



2018 ANNUAL REPORT

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2018 ANNUAL REPORT

March 8, 2019

To the Shareholders:

Your HomeTown Bank Board of Directors is pleased to announce a \$1.35 per share cash dividend. The payout represents a 10-cent per share increase over last year's Spring dividend and is based on a record setting net income performance in 2018.

Last year was like no other I have seen in my 43 years of banking. The new corporate federal income tax rate of 21% was estimated to save about \$1 million dollars. In addition, our 2018 budget projected an increase of approximately \$400,000 in after-tax earnings. The big headwind in 2018 would be the ability to maintain a consistent net interest margin because of the flat U. S. Treasury yield curve. However, the year ended with a nice surprise as we were able to recover almost \$1 million in interest income. The result was a record net income after tax of \$8.647 million compared to \$6.166 million in 2017.

HomeTown Bank loan officers produced a record \$125 million in gross loans compared to \$105.5 million in 2017. Ironically, our net growth was \$8.3 million due to several large loan payoffs and a large percentage of our construction loan funding being delayed due to the heavy rains in the fourth quarter. The good news is most of the funding for those construction loans should take place in the first quarter of 2019 if the weather will cooperate.

Deposit growth for 2018 was below expectations at \$2.5 million as competition has significantly increased for deposit dollars. Banks and other financial institutions from all over the country have advertised above average rates in the Houston market. We have continued to boost our CD rates and our overall interest expense budget for 2019 has been significantly increased to make sure we stay competitive.

Thanks to our strong earnings performance, capital grew to a record \$67.592 million compared to \$62.278 million in 2017. As a result, we paid a record cash dividend of \$4.00 compared to \$3.60 in 2017. All capital ratios exceed regulatory minimums as we continue to achieve the status of a highly capitalized community bank. Loan losses were slightly higher than previous years but remain at a very manageable level. The loan loss reserve is strong at \$4.6 million compared to \$4.27 million in 2017 and stands at 1.17% of total loans compared to 1.11% the previous year.

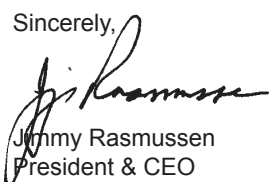
The new tax law was a nice addition in 2018, but community banks are hoping for more meaningful regulatory relief from Congress this year. Several measures have been approved but we are waiting for regulators to provide details. At the top of the list are more simplified capital rules and reduced quarterly reporting. For community banks to remain relevant, new regulations must be tailored to fit the size of the bank, not one size fits all.

HomeTown Bank strives to be a key citizen in all of the communities we serve. We have no exit strategy, only a long-term plan to assist our customers in achieving their financial goals. Future plans include branch expansion with the ultimate goal of providing a solid return to our loyal shareholders.

On a personal note, I want to thank the HomeTown Bank directors and staff for allowing me the opportunity to serve on the Dallas Federal Reserve Board of Directors for the past six years. Now that I have reached my term limit, I look forward to my continued association with the Dallas Fed and applying the many lessons I have learned to make our bank a stronger institution.

Thank you for your investment in HomeTown Bank.

Sincerely,



Jimmy Rasmussen
President & CEO



2018 Appendix A

Statements of Condition

	December 31,	
	2018	2017
Assets		
Cash and balances due from depository institutions:		
Noninterest-bearing balances, currency and coin	\$ 13,390,297	\$ 8,304,331
Interest-bearing balances	10,518,910	8,227,804
Total cash and cash equivalents	23,909,207	16,532,135
Securities available for sale	164,484,812	171,859,624
Securities held to maturity	1,842,340	1,674,330
Loans, total	393,339,752	385,105,970
Less: Reserve for possible loan losses	(4,618,424)	(4,272,957)
Loans, net	388,721,328	380,833,013
Bank Premises, equipment, furniture, fixtures and autos (net of depreciation)	10,069,810	10,380,532
Letters of Credit	1,139,529	5,186,803
Other Assets	4,996,990	10,488,833
TOTAL ASSETS	\$ 595,164,016	\$ 596,955,270
Liabilities		
Demand deposits	354,079,269	348,950,041
Savings deposits	64,426,054	66,578,179
Time deposits	105,617,189	106,005,001
Federal funds purchased	-	-
Letters of Credit	1,139,529	5,186,803
Other Liabilities	2,309,687	7,956,255
TOTAL LIABILITIES	\$ 527,571,728	\$ 534,676,279
Equity Capital Accounts		
Common Stock	12/31/18	12/31/17
Number Shares authorized	382,657	382,657
Number Shares outstanding	382,657	382,657
Common Stock (Par Value) \$1.00	\$ 382,657	\$ 382,657
Surplus	415,455	415,455
Undivided Profits	66,794,176	61,480,879
TOTAL EQUITY CAPITAL	\$ 67,592,288	\$ 62,278,991
TOTAL LIABILITIES AND EQUITY CAPITAL	\$ 595,164,016	\$ 596,955,270



2018 Appendix B

Statements of Income

	December 31,		
	2018	2017	2016
Operating Income			
Interest and fees on loans	\$ 21,846,380	\$ 18,689,909	\$ 17,144,165
Income on Federal funds sold and securities purchased under agreements to resell	190,886	53,357	25,258
Interest on Mortgage-backed securities	1,974,087	2,056,478	2,221,175
Interest on obligations of other U.S. Government Agencies and Corporations	138,703	155,135	207,361
Interest on obligations of States and political subdivisions	1,647,668	1,720,275	1,837,723
Dividends on stock	168,022	73,028	44,266
Interest on other investments	126,212	54,993	34,633
Service charges on deposit accounts	201,608	203,579	209,208
Other charges, collection and exchange charges, commissions and fees	688,588	657,205	662,246
Other operating income	1,343,392	1,686,797	1,006,761
TOTAL OPERATING INCOME	\$ 28,325,546	\$ 25,350,756	\$ 23,392,796
Operating Expenses			
Salaries, wages and other employee benefits	\$ 7,443,921	\$ 6,938,578	\$ 6,624,939
Interest on Time Certificates of Deposit of \$100,000 or more	970,023	776,004	856,216
Interest on other deposits	1,400,639	1,098,140	1,026,479
Occupancy expense of bank premises	920,363	1,001,757	890,127
Furniture and equipment expense (including depreciation of \$388,426, \$474,493, \$544,292)	608,207	682,791	738,530
Provision for possible loan losses	907,000	292,500	101,400
Other expenses	5,435,209	5,379,289	4,619,278
TOTAL OPERATING EXPENSES	\$ 17,685,362	\$ 16,169,059	\$ 14,856,969
Income before income taxes	10,640,184	9,181,697	8,535,827
Income taxes			
Current	2,206,985	3,187,694	2,368,533
Deferred (benefit) expense	(214,247)	(172,122)	(62,976)
Income taxes, net	<u>1,992,738</u>	<u>3,015,572</u>	<u>2,305,557</u>
Net Income	<u>\$ 8,647,446</u>	<u>\$ 6,166,125</u>	<u>\$ 6,230,270</u>
Earnings per common share			
Net Income	<u>\$ 22.60</u>	<u>\$ 16.11</u>	<u>\$ 16.28</u>



2018 Appendix C

Statements of Comprehensive Income

	December 31,		
	2018	2017	2016
Net income	\$ 8,647,446	\$ 6,166,125	\$ 6,230,270
Other comprehensive income, net of tax			
Unrealized gains (losses) on securities:			
Change in unrealized gain (loss) on securities available-for-sale, net of deferred income tax (benefit) expense of (\$475,911), \$495,095, and (\$1,833,511)	(1,790,330)	961,043	(3,559,168)
Reclassification adjustment for realized gains on investment securities available for sale included in net income, net of income taxes of (\$25,265), (\$119,342), and (\$142,293)	(95,043)	(231,642)	(418,802)
Reclassification adjustment for realized losses on investment securities available for sale included in net income, net of income taxes of \$21,759, \$82,776, and \$32,500	<u>81,853</u>	<u>160,682</u>	<u>63,087</u>
Total other comprehensive income	<u>(1,803,520)</u>	<u>890,083</u>	<u>(3,914,883)</u>
Comprehensive income	<u>\$ 6,843,926</u>	<u>\$ 7,056,208</u>	<u>\$ 2,315,387</u>



2018 Appendix D

Statements of Changes in Stockholders' Equity

	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Stockholders' Equity</u>
Balances - December 31, 2016	\$ 382,657	\$ 415,455	\$ 57,952,753	\$ (2,150,517)	\$ 56,600,348
Net Income			6,166,125		6,166,125
Other comprehensive income				890,083	890,083
Reclassification of certain tax effects due to change in tax law			248,268	(248,268)	
Cash dividends (\$3.60 per share)	<u>-</u>	<u>-</u>	<u>(1,377,565)</u>	<u>-</u>	<u>(1,377,565)</u>
Balances - December 31, 2017	382,657	415,455	62,989,581	(1,508,702)	62,278,991
Net Income			8,647,446		8,647,446
Other comprehensive income				(1,803,520)	(1,803,520)
Cash dividends (\$4.00 per share)	<u>-</u>	<u>-</u>	<u>(1,530,629)</u>	<u>-</u>	<u>(1,530,629)</u>
Balances - December 31, 2018	<u>\$ 382,657</u>	<u>\$ 415,455</u>	<u>\$ 70,106,398</u>	<u>\$ (3,312,222)</u>	<u>\$ 67,592,288</u>



2018 Appendix E

Statements of Cash Flows Years Ended December 31, 2018, 2017, and 2016 Increase (Decrease) in Cash and Cash Equivalents

	2018	December 31, 2017	2016
<i>Cash flows from operating activities:</i>			
Net income	\$ 8,647,446	\$ 6,166,125	\$ 6,230,270
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	618,654	669,631	780,565
Provisions for possible loan losses	907,000	292,500	101,400
Provisions for ORE write-down	227,200	10,000	-
Gain on sale of investments	(16,697)	(107,526)	(323,215)
Change in deferred tax assets and liabilities	(71,307)	310,191	(180,290)
Accretion of discounts	(70,460)	(35,675)	(32,939)
Amortization of investment premium	1,987,867	2,728,299	3,077,856
Stock dividends - Federal Home Loan Bank	(4,200)	(2,000)	(900)
Gain on sale of foreclosed assets	53,169	(19,037)	(31,614)
Gain on disposal of assets	-	(144,739)	-
(Increase) decrease in other assets	323,089	(307,813)	(45,624)
(Increase) decrease in accrued interest receivable	467,356	(445,307)	(52,437)
Increase (decrease) in accrued interest payable and other liabilities	(858,082)	1,139,188	152,507
Total adjustments	<u>3,563,589</u>	<u>4,087,712</u>	<u>3,445,309</u>
Net cash provided by operating activities	\$ 12,211,035	\$ 10,253,837	\$ 9,675,579
<i>Cash flows from investing activities:</i>			
Purchases of securities - available for sale	(85,000,659)	(51,441,808)	(109,335,680)
Proceeds from sales, maturities, or calls and principal payments - available for sale	88,028,011	77,211,075	71,810,969
Purchases of securities - held to maturity	-	-	-
Proceeds from principal payments - securities held to maturity	-	-	-
Net increase in loans to customers	(8,977,988)	(35,808,160)	(27,394,313)
Recoveries on loans	80,857	-	40,155
Proceeds from sales of premise and equipment	-	504,271	-
Additions to premises and equipment	(307,932)	(758,158)	(300,403)
Proceeds from sales of foreclosed assets	285,085	155,147	227,751
Net cash used by investing activities	\$ (5,892,626)	\$ (10,137,633)	\$ (64,951,521)



2018 Appendix E

Statements of Cash Flows Years Ended December 31, 2018, 2017, and 2016 Increase (Decrease) in Cash and Cash Equivalents (Continued)

	2018	December 31, 2017	2016
<i>Cash flows from financing activities:</i>			
Net increase in demand and savings account deposits	772,675	21,497,167	2,916,108
Net increase in time deposit accounts	1,816,617	(2,122,210)	13,375,617
Federal funds purchased	-	(12,000,000)	12,000,000
Cash dividends paid on common stock	(1,530,629)	(1,377,565)	(1,339,298)
Net cash provided by financing activities	\$ 1,058,663	\$ 5,997,392	\$ 26,952,427
Net increase in cash and cash equivalents	7,377,072	6,113,596	(28,323,515)
Cash and cash equivalents beginning of year	<u>16,532,135</u>	<u>10,418,539</u>	<u>38,742,054</u>
Cash and cash equivalents end of year	<u>\$ 23,909,207</u>	<u>\$ 16,532,135</u>	<u>\$ 10,418,539</u>

2018 Appendix F

Reconciliations of Reserve for Possible Loan Losses

	2018	December 31, 2017	2016
Balance at beginning of year	\$ 4,272,957	\$ 4,071,266	\$ 4,069,746
Recoveries credited to reserve	80,857	1,857	40,155
Provision for possible loan losses	907,000	292,500	101,400
TOTAL	\$ 5,260,814	\$ 4,365,623	\$ 4,211,301
Losses charged to Reserve	<u>(642,390)</u>	<u>(92,666)</u>	<u>(140,035)</u>
Balance at the end of year	<u>\$ 4,618,424</u>	<u>\$ 4,272,957</u>	<u>\$ 4,071,266</u>



2018 Appendix G

Notes to Financial Statements Valuation of Securities

	DECEMBER 31, 2018		DECEMBER 31, 2017	
	Book Value	Market Value	Book Value	Market Value
Mortgage-Backed Securities	\$ 102,504,923	\$ 99,299,207	\$ 102,030,461	\$ 100,043,315
Obligations of other U.S. Government Agencies and Corporations	7,229,803	6,961,980	9,856,525	9,629,085
Obligations of State and Political Subdivisions	58,942,775	58,223,624	61,882,389	62,187,224
Other Investments (Restricted)				
Senior Housing Crime Prevention Foundation	1,320,269	1,320,269	1,156,459	1,156,459
Lift Fund, Inc.	250,000	250,000	250,000	250,000
Federal Home Loan Bank Stock	248,121	248,121	243,921	243,921
Federal Reserve Bank Stock	23,950	23,950	23,950	23,950
TOTAL	\$ 170,519,841	\$ 166,327,151	\$ 175,443,705	\$ 173,533,954
Deposits and Profit 2018 and 2017				
TOTAL DEPOSITS	\$ 524,122,513		\$ 521,533,222	
TOTAL PROFIT	\$ 8,647,446		\$ 6,166,125	



2018 Appendix H

Selected Financial Data Summary of Operations

The Bank's operations for the past five fiscal years are summarized as follows:

	DECEMBER 31				
	2018	2017	2016	2015	2014
Net Interest Income	23,721,296	20,929,030	\$ 19,631,887	\$ 18,883,505	\$ 18,762,124
Other Operating Income	2,242,263	2,237,719	1,909,828	1,890,315	2,339,139
Total Operating Income - Net	\$ 25,963,559	\$ 23,166,749	\$ 21,541,715	\$ 20,773,820	\$ 21,101,263
Provisions for possible loan losses	907,000	292,500	101,400	50,000	155,000
Operating Expenses-including interest securities gains	14,433,009	13,800,078	13,227,703	12,548,751	12,408,509
Income before income taxes and securities gains	10,623,550	9,074,171	8,212,612	8,175,069	8,537,754
Applicable income taxes	1,992,738	3,015,572	2,305,557	2,184,930	2,279,853
Income before securities gains	8,630,812	6,058,599	5,907,055	5,990,139	6,257,901
Net Securities gains	16,634	107,526	323,215	35,413	27,609
Net Income	\$ 8,647,446	\$ 6,166,125	\$ 6,230,270	\$ 6,025,552	\$ 6,285,510
Net Income per share	\$ 22.60	\$ 16.11	\$ 16.28	\$ 15.75	\$ 16.43
Dividends per share	\$ 4.00 cash dividend	\$ 3.60 cash dividend	\$ 3.50 cash dividend	\$ 3.40 cash dividend	\$ 3.20 cash dividend

Management Summary

HomeTown Bank, National Association, engages in the business of general banking in the cities of Galveston, Friendswood, League City, Alvin and Pearland, Texas. The bank's business is oriented toward serving the financial needs of its customers, both business and personal.

The headquarters for HomeTown Bank remains in Galveston. There are twelve competing banks and credit unions with offices on Galveston Island. Only three of the banks are locally owned. The competitive conditions in Galveston are not unusual for a city with a population of approximately 50,180.

The League City, Alvin, Pearland and two Friendswood locations compete for business in northern Galveston, southern Harris, and eastern Brazoria Counties where both large and small banks and credit unions create intense competition. HomeTown Bank has attracted many residential and commercial real estate loans and retail installment loans for the purchase of automobiles and other consumer items. For the fiscal year ending December 31, 2018, HomeTown Bank had approximately \$59.8 million in outstanding loan commitments compared to \$51.7 million in 2017 and \$47.7 million in 2016. All of the loan commitments outstanding as of December 31, 2018 are expected to be exercised during the year 2019.

No material portion of the bank's deposits has been obtained from a single person or from a few persons. HomeTown Bank continues to be a strong real estate lender as 88.9 percent of the bank's loans are secured by some form of real property. The loans are spread across our market area and strict underwriting standards have produced losses well below peer levels. A large percentage of the commercial real estate portfolio is made up of loans to owner-occupied businesses. The bank's business is not seasonal to any significant extent. HomeTown Bank has no foreign source for deposits or loans, as all of the bank's business is local in nature.

The bank employs approximately 105 full time equivalent persons. The bank is engaged in commercial and consumer activities. The bank does not participate in any international, trust or municipal trading services. To the best of our officers' knowledge, local compliance with federal, state, and local provisions, which have been enacted or adopted, regulating the discharge of materials into the environment or otherwise relating to the protection of the environment, have not had a material effect upon the capital expenditures, earnings or competitive position of the bank.

The bank's common stock is not registered on any stock exchange. There is no market maker and market quotations are not available. As of December 31, 2018, there were 382,657.18 outstanding shares of the common stock of HomeTown Bank, National Association. There were 564 holders of common stock at that date.

Whitley Penn, LLP serves as the bank's outside auditor. The bank's Internal Audit Committee is composed of four outside directors. In addition, the bank employs a full-time internal audit coordinator and auditing consultant who performs specific audits for the bank. HomeTown Bank, N.A. is a national bank and is examined by the Office of the Comptroller of the Currency. The bank is also a member of the Federal Deposit Insurance Corporation, the Federal Reserve System, and files reports quarterly with the Office of Comptroller of the Currency.

Deposits grew .50 percent in 2018 compared to 3.86 percent in 2017 and 3.35 percent in 2016. Deposits for 2019 are projected to increase 1.96 percent. The projected deposit increase will place no burden on capital requirements. Tier 1 Risk Based Capital at year-end 2018 was 17.09 percent compared to 15.85 percent in 2017 and 15.96 percent in 2016. The 2018 Leverage Ratio was 12.01 percent compared to 10.88 percent in 2017 and 10.05 percent in 2016. All capital ratios are substantially above regulatory minimums. A cash dividend of \$4.00 per share totaling \$1,530,629 was paid in 2018. The cash dividend was \$3.60 per share totaling \$1,377,563 in 2017.

As of December 31, 2018, The Baker Group- Oklahoma City, The Independent Bankers Bank- Dallas and Raymond James Fixed Income Capital Markets are the approved vendors for the bank's investment portfolio.

The bank's investment portfolio as of December 31, 2018, represents 27.94 percent of total assets compared to 28.79 percent in 2017.

The bank follows the guidance in Accounting Standards Codification 320 Investments - Debt and Equity Securities. Securities that management has the ability and intent to hold to maturity are classified as "Held to Maturity" and carried at cost. Remaining securities are classified as "Available for Sale" and are carried at fair value. Unrealized gains and losses on "Available for Sale" securities are recognized as direct increases or decreases in stockholder's equity.

As of December 31, 2018, the "Available for Sale" portion of the portfolio showed an unrealized loss in fair value of (\$4,192,689) with an after-tax adjustment to capital of (\$3,312,225). This compares with an unrealized loss of (\$1,909,751) in 2017 with an after-tax adjustment to capital of (\$1,508,703).

Net income after federal income tax for 2018 was \$8,647,445 compared to \$6,166,125 in 2017 and \$6,230,270 in 2016. Net earnings were up 40% percent in 2018 as compared to 2017 due to the passage of the "Tax Cuts and Jobs Act", which lowered the U.S. federal corporate tax rate from 34% to 21% and the recovery of interest income on a problem loan during the year.

New gross loan volume totaled \$124.9 million in 2018 compared to \$105.5 million in 2017 and \$103.1 million in 2016. Income on investment securities was \$4.32 million in 2017 compared to \$4.37 million in 2016.

The loan loss reserve at year-end 2018 totaled \$4,618,424 compared to \$4,272,957 in 2017. As of December 31, 2018, the reserve was 1.17 percent of total loans compared to 1.11 percent in 2017. The reserve is considered adequate by management based on the strong performance of the loan portfolio. The loan loss reserve is reviewed monthly and approved quarterly by the Board of Directors. The 2019 budget will keep the loan loss reserve to total loan ratio in a range from 1.15 to 1.20 percent. As of December 31, 2018, non-accrual loans totaled \$255,980 compared to \$4,637,525 in 2017 and \$6,054,001 in 2016. Non-accrual loans as a percentage of total loans on December 31, 2018 were 0.07 percent compared to 1.20 percent in 2017 and 1.73 percent in 2016. Management believes the amount of non-accrual loans is at a manageable level.

The 2019 budget projects a 7.78 percent increase in net income after tax, excluding the recovery of \$959,290 in interest income in 2018, based on strong loan demand, an improvement in investment yield, and strong cost controls and a lowered tax rate. Deterioration in economic conditions could have a material adverse impact on the quality of the bank's loan portfolio and the demand for its products and services. These forward-looking statements relate to, among other things, expectations of the business environment in which HomeTown Bank, N.A. operates, projections of future performance, perceived opportunities in the market and statements regarding the bank's mission and vision. The bank's actual results, performance, or achievements may differ significantly from the results, performance, or achievements expressed or implied in such forward-looking statements.

Thank you for your investment in HomeTown Bank.

Jimmy Rasmussen
President and CEO

OFFICERS

Jimmy Rasmussen
President & CEO

Allan Rasmussen, Jr.
Senior Executive Vice President

Scott Kusnerik
Executive Vice President

Kyle McFatrige
Executive Vice President/CFO & Cashier

Candy Temple
Executive Vice President

Angela Brooks
Senior Vice President

Stephany Cantu
Senior Vice President

Gayle Culling
Senior Vice President

Rosie Garcia
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Sharon Hansen
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Vice President & BSA Officer

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Donna Rizzo
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Brandon Rogers
Vice President & CRA Officer

Traci Shugart-Garcia
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Denise Spruiell
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Elise Worthen
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Scott Asimakis
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Graylin Beals
Assistant Vice President

Elizabeth Birch
Assistant Vice President

Avery Ford
Assistant Vice President

Armando Garza
Assistant Vice President

Cynthia Gomez
Assistant Vice President

Tiffini Hughes
Assistant Vice President

Lynda Lee
Assistant Vice President

Ana Mireles-Dominguez
Assistant Vice President

Crystal Pena
Assistant Vice President

Diana Torres
Assistant Vice President

Lauren Zahniser
Assistant Vice President

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Kent Ballard

Stacy Dienst

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M.J. Gaido, Jr.

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