency securities	U.S. government and agency securities	\$ 420,321	\$ 156	\$ (15,595)	\$ 404,882	U.S. government and agency securities	\$ 409,152	\$ 129	\$ (15,873)	\$ 393,408	
Municipal securities	Municipal securities	259,423	2,177	(32,402)	229,198	Municipal securities	258,901	545	(40,330)	219,116	
Agency mortgage-backed pass-through securities	Agency mortgage-backed pass-through securities	385,780	272	(41,671)	344,381	Agency mortgage-backed pass-through securities	378,573	22	(50,401)	328,194	
Agency collateralized mortgage obligations	Agency collateralized mortgage obligations	455,153	1	(66,382)	388,772	Agency collateralized mortgage obligations	444,234	—	(78,356)	365,878	
Corporate bonds and other	Corporate bonds and other	124,626	53	(13,690)	110,989	Corporate bonds and other	122,812	29	(14,485)	108,356	
Total	Total	\$ 1,645,303	\$ 2,659	\$ (169,740)	\$ 1,478,222	Total	\$ 1,613,672	\$ 725	\$ (199,445)	\$ 1,414,952	

December 31, 2022			
Amortized	Gross	Gross	Fair
Cost	Unrealized	Unrealized	Value
	Gains	Losses	
(In thousands)			

Available for Sale							
U.S. government and agency securities	\$	433,417	\$	90	\$	(19,227)	\$ 414,280
Municipal securities		580,076		4,319		(43,826)	540,569
Agency mortgage-backed pass-through securities		370,471		362		(42,032)	328,801
Agency collateralized mortgage obligations		461,760		—		(67,630)	394,130
Corporate bonds and other		143,192		2		(13,388)	129,806
Total	\$	1,988,916	\$	4,773	\$	(186,103)	\$ 1,807,586

Investment securities classified as available for sale or held to maturity are evaluated for expected credit losses under ASC Topic 326, "Financial Instruments – Credit Losses." See Note 4 – Securities in the accompanying notes to the consolidated financial statements for additional information. Management does not have the intent to sell any of these securities and believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of cost. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Accordingly, as of **June 30, 2023** **September 30, 2023**, management believes that the unrealized losses detailed in the previous table are due to noncredit-related factors, including changes in interest rates and other market conditions, and therefore, no losses have been recognized in the Company's consolidated statements of income

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The following table summarizes the contractual maturity of securities and their weighted average yields as of the dates indicated. The contractual maturity of a mortgage-backed security is the date at which the last underlying mortgage matures. Available for sale securities are shown at amortized cost. For purposes of the table below, municipal securities are calculated on a tax equivalent basis.

		June 30, 2023										September 30, 2023									
		Within One		After One Year		After Five Years		After Ten Years		Total		Within One		After One Year		After Five Years		After Ten			
		Year		but Within Five		but Within Ten						Year		but Within Five		but Within Ten					
		Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
		(Dollars in thousands)										(Dollars in thousands)									
Available for Sale	Available for Sale											Available for Sale	Available for Sale								
U.S. government and agency securities	U.S. government and agency securities	\$ 76,474	0.55 %	\$ 173,661	0.92 %	\$ 14,419	4.82 %	\$ 155,767	4.83 %	\$ 420,321	2.47 %	\$ 76,493	0.55 %	\$ 178,697	0.92 %	\$ 8,191	4.82 %	\$ 145,771			
Municipal securities	Municipal securities	—	— %	2,895	4.46 %	55,437	2.82 %	201,091	2.79 %	259,423	2.81 %	—	0.00 %	3,821	4.46 %	70,471	2.82 %	184,609			
Agency mortgage-backed pass-through securities	Agency mortgage-backed pass-through securities	7	2.35 %	14,944	3.93 %	13,682	4.26 %	357,147	3.04 %	385,780	3.12 %	635	2.35 %	14,555	3.93 %	13,012	4.26 %	350,371			
Agency collateralized mortgage obligations	Agency collateralized mortgage obligations	—	— %	17,251	2.80 %	7,970	2.68 %	429,932	1.55 %	455,153	1.62 %	—	0.00 %	17,230	2.80 %	7,916	2.68 %	419,088			
Corporate bonds and other	Corporate bonds and other	1,063	4.82 %	3,000	6.20 %	63,391	5.17 %	57,172	2.84 %	124,626	5.05 %	1,070	7.37 %	3,000	6.20 %	62,963	5.17 %	55,779			
Total	Total	\$ 77,544	0.60 %	\$ 211,751	1.42 %	\$ 154,899	4.11 %	\$ 1,201,109	2.78 %	\$ 1,645,303	2.63 %	\$ 78,198	0.65 %	\$ 217,303	1.42 %	\$ 162,553	4.11 %	\$ 1,155,618			
		December 31, 2022										December 31, 2022									
		Within One		After One Year		After Five Years		After Ten Years		Total		Within One		After One Year		After Five Years		After Ten			
		Year		but Within Five		but Within Ten						Year		but Within Five		but Within Ten					
		Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
		(Dollars in thousands)										(Dollars in thousands)									
Available for Sale	Available for Sale											Available for Sale	Available for Sale								
U.S. government and agency securities	U.S. government and agency securities	\$ 76,438	0.54 %	\$ 173,380	0.92 %	\$ 16,081	4.96 %	\$ 167,518	4.92 %	\$ 433,417	2.55 %	\$ 76,438	0.54 %	\$ 173,380	0.92 %	\$ 16,081	4.96 %	\$ 167,518			

Municipal securities	Municipal securities	—	— %	21,195	3.45 %	93,313	2.93 %	465,568	3.39 %	580,076	3.31 %	Municipal securities	—	0.00 %	21,195	3.45 %	93,313	2.93 %	465,568
Agency mortgage-backed pass-through securities	Agency mortgage-backed pass-through securities	1	3.21 %	14,112	4.02 %	11,201	4.53 %	345,157	2.94 %	370,471	3.03 %	Agency mortgage-backed pass-through securities	1	3.21 %	14,112	4.02 %	11,201	4.53 %	345,157
Agency collateralized mortgage obligations	Agency collateralized mortgage obligations	—	— %	17,291	2.80 %	8,008	2.70 %	436,461	1.78 %	461,760	1.83 %	Agency collateralized mortgage obligations	—	0.00 %	17,291	2.80 %	8,008	2.70 %	436,461
Corporate bonds and other	Corporate bonds and other	1,050	1.25 %	4,000	6.20 %	64,176	4.64 %	73,966	2.68 %	143,192	3.66 %	Corporate bonds and other	1,050	1.25 %	4,000	6.20 %	64,176	4.64 %	73,966
Total	Total	\$77,489	0.55 %	\$229,978	1.58 %	\$192,779	3.75 %	\$1,488,670	2.95 %	\$1,988,916	2.78 %	Total	\$77,489	0.55 %	\$229,978	1.58 %	\$192,779	3.75 %	\$1,488,670

The contractual maturity of mortgage-backed securities and collateralized mortgage obligations is not a reliable indicator of their expected life because borrowers may have the right to prepay their obligations. Mortgage-backed securities and collateralized mortgage obligations are typically issued with stated principal amounts and are backed by pools of mortgage loans with varying maturities. The term of the underlying mortgages and loans may vary significantly due to the ability of a borrower to prepay and, in particular, monthly pay downs on mortgage-backed securities tend to cause the average life of the securities to be much different than the stated contractual maturity. During a period of increasing interest rates, fixed rate mortgage-backed securities do not tend to experience heavy prepayments of principal and, consequently, the average life of this security will be lengthened. If interest rates begin to fall, prepayments may increase, thereby shortening the estimated life of this security.

As of **June 30, 2023** **September 30, 2023** and December 31, 2022, we did not own securities of any one issuer (other than the U.S. government and its agencies or sponsored entities) for which the aggregate adjusted cost exceeded 10% of our consolidated shareholders' equity.

The average yield of our securities portfolio was **2.74%** **2.72%** during the **six** **nine** months ended **June 30, 2023** **September 30, 2023** compared with **1.75%** **1.88%** for the **six** **nine** months ended **June 30, 2022** **September 30, 2022**. The increase in average yield during 2023 compared to the same period in 2022 was primarily due to the mix of higher-yielding securities within the portfolio.

Goodwill and Core Deposit Intangibles

Our goodwill was \$497.3 million as of both **June 30, 2023** **September 30, 2023** and December 31, 2022. Goodwill resulting from business combinations represents the excess of the consideration paid over the fair value of the net assets acquired. Goodwill is assessed

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annually for impairment and on an interim basis if an event occurs or circumstances change that would indicate that the carrying amount of the asset may not be recoverable.

Our core deposit intangibles, net, as of **June 30, 2023** **September 30, 2023** was **\$129.8 million** **\$122.9 million** and \$143.5 million as of December 31, 2022. Core deposit intangibles are amortized using the straight-line or an accelerated method over the estimated useful life of seven to ten years.

Deposits

Our lending and investing activities are primarily funded by deposits. We offer a variety of deposit accounts having a wide range of interest rates and terms including demand, savings, money market and certificates and other time accounts. We rely primarily on convenient locations, personalized service and our customer relationships to attract and retain these deposits. We seek customers that will engage in both a lending and deposit relationship with us.

Total deposits at **June 30, 2023** **September 30, 2023** were **\$8.77 billion** **\$8.69 billion**, a decrease of **\$501.3 million** **\$581.0 million**, or **5.4%** **6.3%**, compared with \$9.27 billion at December 31, 2022 primarily driven by seasonality, industry-wide pressures and the maintenance of pricing discipline in an intensely competitive market for deposits. Noninterest-bearing deposits at **June 30, 2023** **September 30, 2023** were **\$3.71 billion** **\$3.66 billion**, a decrease of **\$516.6 million** **\$573.9 million**, or **12.2%** **13.6%**, compared with \$4.23 billion at December 31, 2022. Interest-bearing deposits at **June 30, 2023** **September 30, 2023** were **\$5.05 billion** **\$5.03 billion**, an **increase** **a decrease of \$15.4 million** **\$7.1 million**, or **0.3%** **0.1%**, compared with \$5.04 billion at December 31, 2022. Estimated uninsured deposits totaled **\$4.75 billion** **\$4.73 billion** and estimated uninsured deposits net of collateralized deposits of **\$936 million** **\$865.7 million** were **\$3.82 billion** **\$3.86 billion**, or **43.5%** **44.5%**, of total deposits at **June 30, 2023** **September 30, 2023**.

The following table sets forth the amount of time deposits that met or exceeded the FDIC insurance limit of \$250 thousand by time remaining until maturity:

		As of June 30, 2023	September 30, 2023
		30, 2023	
		(In thousands)	
Three months or less	\$	199,784	174,313
Over three months through six months		171,492	208,390
Over six months through 12 months		75,055	136,494
Over 12 months		55,779	40,987
Total	\$	502,110	560,184

Borrowings

We have an available line of credit with the Federal Home Loan Bank ("FHLB") of Dallas, which allows us to borrow on a collateralized basis. FHLB advances are used to manage liquidity as needed, liquidity. The advances are secured by a blanket lien on certain loans. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At June 30, 2023 September 30, 2023, we had a total borrowing capacity of \$4.10 billion \$3.82 billion, of which \$2.90 billion \$2.28 billion was available and \$1.20 billion \$1.54 billion was outstanding in/through FHLB advances and letters of credit. There were \$370.0 million \$324.0 million of FHLB short-term advances outstanding at June 30, 2023 September 30, 2023 at a weighted-average rate of 5.45% 5.62%. Letters of credit were \$831.3 million \$1.22 billion at June 30, 2023 September 30, 2023, of which \$91.0 million \$50.8 million will expire during the remaining months of 2023, \$45.0 million \$72.8 million will expire in 2024, \$148.0 million \$494.5 million will expire in 2025, \$52.3 million \$57.3 million will expire in 2026, \$453.0 million \$448.0 million will expire in 2027, \$15.0 million \$40.0 million will expire in 2028, and \$27.0 million will expire in 2029, 2029 and \$30.0 million will expire in 2031.

Junior Subordinated Debentures

In connection with the acquisition of F&M Bancshares, Inc., the Company assumed Farmers & Merchants Capital Trust II and Farmers & Merchants Capital Trust III. Each of these trusts is a capital or statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds in the Company's junior subordinated debentures. The preferred trust securities of each trust represent preferred beneficial interests in the assets of the respective trusts and are subject to mandatory redemption upon payment of the junior subordinated debentures held by the trust. The common securities of each trust are wholly owned by the Company. Each trust's ability to pay amounts due on the trust preferred securities is solely dependent upon the Company making payment on the related junior subordinated debentures. The debentures, which are the only assets of each trust, are subordinate and junior in right of payment to all of the Company's present and future senior indebtedness. The Company has fully and unconditionally guaranteed each trust's obligations under the trust securities issued by such trust to the extent not paid or made by such trust, provided

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such trust has funds available for such obligations. The junior subordinated debentures are included in Tier 1 capital under current regulatory guidelines and interpretations. Under the provisions of each issue of the debentures, the Company has the right to defer

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payment of interest on the debentures at any time, or from time to time, for periods not exceeding five years. If interest payments on either issue of the debentures are deferred, the distributions on the applicable trust preferred securities and common securities will also be deferred.

A summary of pertinent information related to the Company's issues of junior subordinated debentures outstanding at June 30, 2023 September 30, 2023 is set forth in the table below:

			Trust Preferred Securities	Interest	Junior Subordinated Debt Owed					Trust Preferred Securities	Interest	Junior Subordinated Debt Owed		
		Issuance Date					Maturity		Issuance Date					Maturity
Description	Description	Date	Outstanding	Rate ⁽¹⁾			Date ⁽²⁾	Description	Date	Outstanding	Rate		to Trusts	Date ⁽¹⁾
(Dollars in thousands)														
Farmers & Merchants Capital Trust II	Farmers & Merchants Capital Trust II	November 13, 2003	\$ 7,500	3 month LIBOR + 3.00%	\$ 7,732		November 8, 2033	Farmers & Merchants Capital Trust II	November 13, 2003	\$ 7,500	3-Month SOFR + 3.26%	\$ 7,732		November 8, 2033
Farmers & Merchants Capital Trust III	Farmers & Merchants Capital Trust III	June 30, 2005	3,500	3 month LIBOR + 1.80%	3,609		July 7, 2035	Farmers & Merchants Capital Trust III	June 30, 2005	3,500	3-Month SOFR + 2.06%	3,609		July 7, 2035
					\$ 11,341							\$ 11,341		

- (1) The 3-month LIBOR in effect as of June 30, 2023 was 5.07%. Transitions to an alternative benchmark rate plus a comparable spread adjustment in the event that 30-day LIBOR is no longer published on a future adjustment date
- (2) All debentures are currently callable.

Subordinated Notes

In December 2017, the Bank completed the issuance, through a private placement, of \$40.0 million aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes (the "Bank Notes") due December 15, 2027. Since As of December 15, 2022, the Bank Notes bear bore a floating rate of interest equal to 3-Month LIBOR + plus 3.03%, which transitions transitioned to an alternative benchmark rate 3-Month SOFR plus a comparable spread adjustment in the event that 30-day LIBOR is no longer published on a future adjustment date, immediately after June 30, 2023, until the Bank Notes mature on December 15, 2027, or such earlier redemption date, payable quarterly in arrears. The Bank Notes are redeemable by the Bank, in whole or in part, on or after December 15, 2022 or, in whole but not in part, upon the occurrence of certain specified tax events, capital events or investment company events. Any redemption will be at a redemption price equal to 100% of the principal amount of Bank Notes being redeemed, plus accrued and unpaid interest, and will be subject to, and require, prior regulatory approval. The Bank Notes are not subject to redemption at the option of the holders. The Bank Notes are eligible for Tier 2 capital treatment, however, during the last five years of the instrument, the amount eligible must be reduced by 20% of the original amount annually and that no amount of the instrument is eligible for inclusion in Tier 2 capital when the remaining maturity of the instrument is less than one year. As the Bank Notes were within five years of maturity, only 80% of the notes are eligible for Tier 2 capital treatment at June 30, 2023 September 30, 2023.

In September 2019, the Company completed the issuance of \$60.0 million aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes (the "Company Notes") due October 1, 2029. The Company Notes bear a fixed interest rate of 4.70% per annum until (but excluding) October 1, 2024, payable semi-annually in arrears on April 1 and October 1, commencing on April 1, 2020. Thereafter, from October 1, 2024 through the maturity date, October 1, 2029, or earlier redemption date, the Company Notes will bear interest at a floating rate equal to the then-current three-month LIBOR, 3-Month SOFR, plus 313 basis points (3.13%) 3.13%, which transitions to an alternative benchmark rate plus a comparable spread adjustment in the event that 30-day transitioned from LIBOR is no longer published on a future adjustment date, immediately after June 30, 2023, for each quarterly interest period, (subject to certain provisions set forth under "Description of the Notes—Interest Rates and Interest Payment Dates" included in the Prospectus Supplement for the Company Notes), payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year. Any redemption will be at a redemption price equal to 100% of the principal amount of Company Notes being redeemed, plus accrued and unpaid interest, and will be subject to, and require, prior regulatory approval. The Company Notes are not subject to redemption at the option of the holders.

Credit Agreement

On December 13, 2022, the Company entered into a loan agreement with another financial institution, or the Loan Agreement, that provides for a \$75.0 million revolving line of credit. At June 30, 2023 September 30, 2023, there were no outstanding borrowings on this line of credit and the Company did not draw on this line of credit during 2023 or 2022. The Company can make draws on the line of credit for a period of 24 months, which began on December 13, 2022, after which the Company will not be permitted to make further draws. Interest accrues on outstanding borrowings at a per annum rate equal to the prime rate quoted by The Wall Street Journal and with a floor rate of 3.50% calculated in accordance with the terms of the revolving promissory note and payable quarterly through the first 24 months. The entire outstanding balance and unpaid interest is payable in full on December 13, 2024.

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The Company may prepay the principal amount of the line of credit without premium or penalty. The obligations of the Company under the Loan Agreement are secured by a pledge of all the issued and outstanding shares of capital stock of Stellar Bank.

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Covenants made under the Loan Agreement include, among other things, while there any obligations outstanding under Loan Agreement, the Company shall maintain a cash flow to debt service (as defined in the Loan Agreement) of not less than 1.25, the Bank's Texas Ratio (as defined in the Loan Agreement) not to exceed 25.0%, the Bank shall maintain a Tier 1 Leverage Ratio (as defined under the Loan Agreement) of at least 7.0% and restrictions on the ability of the Company and its subsidiaries to incur certain additional debt. As of June 30, 2023 September 30, 2023, we believe we were in compliance with all such debt covenants and had not been made aware of any noncompliance by the lender.

Off-Balance Sheet Items

In the normal course of business, we enter into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in our consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. These transactions include commitments to extend credit and standby and commercial letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in our consolidated balance sheets.

Commitments to Extend Credit. We enter into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of our commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. We minimize our exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. The amount and type of collateral obtained, if considered necessary by us, upon extension of credit, is based on management's credit evaluation of the customer. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for credit losses.

Standby Letters of Credit. Standby letters of credit are conditional commitments issued by us to guarantee the performance of a customer to a third party. If the customer does not perform in accordance with the terms of the agreement with the third party, we would be required to fund the commitment and we would have the rights to the underlying collateral. The maximum potential amount of future payments we could be required to make is represented by the contractual amount of the commitment. Our policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

As of [June 30, 2023](#) [September 30, 2023](#) and December 31, 2022, we had outstanding [\\$1.92 billion](#) [\\$1.89 billion](#) and \$2.36 billion, respectively, in commitments to extend credit and [\\$38.5 million](#) [\\$37.8 million](#) and \$35.5 million in commitments associated with outstanding letters of credit for those same periods. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the total outstanding may not necessarily reflect the actual future cash funding requirements.

Liquidity and Capital Resources

Liquidity

Liquidity is the measure of our ability to meet the cash flow requirements of depositors and borrowers, while at the same time meeting our operating, capital, strategic cash flow needs and to maintain reserve requirements to operate on an ongoing basis and manage unexpected events, all at a reasonable cost. During the [six nine months ended June 30, 2023](#) [September 30, 2023](#) and the year ended December 31, 2022, our liquidity needs have been primarily met by deposits, borrowed funds, security and loan maturities and amortizing investment and loan portfolios. The Bank has access to purchased funds from correspondent banks, the Federal Reserve discount window and advances from the FHLB, [on a collateralized basis](#), are available under a security and pledge agreement to take advantage of investment opportunities.

Liquidity risk management is an important element in our asset/liability management process. Our liquidity position is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. We regularly model liquidity stress scenarios to assess potential liquidity outflows or funding problems resulting from economic disruptions, volatility in the financial markets, unexpected credit events or other significant occurrences deemed problematic by management. [These Liquidity stress](#) scenarios are incorporated into our contingency funding plan, which provides the basis for the identification of our liquidity needs.

Our largest source of funds is deposits and our largest use of funds is loans. [Our average Average](#) deposits increased [\\$2.74 billion](#) [\\$2.79 billion](#), or [44.6%](#) [46.3%](#), and [our](#) average loans increased [\\$3.65 billion](#) [\\$3.63 billion](#), or [85.4%](#) [83.7%](#), for the [six nine months ended June 30, 2023](#) [September 30, 2023](#) compared to the [six nine months ended June 30, 2022](#) [September 30, 2022](#). [Our estimated](#) Estimated uninsured deposits totaled [\\$4.75 billion](#) [\\$4.73 billion](#) and our estimated uninsured deposits net of collateralized deposits of [\\$936 million](#) [\\$865.7 million](#) were [\\$3.82 billion](#) [\\$3.86 billion](#), or [43.5%](#) [44.5%](#), of total deposits at [June 30, 2023](#) [September 30, 2023](#). Our average deposit account size was \$86

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thousand at [June 30, 2023](#) [September 30, 2023](#). We predominantly invest excess deposits in Federal Reserve Bank of Dallas balances, securities, interest-bearing deposits at other banks or other short-term liquid investments until the funds are needed to fund

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loan growth. Our securities portfolio had a weighted average life of [7.9](#) [7.5](#) years and [modified duration of 3.0 years at June 30, 2023](#) and a weighted average life of 8.3 years [at September 30, 2023](#) and [modified duration of 4.8 years at December 31, 2022](#), respectively.

Total immediate contingent funding sources, including unrestricted cash, available-for-sale securities that are not pledged and total [available borrowing capacity was \\$4.53 billion](#) [\\$4.11 billion](#), or [51.6%](#) [47.3%](#), of total deposits at [June 30, 2023](#) [September 30, 2023](#). Including policy-driven capacity for brokered deposits, the Bank would [be have been able to add approximately \\$1.23 billion](#) [\\$1.16 billion](#) to its contingent sources of liquidity, bringing total contingent funding sources to approximately [\\$5.76 billion](#) [\\$5.27 billion](#), or [65.7%](#) [60.6%](#), of deposits at [June 30, 2023](#) [September 30, 2023](#).

As of [June 30, 2023](#) [September 30, 2023](#) and December 31, 2022, the Company had no exposure to future cash requirements associated with known uncertainties or capital expenditures of a material nature.

Capital Resources

Capital management consists of providing equity to support our current and future operations. We are subject to capital adequacy requirements imposed by the Federal Reserve, and the Bank is subject to capital adequacy requirements imposed by the FDIC. Both the Federal Reserve and the FDIC have adopted risk-based capital requirements for assessing bank holding company and bank capital adequacy. These standards define capital and establish minimum capital requirements in relation to assets and off-balance sheet exposure, adjusted for credit risk. The risk-based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profiles among bank holding companies and banks, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Assets and off-balance sheet items are assigned to broad risk categories, each with appropriate relative risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

Under current guidelines, the minimum ratio of total capital to risk-weighted assets (which are primarily the credit risk equivalents of balance sheet assets and certain off-balance sheet items such as standby letters of credit) is 8.0%. At least half of total capital must be composed of Tier 1 capital, which includes common shareholders' equity (including retained earnings), less goodwill, other disallowed intangible assets, and disallowed deferred tax assets, among other items. The Federal Reserve also has adopted a minimum leverage ratio, requiring Tier 1 capital of at least 4.0% of average quarterly total consolidated assets, net of goodwill and certain other intangible assets, for all but the most highly rated bank holding companies. The federal banking agencies have also established risk-based and leverage capital guidelines that FDIC-insured depository institutions are required to meet. These regulations are generally similar to those established by the Federal Reserve for bank holding companies.

Under the Federal Deposit Insurance Act, the federal bank regulatory agencies must take “prompt corrective action” against undercapitalized U.S. depository institutions. U.S. depository institutions are assigned one of five capital categories: “well-capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized,” and are subjected to different regulation corresponding to the capital category within which the institution falls. A depository institution is deemed to be “well-capitalized” if the banking institution has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a common equity Tier 1 capital ratio of 6.5% and a leverage ratio of 5.0% or greater, and the institution is not subject to an order, written agreement, capital directive or prompt corrective action directive to meet and maintain a specific level for any capital measure. Under certain circumstances, a well-capitalized, adequately capitalized or undercapitalized institution may be treated as if the institution were in the next lower capital category.

Failure to meet capital guidelines could subject the institution to a variety of enforcement remedies by federal bank regulatory agencies, including: termination of deposit insurance by the FDIC, restrictions on certain business activities and appointment of the FDIC as conservator or receiver.

As of June 30, 2023, September 30, 2023 and December 31, 2022, the Bank was well-capitalized. Total shareholders' equity was \$1.46 billion at June 30, 2023, September 30, 2023 compared with \$1.38 billion at December 31, 2022, an increase of \$75.5 million \$77.7 million. This increase was primarily due the decrease in accumulated other comprehensive loss and to net income of \$72.3 million, \$103.2 million partially offset by the \$0.26 \$0.39 per common share dividend paid for the six nine months ended June 30, 2023, September 30, 2023.

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The following table provides a comparison of our leverage and risk-weighted capital ratios as of the dates indicated to the minimum and well-capitalized regulatory standards, as well as with the capital conservation buffer:

		Stellar Bancorp, Inc. (Consolidated)				Stellar Bancorp, Inc. (Consolidated)			
		Actual Ratio	Minimum Required For Capital Adequacy Purposes	Minimum Required Plus Capital Conservation Buffer	To Be Categorized As Well-Capitalized Under Prompt Corrective Action Provisions	Actual Ratio	Minimum Required For Capital Adequacy Purposes	Minimum Required Plus Capital Conservation Buffer	To Be Categorized As Well-Capitalized Under Prompt Corrective Action Provisions
As of June 30, 2023									
September 30, 2023									
Total Capital (to risk-weighted assets)	Total Capital (to risk-weighted assets)	13.03 %	8.00 %	10.50 %	N/A	13.42 %	8.00 %	10.50 %	N/A
Common Equity Tier 1 capital (to risk-weighted assets)	Common Equity Tier 1 capital (to risk-weighted assets)	10.67 %	4.50 %	7.00 %	N/A	11.14 %	4.50 %	7.00 %	N/A
Tier 1 Capital (to risk-weighted assets)	Tier 1 Capital (to risk-weighted assets)	10.78 %	6.00 %	8.50 %	N/A	11.25 %	6.00 %	8.50 %	N/A
Tier 1 Leverage (to average assets)		9.51 %	4.00 %	4.00 %	N/A				
As of December 31, 2022									
Tier 1 Leverage (to average tangible assets)	Tier 1 Leverage (to average tangible assets)					9.82 %	4.00 %	4.00 %	N/A
December 31, 2022									

Total Capital (to risk-weighted assets)	Total Capital (to risk-weighted assets)	12.39 %	8.00 %	10.50 %	N/A	Total Capital (to risk-weighted assets)	12.39 %	8.00 %	10.50 %	N/A
Common Equity Tier 1 capital (to risk-weighted assets)	Common Equity Tier 1 capital (to risk-weighted assets)	10.04 %	4.50 %	7.00 %	N/A	Common Equity Tier 1 capital (to risk-weighted assets)	10.04 %	4.50 %	7.00 %	N/A
Tier 1 Capital (to risk-weighted assets)	Tier 1 Capital (to risk-weighted assets)	10.15 %	6.00 %	8.50 %	N/A	Tier 1 Capital (to risk-weighted assets)	10.15 %	6.00 %	8.50 %	N/A
Tier 1 Leverage (to average assets)		8.55 %	4.00 %	4.00 %	N/A					
Tier 1 Leverage (to average tangible assets)						Tier 1 Leverage (to average tangible assets)	8.55 %	4.00 %	4.00 %	N/A
Stellar Bank	Stellar Bank					Stellar Bank				
As of June 30, 2023										
September 30, 2023						September 30, 2023				
Total Capital (to risk-weighted assets)	Total Capital (to risk-weighted assets)	12.80 %	8.00 %	10.50 %	10.00 %	Total Capital (to risk-weighted assets)	13.13 %	8.00 %	10.50 %	10.00 %
Common Equity Tier 1 capital (to risk-weighted assets)	Common Equity Tier 1 capital (to risk-weighted assets)	11.22 %	4.50 %	7.00 %	6.50 %	Common Equity Tier 1 capital (to risk-weighted assets)	11.63 %	4.50 %	7.00 %	6.50 %
Tier 1 Capital (to risk-weighted assets)	Tier 1 Capital (to risk-weighted assets)	11.22 %	6.00 %	8.50 %	8.00 %	Tier 1 Capital (to risk-weighted assets)	11.63 %	6.00 %	8.50 %	8.00 %
Tier 1 Leverage (to average assets)		9.89 %	4.00 %	4.00 %	5.00 %					
As of December 31, 2022										
Tier 1 Leverage (to average tangible assets)						Tier 1 Leverage (to average tangible assets)	10.15 %	4.00 %	4.00 %	5.00 %
December 31, 2022						December 31, 2022				
Total Capital (to risk-weighted assets)	Total Capital (to risk-weighted assets)	12.02 %	8.00 %	10.50 %	10.00 %	Total Capital (to risk-weighted assets)	12.02 %	8.00 %	10.50 %	10.00 %
Common Equity Tier 1 capital (to risk-weighted assets)	Common Equity Tier 1 capital (to risk-weighted assets)	10.46 %	4.50 %	7.00 %	6.50 %	Common Equity Tier 1 capital (to risk-weighted assets)	10.46 %	4.50 %	7.00 %	6.50 %

Tier 1 Capital (to risk-weighted assets)	Tier 1 Capital (to risk-weighted assets)	10.46 %	6.00 %	8.50 %	8.00 %	Tier 1 Capital (to risk-weighted assets)	10.46 %	6.00 %	8.50 %	8.00 %
Tier 1 Leverage (to average assets)		8.81 %	4.00 %	4.00 %	5.00 %					
Tier 1 Leverage (to average tangible assets)	Tier 1 Leverage (to average tangible assets)	8.81 %	4.00 %	4.00 %	5.00 %					

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Asset/Liability Management and Interest Rate Risk

Our asset liability and interest rate risk policy provides management with the guidelines for effective balance sheet management. We have established a measurement system for monitoring our net interest rate sensitivity position. We manage our sensitivity position within our established guidelines.

As a financial institution, a component of the market risk that we face is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of our assets and liabilities, and the market value of all interest-earning assets and interest-bearing liabilities, other than those which have a short term to maturity. Interest rate risk is the potential for economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income.

Based upon the nature of our operations, we are not subject to foreign exchange rate or commodity price risk. We do not own any trading assets. We manage our exposure to interest rates by structuring our balance sheet in the ordinary course of a community banking business. The Company enters into interest rate swaps as an accommodation to customers.

Our exposure to interest rate risk is managed by our the Balance Sheet Risk Committee of the Bank Board ("BSRC"). The BSRC formulates strategies based on appropriate levels of interest rate risk. In determining the appropriate level of interest rate risk, the BSRC considers the impact on earnings and capital of the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The BSRC meets regularly to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and market values of assets and liabilities, unrealized gains and losses, purchase and sale activities, commitments to originate loans and the maturities of investments and borrowings. Additionally, the BSRC reviews liquidity, cash flow flexibility, maturities of deposits and consumer and commercial deposit activity.

We use an interest rate risk simulation model and shock analysis to test the interest rate sensitivity of net interest income and the balance sheet, respectively. All instruments on the balance sheet are modeled at the instrument level, incorporating all relevant attributes such as next reset date, reset frequency and call dates, as well as prepayment assumptions for loans and securities and decay rates for nonmaturity deposits. Assumptions based on past experience are incorporated into the model for nonmaturity deposit account decay rates. The assumptions used are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model's simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various management strategies.

We utilize static balance sheet rate shocks to estimate the potential impact on net interest income of changes in interest rates under various rate scenarios. This analysis estimates a percentage of change in the metric from the stable rate base scenario versus alternative scenarios of rising and falling market interest rates by instantaneously shocking a static balance sheet.

The following table summarizes the simulated change in net interest income over a 12-month horizon and the economic value of equity as of the dates indicated:

	Percent Change in Net Interest Income				Percent Change in Economic Value of Equity		Percent Change in Net Interest Income		Percent Change in Economic Value of Equity	
Change in Interest Rates (Basis Points)	Change in Interest Rates (Basis Points)	As of		As of		Change in Interest Rates (Basis Points)	Income		of Equity	
		As of June 30, 2023	December 31, 2022	As of June 30, 2023	December 31, 2022		September 30, 2023	December 31, 2022	September 30, 2023	December 31, 2022
+300	+300	(3.7)%	0.5%	(5.1)%	(2.9)%	+300	(3.7)%	0.5%	(6.1)%	(2.9)%
+200	+200	(2.4)%	0.5%	(2.5)%	(0.7)%	+200	(2.7)%	0.5%	(3.5)%	(0.7)%
+100	+100	(1.1)%	0.4%	(0.6)%	0.6%	+100	(1.3)%	0.4%	(1.3)%	0.6%
Base	Base	0.0%	0.0%	0.0%	0.0%	Base	0.0%	0.0%	0.0%	0.0%
-100	-100	0.5%	(2.0)%	(1.7)%	(3.2)%	-100	0.5%	(2.0)%	(0.3)%	(3.2)%
-200	-200	0.0%	(7.5)%	(6.5)%	(9.4)%	-200	0.4%	(7.5)%	(3.5)%	(9.4)%

These results are primarily due to the size of our cash position, the size and duration of our loan and securities portfolio, the duration of our borrowings and the expected behavior of demand, money market and savings deposits during such rate fluctuations. During the **six nine** months ended **June 30, 2023** **September 30, 2023**, changes in our overall interest rate profile were driven by the decrease in noninterest bearing deposits and certain interest bearing deposits, increases in certificates of deposits and borrowed funds, an increase in loans and decreases in securities and cash and cash equivalents.

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LIBOR Transition

The Company's transition away from LIBOR has been **substantially** completed. **As of June 30, 2023, LIBOR was used as an index rate for less than 1% of the Company's loans.**

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. In designing and evaluating the disclosure controls and procedures, management recognizes that controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) were effective as of the end of the period covered by this Quarterly Report on Form 10-Q. See Exhibits 31.1 and 31.2 for the Certification statements issued by the Company's Chief Executive Officer and Chief Financial Officer, respectively.

Changes in internal control over financial reporting. There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended **June 30, 2023** **September 30, 2023** that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are subject to claims and litigation arising in the ordinary course of business. In the opinion of management, we are not party to any legal proceedings the resolution of which we believe would have a material adverse effect on our business, prospects, financial condition, liquidity, results of operation, cash flows or capital levels. However, one or more unfavorable outcomes in any claim or litigation against us could have a material adverse effect for the period in which such claim or litigation is resolved. In addition, regardless of their merits or their ultimate outcomes, such matters are costly, divert management's attention and may materially adversely affect our reputation, even if resolved in our favor. We intend to defend ourselves vigorously against any future claims or litigation.

ITEM 1A. RISK FACTORS

Adverse developments affecting the financial services industry, such as recent bank failures or concerns involving liquidity, and the soundness of other financial institutions may have a material effect on the Company's operations.

Recent events relating to the failures of certain banking entities in the first quarter of 2023, including Silicon Valley Bank, Signature Bank and First Republic Bank have caused significant volatility in the trading prices of stocks of publicly traded bank holding companies and general uncertainty and concern regarding the liquidity and financial strength of the banking sector as a whole. In the future, events such as these bank failures could have an adverse effect on our financial condition and results of operations and cause volatility in our stock price.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. Stellar has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose Stellar to credit risk and losses in the event of a default by a counterparty or client. Any such losses could have a material adverse effect on Stellar's financial condition and results of operations.

In response to these failures and the resulting market reaction, the Secretary of the Treasury approved actions enabling the FDIC to complete its resolutions of the failed banks in a manner that fully protects depositors by utilizing the Deposit Insurance Fund, including the use of bridge banks to assume all of the deposit obligations of the failed banks, while leaving unsecured lenders and equity holders of such institutions exposed to losses. In addition, the Federal Reserve Bank announced it would make available additional funding to eligible depository institutions under a Bank Term Funding Program to help assure banks have the ability to meet the needs of all their depositors. In an effort to strengthen public confidence in the banking system and protect depositors,

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regulators announced that any losses to the Deposit Insurance Fund to support uninsured depositors will be recovered by a special

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assessment on banks, as required by law, which could increase the cost of our FDIC insurance assessments and may adversely affect our earnings. However, it is uncertain whether these steps by the government will be sufficient to calm the financial markets, reduce the risk of significant depositor withdrawals at other institutions and thereby reduce the risk of additional bank failures. As a result of this uncertainty, we face the potential for reputational risk, deposit outflows, increased costs and competition for liquidity, and increased credit risk which, individually or in the aggregate, could have a material adverse effect on our business, financial condition and results of operations.

There have been no material changes in the risk factors previously disclosed by the Company. Investors should carefully consider the risks described in “Part I—Item 1A.—Risk Factors” in the Company’s Annual Reports on Form 10-K for the year ended December 31, 2022 and the Company’s other SEC filings.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In 2022, the Company’s Board of Directors authorized a share repurchase program, or the 2022 Repurchase Program, under which the Company may repurchase up to \$40.0 million of the Company’s common stock starting September 22, 2022 through September 30, 2023. During the second quarter of 2023, the Company’s Board of Directors authorized the expansion of its existing share repurchase program to provide that the Company may repurchase up to \$60 million of the Company’s common stock through May 31, 2024.

Repurchases under the Company’s share repurchase program may be made from time to time at the Company’s discretion in open market transactions, through block trades, in privately negotiated transactions, and pursuant to any trading plan that may be adopted by the Company’s management in accordance with Rule 10b5-1 of the Exchange Act or otherwise. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, market conditions, and other corporate liquidity requirements and priorities. The repurchase program does not obligate the Company to acquire a specific dollar amount or number of shares and may be modified, suspended or discontinued at any time.

There were no repurchases by the Company during the three months ended **June 30, 2023** **September 30, 2023**. The number of shares that may be repurchased under the plan was **2,575,107**, **2,814,258**, which was computed based on the closing share price of the Company’s common stock as of **June 30, 2023** **September 30, 2023**.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibit Number	Description
3.1	Second Amended and Restated Certificate of Formation of Stellar Bancorp, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on October 3, 2022)
3.2	Bylaws of Stellar Bancorp, Inc. (incorporated herein by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on October 3, 2022)
31.1*	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2*	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1**	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	Inline XBRL Instance Document – the instance document does not appear in the Interactive Data File because XBRL tags are embedded within the Inline XBRL document.
101.SCH*	Inline XBRL Taxonomy Extension Schema Document
101.CAL*	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (embedded within the Inline XBRL document)

* Filed with this Quarterly Report on Form 10-Q.

** Furnished with this Quarterly Report on Form 10-Q.

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SIGNATURES

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

Stellar Bancorp, Inc.
(Registrant)

Date: July 28, 2023 November 3, 2023

/s/ Robert R. Franklin, Jr.

Robert R. Franklin, Jr.
Chief Executive Officer

Date: July 28, 2023 November 3, 2023

/s/ Paul P. Egge

Paul P. Egge
Chief Financial Officer

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**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO RULE 13a-14(a) OF
THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED**

I, Robert R. Franklin, Jr., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Stellar Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: ~~July 28, 2023~~ November 3, 2023

/s/ Robert R. Franklin, Jr.

Robert R. Franklin, Jr.
Chief Executive Officer

**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER PURSUANT TO RULE 13a-14(a) OF
THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED**

I, Paul P. Egge, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Stellar Bancorp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 28, 2023 November 3, 2023

/s/ Paul P. Egge

Paul P. Egge
Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 (AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002)

In connection with the Quarterly Report of Stellar Bancorp, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2023 September 30, 2023 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert R. Franklin, Jr., Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and operating results of the Company as of the dates and for the periods expressed in the Report.

IN WITNESS WHEREOF, the undersigned has executed this Certificate, effective as of July 28, 2023 November 3, 2023.

/s/ Robert R. Franklin, Jr.

Robert R. Franklin, Jr.
Chief Executive Officer

Exhibit 32.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 (AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002)

In connection with the Quarterly Report of Stellar Bancorp, Inc. (the "Company") on Form 10-Q for the period ending **June 30, 2023** **September 30, 2023** as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Paul P. Egge, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and operating results of the Company as of the dates and for the periods expressed in the Report.

IN WITNESS WHEREOF, the undersigned has executed this Certificate, effective as of **July 28, 2023** **November 3, 2023**.

/s/ Paul P. Egge

Paul P. Egge
Chief Financial Officer

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