

TEXAS INSTRUMENTS INC  
Form 10-Q  
May 03, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2018

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 001-03761

TEXAS INSTRUMENTS INCORPORATED

(Exact Name of Registrant as Specified in Its Charter)

Delaware 75-0289970  
(State of Incorporation) (I.R.S. Employer Identification No.)

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12500 TI Boulevard, Dallas, Texas 75243  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code 214-479-3773

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	(Do not check if a 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

978,918,151

Number of shares of Registrant's common stock outstanding as of

April 24, 2018



## TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

## PART I - FINANCIAL INFORMATION

## ITEM 1. Financial Statements.

Consolidated Statements of Income (Millions of dollars, except share and per-share amounts)	For Three Months Ended	
	March 31,	
	2018	2017
Revenue	\$ 3,789	\$ 3,402
Cost of revenue (COR)	1,342	1,258
Gross profit	2,447	2,144
Research and development (R&D)	385	369
Selling, general and administrative (SG&A)	433	439
Acquisition charges	80	80
Restructuring charges/other	1	4
Operating profit	1,548	1,252
Other income (expense), net (OI&E)	28	21
Interest and debt expense	23	18
Income before income taxes	1,553	1,255
Provision for income taxes	187	258
Net income	\$ 1,366	\$ 997
Earnings per common share (EPS):		
Basic	\$ 1.38	\$ .99
Diluted	\$ 1.35	\$ .97
Average shares outstanding (millions):		
Basic	983	998
Diluted	1,005	1,019
Cash dividends declared per common share	\$ .62	\$ .50

As a result of accounting rule ASC 260, which requires a portion of Net income to be allocated to unvested restricted stock units (RSUs) on which we pay dividend equivalents, diluted EPS is calculated using the following:

Net income	\$ 1,366	\$ 997
Income allocated to RSUs	(11 )	(10 )
Income allocated to common stock for diluted EPS	\$ 1,355	\$ 987

See accompanying notes.



## TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Millions of dollars)	For Three Months Ended	
	March 31, 2018	2017
Net income	\$ 1,366	\$ 997
Other comprehensive income (loss), net of taxes		
Net actuarial losses of defined benefit plans:		
Adjustments	(16 )	(12 )
Recognized within Net income	9	12
Prior service credit of defined benefit plans:		
Recognized within Net income	(1 )	(1 )
Other comprehensive income (loss)	(8 )	(1 )
Total comprehensive income	\$ 1,358	\$ 996

See accompanying notes.

## TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

	March 31, 2018	December 31, 2017
Consolidated Balance Sheets		
(Millions of dollars, except share amounts)		
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,717	\$ 1,656
Short-term investments	2,362	2,813
Accounts receivable, net of allowances of (\$8) and (\$8)	1,454	1,278
Raw materials	144	126
Work in process	1,076	1,089
Finished goods	812	742
Inventories	2,032	1,957
Prepaid expenses and other current assets	1,025	1,030
Total current assets	8,590	8,734
Property, plant and equipment at cost	4,907	4,789
Accumulated depreciation	(2,171 )	(2,125 )
Property, plant and equipment	2,736	2,664
Long-term investments	271	268
Goodwill	4,362	4,362
Acquisition-related intangibles	866	946
Deferred tax assets	218	264
Capitalized software licenses	102	110
Overfunded retirement plans	215	208
Other long-term assets	147	86
Total assets	\$ 17,507	\$ 17,642
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of long-term debt	\$ 500	\$ 500
Accounts payable	488	466
Accrued compensation	344	722
Income taxes payable	133	128
Accrued expenses and other liabilities	395	442
Total current liabilities	1,860	2,258
Long-term debt	3,578	3,577
Underfunded retirement plans	92	89
Deferred tax liabilities	53	78
Other long-term liabilities	1,282	1,303
Total liabilities	6,865	7,305
Stockholders' equity:		
Preferred stock, \$25 par value. Authorized – 10,000,000 shares		
Participating cumulative preferred. None issued.	—	—
Common stock, \$1 par value. Authorized – 2,400,000,000 shares		
Shares issued – 1,740,815,939	1,741	1,741
Paid-in capital	1,770	1,776
Retained earnings	35,619	34,662

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Treasury common stock at cost

Shares: March 31, 2018 – 759,098,020; December 31, 2017 – 757,657,217	(28,096)	(27,458)
Accumulated other comprehensive income (loss), net of taxes (AOCI)	(392 )	(384 )
Total stockholders' equity	10,642	10,337
Total liabilities and stockholders' equity	\$ 17,507	\$ 17,642

See accompanying notes.



## TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Millions of dollars)	For Three Months Ended March 31,	
	2018	2017
<b>Cash flows from operating activities</b>		
Net income	\$ 1,366	\$ 997
<b>Adjustments to Net income:</b>		
Depreciation	137	139
Amortization of acquisition-related intangibles	80	80
Amortization of capitalized software	12	11
Stock compensation	70	68
Deferred taxes	(31 )	9
<b>Increase (decrease) from changes in:</b>		
Accounts receivable	(176 )	(68 )
Inventories	(97 )	(53 )
Prepaid expenses and other current assets	356	(71 )
Accounts payable and accrued expenses	(51 )	(78 )
Accrued compensation	(372 )	(356 )
Income taxes payable	(131 )	149
Changes in funded status of retirement plans	(15 )	(14 )
Other	(36 )	(18 )
Cash flows from operating activities	1,112	795
<b>Cash flows from investing activities</b>		
Capital expenditures	(189 )	(127 )
Proceeds from asset sales	—	40
Purchases of short-term investments	(996 )	(757 )
Proceeds from short-term investments	1,455	1,120
Other	(4 )	(9 )
Cash flows from investing activities	266	267
<b>Cash flows from financing activities</b>		
Repayment of debt	—	(250 )
Dividends paid	(611 )	(500 )
Stock repurchases	(873 )	(550 )
Proceeds from common stock transactions	178	161
Other	(11 )	(4 )
Cash flows from financing activities	(1,317)	(1,143)
Net change in Cash and cash equivalents	61	(81 )
Cash and cash equivalents at beginning of period	1,656	1,154
Cash and cash equivalents at end of period	\$ 1,717	\$ 1,073

See accompanying notes.



## TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

## Notes to financial statements

## 1. Description of business, including segment and geographic area information

We design, make and sell semiconductors to electronics designers and manufacturers all over the world. We have two reportable segments, which are established along major categories of products as follows:

• **Analog** – consisting of the following product lines: Power, Signal Chain and High Volume.

• **Embedded Processing** – consisting of the following product lines: Connected Microcontrollers and Processors.

We report the results of our remaining business activities in Other. Other includes operating segments that do not meet the quantitative thresholds for individually reportable segments and cannot be aggregated with other operating segments. Other includes DLP® products, calculators and custom ASIC products.

Our centralized manufacturing and support organizations, such as facilities, procurement and logistics, provide support to our operating segments, including those in Other. Costs incurred by these organizations, including depreciation, are charged to the segments on a per-unit basis. Consequently, depreciation expense is not an independently identifiable component within the segments' results and, therefore, is not provided.

## Segment information

	For Three Months Ended March 31,	
	2018	2017
<b>Revenue:</b>		
Analog	\$ 2,566	\$ 2,256
Embedded Processing	926	803
Other	297	343
<b>Total revenue</b>	<b>\$ 3,789</b>	<b>\$ 3,402</b>
<b>Operating profit:</b>		
Analog	\$ 1,166	\$ 935
Embedded Processing	328	240
Other	54	77
<b>Total operating profit</b>	<b>\$ 1,548</b>	<b>\$ 1,252</b>

## Geographic area information

The following geographic area information includes revenue based on product shipment destination. The revenue information is not necessarily indicative of the geographic area in which the end applications containing our products are ultimately consumed because our products tend to be shipped to the locations where our customers manufacture their products. Specifically, many of our products are shipped to our customers in China who may include these parts in the manufacture of their own end products, which they may in turn export to their customers around the world.

For Three  
Months Ended

	March 31,	
	2018	2017
Revenue:		
United States	\$ 504	\$ 399
Asia (a)	2,215	2,004
Europe, Middle East and Africa	771	683
Japan	220	250
Rest of world	79	66
Total revenue	\$ 3,789	\$ 3,402

(a) Revenue from products shipped into China, including Hong Kong, was \$1.6 billion and \$1.5 billion in the three months ended March 31, 2018, and March 31, 2017, respectively.

TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

2. Basis of presentation and significant accounting policies and practices

Basis of presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) and on the same basis as the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2017, except for the effects of adopting Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606). The Consolidated Statements of Income, Comprehensive Income and Cash Flows for the periods ended March 31, 2018 and 2017, and the Consolidated Balance Sheet as of March 31, 2018, are not audited but reflect all adjustments that are of a normal recurring nature and are necessary for a fair statement of the results of the periods shown. Certain information and note disclosures normally included in annual consolidated financial statements have been omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. Because the consolidated interim financial statements do not include all of the information and notes required by GAAP for a complete set of financial statements, they should be read in conjunction with the audited consolidated financial statements and notes included in our annual report on Form 10-K for the year ended December 31, 2017. The results for the three-month periods are not necessarily indicative of a full year's results.

Significant accounting policies and practices

Revenue recognition

We generate revenue primarily from the sale of semiconductor products, either directly to a customer or to a distributor, or at the conclusion of a consignment process. We have a variety of types of contracts with our customers and distributors. In determining whether a contract exists, we evaluate the terms of the agreement, the relationship with the customer or distributor and their ability to pay.

We recognize revenue from sales of our products, including sales to our distributors, at a point in time, generally upon shipment or delivery to the customer or distributor, depending upon the terms of the sales order. Control is considered transferred when title and risk of loss pass, when the customer becomes obligated to pay and, where required, when the customer has accepted the products. For sales to distributors, payment is due on our standard commercial terms and is not contingent upon resale of the products.

Revenue from sales of our products that is subject to inventory consignment agreements is recognized at a point in time, when the customer or distributor pulls product from consignment inventory that we store at designated locations. Transfer of control occurs at that point, when title and risk of loss transfers and the customer or distributor becomes obligated to pay for the products pulled from inventory. Until the products are pulled for use or sale by the customer or distributor, we retain control over the products' disposition, including the right to pull back or relocate the products.

The amount of revenue recognized is adjusted based on allowances, which are prepared on a portfolio basis using a most likely amount methodology based on analysis of historical data, current economic conditions and contractual terms. These allowances, which are not material, generally include adjustments for pricing arrangements, product returns and incentives. The length of time between invoicing and payment is not significant under any of our payment terms. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component.

In addition, we record allowances for accounts receivable that we estimate may not be collected. We monitor collectability of accounts receivable primarily through review of accounts receivable aging. When collection is at risk, we assess the impact on amounts recorded for bad debts and, if necessary, record a charge in the period such determination is made.

We recognize shipping fees, if any, received from customers in revenue. We include shipping and handling costs in COR. The majority of our customers pay these fees directly to third parties.

#### Earnings per share (EPS)

Unvested share-based payment awards that contain non-forfeitable rights to receive dividends or dividend equivalents, such as our restricted stock units (RSUs), are considered to be participating securities and the two-class method is used for purposes of calculating EPS. Under the two-class method, a portion of Net income is allocated to these participating securities and, therefore, is excluded from the calculation of EPS allocated to common stock, as shown in the table below.

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## TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Computation and reconciliation of earnings per common share are as follows (shares in millions):

	For Three Months Ended March 31,					
	2018			2017		
	Net		EPS	Net		EPS
	Income	Shares	EPS	Income	Shares	EPS
<b>Basic EPS:</b>						
Net income	\$ 1,366			\$ 997		
Income allocated to RSUs	(11 )			(10 )		
Income allocated to common stock for basic EPS calculation	\$ 1,355	983	\$ 1.38	\$ 987	998	\$ .99
<b>Adjustment for dilutive shares:</b>						
Stock compensation plans		22			21	
<b>Diluted EPS:</b>						
Net income	\$ 1,366			\$ 997		
Income allocated to RSUs	(11 )			(10 )		
Income allocated to common stock for diluted EPS calculation	\$ 1,355	1,005	\$ 1.35	\$ 987	1,019	\$ .97

Potentially dilutive securities representing 5 million and 6 million shares of common stock that were outstanding during the first quarters of 2018 and 2017, respectively, were excluded from the computation of diluted earnings per common share for these periods because their effect would have been anti-dilutive.

#### Derivatives and hedging

We use derivative financial instruments to manage exposure to foreign exchange risk. These instruments are primarily forward foreign currency exchange contracts, which are used as economic hedges to reduce the earnings impact that exchange rate fluctuations may have on our non-U.S. dollar net balance sheet exposures. Gains and losses from changes in the fair value of these forward foreign currency exchange contracts are credited or charged to OI&E. We do not apply hedge accounting to our foreign currency derivative instruments.

In connection with the issuance of long-term debt, we may use financial derivatives such as treasury-rate lock agreements that are recognized in AOCI and amortized over the life of the related debt. The results of these derivative transactions have not been material.

We do not use derivatives for speculative or trading purposes.

#### Fair values of financial instruments

The fair values of our derivative financial instruments were not material as of March 31, 2018. Our investments in cash equivalents, short-term investments and certain long-term investments, as well as our deferred compensation liabilities, are carried at fair value. The carrying values for other current financial assets and liabilities, such as

accounts receivable and accounts payable, approximate fair value due to the short maturity of such instruments. The carrying value of our long-term debt approximates the fair value as measured using broker-dealer quotes, which are Level 2 inputs. See Note 4 for a description of fair value and the definition of Level 2 inputs.

Changes in accounting standards – adopted standards for current period

ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606)

This standard provides a single set of guidelines for revenue recognition to be used across all industries and requires additional disclosures. We adopted Accounting Standards Codification Topic 606 (ASC 606) as of January 1, 2018, using the modified retrospective transition method applied only to contracts that were not completed as of the adoption date. The reported results for 2018 reflect the application of the new accounting guidance, while the reported results for prior period amounts are not adjusted and continue to be reported in accordance with our historical accounting under ASC 605, Revenue Recognition (ASC 605).



TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

The most significant impact from adopting the standard relates to our accounting for royalty income on licenses of intellectual property; however, the effect of such change during any individual reporting period will not materially impact our results of operations and financial position. Although royalty income is recorded within OI&E, the new revenue guidance applies to these agreements by analogy, and therefore, such agreements have been evaluated for ASC transition considerations. Under ASC 606, royalty income for our fixed-rate royalty agreements is bifurcated between two performance obligations: providing a right to use our initial patent portfolio and the right to access our future patents when those patents are developed. We have determined that the value of these agreements is allocated more heavily to the initial performance obligation. As a result, income from these agreements is recognized predominately at the time of contract execution rather than ratably over the life of the agreements, accelerating the timing of when we recognize royalty income in OI&E.

The timing of revenue recognition, billings and cash collections may result in billed accounts receivable, unbilled receivables (contract assets), and customer advances and deposits (contract liabilities). These items are included in other current and non-current assets and liabilities on the Consolidated Balance Sheets.

The time frame between when the customer places an order for products and when it is shipped is less than 12 months. Generally, we invoice customers for payment upon shipment or when goods are pulled from consignment inventory, which results in an unconditional right to consideration. Our contract assets are primarily related to our rights to consideration for satisfied or partially satisfied performance obligations on our royalty agreements for which payment has not been received as of the reporting date.

We recognized an increase to opening retained earnings of \$206 million, net of taxes, as of January 1, 2018, due to the cumulative impact of adopting ASC 606, with the impact primarily related to our fixed payment patent licensing agreements that were not completed as of the adoption date. A contract asset of \$283 million and deferred tax liabilities of \$55 million were recorded as of January 1, 2018, related to the transition period adjustments.

Occasionally, as of the end of a reporting period, some of the performance obligations associated with contracts will have been unsatisfied or only partially satisfied. In accordance with the practical expedients available in the guidance, we do not disclose the value of unsatisfied performance obligations for contracts with an original expected duration of one year or less. Similarly, we do not disclose information for variable-rate consideration on our sales-based or usage-based royalties for our patent licenses.

For royalty income from licensing our patent portfolios, income is allocated to performance obligations that have not yet been satisfied. The remaining performance obligations represent contracted income that has not yet been recognized, including amounts that will be invoiced and recognized as income in future periods. As of March 31, 2018, we had \$75 million of remaining performance obligations that had not yet been satisfied. We expect to recognize approximately 20 percent of our remaining performance obligations as income over the next 12 months and the remainder thereafter.

As of March 31, 2018, we had contract assets of \$273 million. During the three months ended March 31, 2018, our contract assets were reduced by \$10 million, due to \$14 million of cash received offset by \$4 million of income recognized.

We incur commission expenses paid to internal sales personnel that are incremental to obtaining contracts with customers. We generally expense sales commissions when incurred because the amortization period would have been one year or less. These costs are included in SG&A.

## Other standards

The following standards were adopted during the current period and did not have a material impact on our financial position and results of operations:

ASU	Description	Adopted Date
ASU No. 2016-01	Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities	January 1, 2018
ASU No. 2017-01	Business Combinations (Topic 805): Clarifying the Definition of a Business	January 1, 2018
ASU No. 2017-05	Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets	January 1, 2018

TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Changes in accounting standards – standards not yet adopted

ASU No. 2016-02, Leases (Topic 842)

This standard requires all leases that have a term of over 12 months to be recognized on the balance sheet with the liability for lease payments and the corresponding right-of-use asset initially measured at the present value of amounts expected to be paid over the term. Recognition of the costs of these leases on the income statement will be dependent upon their classification as either an operating or a financing lease. Costs of an operating lease will continue to be recognized as a single operating expense on a straight-line basis over the lease term. Costs for a financing lease will be disaggregated and recognized as both an operating expense (for the amortization of the right-of-use asset) and interest expense (for interest on the lease liability). This standard will be effective for our interim and annual periods beginning January 1, 2019, and must be applied on a modified retrospective basis. In March 2018, the FASB tentatively approved an optional transition method to initially account for the impact of the adoption with a cumulative-effect adjustment to the January 1, 2019, rather than January 1, 2017, financial statements. This would eliminate the need to restate amounts presented prior to January 1, 2019. We plan to adopt the standard effective January 1, 2019, and expect to elect this optional transition method. We are currently evaluating the potential impact of this standard on our financial position, but we do not expect it to have a material impact on our results of operations.

ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

This standard requires entities to use a current lifetime expected credit loss methodology to measure impairments of certain financial assets. Using this methodology will result in earlier recognition of losses than under the current incurred loss approach, which requires waiting to recognize a loss until it is probable of having been incurred. There are other provisions within the standard that affect how impairments of other financial assets may be recorded and presented, and that expand disclosures. This standard will be effective for our interim and annual periods beginning January 1, 2020, and permits earlier application but not before periods beginning January 1, 2019. The standard will be applied using a modified retrospective approach. We are currently evaluating the potential impact of this standard, but we do not expect it to have a material impact on our financial position and results of operations.

ASU No. 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

This standard allows a reclassification of stranded tax effects as a result of the U.S. Tax Cuts and Jobs Act (the Tax Act) from accumulated other comprehensive income to retained earnings. The provisions from this guidance are effective for interim and annual periods beginning after January 1, 2019. Early adoption is permitted. This standard should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effects of the Tax Act are recognized. We plan to adopt this standard during the interim period in which we complete our accounting for the tax effects of the enactment of the Tax Act, applying the guidance to the period of adoption. This standard will have no impact on our results of operations. We are currently evaluating the potential impact of this standard on our financial position.

### 3. Income taxes

Our Provision for income taxes was \$187 million and \$258 million for the first quarters of 2018 and 2017, respectively.

Our estimated annual effective tax rate is about 20 percent, which does not include discrete tax items. This differs from the 21 percent statutory corporate tax rate due to the effect of U.S. tax benefits, offset by a 2018 transitional tax effect.

We have included the provisions of the Tax Act in the calculation of our estimated annual effective tax rate. The estimates could change when additional information on implementation of the provisions of the Tax Act becomes available.

The Tax Act was enacted on December 22, 2017. We have not completed our accounting for the tax effects of enactment of the Tax Act. We have made reasonable estimates of the tax on indefinitely reinvested earnings and the effects on our existing deferred tax balances. This resulted in additional tax expense in 2017 of \$773 million, consisting of \$714 million related to the tax on indefinitely reinvested earnings and \$59 million related to remeasuring our existing deferred tax balances.

The tax on indefinitely reinvested earnings is based on our non-U.S. post-1986 earnings and profits (E&P) that we previously deferred from U.S. income taxes. We have not yet completed our calculation of the total post-1986 E&P for these non-U.S. subsidiaries.

In the first quarter of 2018 we reduced the amount of income tax expense recorded for indefinitely reinvested earnings to \$669 million from \$714 million recorded in 2017. This adjustment did not affect the estimated annual effective tax rate for 2018.

The calculations of the tax effect of the Tax Act for both indefinitely reinvested earnings and deferred tax assets and liabilities are expected to be completed with the preparation of the U.S. 2017 tax return in the third quarter of 2018.

## TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Provision for income taxes is based on the following:

	For Three Months Ended March 31,	
	2018	2017
Taxes calculated using the estimated annual effective tax rate	\$ 316	\$ 382
Discrete tax items	(129)	(124)
Provision for income taxes	\$ 187	\$ 258
Estimated annual effective tax rate	20 %	30 %
Actual effective tax rate	12 %	21 %

#### 4. Valuation of debt and equity investments and certain liabilities

##### Debt and equity investments

We classify our investments as available for sale, trading, equity method or non-marketable equity. Most of our investments are debt securities, which are classified as available for sale.

Available-for-sale and trading securities are stated at fair value, which is generally based on market prices or broker quotes. See Fair-value considerations below. Unrealized gains and losses from available-for-sale debt securities are recorded as an increase or decrease, net of taxes, in AOCI on our Consolidated Balance Sheets. We record other-than-temporary impairments on available-for-sale debt securities in OI&E in our Consolidated Statements of Income.

We classify certain mutual funds as trading securities. These mutual funds hold a variety of debt and equity investments intended to generate returns that offset changes in certain deferred compensation liabilities. We record changes in the fair value of these mutual funds and the related deferred compensation liabilities in SG&A.

Our other investments include equity-method investments and non-marketable equity investments, which are not measured at fair value. These investments consist of interests in venture capital funds and other non-marketable equity securities. Gains and losses from equity-method investments are recognized in OI&E based on our ownership share of the investee's financial results.

Details of our investments are as follows:

March 31, 2018			December 31, 2017		
Cash			Cash		
and			and		
Cash	Short-Term	Long-Term	Cash	Short-Term	Long-Term
Equivalents	Investments	Investments	Equivalents	Investments	Investments

Measured at fair value:						
Available-for-sale debt securities:						
Money market funds	\$ 369	\$ —	\$ —	\$ 525	\$ —	\$ —
Corporate obligations	413	764	—	172	698	—
U.S. government agency and Treasury securities	699	1,598	—	700	2,115	—
Trading securities:						
Mutual funds	—	—	243	—	—	236
Total	1,481	2,362	243	1,397	2,813	236
Other measurement basis:						
Equity-method investments	—	—	24	—	—	26
Non-marketable equity investments	—	—	4	—	—	6
Cash on hand	236	—	—	259	—	—
Total	\$ 1,717	\$ 2,362	\$ 271	\$ 1,656	\$ 2,813	\$ 268

As of March 31, 2018, and December 31, 2017, unrealized gains and losses associated with our available-for-sale investments were not material. We did not recognize any credit losses related to available-for-sale investments for the three months ended March 31, 2018, and March 31, 2017.

## TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

For the three months ended March 31, 2018, and March 31, 2017, the proceeds from sales, redemptions and maturities of short-term available-for-sale investments were \$1.46 billion and \$1.12 billion, respectively. Gross realized gains and losses from these sales were not material.

The following table presents the aggregate maturities of our available-for-sale investments as of March 31, 2018:

Due	Fair Value
One year or less	\$ 3,833
One to two years	10

Other-than-temporary declines and impairments in the values of our available-for-sale investments, which were recognized in OI&E, were not material in the three months ended March 31, 2018, and March 31, 2017.

#### Fair-value considerations

We measure and report certain financial assets and liabilities at fair value on a recurring basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an 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 three-level hierarchy discussed below indicates the extent and level of judgment used to estimate fair-value measurements.

Level 1 – Uses unadjusted quoted prices that are available in active markets for identical assets or liabilities as of the reporting date.

- Level 2 – Uses inputs other than Level 1 that are either directly or indirectly observable as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rates and volatility factors, are corroborated by readily observable data. We utilize a third-party data service to provide Level 2 valuations. We verify these valuations for reasonableness relative to unadjusted quotes obtained from brokers or dealers based on observable prices for similar assets in active markets.

Level 3 – Uses inputs that are unobservable, supported by little or no market activity and reflect the use of significant management judgment. These values are generally determined using pricing models that utilize management estimates of market participant assumptions. As of March 31, 2018 and December 31, 2017, we had no Level 3 assets or liabilities, other than certain assets held by our postretirement plans.

The following are our assets and liabilities that were accounted for at fair value on a recurring basis. These tables do not include cash on hand, assets held by our postretirement plans, or assets and liabilities that are measured at historical cost or any basis other than fair value.

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	March 31, 2018			December 31, 2017		
	Level 1	Level 2	Total	Level 1	2	Total
<b>Assets:</b>						
Money market funds	\$ 369	\$ —	\$ 369	\$ 525	\$ —	\$ 525
Corporate obligations	—	1,177	1,177	—	870	870
U.S. government agency and Treasury securities	2,247	50	2,297	2,765	50	2,815
Mutual funds	243	—	243	236	—	236
<b>Total assets</b>	<b>\$ 2,859</b>	<b>\$ 1,227</b>	<b>\$ 4,086</b>	<b>\$ 3,526</b>	<b>\$ 920</b>	<b>\$ 4,446</b>
<b>Liabilities:</b>						
Deferred compensation	\$ 256	\$ —	\$ 256	\$ 255	\$ —	\$ 255
<b>Total liabilities</b>	<b>\$ 256</b>	<b>\$ —</b>	<b>\$ 256</b>	<b>\$ 255</b>	<b>\$ —</b>	<b>\$ 255</b>

5. Goodwill and acquisition-related intangibles

Goodwill was \$4.36 billion as of March 31, 2018, and December 31, 2017. There was no impairment of goodwill during the three months ended March 31, 2018, or March 31, 2017.



## TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

The components of Acquisition-related intangibles are as follows:

	Amortization Period (Years)	March 31, 2018			December 31, 2017		
		Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Developed technology	7 - 10	\$ 2,130	\$ 1,415	\$ 715	\$ 2,130	\$ 1,361	\$ 769
Customer relationships	8	810	659	151	810	633	177
<b>Total</b>		<b>\$ 2,940</b>	<b>\$ 2,074</b>	<b>\$ 866</b>	<b>\$ 2,940</b>	<b>\$ 1,994</b>	<b>\$ 946</b>

Amortization of acquisition-related intangibles was \$80 million for the first quarters of both 2018 and 2017. Fully amortized assets are written off against accumulated amortization.

## 6. Postretirement benefit plans

Expense related to defined benefit and retiree health care benefit plans is as follows:

For Three Months Ended March 31,	U.S. Defined Benefit		U.S. Retiree Health Care		Non-U.S. Defined Benefit	
	2018	2017	2018	2017	2018	2017
Service cost	\$ 5	\$ 5	\$ 1	\$ 1	\$ 9	\$ 9
Interest cost	9	10	4	4	12	11
Expected return on plan assets	(11)	(10)	(4)	(4)	(17)	(16)
Recognized net actuarial loss	4	4	1	1	5	7
Amortization of prior service credit	—	—	(1)	(1)	—	—
Net periodic benefit costs	7	9	1	1	9	11
Settlement losses	2	6	—	—	—	—
<b>Total, including other postretirement losses</b>	<b>\$ 9</b>	<b>\$ 15</b>	<b>\$ 1</b>	<b>\$ 1</b>	<b>\$ 9</b>	<b>\$ 11</b>

## 7. Debt and lines of credit

## Short-term borrowings

We maintain a line of credit to support commercial paper borrowings, if any, and to provide additional liquidity through bank loans. As of March 31, 2018, we had a variable-rate revolving credit facility from a consortium of

investment-grade banks that allows us to borrow up to \$2 billion until March 2023. The interest rate on borrowings under this credit facility, if drawn, is indexed to the applicable London Interbank Offered Rate (LIBOR). As of March 31, 2018, our credit facility was undrawn, and we had no commercial paper outstanding.

#### Long-term debt

On April 30, 2018, we agreed to issue \$1.30 billion principal amount of debt that we expect to use for general corporate purposes, including to replenish our cash on hand following the repayment of maturing debt. The offering is expected to close on May 7, 2018.

## TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

Long-term debt outstanding is as follows:

	March 31, 2018	December 31, 2017
Notes due 2018 at 1.00%	500	500
Notes due 2019 at 1.65%	750	750
Notes due 2020 at 1.75%	500	500
Notes due 2021 at 2.75%	550	550
Notes due 2022 at 1.85%	500	500
Notes due 2023 at 2.25%	500	500
Notes due 2024 at 2.625%	300	300
Notes due 2027 at 2.90%	500	500
Total debt	4,100	4,100
Net unamortized discounts, premiums and debt issuance costs	(22 )	(23 )
Total debt, including net unamortized discounts, premiums and debt issuance costs	4,078	4,077
Current portion of long-term debt	(500 )	(500 )
Long-term debt	\$ 3,578	\$ 3,577

Interest and debt expense was \$23 million and \$18 million for the first quarters of 2018 and 2017, respectively. This was net of the amortization of the debt discounts, premiums and debt issuance costs. Capitalized interest was not material.

## 8. Contingencies

### Indemnification guarantees

We routinely sell products with an intellectual property indemnification included in the terms of sale. Historically, we have had only minimal, infrequent losses associated with these indemnities. Consequently, we cannot reasonably estimate any future liabilities that may result.

### Warranty costs/product liabilities

We accrue for known product-related claims if a loss is probable and can be reasonably estimated. During the periods presented, there have been no material accruals or payments regarding product warranty or product liability. Historically, we have experienced a low rate of payments on product claims. Although we cannot predict the likelihood or amount of any future claims, we do not believe they will have a material adverse effect on our financial condition, results of operations or liquidity. Our stated warranties for semiconductor products obligate us to repair, replace or credit the purchase price of a covered product back to the buyer. Product claim consideration may exceed the price of our products.

### General

We are subject to various legal and administrative proceedings. Although it is not possible to predict the outcome of these matters, we believe that the results of these proceedings will not have a material adverse effect on our financial condition, results of operations or liquidity.

#### 9. Supplemental financial information

##### Acquisition charges

Acquisition charges represent the ongoing amortization of intangible assets resulting from the acquisition of National Semiconductor Corporation. These amounts are included in Other for segment reporting purposes, consistent with how management measures the performance of its segments. See Note 5 for additional information.

##### Restructuring charges/other

Restructuring charges/other are included in Other for segment reporting purposes.

## TEXAS INSTRUMENTS INCORPORATED AND SUBSIDIARIES

As of March 31, 2018, we have recognized \$21 million of restructuring charges for severance and benefit costs related to the previously reported reorganization of the product lines within our two reportable segments. We have paid \$18 million to terminated employees for severance and benefits. Any further charges are not expected to be material.

As of March 31, 2018, we have recognized \$33 million of restructuring charges for severance and benefits costs, as well as accelerated depreciation, related to the phase out of a manufacturing facility in Greenock, Scotland. Total restructuring charges, primarily severance and benefit costs, are estimated to be about \$40 million. The remaining charges are expected to be recognized through 2019.

Changes in accrued restructuring balances are as follows:

Balance, December 31, 2017	\$ 29
Restructuring charges	1
Non-cash items (a)	1
Payments	(2)
Balance, March 31, 2018	\$ 29

(a) Reflects charges for impacts of accelerated depreciation and changes in exchange rates.

The restructuring accrual balances are primarily reported as a component of either Accrued expenses and other liabilities or Other long-term liabilities on our Consolidated Balance Sheets, depending on the expected timing of payment.

Details on amounts reclassified out of Accumulated other comprehensive income (loss), net of taxes, to Net income

Our Consolidated Statements of Comprehensive Income include items that have been recognized within Net income during the periods ended March 31, 2018, and March 31, 2017. The table below details where these transactions are recorded in our Consolidated Statements of Income.

	For Three Months Ended		Impact to Related Statement of Income Lines
	March 31, 2018	March 31, 2017	
Net actuarial losses of defined benefit plans:			
Recognized net actuarial loss and Settlement losses (a)	\$ 12	\$ 18	Decrease to OI&E
Tax effect	(3)	(6)	Decrease to Provision for income taxes
Recognized within Net income, net of taxes	\$ 9	\$ 12	Decrease to Net income
Prior service credit of defined benefit plans:			
Amortization of prior service credit (a)	\$ (1)	\$ (1)	Increase to OI&E
Tax effect	—	—	Increase to Provision for income taxes
Recognized within Net income, net of taxes	\$ (1)	\$ (1)	Increase to Net income

(a) Detailed in Note 6.

Stock compensation

Total shares of 6,893,414 were issued from treasury shares during the first quarter of 2018 related to stock compensation.

ITEM 2. Management's discussion and analysis of financial condition and results of operations.

Overview

We design, make and sell semiconductors to electronics designers and manufacturers all over the world. Our business model is designed around the following four sustainable competitive advantages, that we believe, in combination, put us in a unique class of companies:

• **A strong foundation of manufacturing and technology.** We invest in manufacturing technologies and do most of our manufacturing in-house. This strategic decision to directly control our manufacturing helps ensure a consistent supply of products for our customers and also allows us to invest in technology that differentiates the features of our products. We have focused on creating a competitive manufacturing cost advantage by increasing factory loadings of our advanced analog 300-millimeter wafers, which have about a 40 percent cost advantage per unpackaged chip over 200-millimeter wafers. 300-millimeter wafers will support the majority of our Analog growth going forward. Additionally, we keep our manufacturing costs low by using mature assets acquired ahead of demand when their prices are most attractive.

• **Broad portfolio of differentiated analog and embedded processing semiconductors.** Our customers need multiple chips for their systems. The breadth of our portfolio means we can solve more of these needs than our competitors, which gives us access to more customers and the opportunity to sell more products and generate more revenue per customer system. We invest more than \$1 billion each year to develop new products for our portfolio, which includes tens of thousands of products.

• **Broadest reach of market channels.** Customers often begin their initial product selection process and design-in journey on our website, and the breadth of our portfolio attracts more customers to our website than any of our competitors. Our web presence, combined with our global sales force that is also greater in size than those of our competitors, are advantages that give us unique access to about 100,000 customers designing TI semiconductors into their end products.

• **Diversity and longevity of our products, markets and customer positions.** Together, the attributes above result in diverse and long-lived positions that deliver high terminal value to our shareholders. Because of the breadth of our portfolio, we are not dependent on any single product, and because of the breadth of our markets we are not dependent on any single application or customer. Some of our products generate revenue for decades, which strengthens the return on our investments.

Our strategic focus, and where we invest the majority of our resources, is on Analog and Embedded Processing, with a particular emphasis on designing and selling those products into the industrial and automotive markets, which we believe represent the best growth opportunities. Analog and embedded processing products sold into industrial and automotive markets provide long product life cycles, intrinsic diversity, and less capital-intensive manufacturing, which we believe offer stability, profitability and strong cash generation. This business model is the foundation of our capital management strategy, which is based on our belief that free cash flow growth, especially on a per share basis, is important for maximizing shareholder value over the long term. We also believe that free cash flow will be valued only if it is productively invested in the business or returned to shareholders.

The combined effect of these sustainable competitive advantages is that over time we have gained market share in Analog and Embedded Processing and have grown free cash flow. Our business model puts us in a unique class of companies with the ability to grow, generate cash, and return that cash to shareholders.

Management's discussion and analysis of financial condition and results of operations (MD&A) should be read in conjunction with the financial statements and the related notes that appear elsewhere in this document. In the following discussion of our results of operations:

-

Our segments represent groups of similar products that are combined on the basis of similar design and development requirements, product characteristics, manufacturing processes and distribution channels, and how management allocates resources and measures results. See Note 1 to the financial statements for more information regarding our segments.

• All dollar amounts in the tables are stated in millions of U.S. dollars.

• When we discuss our results:

o Unless otherwise noted, changes in our revenue are attributable to changes in customer demand, which are evidenced by fluctuations in shipment volumes.

o New products tend not to have a significant impact on our revenue in any given period because we sell such a large number of products.



- o From time to time, our revenue and gross profit are affected by changes in demand for higher-priced or lower-priced products, which we refer to as changes in the “mix” of products shipped.
- o Because we own much of our manufacturing capacity, a significant portion of our operating cost is fixed. When factory loadings decrease, our fixed costs are spread over reduced output and, absent other circumstances, our profit margins decrease. Conversely, as factory loadings increase, our fixed costs are spread over increased output and, absent other circumstances, our profit margins increase. Increases and decreases in factory loadings tend to correspond to increases and decreases in demand.
- o Over time, we have been allocating resources from areas like manufacturing support and SG&A into R&D activities.

#### Performance summary

Our first-quarter revenue was \$3.79 billion, net income was \$1.37 billion and earnings per share (EPS) were \$1.35. Earnings per share include 14 cents in tax-related benefits not in our original guidance.

Revenue increased 11 percent from the same quarter a year ago. Demand for our Analog and Embedded Processing products continued to be strong in the industrial and automotive markets.

Our cash flow from operations of \$5.7 billion for the trailing 12 months again underscored the strength of our business model. Free cash flow for the trailing 12 months was up 17 percent from a year ago to \$4.9 billion, or 32.1 percent of revenue. This reflects the quality of our product portfolio, as well as the efficiency of our manufacturing strategy, including the benefit of 300-millimeter Analog production.

We have returned \$5.1 billion to owners in the past 12 months through stock repurchases and dividends, consistent with our strategy to return to owners all of our free cash flow. Over the last 12 months, our dividends represented 45 percent of free cash flow, emphasizing their sustainability.

We now expect our ongoing annual operating tax rate to be about 16 percent starting in 2019 and 20 percent in 2018, lower than our previous expectation of 18 percent and 23 percent, respectively.

For an explanation of free cash flow and the term “annual operating tax rate,” see the Non-GAAP financial information section.

#### Results of operations – first-quarter 2018 compared with first-quarter 2017

Revenue increased \$387 million, or 11 percent, due to higher revenue from Analog and Embedded Processing.

Gross profit of \$2.45 billion was up \$303 million, or 14 percent, due to higher revenue and lower manufacturing costs. As a percentage of revenue, gross profit increased to 64.6 percent from 63.0 percent.

Operating expenses (R&D and SG&A) were \$818 million compared with \$808 million.

Acquisition charges of \$80 million were non-cash. See Note 9 to the financial statements.

Operating profit was \$1.55 billion, or 40.9 percent of revenue, compared with \$1.25 billion, or 36.8 percent of revenue.

OI&E was \$28 million of income compared with \$21 million.

Our Provision for income taxes was \$187 million compared with \$258 million, which includes discrete tax benefits of \$129 million and \$124 million, respectively. The decrease in our tax provision was primarily due to a lower U.S. statutory corporate tax rate and other net benefits resulting from the U.S. Tax Cuts and Jobs Act (the Tax Act), partially offset by higher income before income taxes. The \$129 million discrete tax benefits include \$82 million due to stock-based compensation, \$45 million due to updated estimates related to the Tax Act, and \$2 million of other net tax benefits.

Our annual operating tax rate, which does not include discrete tax items, is about 20 percent compared with 31 percent in 2017. We use “annual operating tax rate” to describe the estimated annual effective tax rate. The 2018 rate differs from the 21 percent U.S. statutory corporate tax rate due to the effect of U.S. tax benefits, offset by a transitional non-cash tax expense.

Net income was \$1.37 billion compared with \$997 million. EPS was \$1.35 compared with \$0.97.

## First-quarter 2018 segment results

Our segment results compared with the year-ago quarter are as follows:

Analog (includes Power, Signal Chain and High Volume product lines)

	1Q18	1Q17	Change
Revenue	\$ 2,566	\$ 2,256	14 %
Operating profit	1,166	935	25 %
Operating profit % of revenue	45.4 %	41.4 %	

Analog revenue increased due to Power and, to a lesser extent, Signal Chain. High Volume revenue was about even. Operating profit increased due to higher revenue and associated gross profit.

Embedded Processing (includes Connected Microcontrollers and Processors product lines)

	1Q18	1Q17	Change
Revenue	\$ 926	\$ 803	15 %
Operating profit	328	240	37 %
Operating profit % of revenue	35.4 %	29.9 %	

Embedded Processing revenue increased in both product lines, led by Processors. Operating profit increased primarily due to higher revenue and associated gross profit.

Other (includes DLP<sup>®</sup> products, calculators and custom ASIC products)

	1Q18	1Q17	Change
Revenue	\$ 297	\$ 343	(13 )%
Operating profit*	54	77	(30 )%
Operating profit % of revenue	18.2 %	22.4 %	

\* Includes Acquisition charges and Restructuring charges/other

Other revenue decreased by \$46 million, and operating profit declined by \$23 million.

## Financial condition

At the end of the first quarter of 2018, total cash (Cash and cash equivalents plus Short-term investments) was \$4.08 billion, a decrease of \$390 million from the end of 2017.

Accounts receivable were \$1.45 billion, an increase of \$176 million compared with the end of 2017. Days sales outstanding at the end of the first quarter of 2018 were 35 compared with 31 at the end of 2017.

Inventory was \$2.03 billion, an increase of \$75 million from the end of 2017. Days of inventory at the end of the first quarter of 2018 were 136 compared with 134 at the end of 2017.

## Liquidity and capital resources

Our primary source of liquidity is cash flow from operations. Additional sources of liquidity are Cash and cash equivalents, Short-term investments and a variable-rate, revolving credit facility. Cash flows from operating activities for the first three months of 2018 were \$1.11 billion, an increase of \$317 million from the year-ago period. This

increase was primarily due to higher Net income.

Our revolving credit facility is with a consortium of investment-grade banks and allows us to borrow up to \$2 billion until March 2023. This credit facility also serves as support for the issuance of commercial paper. As of March 31, 2018, our credit facility was undrawn, and we had no commercial paper outstanding.

Investing activities for the first three months of 2018 provided \$266 million compared with \$267 million in the year-ago period. Capital expenditures were \$189 million compared with \$127 million in the year-ago period and were primarily for semiconductor manufacturing equipment in both periods. We had proceeds from sales of short-term investments, net of purchases, that provided cash of \$459 million compared with \$363 million in the year-ago period.

Financing activities for the first three months of 2018 used \$1.32 billion compared with \$1.14 billion in the year-ago period. In the year-ago period, we repaid \$250 million of maturing debt. Dividends paid were \$611 million compared with \$500 million in the year-ago period, reflecting an increase in the dividend rate, partially offset by fewer shares outstanding. We used \$873 million to repurchase 8.2 million shares of our common stock compared with \$550 million used in the year-ago period to repurchase 7.1 million shares. Employee exercises of stock options provided cash proceeds of \$178 million compared with \$161 million in the year-ago period.

On April 30, 2018, we agreed to issue \$1.30 billion principal amount of debt that we expect to use for general corporate purposes, including to replenish our cash on hand following the repayment of maturing debt. The offering is expected to close on May 7, 2018.

We had \$1.72 billion of Cash and cash equivalents and \$2.36 billion of Short-term investments as of March 31, 2018. We believe we have the necessary financial resources and operating plans to fund our working capital needs, capital expenditures, dividend and debt-related payments, and other business requirements for at least the next 12 months.

#### Non-GAAP financial information

This MD&A includes references to free cash flow and ratios based on that measure. These are financial measures that were not prepared in accordance with generally accepted accounting principles in the United States (GAAP). Free cash flow was calculated by subtracting Capital expenditures from the most directly comparable GAAP measure, Cash flows from operating activities (also referred to as cash flow from operations).

We believe that free cash flow and the associated ratios provide insight into our liquidity, our cash-generating capability and the amount of cash potentially available to return to shareholders, as well as insight into our financial performance. These non-GAAP measures are supplemental to the comparable GAAP measures.

Reconciliation to the most directly comparable GAAP measures is provided in the table below.

	For 12 Months Ended March 31,			
	2018	2017		Change
Cash flow from operations (GAAP)	\$ 5,680	\$ 4,756	19	%
Capital expenditures	(757 )	(534 )		
Free cash flow (non-GAAP)	\$ 4,923	\$ 4,222	17	%
Revenue	\$ 15,348	\$ 13,764		
Cash flow from operations as a percent of revenue (GAAP)	37.0 %	34.6 %		
Free cash flow as a percent of revenue (non-GAAP)	32.1 %	30.7 %		

This MD&A also includes references to an annual operating tax rate, a non-GAAP term we use to describe the estimated annual effective tax rate, a GAAP measure that by definition does not include discrete tax items. We believe the term annual operating tax rate more clearly communicates that discrete tax items are excluded from such rate. The term also helps differentiate from the effective tax rate, which includes discrete tax items. No adjustments are made to the estimated annual effective tax rate when using the term annual operating tax rate.

#### Long-term contractual obligations

Information regarding long-term debt obligations is described in the long-term contractual obligations table in Item 7 of our Form 10-K for the year ended December 31, 2017.

#### Critical accounting policies

Our critical accounting policies are described in Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies in our Annual Report on Form 10-K for the year ended December 31, 2017.

On January 1, 2018, we adopted Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606), which is discussed in Note 2 of our consolidated financial statements.

Changes in accounting standards

See Note 2 to the financial statements for detailed information regarding the status of new accounting and reporting standards.

ITEM 4. Controls and Procedures.

An evaluation as of the end of the period covered by this report was carried out under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that those disclosure controls and procedures were effective. In addition, there has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

## ITEM 1A. Risk Factors.

Information concerning our risk factors is contained in Item 1A of our Form 10-K for the year ended December 31, 2017, and is incorporated by reference herein.

## ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The following table contains information regarding our purchases of our common stock during the quarter.

## ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(1)</sup>	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(1)</sup>
January 1, 2018 through January 31, 2018	3,446,350	\$ 110.91	2,978,806	\$ 8.91 billion
February 1, 2018 through February 28, 2018	3,814,825	104.01	3,814,825	8.52 billion
March 1, 2018 through March 31, 2018	1,540,586	105.76	1,540,586	8.35 billion
Total	8,801,761 <sup>(2)</sup>	\$ 107.02 <sup>(2)</sup>	8,334,217	\$ 8.35 billion <sup>(3)</sup>

<sup>(1)</sup>All open-market purchases during the quarter were made under the authorization from our board of directors to purchase up to \$7.5 billion of additional shares of TI common stock announced September 17, 2015. On September 21, 2017, our board of directors authorized the purchase of an additional \$6.0 billion of our common stock.

<sup>(2)</sup>In addition to open-market purchases, 467,544 shares of common stock were surrendered by employees to satisfy tax withholding obligations in connection with the vesting of restricted stock units.

<sup>(3)</sup>As of March 31, 2018, this amount consisted of the remaining portion of the \$7.5 billion authorized in September 2015 and the \$6.0 billion authorized in September 2017. No expiration date has been specified for these authorizations.



## ITEM 6. Exhibits.

Designation

of Exhibits

in This

Report	Description of Exhibit
3(a)	<u>Restated Certificate of Incorporation of the Registrant, dated April 18, 1985, as amended (incorporated by reference to Exhibit 3(a) of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2014).</u>
3(b)	<u>By-Laws of the Registrant (incorporated by reference to Exhibit 3 of the Registrant's Current Report on Form 8-K filed December 12, 2016).</u>
31(a)	<u>Certification of Chief Executive Officer of Periodic Report Pursuant to Rule 13a-15(e) or Rule 15d-15(e).<sup>†</sup></u>
31(b)	<u>Certification of Chief Financial Officer of Periodic Report Pursuant to Rule 13a-15(e) or Rule 15d-15(e).<sup>†</sup></u>
32(a)	<u>Certification by Chief Executive Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350.<sup>†</sup></u>
32(b)	<u>Certification by Chief Financial Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350.<sup>†</sup></u>
101.ins	XBRL Instance Document <sup>†</sup>
101.def	XBRL Taxonomy Extension Definition Linkbase Document <sup>†</sup>
101.sch	XBRL Taxonomy Extension Schema Document <sup>†</sup>
101.cal	XBRL Taxonomy Extension Calculation Linkbase Document <sup>†</sup>
101.lab	XBRL Taxonomy Extension Label Linkbase Document <sup>†</sup>
101.pre	XBRL Taxonomy Extension Presentation Linkbase Document <sup>†</sup>

Filed or furnished herewith.

## Notice regarding forward-looking statements

This report includes forward-looking statements intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements generally can be identified by phrases such as TI or its management “believes,” “expects,” “anticipates,” “foresees,” “forecasts,” “estimates” or other words or phrases of similar import. Similarly, statements herein that describe TI’s business strategy, outlook, objectives, plans, intentions or goals also are forward-looking statements. All such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those in forward-looking statements.

We urge you to carefully consider the following important factors that could cause actual results to differ materially from the expectations of TI or our management:

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Total residential real estate	3,954	3,964	237	5,725	5,912	387
Consumer	—	—	—	26	42	1
Total	\$26,967	\$27,872	\$4,152	\$40,238	\$42,171	\$3,714

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The following table presents the average recorded investment and interest income recognized for loans individually evaluated for impairment, excluding purchased credit impaired loans, by class of loan, during the stated periods:

	Three Months Ended September 30, 2016		2015		Nine Months Ended September 30, 2016		2015	
	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized
(in thousands)								
With no related allowance recorded:								
Agricultural	\$1,266	\$ 14	\$1,516	\$ 13	\$1,285	\$ 41	\$1,534	\$ 47
Commercial and industrial	5,115	34	1,318	26	5,233	39	1,665	79
Credit cards	—	—	—	—	—	—	—	—
Commercial real estate:								
Construction and development	—	—	325	3	—	—	326	4
Farmland	2,414	29	2,730	35	2,426	78	2,749	93
Multifamily	—	—	1,839	26	—	—	1,849	43
Commercial real estate-other	2,594	9	12,327	147	2,865	8	12,374	250
Total commercial real estate	5,008	38	17,221	211	5,291	86	17,298	390
Residential real estate:								
One- to four- family first liens	2,843	32	2,354	17	2,867	88	2,345	27
One- to four- family junior liens	—	—	773	9	—	—	775	15
Total residential real estate	2,843	32	3,127	26	2,867	88	3,120	42
Consumer	—	—	20	1	—	—	21	1
Total	\$14,232	\$ 118	\$23,202	\$ 277	\$14,676	\$ 254	\$23,638	\$ 559
With an allowance recorded:								
Agricultural	\$1,854	\$ 12	\$1,561	\$ 12	\$1,870	\$ 32	\$1,575	\$ 36
Commercial and industrial	3,988	16	1,103	12	3,789	26	1,144	32
Credit cards	—	—	—	—	—	—	—	—
Commercial real estate:								
Construction and development	270	—	151	1	271	3	151	2
Farmland	—	—	69	1	—	—	70	2
Multifamily	159	—	158	1	158	—	160	5
Commercial real estate-other	5,416	—	431	5	5,416	—	432	13
Total commercial real estate	5,845	—	809	8	5,845	3	813	22
Residential real estate:								
One- to four- family first liens	1,118	8	1,369	7	1,123	22	1,375	27
One- to four- family junior liens	—	—	15	—	—	—	15	—
Total residential real estate	1,118	8	1,384	7	1,123	22	1,390	27
Consumer	—	—	9	—	—	—	9	—
Total	\$12,805	\$ 36	\$4,866	\$ 39	\$12,627	\$ 83	\$4,931	\$ 117
Total:								
Agricultural	\$3,120	\$ 26	\$3,077	\$ 25	\$3,155	\$ 73	\$3,109	\$ 83
Commercial and industrial	9,103	50	2,421	38	9,022	65	2,809	111
Credit cards	—	—	—	—	—	—	—	—
Commercial real estate:								
Construction and development	270	—	476	4	271	3	477	6
Farmland	2,414	29	2,799	36	2,426	78	2,819	95
Multifamily	159	—	1,997	27	158	—	2,009	48

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Commercial real estate-other	8,010	9	12,758	152	8,281	8	12,806	263
Total commercial real estate	10,853	38	18,030	219	11,136	89	18,111	412
Residential real estate:								
One- to four- family first liens	3,961	40	3,723	24	3,990	110	3,720	54
One- to four- family junior liens	—	—	788	9	—	—	790	15
Total residential real estate	3,961	40	4,511	33	3,990	110	4,510	69
Consumer	—	—	29	1	—	—	30	1
Total	\$27,037	\$ 154	\$28,068	\$ 316	\$27,303	\$ 337	\$28,569	\$ 676

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The following table presents the contractual aging of the recorded investment in past due loans by class of loans at September 30, 2016 and December 31, 2015:

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable
(in thousands)						
September 30, 2016						
Agricultural	\$376	\$—	\$520	\$896	\$120,729	\$121,625
Commercial and industrial	2,204	2,264	7,435	11,903	463,299	475,202
Credit cards	—	—	—	—	1,526	1,526
Commercial real estate:						
Construction and development	319	—	584	903	125,612	126,515
Farmland	—	118	167	285	94,853	95,138
Multifamily	—	90	226	316	118,076	118,392
Commercial real estate-other	1,929	182	7,049	9,160	670,441	679,601
Total commercial real estate	2,248	390	8,026	10,664	1,008,982	1,019,646
Residential real estate:						
One- to four- family first liens	2,134	1,119	1,520	4,773	364,834	369,607
One- to four- family junior liens	650	94	663	1,407	115,884	117,291
Total residential real estate	2,784	1,213	2,183	6,180	480,718	486,898
Consumer	59	20	19	98	36,837	36,935
Total	\$7,671	\$3,887	\$18,183	\$29,741	\$2,112,091	\$2,141,832
Included in the totals above are the following purchased credit impaired loans	\$779	\$359	\$654	\$1,792	\$20,878	\$22,670
December 31, 2015						
Agricultural	\$19	\$190	\$169	\$378	\$121,336	\$121,714
Commercial and industrial	1,046	710	644	2,400	465,012	467,412
Credit cards	2	17	4	23	1,354	1,377
Overdrafts	175	8	31	214	1,269	1,483
Commercial real estate:						
Construction and development	—	—	415	415	120,338	120,753
Farmland	120	—	80	200	88,884	89,084
Multifamily	—	—	224	224	121,539	121,763
Commercial real estate-other	1,190	754	1,636	3,580	656,761	660,341
Total commercial real estate	1,310	754	2,355	4,419	987,522	991,941
Residential real estate:						
One- to four- family first liens	2,611	1,293	1,772	5,676	422,557	428,233
One- to four- family junior liens	168	120	317	605	101,668	102,273
Total residential real estate	2,779	1,413	2,089	6,281	524,225	530,506
Consumer	62	6	17	85	37,424	37,509
Total	\$5,393	\$3,098	\$5,309	\$13,800	\$2,138,142	\$2,151,942
Included in the totals above are the following purchased credit impaired loans	\$473	\$799	\$989	\$2,261	\$23,331	\$25,592
Non-accrual and Delinquent Loans						

Loans are placed on non-accrual when (1) payment in full of principal and interest is no longer expected or (2) principal or interest has been in default for 90 days or more (unless the loan is both well secured with marketable collateral and in the process of collection). All loans rated doubtful or worse, and certain loans rated substandard, are placed on non-accrual.

A non-accrual asset may be restored to an accrual status when (1) all past due principal and interest has been paid (excluding renewals and modifications that involve the capitalizing of interest) or (2) the loan becomes well secured with marketable collateral and is in the process of collection. An established track record of performance is also considered when determining accrual status.

Delinquency status of a loan is determined by the number of days that have elapsed past the loan's payment due date, using the following classification groupings: 30-59 days, 60-89 days and 90 days or more.

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The following table sets forth the composition of the Company's recorded investment in loans on nonaccrual status and past due 90 days or more and still accruing by class of loans, excluding purchased credit impaired loans, as of September 30, 2016 and December 31, 2015:

	September 30, 2016		December 31, 2015	
	Loans Past Due 90 Days or More and Still Accruing		Loans Past Due 90 Days or More and Still Accruing	
	Non-Accrual		Non-Accrual	
(in thousands)				
Agricultural	\$401	\$ —	\$172	\$ —
Commercial and industrial	5,966	—	575	—
Credit cards	—	—	—	—
Commercial real estate:				
Construction and development	343	248	95	—
Farmland	228	—	20	80
Multifamily	226	—	224	—
Commercial real estate-other	6,994	60	1,452	—
Total commercial real estate	7,791	308	1,791	80
Residential real estate:				
One- to four- family first liens	1,102	448	1,182	199
One- to four- family junior liens	105	186	281	—
Total residential real estate	1,207	634	1,463	199
Consumer	12	—	11	5
Total	\$15,377	\$ 942	\$4,012	\$ 284

Not included in the loans above as of September 30, 2016 and December 31, 2015 were purchased credit impaired loans with an outstanding balance of \$2.8 million and \$4.1 million, net of a discount of \$0.9 million and \$1.4 million, respectively.

As of September 30, 2016, the Company had no commitments to lend additional funds to any borrowers who have had a TDR.

**Purchased Loans**

Purchased loans acquired in a business combination are recorded and initially measured at their estimated fair value as of the acquisition date. Credit discounts are included in the determination of fair value. An allowance for loan losses is not carried over. These purchased loans are segregated into two types: purchased credit impaired loans and purchased non-credit impaired loans.

Purchased non-credit impaired loans are accounted for in accordance with ASC 310-20 "Nonrefundable Fees and Other Costs" as these loans do not have evidence of significant credit deterioration since origination and it is probable all contractually required payments will be received from the borrower.

Purchased credit impaired loans are accounted for in accordance with ASC 310-30 "Loans and Debt Securities Acquired with Deteriorated Credit Quality" as they display significant credit deterioration since origination and it is probable, as of the acquisition date, that the Company will be unable to collect all contractually required payments from the borrower.

For purchased non-credit impaired loans the accretable discount is the discount applied to the expected cash flows of the portfolio to account for the differences between the interest rates at acquisition and rates currently expected on similar portfolios in the marketplace. As the accretable discount is accreted to interest income over the expected average life of the portfolio, the result will be interest income on loans at the estimated current market rate. We

anticipate recording a provision for the acquired portfolio in future quarters as the former Central loans renew and the discount is accreted.

For purchased credit impaired loans the difference between contractually required payments at acquisition and the cash flows expected to be collected is referred to as the non-accretable difference. Further, any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized into interest income over the expected remaining life of the loan if the timing and amount of the future cash flows are reasonably estimable. This discount includes an adjustment on loans that are not accruing or paying contractual interest so that interest income will be recognized at the estimated current market rate.



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Subsequent to the purchase date, increases in cash flows over those expected at the purchase date are recognized as interest income prospectively. The present value of any decreases in expected cash flows after the purchase date is recognized by recording an allowance for credit losses and a provision for loan losses.

Changes in the accretable yield for loans acquired and accounted for under ASC 310-30 were as follows for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
(in thousands)				
Balance at beginning of period	\$3,544	\$1,839	\$1,446	\$—
Purchases	—	—	—	1,882
Accretion	(1,167 )	(184 )	(2,277 )	(227 )
Reclassification from nonaccretable difference	595	—	3,803	—
Balance at end of period	\$2,972	\$1,655	\$2,972	\$1,655

#### 7. Goodwill and Intangible Assets

The excess of the cost of an acquisition over the fair value of the net assets acquired, including core deposit, trade name, and client relationship intangibles, consists of goodwill. Under ASC Topic 350, goodwill and the non-amortizing portion of the trade name intangible are subject to at least annual assessments for impairment by applying a fair value based test. The Company reviews goodwill and the non-amortizing portion of the trade name intangible at the reporting unit level to determine potential impairment annually on October 1, or more frequently if events or changes in circumstances indicate that the carrying value may not be recoverable, by comparing the carrying value of the reporting unit with the fair value of the reporting unit. No impairment was recorded on either the goodwill or the trade name intangible assets during the nine months ended September 30, 2016. The carrying amount of goodwill was \$64.7 million at September 30, 2016 and \$64.6 million at December 31, 2015. The increase of \$0.1 million in goodwill was due to the finalization of merger accounting issues related to the Central merger.

In addition to goodwill, the Company recognized a \$12.7 million core deposit intangible, and a \$1.4 million trade name intangible in 2015 due to the Central merger.

The following table presents the changes in the carrying amount of intangibles (excluding goodwill), gross carrying amount, accumulated amortization, and net book value as of and for the nine months ended September 30, 2016:

	Insurance Agency Intangible	Core Deposit Intangible	Indefinite-Lived Trade Name Intangible	Finite-Lived Trade Name Intangible	Customer List Intangible	Total
(in thousands)						
September 30, 2016						
Balance, beginning of period	\$ 275	\$ 10,480	\$ 7,040	\$ 1,203	\$ 143	\$19,141
Additions from business combination	—	—	—	—	—	—
Amortization expense	(54 )	(2,791 )	—	(185 )	(16 )	(3,046 )
Balance at end of period	\$ 221	\$ 7,689	\$ 7,040	\$ 1,018	\$ 127	\$16,095
Gross carrying amount	\$ 1,320	\$ 18,206	\$ 7,040	\$ 1,380	\$ 330	\$28,276
Accumulated amortizations	(1,099 )	(10,517 )	—	(362 )	(203 )	(12,181 )
Net book value	\$ 221	\$ 7,689	\$ 7,040	\$ 1,018	\$ 127	\$16,095

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## 8. Other Assets

The components of the Company's other assets were as follows:

	September 30, December 31,	
	2016	2015
(in thousands)		
Federal Home Loan Bank Stock	\$ 11,614	\$ 9,832
FDIC indemnification asset, net	1,530	4,274
Prepaid expenses	2,172	2,271
Mortgage servicing rights	1,838	2,249
Federal & state income taxes receivable, current	—	1,079
Accounts receivable & other miscellaneous assets	1,731	2,104
	\$ 18,885	\$ 21,809

The Bank is a member of the FHLB of Des Moines, and ownership of FHLB stock is a requirement for such membership. The amount of FHLB stock the Bank is required to hold is directly related to the amount of FHLB advances borrowed. Because this security is not readily marketable and there are no available market values, this security is carried at cost and evaluated for potential impairment each quarter. Redemption of this investment is at the option of the FHLB. No impairment was recorded on FHLB stock in the nine months ended September 30, 2016 or in the year ended December 31, 2015.

As part of the Central merger, the Company became a party to certain loss-share agreements with the FDIC from previous Central-related acquisitions. These agreements cover realized losses on loans and foreclosed real estate for specified periods. These loss-share assets are measured separately from the loan portfolios because they are not contractually embedded in the loans and are not transferable with the loans should the Company choose to dispose of them. Fair values at the acquisition dates were estimated based on projected cash flows available for loss-share based on the credit adjustments estimated for each loan. The loss-share assets are recorded within other assets on the balance sheet.

Mortgage servicing rights are recorded at fair value based on assumptions provided by a third-party valuation service. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the servicing cost per loan, the discount rate, the escrow float rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

## 9. Short-Term Borrowings

Short-term borrowings were as follows as of September 30, 2016 and December 31, 2015:

	September 30, December 31,	
	2016	2015
	Weighted	Weighted
(in thousands)	Average	Average
	Balance	Balance
	Cost	Cost
Federal funds purchased	0.45 % \$19,309	0.34 % \$1,500
Securities sold under agreements to repurchase	0.22 63,469	0.31 67,463
Total	0.27 % \$82,778	0.31 % \$68,963

At September 30, 2016 and December 31, 2015, the Company had no borrowings through the Federal Reserve Discount Window, while the borrowing capacity was \$11.9 million as of September 30, 2016 and \$11.8 million as of December 31, 2015. As of September 30, 2016 and December 31, 2015, the Bank had municipal securities pledged with a market value of \$13.2 million and \$13.1 million pledged, respectively, to the Federal Reserve to secure potential borrowings. The Company also has various other unsecured federal funds agreements with correspondent banks. As of September 30, 2016 and December 31, 2015, there were \$19.3 million and \$1.5 million of borrowings through these correspondent bank federal funds agreements, respectively.

Securities sold under agreements to repurchase are agreements in which the Company acquires funds by selling assets to another party under a simultaneous agreement to repurchase the same assets at a specified price and date. The Company enters into repurchase agreements and also offers a demand deposit account product to customers that sweeps their balances in excess of an agreed upon target amount into overnight repurchase agreements. All securities sold under agreements to repurchase are recorded on the face of the balance sheet.

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On April 30, 2015, the Company entered into a \$5.0 million unsecured line of credit with a correspondent bank. Interest is payable at a rate of one-month LIBOR plus 2.00%. The line was renewed in April 2016, and is now scheduled to mature on April 27, 2017. The Company had no balance outstanding under this agreement as of September 30, 2016.

## 10. Subordinated Notes Payable

The Company has established three statutory business trusts under the laws of the state of Delaware: Central Bancshares Capital Trust II, Barron Investment Capital Trust I, and MidWestOne Statutory Trust II. The trusts exist for the exclusive purposes of (i) issuing trust securities representing undivided beneficial interests in the assets of the respective trust; (ii) investing the gross proceeds of the trust securities in junior subordinated deferrable interest debentures (subordinated debentures); and (iii) engaging in only those activities necessary or incidental thereto. For regulatory capital purposes, these trust securities qualify as a component of Tier 1 capital.

The table below summarizes the outstanding junior subordinated notes and the related trust preferred securities issued by each trust as of September 30, 2016 and December 31, 2015:

(in thousands)	Face Value	Book Value	Interest Rate	Interest Rate at 9/30/2016	Maturity Date	Callable Date
September 30, 2016						
Central Bancshares Capital Trust II <sup>(1) (2)</sup>	\$7,217	\$6,599	Three-month LIBOR + 3.50%	4.35 %	03/15/2038	03/15/2013
Barron Investment Capital Trust I <sup>(1) (2)</sup>	2,062	1,604	Three-month LIBOR + 2.15%	3.01 %	09/23/2036	09/23/2011
MidWestOne Statutory Trust II <sup>(1)</sup>	15,464	15,464	Three-month LIBOR + 1.59%	2.44 %	12/15/2037	12/15/2012
Total	\$24,743	\$23,667				
(in thousands)	Face Value	Book Value	Interest Rate	Interest Rate at 12/31/2015	Maturity Date	Callable Date
December 31, 2015						
Central Bancshares Capital Trust II <sup>(1) (2)</sup>	\$7,217	\$6,552	Three-month LIBOR + 3.50%	4.01 %	03/15/2038	03/15/2013
Barron Investment Capital Trust I <sup>(1) (2)</sup>	2,062	1,571	Three-month LIBOR + 2.15%	2.74 %	09/23/2036	09/23/2011
MidWestOne Statutory Trust II <sup>(1)</sup>	15,464	15,464	Three-month LIBOR + 1.59%	2.10 %	12/15/2037	12/15/2012
Total	\$24,743	\$23,587				

(1) All distributions are cumulative and paid in cash quarterly.

(2) Central Bancshares Capital Trust II and Barron Investment Capital Trust I were established by Central prior to the Company's merger with Central, and the junior subordinated notes issued by Central were assumed by the Company. The trust preferred securities are subject to mandatory redemption, in whole or in part, upon repayment of the junior subordinated notes at the stated maturity date or upon redemption of the junior subordinated notes. 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 notes. The Company's obligation under the junior subordinated notes and other relevant trust agreements, in aggregate, constitutes a full and unconditional guarantee by the Company of each trust's obligations under the trust preferred securities issued by each trust. The Company has the right to defer payment of interest on the notes and, therefore, distributions on the trust preferred securities, for up to five years, but not beyond the stated maturity date in the table above. During any such deferral period the Company may not pay cash dividends on its stock and generally may not repurchase its stock.

11. Long-Term Borrowings

Long-term borrowings were as follows as of September 30, 2016 and December 31, 2015:

(in thousands)	September 30, 2016		December 31, 2015	
	Weighted Average Cost	Balance	Weighted Average Cost	Balance
FHLB Borrowings	1.55%	\$100,000	1.64%	\$87,000
Note payable to unaffiliated bank	2.27	18,750	2.17	22,500
Total	1.66%	\$118,750	1.75%	\$109,500

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The Company utilizes FHLB borrowings as a supplement to customer deposits to fund earning assets and to assist in managing interest rate risk. As a member of the Federal Home Loan Bank of Des Moines, the Bank may borrow funds from the FHLB in amounts up to 35% of the Bank's total assets, provided the Bank is able to pledge an adequate amount of qualified assets to secure the borrowings. Advances from the FHLB are collateralized primarily by one- to four-family residential, commercial and agricultural real estate first mortgages equal to various percentages of the total outstanding notes. See Note 6 "Loans Receivable and the Allowance for Loan Losses" of the notes to the consolidated financial statements.

On April 30, 2015, the Company entered into a \$35.0 million unsecured note payable with a correspondent bank with a maturity date of June 30, 2020. The Company drew \$25.0 million on the note prior to June 30, 2015, at which time the ability to obtain additional advances ceased. Payments of principal and interest are payable quarterly, which began September 30, 2015. As of September 30, 2016, \$18.8 million of that note was outstanding.

## 12. Income Taxes

The income tax provisions for the three and nine months ended September 30, 2016 and 2015 were less than the amounts computed by applying the maximum effective federal income tax rate of 35% to the income before income taxes, because of the following items:

(in thousands)	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2016		2015		2016		2015	
	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income
Expected provision	\$3,098	35.0 %	\$3,407	35.0 %	\$7,997	35.0 %	\$8,144	35.0 %
Tax-exempt interest	(761 )	(8.6 )	(742 )	(7.6 )	(2,260 )	(9.9 )	(2,077 )	(8.9 )
Bank-owned life insurance	(114 )	(1.3 )	(117 )	(1.2 )	(363 )	(1.6 )	(330 )	(1.4 )
State income taxes, net of federal income tax benefit	398	4.5	(35 )	(0.4 )	1,045	4.6	478	2.1
Non-deductible acquisition expenses	18	0.2	21	0.2	71	0.3	676	2.9
General business credits	(15 )	(0.2 )	(423 )	(4.3 )	(168 )	(0.7 )	(439 )	(1.9 )
Other	5	0.1	10	0.1	6	—	(62 )	(0.3 )
Total income tax provision	\$2,629	29.7 %	\$2,121	21.8 %	\$6,328	27.7 %	\$6,390	27.5 %

The Company also recognized income tax expense pertaining to state franchise and income taxes payable by the Bank.

## 13. Estimated Fair Value of Financial Instruments and Fair Value Measurements

Fair value is the price that would be received in selling an asset or paid in transferring a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (1) independent, (2) knowledgeable, (3) able to transact and (4) willing to transact.

GAAP requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset

(replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, GAAP establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

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Level 1 Inputs – Unadjusted quoted prices for identical assets or liabilities in active markets that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 Inputs – Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

It is the Company's policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. The Company is required to use observable inputs, to the extent available, in the fair value estimation process unless that data results from forced liquidations or distressed sales. A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Valuation methods for instruments measured at fair value on a recurring basis.

Securities Available for Sale - The Company's investment securities classified as available for sale include: debt securities issued by the U.S. Treasury and other U.S. Government agencies and corporations, debt securities issued by state and political subdivisions, mortgage-backed securities, collateralized mortgage obligations, corporate debt securities, and equity securities. Quoted exchange prices are available for equity securities, which are classified as Level 1. The Company utilizes an independent pricing service to obtain the fair value of debt securities. On a quarterly basis, the Company selects a sample of 30 securities from its primary pricing service and compares them to a secondary independent pricing service to validate value. In addition, the Company periodically reviews the pricing methodology utilized by the primary independent service for reasonableness. Debt securities issued by the U.S. Treasury and other U.S. Government agencies and corporations and mortgage-backed obligations are priced utilizing industry-standard models that consider various assumptions, including time value, yield curves, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data, or are supported by observable levels at which transactions are executed in the marketplace and are classified as Level 2. Municipal securities are valued using a type of matrix, or grid, pricing in which securities are benchmarked against the treasury rate based on credit rating. These model and matrix measurements are classified as Level 2 in the fair value hierarchy. On an annual basis, a group of selected municipal securities are priced by a securities dealer and that price is used to verify the primary independent service's valuation.

The following table summarizes assets measured at fair value on a recurring basis as of September 30, 2016 and December 31, 2015. There were no liabilities subject to fair value measurement as of these dates. The assets are segregated by the level of valuation inputs within the fair value hierarchy utilized to measure fair value:

## Fair Value Measurement at September 30, 2016 Using

(in thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available for sale debt securities:				
U.S. Government agencies and corporations	\$6,044	\$ —	\$ 6,044	\$ —
State and political subdivisions	165,809	—	165,809	—
Mortgage-backed securities	43,569	—	43,569	—
Collateralized mortgage obligations	172,172	—	172,172	—
Corporate debt securities	47,366	—	47,366	—



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Total available for sale debt securities	434,960	—	434,960	—
Other equity securities	1,279	1,279	—	—
Total securities available for sale	\$436,239	\$ 1,279	\$ 434,960	\$ —

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(in thousands)	Fair Value Measurement at December 31, 2015 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available for sale debt securities:				
U.S. Treasury securities	\$6,910	\$ —	\$ 6,910	\$ —
U.S. Government agencies and corporations	26,653	—	26,653	—
State and political subdivisions	183,384	—	183,384	—
Mortgage-backed securities	57,062	—	57,062	—
Collateralized mortgage obligations	106,404	—	106,404	—
Corporate debt securities	45,566	—	45,566	—
Total available for sale debt securities	425,979	—	425,979	—
Other equity securities	1,262	1,262	—	—
Total securities available for sale	\$427,241	\$ 1,262	\$ 425,979	\$ —

There were no transfers of assets between levels of the fair value hierarchy during the three and nine months ended September 30, 2016 or the year ended December 31, 2015.

There have been no changes in valuation techniques used for any assets measured at fair value during the three and nine months ended September 30, 2016 or the year ended December 31, 2015.

Changes in the fair value of available for sale securities are included in other comprehensive income to the extent the changes are not considered OTTI. OTTI tests are performed on a quarterly basis and any decline in the fair value of an individual security below its cost that is deemed to be other-than-temporary results in a write-down that is reflected directly in the Company's consolidated statements of operations.

Valuation methods for instruments measured at fair value on a nonrecurring basis

**Collateral Dependent Impaired Loans** - From time to time, a loan is considered impaired and an allowance for credit losses is established. The specific reserves for collateral dependent impaired loans are based on the fair value of the collateral less estimated costs to sell. The fair value of collateral is determined based on appraisals. In some cases, adjustments are made to the appraised values due to various factors, including age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. Because many of these inputs are unobservable, the valuations are classified as Level 3.

**Other Real Estate Owned ("OREO")** - OREO represents property acquired through foreclosures and settlements of loans. Property acquired through or in lieu of foreclosure are initially recorded at fair value less estimated selling cost at the date of foreclosure, establishing a new cost basis. The Company considers third party appraisals as well as independent fair value assessments from real estate brokers or persons involved in selling OREO in determining the fair value of particular properties. Accordingly, the valuation of OREO is subject to significant external and internal judgment. The Company also periodically reviews OREO to determine whether the property continues to be carried at the lower of its recorded book value or fair value of the property, less disposal costs. Because many of these inputs are unobservable, the valuations are classified as Level 3.

The following table discloses the Company's estimated fair value amounts of its assets recorded at fair value on a nonrecurring basis. It is management's belief that the fair values presented below are reasonable based on the valuation techniques and data available to the Company as of September 30, 2016 and December 31, 2015, as more fully described above.

(in thousands)	Fair Value Measurement at September 30, 2016		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)

	Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets:			
Collateral dependent impaired loans	\$7,017	\$	—\$ 7,017
Other real estate owned	\$3,452	\$	—\$ 3,452

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Fair Value Measurement at December 31, 2015 Using					
(in thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Assets:</b>					
Collateral dependent impaired loans	\$23,812	\$	—	\$	23,812
Other real estate owned	\$8,834	\$	—	\$	8,834
The following presents the carrying amount and estimated fair value of the financial instruments held by the Company at September 30, 2016 and December 31, 2015. The information presented is subject to change over time based on a variety of factors. The operations of the Company are managed on a going concern basis and not a liquidation basis. As a result, the ultimate value realized from the financial instruments presented could be substantially different when actually recognized over time through the normal course of operations. Additionally, a substantial portion of the Company's inherent value is the capitalization and franchise value of the Bank. Neither of these components has been given consideration in the presentation of fair values below.					
September 30, 2016					
(in thousands)	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Financial assets:</b>					
Cash and cash equivalents	\$51,958	\$ 51,958	\$ 51,958	\$	—
<b>Investment securities:</b>					
Available for sale	436,239	436,239	1,279	434,960	—
Held to maturity	151,110	153,474	—	153,474	—
Total investment securities	587,349	589,713	1,279	588,434	—
Loans held for sale	2,742	2,786	—	—	2,786
Loans, net	2,120,437	2,122,937	—	2,122,937	—
Accrued interest receivable	13,139	13,139	13,139	—	—
Federal Home Loan Bank stock	11,614	11,614	—	11,614	—
<b>Financial liabilities:</b>					
<b>Deposits:</b>					
Non-interest bearing demand	493,820	493,820	493,820	—	—
Interest-bearing checking	1,114,536	1,114,536	1,114,536	—	—
Savings	196,426	196,426	196,426	—	—
Certificates of deposit under \$100,000	332,194	332,351	—	332,351	—
Certificates of deposit \$100,000 and over	308,956	309,792	—	309,792	—
Total deposits	2,445,932	2,446,925	1,804,782	642,143	—
Federal funds purchased and securities sold under agreements to repurchase	82,778	82,778	82,778	—	—
Federal Home Loan Bank borrowings	100,000	101,019	—	101,019	—
Junior subordinated notes issued to capital trusts	23,667	19,139	—	19,139	—
Long-term debt	18,750	18,750	—	18,750	—

Accrued interest payable	1,552	1,552	1,552	—	—
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	December 31, 2015				
	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)					
Financial assets:					
Cash and cash equivalents	\$47,097	\$ 47,097	\$ 47,097	\$ —	—
Investment securities:					
Available for sale	427,241	427,241	1,262	425,979	—
Held to maturity	118,423	118,234	—	118,234	—
Total investment securities	545,664	545,475	1,262	544,213	—
Loans held for sale	3,187	3,262	—	—	3,262
Loans, net	2,132,512	2,132,009	—	2,132,009	—
Accrued interest receivable	13,736	13,736	13,736	—	—
Federal Home Loan Bank stock	9,832	9,832	—	9,832	—
Financial liabilities:					
Deposits:					
Non-interest bearing demand	559,586	559,586	559,586	—	—
Interest-bearing checking	1,064,350	1,064,350	1,064,350	—	—
Savings	189,489	189,489	189,489	—	—
Certificates of deposit under \$100,000	348,268	346,875	—	346,875	—
Certificates of deposit \$100,000 and over	301,828	301,521	—	301,521	—
Total deposits	2,463,522	2,461,821	1,813,425	648,396	—
Federal funds purchased and securities sold under agreements to repurchase	68,963	68,963	68,963	—	—
Federal Home Loan Bank borrowings	87,000	86,817	—	86,817	—
Junior subordinated notes issued to capital trusts	23,587	18,611	—	18,611	—
Long-term debt	22,500	22,500	—	22,500	—
Accrued interest payable	1,507	1,507	1,507	—	—

• Cash and cash equivalents, federal funds purchased, securities sold under repurchase agreements, and accrued interest are instruments with carrying values that approximate fair value.

• Investment securities available for sale are measured at fair value on a recurring basis. Held to maturity securities are carried at amortized cost. Fair value is based upon quoted prices, if available. If a quoted price is not available, the fair value is obtained from benchmarking the security against similar securities by using a third-party pricing service.

• Loans held for sale are carried at the lower of cost or fair value, with fair value being based on recent observable loan sales. The portfolio has historically consisted primarily of residential real estate loans.

• For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans are determined using estimated future cash flows, discounted at the interest rates currently being offered for loans with similar terms to borrowers with similar credit quality. The Company does record nonrecurring fair value adjustments to loans to reflect (1) partial write-downs and allowances that are based on the observable market price or appraised value of the collateral or (2) the full charge-off of the loan carrying value.

• The fair value of FHLB stock is estimated at its carrying value and redemption price of \$100 per share.

Deposit liabilities are carried at historical cost. The fair value of non-interest bearing demand deposits, savings accounts and certain interest-bearing checking deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. If the fair value of the fixed maturity certificates of deposit is calculated at less than the carrying amount, the carrying value of these deposits is reported as the fair value.

FHLB borrowings, junior subordinated notes issued to capital trusts, and long-term debt are recorded at historical cost. The fair value of these items is estimated using discounted cash flow analysis, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

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The following presents the valuation technique(s), unobservable inputs, and quantitative information about the unobservable inputs used for fair value measurements of the financial instruments held by the Company at September 30, 2016, categorized within Level 3 of the fair value hierarchy:

(dollars in thousands)	Quantitative Information About Level 3 Fair Value Measurements				
	Fair Value at September 30, 2016	Valuation Techniques(s)	Unobservable Input	Range of Inputs	Weighted Average
Collateral dependent impaired loans	\$7,017	Modified appraised value	Third party appraisal	NM * NM * NM *	
			Appraisal discount	NM * NM * NM *	
Other real estate owned	\$3,452	Modified appraised value	Third party appraisal	NM * NM * NM *	
			Appraisal discount	NM * NM * NM *	

\* Not Meaningful. Third party appraisals are obtained as to the value of the underlying asset, but disclosure of this information would not provide meaningful information, as the range will vary widely from loan to loan. Types of discounts considered include age of the appraisal, local market conditions, current condition of the property, and estimated sales costs. These discounts will also vary from loan to loan, thus providing a range would not be meaningful.

Changes in assumptions or estimation methodologies may have a material effect on these estimated fair values.

#### 14. Operating Segments

The Company's activities are considered to be a single industry segment for financial reporting purposes. The Company is engaged in the business of commercial and retail banking, investment management and insurance services with operations throughout central and eastern Iowa, the Twin Cities area of Minnesota and Wisconsin, and Florida. Substantially all income is derived from a diverse base of commercial, mortgage and retail lending activities, and investments.

#### 15. Branch Sale

On May 9, 2016, the Bank entered into an agreement to sell its Davenport, Iowa branch to CBI Bank and Trust ("CBI Bank") headquartered in Muscatine, Iowa, a unit of Central Bancshares, Inc. of Muscatine, Iowa. CBI Bank assumed approximately \$12.0 million in deposits and \$33.0 million in loans on the sale completion date of August 5, 2016, and the Company realized a net gain of \$0.7 million, which is included on the Consolidated Statement of Operations in Other gain (loss).

#### 16. Effect of New Financial Accounting Standards

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contract with Customers (Topic 606). The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following five steps: 1) identify the contracts(s) with the customer; 2) identify the performance obligations in the contract; 3) determine the transaction price; 4) allocate the transaction price to the performance obligations in the contract; and 5) recognize revenue when (or as) the entity satisfies a performance obligation. The guidance also specifies the accounting for some costs to obtain or fulfill a



contract with a customer. For a public entity, the amendments in this update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The adoption of this amendment is not expected to have a material effect on the Company's consolidated financial statements.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. The amendments in this update provide guidance in GAAP about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. In doing so, the amendment should reduce diversity in the timing and content of footnote disclosures. Disclosures are required if it is probable an entity will be unable to meet its obligations within the look-forward period of twelve months after the financial statements are made available. Incremental substantial doubt disclosure is required if the probability is not mitigated by management's plans. The new standard applies to all entities for the first annual period ending after December 15, 2016, and interim periods thereafter. The adoption of this standard is not expected to have a material effect on the Company's consolidated financial statements.

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In July 2015, the FASB announced a delay to the effective date of Accounting Standards Update No. 2015-09, Revenue from Contract with Customers (Topic 606). Reporting entities may choose to adopt the standard as of the original date, or take advantage of a one-year delay. For a public entity, the revised effective date is for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is not permitted prior to the original effective date. The adoption of this amendment is not expected to have a material effect on the Company's consolidated financial statements.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01, Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities. The guidance in this update makes changes to the current GAAP model primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. In addition, the FASB clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. The treatment of gains and losses for all equity securities, including those without a readily determinable market value, is expected to result in additional volatility in the income statement, with the loss of mark to market via equity for these investments. Additionally, changes in the allowable method for determining the fair value of financial instruments in the financial statement footnotes ("exit price" only), will likely require changes to current methodologies of determining these values, and how they are disclosed in the financial statement footnotes. The new standard applies to public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. The adoption of this amendment is not expected to have a material effect on the Company's consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842). The guidance in this update is meant to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, Elements of Financial Statements, and, therefore, recognition of those lease assets and lease liabilities represents an improvement over previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases. Disclosures are required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. To meet that objective, qualitative disclosures along with specific quantitative disclosures are required. The new standard applies to public business entities in fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The Company is still evaluating the effect of this guidance on the Company's consolidated financial statements.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, Compensation - Stock Compensation (Topic 718). The guidance involves several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new standard applies to public business entities for annual periods beginning after December 15, 2016, including interim periods within those annual periods, with early adoption permitted. An entity that elects early adoption must adopt all of the amendments in the same period. The Company is still evaluating the effect of this guidance on the Company's consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, Financial Instruments-Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model

for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. The amendment requires the use of a new model covering current expected credit losses (CECL), which will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. Upon initial recognition of the exposure, the CECL model requires an entity to estimate the credit losses expected over the life of an exposure (or pool of exposures). The estimate of expected credit losses (ECL) should consider historical information, current information, and reasonable and supportable forecasts, including estimates of prepayments. The new guidance also amends the current available for sale (AFS) security OTTI model for debt securities. The new model will require an estimate of ECL only when the fair value is below the amortized cost of the asset. The length of time the fair value of an AFS debt security has been below the amortized cost will no longer impact the determination of whether a credit loss exists. As such, it is no longer an other-than-temporary model. Finally, the purchased financial assets with credit deterioration (PCD) model applies to purchased financial assets (measured at amortized cost or AFS) that have experienced more than insignificant credit deterioration since origination. This represents a change from the scope of what are considered purchased credit-impaired assets under today's model.

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Different than the accounting for originated or purchased assets that do not qualify as PCD, the initial estimate of expected credit losses for a PCD would be recognized through an allowance for loan and lease losses with an offset to the cost basis of the related financial asset at acquisition. The new standard applies to public business entities that are SEC filers in fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption permitted for fiscal years beginning after December 31, 2018, including interim periods within those fiscal years. The Company is still evaluating the effect of this guidance on the Company's consolidated financial statements, but it is expected to be material.

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments, a consensus of the FASB Emerging Issues Task Force. The new guidance addresses diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other topics. This update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The amendments in this update apply to all entities, including both business entities and not-for-profit entities that are required to present a statement of cash flows under Topic 230. The update applies to public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted, and the Company has elected to adopt the guidance effective September 30, 2016.

### 17. Contingency

In the second quarter of 2012, the Bank, terminated its non-contributory defined benefit pension plan. In the normal course of business, the termination of the plan is subject to audit by the Pension Benefit Guaranty Corporation (PBGC), which may result in additional distribution of assets to participants. The Bank has received an initial summary of audit findings and is requesting reconsideration of this initial determination. In addition, the Bank has identified a potential inadvertent drafting issue with the wording of the plan amendment adopted by the Bank in 2005. The Bank has evaluated the likelihood of a potential future liability relating to this amendment issue and determined that while future liability is possible, the amount of the liability cannot be reasonably estimated at this time. As such, no liability relating to this matter has been recorded in the financial statements for the third quarter of 2016.

### 18. Subsequent Events

Management evaluated subsequent events through the date the consolidated financial statements were issued. Events or transactions occurring after September 30, 2016, but prior to the date the consolidated financial statements were issued, that provided additional evidence about conditions that existed at September 30, 2016 have been recognized in the consolidated financial statements for the three and nine months ended September 30, 2016. Events or transactions that provided evidence about conditions that did not exist at September 30, 2016, but arose before the consolidated financial statements were issued, have not been recognized in the consolidated financial statements for the three and nine months ended September 30, 2016.

On October 11, 2016, the board of directors of the Company declared a cash dividend of \$0.16 per share payable on December 15, 2016 to shareholders of record as of the close of business on December 1, 2016.

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

### OVERVIEW

The Company provides financial services to individuals, businesses, governmental units and institutional customers located primarily in the Upper Midwest through its bank subsidiary, MidWestOne Bank. The Bank has office locations in central and east-central Iowa, the Twin Cities area of Minnesota, Wisconsin, and Florida. The Bank is actively engaged in many areas of commercial banking, including: acceptance of demand, savings and time deposits; making commercial, real estate, agricultural and consumer loans; and other banking services tailored for its individual customers. The Wealth Management Division of MidWestOne Bank administers estates, personal trusts,

conservatorships, and pension and profit-sharing accounts along with providing brokerage and other investment management services to customers. MidWestOne Insurance Services, Inc., also a wholly-owned subsidiary of the Company, provides personal and business insurance services in Iowa.

We operate as an independent community bank that offers a broad range of customer-focused financial services as an alternative to large regional banks in our market areas. Management has invested in infrastructure and staffing to support our strategy of serving the financial needs of businesses, individuals and municipalities in our market areas. We focus our efforts on core deposit generation, especially transaction accounts, and quality loan growth with an emphasis on growing commercial loan balances. We seek to maintain a disciplined pricing strategy on deposit generation that will allow us to compete for high quality loans while maintaining an appropriate spread over funding costs.

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Our results of operations depend primarily on our net interest income, which is the difference between the interest income on our earning assets, such as loans and securities, and the interest expense paid on our deposits and borrowings. Results of operations are also affected by non-interest income and expense, the provision for loan losses and income tax expense. Significant external factors that impact our results of operations include general economic and competitive conditions, as well as changes in market interest rates, government policies, and actions of regulatory authorities.

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes and with the statistical information and financial data appearing in this report as well as our 2015 Annual Report on Form 10-K. Results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of results to be attained for any other period.

**Critical Accounting Policies**

Critical accounting estimates are those which are both most important to the portrayal of our financial condition and results of operations, and require our management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Our critical accounting estimates relate to the allowance for loan losses, application of purchase accounting, goodwill and intangible assets, and fair value of available for sale investment securities, all of which involve significant judgment by our management. Information about our critical accounting estimates is included under Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2015.

**RESULTS OF OPERATIONS****Comparison of Operating Results for the Three Months Ended September 30, 2016 and September 30, 2015  
Summary**

For the quarter ended September 30, 2016, we earned net income of \$6.2 million, which was a decrease of \$1.4 million from \$7.6 million for the quarter ended September 30, 2015. Basic and diluted earnings per common share for the third quarter of 2016 were \$0.54 for both, versus \$0.67 for both for the third quarter of 2015. After excluding the effects of \$0.2 million (\$0.1 million after tax) of expenses related to the merger of MidWestOne Bank with Central Bank, adjusted diluted earnings per share for the third quarter of 2016 were \$0.55, versus \$0.68 diluted earnings per share after excluding \$0.2 million (\$0.2 million after tax) of expenses related to the merger with Central in the third quarter of 2015. Our annualized Return on Average Assets ("ROAA") for the third quarter of 2016 was 0.83% compared with a ROAA of 1.03% for the same period in 2015. Our annualized Return on Average Shareholders' Equity ("ROAE") was 8.06% for the three months ended September 30, 2016 compared with 10.55% for the three months ended September 30, 2015. The annualized Return on Average Tangible Equity ("ROATE") was 12.07% for the third quarter of 2016 compared with 15.76% for the same period in 2015.

The following table presents selected financial results and measures as of and for the quarters ended September 30, 2016 and 2015.

(dollars in thousands)	As of and for the Three Months Ended September 30,	
	2016	2015
Net Income	\$6,222	\$7,615
Average Assets	2,995,521	2,926,612
Average Shareholders' Equity	307,005	286,256
Return on Average Assets* (ROAA)	0.83 %	1.03 %
Return on Average Shareholders' Equity* (ROAE)	8.06	10.55
Return on Average Tangible Equity* (ROATE)	12.07	15.76
Total Equity to Assets (end of period)	10.31	9.75
Tangible Equity to Tangible Assets (end of period)	7.94	7.33

\* Annualized

We have traditionally disclosed certain non-GAAP ratios, including our ROATE and the ratio of our tangible equity to tangible assets. We believe these ratios provide investors with information regarding our financial condition and results of operations and how we evaluate them internally.

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The following tables provide a reconciliation of the non-GAAP measures to the most comparable GAAP equivalents.

	For the Three Months Ended September 30,	
(dollars in thousands, except per share amounts)	2016	2015
Net Income:		
Net income	\$6,222	\$7,615
Plus: Intangible amortization, net of tax <sup>(1)</sup>	631	520
Adjusted net income	\$6,853	\$8,135
Average Tangible Equity:		
Average total shareholders' equity	\$307,005	\$286,256
Less: Average intangibles, net of amortization	(81,212 )	(81,486 )
Average tangible equity	\$225,793	\$204,770
ROATE (annualized)	12.07 %	15.76 %
Net Income:		
Net income	\$6,222	\$7,615
Plus: Merger-related expenses	182	225
Net tax effect of merger-related expenses <sup>(2)</sup>	(51 )	(57 )
Net income exclusive of merger-related expenses	\$6,353	\$7,783
Diluted average number of shares	11,461,108	11,434,186
Earnings Per Common Share-Diluted	\$0.54	\$0.67
Earnings Per Common Share-Diluted, exclusive of merger-related expenses	\$0.55	\$0.68
(1) Computed on a tax-equivalent basis, assuming a federal income tax rate of 35%.		
(2) Computed based on qualifying tax deductible expenses, assuming a federal income tax rate of 35%.		
Adjusted Noninterest Income:		
Noninterest income	\$5,714	\$5,460
Less: Impairment losses on investment securities, net	—	—
Gain (loss) on sale of available for sale securities	—	—
Gain (loss) on sale of premises and equipment	(37 )	(5 )
Other gain (loss)	306	29
Adjusted noninterest income	\$5,445	\$5,436
Total Revenue:		
Net interest income	\$24,581	\$26,759
Plus: Noninterest income	5,714	5,460
Less: Impairment losses on investment securities, net	—	—
Gain (loss) on sale of available for sale securities	—	—
Gain (loss) on sale of premises and equipment	(37 )	(5 )
Other gain (loss)	306	29
Total Revenue	\$30,026	\$32,195
Adjusted Noninterest Income as a Percentage of Total Revenue	18.1 %	16.9 %
	As of September 30,	
(dollars in thousands)	2016	2015
Tangible Equity:		
Total shareholders' equity	\$309,584	\$290,666
Less: Intangible assets, net of amortization and associated deferred tax liability	(77,327 )	(77,761 )
Tangible equity	\$232,257	\$212,905
Tangible Assets:		
Total assets	\$3,001,974	\$2,981,840
Less: Intangible assets, net of amortization and associated deferred tax liability	(77,327 )	(77,761 )



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Tangible assets	\$2,924,647	\$2,904,079
Tangible Equity/Tangible Assets	7.94	% 7.33 %

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## Net Interest Income

Net interest income is the difference between interest income and fees earned on earning assets and interest expense incurred on interest-bearing liabilities. Interest rate levels and volume fluctuations within earning assets and interest-bearing liabilities impact net interest income. Net interest margin is net interest income as a percentage of average earning assets.

Certain assets with tax favorable treatment are evaluated on a tax-equivalent basis. Tax-equivalent basis assumes a federal income tax rate of 35%. Tax favorable assets generally have lower contractual pretax yields than fully taxable assets. A tax-equivalent analysis is performed by adding the tax savings to the earnings on tax-favorable assets. After factoring in the tax-favorable effects of these assets, the yields may be more appropriately evaluated against alternative earning assets. In addition to yield, various other risks are factored into the evaluation process.

Net interest income of \$24.6 million for the third quarter of 2016 decreased \$2.2 million, or 8.1%, from \$26.8 million for the third quarter of 2015, primarily due to a decrease of \$2.1 million, or 7.0%, in interest income. A decrease in the merger-related discount accretion to \$0.6 million for the third quarter of 2016 compared to \$1.7 million for the third quarter of 2015, and generally lower rates being received on new loans, partially offset by an increase in average loan balances, resulted in loan interest income declining \$2.4 million, or 8.8%, to \$24.3 million for the third quarter of 2016 compared to the third quarter of 2015. Income from investment securities was \$3.5 million for the third quarter of 2016, up from \$3.3 million for the third quarter of 2015, which resulted from an increase of \$19.3 million in the average balance, along with an increase of 6 basis points in the yield of investment securities between the two comparable periods.

Interest expense increased \$0.1 million, or 2.5%, to \$3.3 million for the third quarter of 2016, compared to \$3.2 million for the same period in 2015, primarily due to an increase in both the average balance and rate of FHLB borrowings. This increase was partially offset by decreases in the cost of interest on most other categories of interest-bearing liabilities. The decline in the cost of interest-bearing deposits was despite a decrease in the merger-related amortization of the purchase accounting premium on certificates of deposit, from \$0.4 million for the third quarter of 2015, to \$0.2 million for the same period of 2016. Amortization of the purchase accounting premium on certificates of deposit acts to decrease deposit interest expense.

Our net interest margin on a tax-equivalent basis for the third quarter of 2016 declined to 3.72% compared with the net interest margin of 4.14% for the third quarter of 2015. Net interest margin is a measure of the net return on earning assets and is computed by dividing annualized net interest income on a tax-equivalent basis by the average of total earning assets for the period. Our overall yield on earning assets decreased to 4.20% for the third quarter of 2016 from 4.62% for the third quarter of 2015. This decline was due primarily to a lower yield received on loans, and the effect of lower merger-related discount accretion in the third quarter of 2016 compare to the third quarter of 2015. The average cost of interest-bearing liabilities was the same in the third quarter of 2016, at 0.61%, as for the third quarter of 2015.

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The following table shows consolidated average balance sheets, detailing the major categories of assets and liabilities, the interest income earned on earning assets, the interest expense paid for interest-bearing liabilities, and the related yields and interest rates for the quarters ended September 30, 2016 and 2015. Dividing annualized income or expense by the average balances of assets or liabilities results in average yields or rates. Average information is provided on a daily average basis.

	Three Months Ended September 30,					
	2016			2015		
	Average Balance	Interest Income/ Expense	Average Rate/ Yield	Average Balance	Interest Income/ Expense	Average Rate/ Yield
(dollars in thousands)						
Average Earning Assets:						
Loans <sup>(1)(2)(3)</sup>	\$2,150,195	\$24,775	4.58 %	\$2,124,037	\$27,090	5.06 %
Investment securities:						
Taxable investments	360,550	2,088	2.30	355,432	1,914	2.14
Tax exempt investments <sup>(2)</sup>	191,253	2,133	4.44	177,059	2,087	4.68
Total investment securities	551,803	4,221	3.04	532,491	4,001	2.98
Federal funds sold and interest-bearing balances	52,121	66	0.50	15,994	13	0.32
Total interest-earning assets	\$2,754,119	\$29,062	4.20 %	\$2,672,522	\$31,104	4.62 %
Cash and due from banks	35,287			43,145		
Premises and equipment	75,882			73,364		
Allowance for loan losses	(21,609 )			(17,519 )		
Other assets	151,842			155,100		
Total assets	\$2,995,521			\$2,926,612		
Average Interest-Bearing Liabilities:						
Savings and interest-bearing demand deposits	\$1,292,623	\$860	0.26 %	\$1,210,924	\$754	0.25 %
Certificates of deposit	653,462	1,614	0.98	678,470	1,731	1.01
Total deposits	1,946,085	2,474	0.51	1,889,394	2,485	0.52
Federal funds purchased and repurchase agreements	67,591	41	0.24	70,140	70	0.40
Federal Home Loan Bank borrowings	106,239	469	1.76	81,869	334	1.62
Long-term debt and other	45,127	326	2.87	50,307	341	2.69
Total borrowed funds	218,957	836	1.52	202,316	745	1.46
Total interest-bearing liabilities	\$2,165,042	\$3,310	0.61 %	\$2,091,710	\$3,230	0.61 %
Net interest spread <sup>(2)</sup>			3.59 %			4.01 %
Demand deposits	502,611			535,379		
Other liabilities	20,863			16,267		
Shareholders' equity	307,005			286,256		
Total liabilities and shareholders' equity	\$2,995,521			\$2,929,612		
Interest income/earning assets <sup>(2)</sup>	\$2,754,119	\$29,062	4.20 %	\$2,672,522	\$31,104	4.62 %
Interest expense/earning assets	\$2,754,119	\$3,310	0.48 %	\$2,672,522	\$3,230	0.48 %
Net interest margin <sup>(2)(4)</sup>		\$25,752	3.72 %		\$27,874	4.14 %

Non-GAAP to GAAP Reconciliation:

Tax Equivalent Adjustment:

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Loans	\$432	\$393
Securities	739	722
Total tax equivalent adjustment	1,171	1,115
Net Interest Income	\$24,581	\$26,759

(1) Loan fees included in interest income are not material.

(2) Computed on a tax-equivalent basis, assuming a federal income tax rate of 35%.

(3) Non-accrual loans have been included in average loans, net of unearned discount.

(4) Net interest margin is tax-equivalent net interest income as a percentage of average earning assets.

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The following table sets forth an analysis of volume and rate changes in interest income and interest expense on our average earning assets and average interest-bearing liabilities during the three months ended September 30, 2016, compared to the same period in 2015, reported on a fully tax-equivalent basis assuming a 35% tax rate. The table distinguishes between the changes related to average outstanding balances (changes in volume holding the initial interest rate constant) and the changes related to average interest rates (changes in average rate holding the initial outstanding balance constant). The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

	Three Months Ended September 30, 2016 Compared to 2015 Change due to		
	Volume	Rate/Yield	Net
(in thousands)			
Increase (decrease) in interest income:			
Loans, tax equivalent	\$ 2,077	\$ (4,392 )	\$ (2,315 )
Investment securities:			
Taxable investments	28	146	174
Tax exempt investments	546	(500 )	46
Total investment securities	574	(354 )	220
Federal funds sold and interest-bearing balances	42	11	53
Change in interest income	2,693	(4,735 )	(2,042 )
Increase (decrease) in interest expense:			
Savings and interest-bearing demand deposits	67	39	106
Certificates of deposit	(65 )	(52 )	(117 )
Total deposits	2	(13 )	(11 )
Federal funds purchased and repurchase agreements	(2 )	(27 )	(29 )
Federal Home Loan Bank borrowings	105	30	135
Other long-term debt	(119 )	104	(15 )
Total borrowed funds	(16 )	107	91
Change in interest expense	(14 )	94	80
Increase in net interest income	\$ 2,707	\$ (4,829 )	\$ (2,122 )
Percentage decrease in net interest income over prior period			(7.6 )%

Interest income and fees on loans on a tax-equivalent basis in the third quarter of 2016 decreased \$2.3 million, or 8.5%, compared with the same period in 2015. This decrease includes the effect of the merger-related discount accretion of \$0.6 million on loans for the third quarter of 2016 compared to \$1.7 million of merger-related discount accretion for the third quarter of 2015. Average loans were \$26.2 million, or 1.2%, higher in the third quarter of 2016 compared with the third quarter of 2015, due primarily to the origination of new loans (primarily commercial real estate and agricultural), and despite the loss of approximately \$33.0 million of loans due to the sale of the Company's Davenport, Iowa branch in early August 2016. In addition to purchase accounting adjustments, the yield on our loan portfolio is affected by the amount of nonaccrual loans (which do not earn interest income), the mix of the portfolio (real estate loans generally have a lower overall yield than commercial and agricultural loans), the effects of competition and the interest rate environment on the amounts and volumes of new loan originations, and the mix of variable-rate versus fixed-rate loans in our portfolio. The decrease in interest income on loans was primarily the result of a decrease in the average yield on loans from 5.06% in the third quarter of 2015 to 4.58% in the third quarter of 2016, which was primarily attributable to purchase accounting adjustments, partially offset by the higher average balances in the loan portfolio.

Interest income on investment securities on a tax-equivalent basis totaled \$4.2 million in the third quarter of 2016 compared with \$4.0 million for the same period of 2015, including \$0.1 million of purchase accounting premium amortization expense in both the 2015 and 2016 periods. The tax-equivalent yield on our investment portfolio in the third quarter of 2016 increased to 3.04% from 2.98% in the comparable period of 2015. The average balance of investments in the third quarter of 2016 was \$551.8 million compared with \$532.5 million in the third quarter of 2015,

an increase of \$19.3 million, or 3.6%. The increase in average balance resulted primarily from deploying excess cash available at the end of the prior quarter into new investments.

Interest expense on deposits was generally unchanged in the third quarter of 2016 compared with the same period in 2015 at \$2.5 million for both periods. While the Company experienced an increase in average balances of interest-bearing deposits for the third quarter of 2016 of \$56.7 million compared with the same period in 2015, this increase was offset by the weighted average rate paid on interest-bearing deposits declining to 0.51% in the third quarter of 2016, compared with 0.52% in the third quarter of 2015. This decrease includes the effect of the merger-related premium amortization of \$0.2 million on certificates of deposit

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for the third quarter of 2016 compared with \$0.4 million for the same period in 2015. The premium amortization acts to decrease deposit interest expense.

Interest expense on borrowed funds of \$0.8 million in the third quarter of 2016 was an increase of \$0.1 million, or 12.2%, compared with \$0.7 million for the same period in 2015. Average borrowed funds for the third quarter of 2016 were \$16.6 million higher compared with the same period in 2015. This increase was primarily due to the \$24.4 million increase in the average level of FHLB borrowing. The weighted average rate on borrowed funds increased to 1.52% for the third quarter of 2016 compared with 1.46% for the third quarter of 2015, primarily reflecting the increased cost of FHLB borrowings.

**Provision for Loan Losses**

The provision for loan losses is a current charge against income and represents an amount which management believes is sufficient to maintain an adequate allowance for known and probable losses in the loan portfolio. In assessing the adequacy of the allowance for loan losses, management considers the size and quality of the loan portfolio measured against prevailing economic conditions, regulatory guidelines, and historical loan loss experience. When a determination is made by management to charge off a loan balance, such write-off is charged against the allowance for loan losses.

We recorded a provision for loan losses of \$1.0 million in the third quarter of 2016, a decrease of \$1.1 million, from \$2.1 million in the third quarter of 2015. The higher provision expense in 2015 was primarily due to the greater volume of acquired loans coming out of purchase accounting and moving into the Company's standard allowance for loan loss methodology. Net loans charged off in the third quarter of 2016 totaled \$0.8 million, compared to \$0.4 million net loans charged off in the third quarter of 2015. We determine an appropriate provision based on our evaluation of the adequacy of the allowance for loan losses in relationship to a continuing review of problem loans, current economic conditions, actual loss experience and industry trends. We believed that the allowance for loan losses was adequate based on the inherent risk in the portfolio as of September 30, 2016; however, there is no assurance losses will not exceed the allowance, and any growth in the loan portfolio and the uncertainty of the general economy may require additional provisions in future periods as deemed necessary.

Sensitive assets include nonaccrual loans, loans on the Bank's watch loan reports and other loans identified as having higher potential for loss. We review sensitive assets on at least a quarterly basis for changes in the customers' ability to pay and changes in the valuation of underlying collateral in order to estimate probable losses. We also periodically review a watch loan list which is comprised of loans that have been restructured or involve customers in industries which have been adversely affected by market conditions. The majority of these loans are being repaid in conformance with their contracts.

**Noninterest Income**

	Three Months Ended September 30,			
	2016	2015	\$ Change	% Change
(dollars in thousands)				
Trust, investment, and insurance fees	\$1,306	\$1,428	\$(122 )	(8.5 )%
Service charges and fees on deposit accounts	1,346	1,297	49	3.8
Loan origination and servicing fees	1,162	1,025	137	13.4
Other service charges and fees	1,307	1,342	(35 )	(2.6 )
Bank-owned life insurance income	324	344	(20 )	(5.8 )
Loss on sale of premises and equipment	(37 )	(5 )	(32 )	NM
Other gain (loss)	306	29	277	NM
Total noninterest income	\$5,714	\$5,460	\$254	4.7 %
Noninterest income as a % of total revenue*	18.1	% 16.9	%	

NM - Percentage change not considered meaningful.

\* See the non-GAAP reconciliation at the beginning of this section for the reconciliation of this non-GAAP measure to its most directly comparable GAAP financial measures.

Total noninterest income for the third quarter of 2016 increased to \$5.7 million, up \$0.2 million, or 4.7%, from \$5.5 million in the third quarter of 2015. The greatest increase was in other gain (loss), which increased \$0.3 million to a \$0.3 million gain for the third quarter of 2016, compared to a negligible gain for the third quarter of 2015. Other gain (loss) represents gains and losses on other real estate owned, repossessed assets, and branch banking offices. The third quarter of 2016 reflects a net gain on other real estate owned of \$0.1 million, a write down of other real estate owned of \$0.5 million, and a net gain on the sale of the Bank's Davenport, Iowa branch of \$0.7 million, while the third quarter of 2015 included a small net gain on other real estate owned. These items were previously classified as other service charges and fees and have now been broken out to provide additional transparency. Loan origination and servicing fees increased from \$1.0 million for the third quarter of 2015 to \$1.2 million for the third quarter



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of 2016. These increases were partially offset by a decrease in trust, investment and insurance fees of \$0.1 million, or 8.5%, from \$1.4 million for the third quarter of 2015 to \$1.3 million for the third quarter of 2016.

Management's strategic goal is for noninterest income to constitute 25% of total revenues (net interest income plus noninterest income excluding gain/loss on securities and premises and equipment and impairment of investment securities) over time. For the three months ended September 30, 2016, noninterest income comprised 18.1% of total revenues, compared with 16.9% for the same period in 2015. With the recent merger of Central Bank into MidWestOne Bank, management expects to see gradual improvement in this ratio in future periods.

## Noninterest Expense

	Three Months Ended September 30,			
	2016	2015	\$ Change	% Change
(dollars in thousands)				
Salaries and employee benefits	\$11,641	\$12,191	\$ (550 )	(4.5 )%
Net occupancy and equipment expense	3,293	2,719	574	21.1
Professional fees	1,014	959	55	5.7
Data processing expense	599	928	(329 )	(35.5 )
FDIC insurance expense	412	431	(19 )	(4.4 )
Amortization of intangible assets	970	800	170	21.3
Other operating expense	2,510	2,314	196	8.5
Total noninterest expense	\$20,439	\$20,342	\$ 97	0.5 %

Noninterest expense for the third quarter of 2016 was \$20.4 million, up \$0.1 million, or 0.5%, from the third quarter of 2015. Net occupancy and equipment expense increased \$0.6 million, or 21.1%, from \$2.7 million for the third quarter of 2015 to \$3.3 million for the third quarter of 2016 due to the additional depreciation expense associated with the completion of the Company's new operations center and remodeling of its corporate headquarters. Other operating expense for the third quarter of 2016 increased \$0.2 million, or 8.5%, compared with the third quarter of 2015, and amortization of intangible assets expense increased from \$0.8 million for the third quarter of 2015 to \$1.0 million for the third quarter of 2016. These increases were partially offset by a decrease in salaries and employee benefits of \$0.6 million, or 4.5%, and a decrease in data processing fees of \$0.3 million, or 35.5%, both due to merger-related cost savings. Merger-related expenses in the third quarter of 2016 were \$0.2 million (\$0.1 million after tax) relating to the merger of MidWestOne Bank and Central Bank, compared to \$0.2 million (\$0.2 million after tax) in the third quarter of 2015 relating to the holding company merger. The majority of the third quarter 2016 merger expenses were comprised of data processing expenses from bills received in the third quarter of 2016 relating to the bank merger, which were \$0.1 million for the third quarter of 2016 compared to no merger-related data processing expenses in the third quarter of 2015. Merger-related professional fees expense decreased \$0.1 million, or 90.7%, for the third quarter of 2016, compared with the third quarter of 2015.

## Income Tax Expense

Our effective income tax rate, or income taxes divided by income before taxes, was 29.7% for the third quarter of 2016, which was higher than the effective tax rate of 21.8% for the third quarter of 2015. Income tax expense was \$2.6 million in the third quarter of 2016 compared to \$2.1 million for the same period of 2015. The primary reason for the increase in income tax expense was the partial recognition of rehabilitation and historic tax credits on the Company's headquarters building in the amount of \$1.3 million in the third quarter of 2015.

Comparison of Operating Results for the Nine Months Ended September 30, 2016 and September 30, 2015  
Summary

For the nine months ended September 30, 2016, we earned net income of \$16.5 million, compared with \$16.9 million for the nine months ended September 30, 2015, a decrease of 2.1%. The decrease in net income was due primarily to increased noninterest expense during the first nine months 2016 compared to the first nine months of 2015, which included only five months of post-merger operations. Basic and diluted earnings per common share for the first nine months of 2016 were \$1.45 and \$1.44, respectively, versus \$1.69 and \$1.68, respectively, for the first nine months of

2015. After excluding the effects of \$4.2 million (\$2.6 million after tax) of expenses related to the merger with Central Bank, adjusted diluted earnings per share for the nine months ended September 30, 2016 were \$1.67, compared to \$1.97, after excluding \$3.4 million (\$2.9 million after tax) of expenses related to the merger with Central, for the same period last year. Our annualized ROAA for the first nine months of 2016 was 0.74% compared with 0.85% for the same period in 2015. Our annualized ROAE was 7.28% for the nine months ended September 30, 2016 versus 9.29% for the nine months ended September 30, 2015. The annualized ROATE was 11.19% for the first nine months of 2016 compared with 13.52% for the same period in 2015.

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The following table presents selected financial results and measures as of and for the nine months ended September 30, 2016 and 2015.

(dollars in thousands)	As of and for the Nine Months Ended September 30,	
	2016	2015
Net Income	\$16,521	\$16,880
Average Assets	2,984,220	2,640,774
Average Shareholders' Equity	303,146	242,872
Return on Average Assets* (ROAA)	0.74	% 0.85
Return on Average Shareholders' Equity* (ROAE)	7.28	9.29
Return on Average Tangible Equity* (ROATE)	11.19	13.52
Total Equity to Assets (end of period)	10.31	9.75
Tangible Equity to Tangible Assets (end of period)	7.94	7.33

\* Annualized

We have traditionally disclosed certain non-GAAP ratios, including our ROATE and the ratio of our tangible equity to tangible assets. We believe these ratios provide investors with information regarding our financial condition and results of operations and how we evaluate them internally.

The following tables provide a reconciliation of the non-GAAP measures to the most comparable GAAP equivalents.

(dollars in thousands, except per share amounts)	For the Nine Months Ended September 30,	
	2016	2015
Net Income:		
Net income	\$16,521	\$16,880
Plus: Intangible amortization, net of tax <sup>(1)</sup>	1,980	1,388
Adjusted net income	\$18,501	\$18,268
Average Tangible Equity:		
Average total shareholders' equity	\$303,146	\$242,872
Less: Average intangibles, net of amortization	(82,237 )	(62,204 )
Average tangible equity	\$220,909	\$180,668
ROATE (annualized)	11.19	% 13.52
Net Income:		
Net income	\$16,521	\$16,880
Plus: Merger-related expenses	4,162	3,402
Net tax effect of merger-related expenses <sup>(2)</sup>	(1,544 )	(514 )
Net income exclusive of merger-related expenses	\$19,139	\$19,768
Diluted average number of shares	11,451,958	10,038,093
Earnings Per Common Share-Diluted	\$1.44	\$1.68
Earnings Per Common Share-Diluted, exclusive of merger-related expenses	\$1.67	\$1.97

(1) Computed on a tax-equivalent basis, assuming a federal income tax rate of 35%.

(2) Computed based on qualifying tax deductible expenses, assuming a federal income tax rate of 35%.

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	For the Nine Months Ended September 30,			
(dollars in thousands)	2016	2015		
Adjusted Noninterest Income:				
Noninterest income	\$ 17,714	\$ 14,555		
Less: Impairment losses on investment securities, net	—	—		
Gain (loss) on sale of available for sale securities	467	1,011		
Gain (loss) on sale of premises and equipment	(53 )	(15 )		
Other gain (loss)	1,378	(396 )		
Adjusted noninterest income	\$ 15,922	\$ 13,955		
Total Revenue:				
Net interest income	\$ 75,076	\$ 63,724		
Plus: Noninterest income	17,714	14,555		
Less: Impairment losses on investment securities, net	—	—		
Gain (loss) on sale of available for sale securities	467	1,011		
Gain (loss) on sale of premises and equipment	(53 )	(15 )		
Other gain (loss)	1,378	(396 )		
Total Revenue	\$ 90,998	\$ 77,679		
Adjusted Noninterest Income as a Percentage of Total Revenue	17.5 %	18.0 %		
			As of September 30,	
(dollars in thousands)			2016	2015
Tangible Equity:				
Total shareholders' equity			\$ 309,584	\$ 290,666
Less: Intangible assets, net of amortization and associated deferred tax liability			(77,327 )	(77,761 )
Tangible equity			\$ 232,257	\$ 212,905
Tangible Assets:				
Total assets			\$ 3,001,974	\$ 2,981,840
Less: Intangible assets, net of amortization and associated deferred tax liability			(77,327 )	(77,761 )
Tangible assets			\$ 2,924,647	\$ 2,904,079
Tangible Equity/Tangible Assets			7.94 %	7.33 %

**Net Interest Income**

Our net interest income for the nine months ended September 30, 2016 was \$75.1 million, up \$11.4 million, or 17.8%, from \$63.7 million for the nine months ended September 30, 2015, primarily due to an increase of \$12.8 million, or 17.8%, in interest income. Loan interest income increased \$13.1 million, or 21.5%, to \$74.1 million for the first nine months of 2016 compared to the first nine months of 2015, primarily due to the merger-related increase in average loan balances of \$305.0 million, or 16.4%, between the two periods, and despite the effect of a decrease in the merger-related discount accretion to \$2.4 million for the nine months ended September 30, 2016, compared to \$3.0 million for the nine months ended September 30, 2015. Interest income on investment securities increased \$0.3 million, or 3.1%, to \$10.2 million for the first nine months of 2016 compared to the first nine months of 2015 primarily due to an increase of 13 basis points on the portfolio's yield, somewhat offset by a decrease of \$7.4 million in the average balance between the comparative periods. There was no income from loan pool participations in the first nine months of 2016 compared to \$0.8 million of income in the first nine months of 2015, as the Company sold its remaining loan pool participations in June 2015.

Total interest expense was \$9.3 million for the nine months ended September 30, 2016, an increase of \$1.4 million, or 17.7%, compared to the first nine months of 2015. Interest expense on deposits increased \$0.9 million, or 16.2%, to \$6.8 million for the nine months ended September 30, 2016 (including \$0.8 million in merger-related amortization of the purchase accounting premium on certificates of deposit), compared to \$5.9 million (including \$1.0 million in merger-related amortization) for the nine months ended September 30, 2015.

Our net interest margin on a tax-equivalent basis for the first nine months of 2016 increased to 3.83% compared with the net interest margin of 3.69% for the first nine months of 2015. Net interest margin is a measure of the net return on earning assets and is computed by dividing annualized net interest income on a tax-equivalent basis by the average of total earning assets for the period. Our overall yield on earning assets was 4.29% for the first nine months of 2016, an increase of 16 basis points compared to the first nine months of 2015. This increase was despite the inclusion of \$2.4 million of merger-related discount accretion income

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for loans in the first nine months of 2016, compared to \$3.0 million of discount for the first nine months of 2015. The average cost of interest-bearing liabilities increased in the first nine months of 2016 to 0.58% from 0.56% for the first nine months of 2015, due primarily to the higher cost of obtaining deposits during the period and increased rates on FHLB borrowings, despite the inclusion of \$0.8 million of merger-related amortization of the purchase accounting premium on certificates of deposit in the first nine months of 2016, compared to \$1.0 million of such amortization for the first nine months of 2015.

The following table shows consolidated average balance sheets, detailing the major categories of assets and liabilities, the interest income earned on earning assets, the interest expense paid for interest-bearing liabilities, and the related yields and interest rates for the nine months ended September 30, 2016 and 2015. Dividing annualized income or expense by the average balances of assets or liabilities results in average yields or costs. Average information is provided on a daily average basis.

	Nine Months Ended September 30,					
	2016			2015		
	Average Balance	Interest Income/ Expense	Average Rate/ Yield	Average Balance	Interest Income/ Expense	Average Rate/ Yield
(dollars in thousands)						
Average Earning Assets:						
Loans <sup>(1)(2)(3)</sup>	\$2,164,740	\$75,379	4.65 %	\$1,859,735	\$62,037	4.46 %
Loan pool participations <sup>(4)</sup>	—	—	—	13,413	798	7.95
Investment securities:						
Taxable investments	341,621	5,924	2.32	359,475	5,721	2.13
Tax exempt investments <sup>(2)</sup>	189,712	6,504	4.58	179,297	6,341	4.73
Total investment securities	531,333	12,428	3.12	538,772	12,062	2.99
Federal funds sold and interest-bearing balances	40,813	145	0.47	16,025	29	0.24
Total interest-earning assets	\$2,736,886	\$87,952	4.29 %	\$2,427,945	\$74,926	4.13 %
Cash and due from banks	37,120			36,714		
Premises and equipment	76,247			62,528		
Allowance for loan losses	(20,736 )			(18,461 )		
Other assets	154,703			132,048		
Total assets	\$2,984,220			\$2,640,774		
Average Interest-Bearing Liabilities:						
Savings and interest-bearing demand deposits	\$1,270,067	\$2,562	0.27 %	\$1,076,323	\$2,031	0.25 %
Certificates of deposit	650,176	4,260	0.88	632,419	3,841	0.81
Total deposits	1,920,243	6,822	0.47	1,708,742	5,872	0.46
Federal funds purchased and repurchase agreements	74,006	151	0.27	69,077	157	0.30
Federal Home Loan Bank borrowings	106,909	1,387	1.73	86,797	1,086	1.67
Long-term debt and other	46,452	978	2.81	37,658	817	2.90
Total borrowed funds	227,367	2,516	1.48	193,532	2,060	1.42
Total interest-bearing liabilities	\$2,147,610	\$9,338	0.58 %	\$1,902,274	\$7,932	0.56 %
Net interest spread <sup>(2)</sup>			3.71 %			3.57 %
Demand deposits	514,991			450,219		
Other liabilities	18,473			45,409		
Shareholders' equity	303,146			242,872		
Total liabilities and shareholders' equity	\$2,984,220			\$2,640,774		

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Interest income/earning assets <sup>(2)</sup>	\$2,736,886	\$87,952	4.29 %	\$2,427,945	\$74,926	4.13 %
Interest expense/earning assets	\$2,736,886	\$9,338	0.46 %	\$2,427,945	\$7,932	0.44 %
Net interest margin <sup>(2)(5)</sup>		\$78,614	3.83 %		\$66,994	3.69 %

Non-GAAP to GAAP Reconciliation:

Tax Equivalent Adjustment:

Loans	\$1,285	\$1,078
Securities	2,253	2,192
Total tax equivalent adjustment	3,538	3,270
Net Interest Income	\$75,076	\$63,724

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- (1) Loan fees included in interest income are not material.  
(2) Computed on a tax-equivalent basis, assuming a federal income tax rate of 35%.  
(3) Non-accrual loans have been included in average loans, net of unearned discount.  
(4) Includes interest income and discount realized on loan pool participations.  
(5) Net interest margin is tax-equivalent net interest income as a percentage of average earning assets.

The following table sets forth an analysis of volume and rate changes in interest income and interest expense on our average earning assets and average interest-bearing liabilities during the nine months ended September 30, 2016, compared to the same period in 2015, reported on a fully tax-equivalent basis assuming a 35% tax rate. The table distinguishes between the changes related to average outstanding balances (changes in volume holding the initial interest rate constant) and the changes related to average interest rates (changes in average rate holding the initial outstanding balance constant). The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

	Nine Months Ended September 30, 2016 Compared to 2015 Change due to		
	Volume	Rate/Yield	Net
(in thousands)			
Increase (decrease) in interest income:			
Loans, tax equivalent	\$ 10,591	\$ 2,751	\$ 13,342
Loan pool participations	(399 )	(399 )	(798 )
Investment securities:			
Taxable investments	(416 )	619	203
Tax exempt investments	453	(290 )	163
Total investment securities	37	329	366
Federal funds sold and interest-bearing balances	72	44	116
Change in interest income	10,301	2,725	13,026
Increase (decrease) in interest expense:			
Savings and interest-bearing demand deposits	368	163	531
Certificates of deposit	103	316	419
Total deposits	471	479	950
Federal funds purchased and repurchase agreements	15	(21 )	(6 )
Federal Home Loan Bank borrowings	261	40	301
Other long-term debt	202	(41 )	161
Total borrowed funds	478	(22 )	456
Change in interest expense	949	457	1,406
Change in net interest income	\$ 9,352	\$ 2,268	\$ 11,620
Percentage change in net interest income over prior period			17.3 %

Interest income and fees on loans on a tax-equivalent basis increased \$13.3 million, or 21.5%, in the first nine months of 2016 compared to the same period in 2015. This increase reflects the effect of the merger-related discount accretion for loans of \$2.4 million in the first nine months of 2016, compared to \$3.0 million of discount accretion in the first nine months of 2015. The increased income is mainly due to an increase in average loans balances of \$305.0 million, or 16.4%, in the first nine months of 2016 compared to the same period in 2015, primarily resulting from the merger. The yield on loans increased from 4.46% in the first nine months of 2015 to 4.65% in the same period of 2016. The yield on our loan portfolio is affected by the amount of nonaccrual loans (which do not earn interest income), the mix of the portfolio (real estate loans generally have a lower overall yield than commercial and agricultural loans), the effects of competition and the interest rate environment on the amounts and volumes of new loan originations, and the mix of variable-rate versus fixed-rate loans in our portfolio.



Interest and discount income on loan pool participations was nothing for the first nine months of 2016, a decrease of \$0.8 million compared to the first nine months of 2015. The Company sold its remaining loan pool participations in the second quarter of 2015.

Interest income on investment securities on a tax-equivalent basis totaled \$12.4 million in the first nine months of 2016 compared with \$12.1 million for the same period of 2015, reflecting \$0.2 million of purchase accounting premium amortization expense in the first nine months of 2016 compared to \$0.2 million of purchase accounting premium amortization in the first nine months of 2015. The tax-equivalent yield on our investment portfolio for the first nine months of 2016 increased to 3.12% from

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2.99% in the comparable period of 2015, with the first nine months of 2016 yield including 7 basis points of decrease attributable to purchase accounting. The average balance of investments in the first nine months of 2016 was \$531.3 million compared with \$538.8 million in the first nine months of 2015, a decrease of \$7.4 million, or 1.4%.

Interest expense on deposits was \$6.8 million for the first nine months of 2016 compared with \$5.9 million for the same period in 2015. This increase was in part due to average interest-bearing deposits for the first nine months of 2016 increasing \$211.5 million, or 12.4%, compared with the same period in 2015, due primarily to the merger.

The weighted average rate paid on interest-bearing deposits was 0.47% for the first nine months of 2016 compared with 0.46% for the first nine months of 2015. This increase reflects the merger-related amortization of the purchase accounting premium on certificates of deposit in the amount of \$0.8 million for the first nine months of 2016 compared with \$1.0 million for the first nine months of 2015. The impact of the amortization in 2016 was to reduce the average cost of deposits by 6 basis points.

Interest expense on borrowed funds in the first nine months of 2016 was \$2.5 million, compared with \$2.1 million for the same period in 2015. Average borrowed funds for the first nine months of 2016 were \$33.8 million higher compared with the same period in 2015. This increase was primarily due to the borrowing of \$25.0 million in new long-term debt as well as \$21.6 million of subordinated notes assumed in the merger during the second quarter of 2015, and the \$20.1 million increase in the average level of FHLB borrowings for the first nine months of 2016 compared to the first nine months of 2015. The weighted average rate on borrowed funds increased to 1.48% for the first nine months of 2016 compared with 1.42% for the first nine months of 2015, reflecting the increased cost of new debt relative to that of pre-merger debt.

**Provision for Loan Losses**

We recorded a provision for loan losses of \$3.2 million in the first nine months of 2016, \$0.4 million, or 11.0%, less than the \$3.6 million provision in the first nine months of 2015. The decreased provision is primarily due to the lower level of loans moving from the purchased accounting portfolio to the Company's standard allowance for loan loss methodology. Net loans charged off in the first nine months of 2016 totaled \$1.3 million compared with \$1.1 million in the first nine months of 2015.

**Noninterest Income**

	Nine Months Ended September 30,		\$	%
	2016	2015	Change	Change
(dollars in thousands)				
Trust, investment, and insurance fees	\$4,244	\$4,642	\$(398 )	(8.6 )%
Service charges and fees on deposit accounts	3,887	3,098	789	25.5
Loan origination and servicing fees	2,636	2,096	540	25.8
Other service charges and fees	4,115	3,155	960	30.4
Bank-owned life insurance income	1,040	964	76	7.9
Gain on sale or call of available for sale securities	467	1,011	(544 )	(53.8 )
Loss on sale of premises and equipment	(53 )	(15 )	(38 )	NM
Other gain (loss)	1,378	(396 )	1,774	NM
Total noninterest income	\$17,714	\$14,555	\$3,159	21.7 %
Adjusted noninterest income as a % of total revenue*	17.5 %	18.0 %		

NM - Percentage change not considered meaningful.

\* See the non-GAAP reconciliation at the beginning of this section for the reconciliation of this non-GAAP measure to its most directly comparable GAAP financial measures.

Total noninterest income rose to \$17.7 million for the first nine months of 2016, an increase of \$3.2 million, or 21.7%, from \$14.6 million during the same period of 2015. The greatest increase for the nine months ended September 30, 2016, was in other gain (loss), which increased \$1.8 million to a gain of \$1.4 million for the nine months ended September 30, 2016, compared to a loss of \$0.4 million for the nine months ended September 30, 2015. The first nine months of 2016 reflect a net gain on other real estate owned of \$0.8 million, and a net gain on the sales of the Rice

Lake and Barron, Wisconsin and Davenport, Iowa branches of \$1.2 million. The first nine months of 2015 included a net loss on other real estate owned of \$0.4 million, due primarily the sale of the loan pool participations in June 2015. Other service charges and fees rose from \$3.2 million for the nine months ended September 30, 2015, to \$4.1 million for the nine months ended September 30, 2016, an increase of \$0.9 million, or 30.4%. Another significant contributor to the overall increase in noninterest income was service charges and fees on deposit accounts, which increased \$0.8 million to \$3.9 million for the first nine months of 2016, compared with \$3.1 million for the same period of 2015. Loan origination and servicing fees in the first nine months of 2016 increased \$0.5 million, or 25.8%, from \$2.1 million for the same period in 2015. These increases were partially offset by decreased gains on the sale of available for sale securities of \$0.5

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million between the nine months ended September 30, 2016 and the same period of 2015. In addition, trust, investment, and insurance fees also decreased to \$4.2 million for the first nine months of 2016, a decline of \$0.4 million, or 8.6%, from \$4.6 million for the same period in 2015.

Management's strategic goal is for noninterest income to constitute 25% of total revenues (net interest income plus noninterest income excluding gain/loss on securities and premises and equipment and impairment of investment securities) over time. For the nine months ended September 30, 2016, noninterest income comprised 17.5% of total revenues, compared with 18.0% for the same period in 2015. With the recent merger of Central Bank into MidWestOne Bank, management expects to see gradual improvement in this ratio in future periods.

## Noninterest Expense

	Nine Months Ended September 30,			
	2016	2015	\$ Change	% Change
(dollars in thousands)				
Salaries and employee benefits	\$37,607	\$29,054	\$8,553	29.4 %
Net occupancy and equipment expense	9,870	6,585	3,285	49.9
Professional fees	3,181	3,868	(687)	(17.8)
Data processing expense	3,981	2,028	1,953	96.3
FDIC insurance expense	1,231	1,058	173	16.4
Amortization of intangible assets	3,046	2,136	910	42.6
Other operating expense	7,784	6,638	1,146	17.3
Total noninterest expense	\$66,700	\$51,367	\$15,333	29.8 %

Noninterest expense increased to \$66.7 million for the nine months ended September 30, 2016 compared with \$51.4 million for the nine months ended September 30, 2015, an increase of \$15.3 million, or 29.8%. All categories of noninterest expense increased for the nine months ended September 30, 2016, with the exception of professional fees, which decreased \$0.7 million, or 17.8%, due to lower merger-related professional fee expenses of \$0.3 million for the first nine months of 2016 compared with \$1.9 million for the same period last year. Salaries and employee benefits increased \$8.5 million, or 29.4%, from \$29.1 million for the nine months ended September 30, 2015, to \$37.6 million for the nine months ended September 30, 2016. This increase in salaries and employee benefits includes \$1.7 million of merger-related expenses, mainly severance and retention payments, for the nine months ended September 30, 2016, compared to \$0.5 million for the same period in 2015. Net occupancy and equipment expense rose from \$6.6 million for the first nine months of 2015 to \$9.9 million for the same period of 2016, an increase of \$3.3 million, or 49.9%, primarily due to the merger. The increase in data processing expense for the nine months ended September 30, 2016, of \$2.0 million, or 96.3%, compared to the same period of 2015, was attributable primarily to contract termination expenses of \$1.9 million in connection with the merger of the banks.

## Income Tax Expense

Our effective tax rate, or income taxes divided by income before taxes, was 27.7% for the first nine months of 2016, and 27.5% for the first nine months of 2015. Income tax expense decreased to \$6.3 million in the first nine months of 2016 compared with \$6.4 million for the same period of 2015, primarily due to the decrease in the level of taxable income between the two periods and the non-deductible merger-related expenses incurred in the respective periods.

## FINANCIAL CONDITION

Our total assets increased to \$3.00 billion at September 30, 2016, from \$2.98 billion at December 31, 2015, mainly attributable to an increase in investment securities, which increased \$41.7 million, or 7.6%, and cash and cash equivalents, which increased \$4.9 million, or 10.3%, between these dates. These increases were partially offset by decreases in total loans of \$10.1 million, or 0.5%, primarily due to the sale of our Rice Lake and Barron, Wisconsin and Davenport, Iowa branch offices, and decreases in other real estate owned of \$5.4 million, or 60.9%, between December 31, 2015 and September 30, 2016. Total deposits at September 30, 2016, were \$2.45 billion, a decrease of \$17.6 million, or 0.7%, from December 31, 2015, again primarily due to the sale of our Rice Lake and Barron,

Wisconsin and Davenport, Iowa branch offices. The mix of deposits saw a decrease in non-interest bearing demand deposits of \$65.8 million, or 11.8%, and a decrease of \$8.9 million, or 1.38%, in certificates of deposit between December 31, 2015 and September 30, 2016. These decreases were partially offset by increases between December 31, 2015 and September 30, 2016 of \$50.2 million, or 4.7%, in interest-bearing checking deposits, and \$6.9 million, or 3.7%, in savings deposits. Federal funds purchased increased \$17.8 million, from \$1.5 million at December 31, 2015, to \$19.3 million at September 30, 2016, to help offset the overall decline in deposit balances. At September 30, 2016, the long-term borrowings incurred by the Company in connection with the closing of the holding company merger had an outstanding balance of \$18.8 million, a decrease of \$3.8 million, or 16.7%, from December 31, 2015, due to normal scheduled repayments. Securities sold under agreement to repurchase declined \$4.0 million between December 31, 2015 and September 30, 2016, while FHLB borrowings

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increased \$13.0 million, or 14.9%, between December 31, 2015, and September 30, 2016, to \$100.0 million at September 30, 2016.

**Investment Securities**

Investment securities totaled \$587.3 million at September 30, 2016, or 19.6% of total assets, an increase of \$41.7 million, or 7.6%, from \$545.7 million, or 18.3% of total assets, as of December 31, 2015. A total of \$436.2 million of the investment securities were classified as available for sale at September 30, 2016, compared to \$427.2 million at December 31, 2015. This represents an increase in investment securities available for sale of \$9.0 million, or 2.1%, from December 31, 2015 to September 30, 2016. As of September 30, 2016, the portfolio consisted mainly of obligations of states and political subdivisions (43.9%), mortgage-backed securities and collateralized mortgage obligations (41.8%), and obligations of U.S. government agencies (1.0%). Investment securities held to maturity were \$151.1 million at September 30, 2016, compared to \$118.4 million at December 31, 2015.

**Loans**

The composition of loans (before deducting the allowance for loan losses) was as follows:

	September 30, 2016		December 31, 2015		
	Balance	% of Total	Balance	% of Total	
(dollars in thousands)					
Agricultural	\$121,625	5.7	% \$121,714	5.7	%
Commercial and industrial	475,202	22.2	467,412	21.7	
Credit cards	1,526	0.1	1,377	0.1	
Overdrafts <sup>1</sup>	—	0.0	1,483	0.1	
Commercial real estate:					
Construction and development	126,515	5.9	120,753	5.6	
Farmland	95,138	4.4	89,084	4.1	
Multifamily	118,392	5.5	121,763	5.7	
Commercial real estate-other	679,601	31.7	660,341	30.7	
Total commercial real estate	1,019,646	47.5	991,941	46.1	
Residential real estate:					
One- to four-family first liens	369,607	17.3	428,233	19.9	
One- to four-family junior liens	117,291	5.5	102,273	4.7	
Total residential real estate	486,898	22.8	530,506	24.6	
Consumer	36,935	1.7	37,509	1.7	
Total loans	\$2,141,832	100.0	% \$2,151,942	100.0	%

(1) As of the first quarter of 2016, overdrafts are no longer included as a separate class of loan.

Total loans (excluding loans held for sale) decreased \$10.1 million, or 0.5%, from \$2.15 billion at December 31, 2015, to \$2.14 billion at September 30, 2016. The decrease was primarily concentrated in residential real estate loans. This decrease was partially offset by increases in commercial real estate-other, commercial and industrial, farmland, and construction and development loans. As of September 30, 2016, the largest category of loans was commercial real estate loans, comprising approximately 48% of the portfolio, of which 6% of total loans were multifamily residential mortgages, 6% of total loans were construction and development, and 4% of total loans were farmland. Residential real estate loans was the next largest category at 23% of total loans, followed by commercial and industrial loans at 22%, agricultural loans at 6%, and consumer loans at 2%. The Company also held \$22.3 million net of a discount of \$4.8 million, or 1.0% of the total loan portfolio, in purchased credit impaired loans as a result of the merger.

We have minimal direct exposure to subprime mortgages in our loan portfolio. Our loan policy provides a guideline that real estate mortgage borrowers have a Beacon score of 640 or greater. Exceptions to this guideline have been noted but the overall exposure is deemed minimal by management. Mortgages we originate and sell on the secondary market are typically underwritten according to the guidelines of secondary market investors. These mortgages are sold on a non-recourse basis.



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## Premises and Equipment

As of September 30, 2016, premises and equipment totaled \$75.1 million, a decrease of \$1.1 million, or 1.4%, from \$76.2 million at December 31, 2015. This decrease was primarily due to normal depreciation expense of \$3.3 million, partially offset by ongoing capital improvement projects. The Company completed the construction of a new Home Mortgage and Operations Center, which was complete at the end of 2015, at a total cost of \$16.0 million. The Company also undertook the restoration and remodeling of the building that serves as the main office of the Bank and headquarters of the Company, which was completed in April 2016 at a cost of \$13.8 million.

## Deposits

Total deposits as of September 30, 2016 were \$2.45 billion, a decrease of \$17.6 million, or 0.7% from December 31, 2015. Interest-bearing checking deposits were the largest category of deposits at September 30, 2016, representing approximately 45.6% of total deposits. Total interest-bearing checking deposits were \$1.11 billion at September 30, 2016, an increase of \$50.2 million, or 4.7%, from \$1.06 billion at December 31, 2015. Included in interest-bearing checking deposits at September 30, 2016 were \$39.0 million of brokered deposits in the Insured Cash Sweep (ICS) program, an increase of \$18.8 million, or 92.7%, from \$20.3 million at December 31, 2015, due primarily to the addition of one account holder. Non-interest bearing demand deposits were \$493.8 million at September 30, 2016, a decrease of \$65.8 million, or 11.8%, from \$559.6 million at December 31, 2015. Savings deposits were \$196.4 million at September 30, 2016, an increase of \$6.9 million, or 3.7%, from December 31, 2015. Total certificates of deposit were \$641.2 million at September 30, 2016, down \$8.9 million, or 1.4%, from \$650.1 million at December 31, 2015. Included in total certificates of deposit at September 30, 2016 was \$3.0 million of brokered deposits in the Certificate of Deposit Account Registry Service (CDARS) program, an increase of \$0.1 million, or 5.2%, from December 31, 2015. Based on recent experience, management anticipates that many of the maturing certificates of deposit will not be renewed upon maturity due to the current low interest rate environment. Approximately 87.4% of our total deposits were considered “core” deposits as of September 30, 2016.

## Goodwill and Other Intangible Assets

Goodwill increased from \$64.5 million as of December 31, 2015, to \$64.7 million as of September 30, 2016 due to the finalization of merger accounting amounts related to the Central merger in the first quarter of 2016. Other intangible assets decreased \$3.0 million, or 15.9%, to \$16.1 million at September 30, 2016 compared to \$19.1 million at December 31, 2015, due to normal amortization. See Note 7. “Goodwill and Intangible Assets” to our consolidated financial statements for additional information.

## Debt

## Federal Home Loan Bank Borrowings

FHLB borrowings totaled \$100.0 million as of September 30, 2016 compared with \$87.0 million as of December 31, 2015. We utilize FHLB borrowings as a supplement to customer deposits to fund earning assets and to assist in managing interest rate risk. Thus, when deposits decline, FHLB borrowing may increase to provide necessary liquidity. See Note 11. “Long-Term Borrowings” to our consolidated financial statements for additional information related to our FHLB borrowings.

## Junior Subordinated Notes Issued to Capital Trusts

Junior subordinated notes that have been issued to capital trusts that issued trust preferred securities were \$23.7 million as of September 30, 2016, an increase of \$0.1 million from December 31, 2015. This increase was due to the accretion of the purchase accounting discount on the two junior subordinated notes assumed in the Central merger. See Note 10. “Subordinated Notes Payable” to our consolidated financial statements for additional information related to our junior subordinated notes.

## Long-term Debt

Long-term debt in the form of a \$35.0 million unsecured note, of which \$25.0 million was drawn upon, payable to a correspondent bank was entered into on April 30, 2015 in connection with the payment of the merger consideration at the closing of the Central merger, of which \$18.8 million was outstanding as of September 30, 2016. See Note 11. “Long-Term Borrowings” to our consolidated financial statements for additional information related to our long-term debt.





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## Nonperforming Assets

The following tables set forth information concerning nonperforming loans by class of loans at September 30, 2016 and December 31, 2015:

	90 Days or More Past Due and Still Accruing Interest	Restructured	Nonaccrual	Total
(in thousands)				
September 30, 2016				
Agricultural	\$ —	\$ 2,795	\$ 401	\$3,196
Commercial and industrial	—	669	5,966	6,635
Credit cards	—	—	—	—
Commercial real estate:				
Construction and development	248	—	343	591
Farmland	—	2,174	228	2,402
Multifamily	—	—	226	226
Commercial real estate-other	60	248	6,994	7,302
Total commercial real estate	308	2,422	7,791	10,521
Residential real estate:				
One- to four- family first liens	448	1,447	1,102	2,997
One- to four- family junior liens	186	13	105	304
Total residential real estate	634	1,460	1,207	3,301
Consumer	—	12	12	24
Total	\$ 942	\$ 7,358	\$ 15,377	\$23,677

	90 Days or More Past Due and Still Accruing Interest	Restructured	Nonaccrual	Total
(in thousands)				
December 31, 2015				
Agricultural	\$ —	\$ 2,901	\$ 172	\$3,073
Commercial and industrial	—	1,122	575	1,697
Credit cards	—	—	—	—
Overdrafts	—	—	—	—
Commercial real estate:				
Construction and development	—	—	95	95
Farmland	80	2,209	20	2,309
Multifamily	—	—	224	224
Commercial real estate-other	—	—	1,452	1,452
Total commercial real estate	80	2,209	1,791	4,080
Residential real estate:				
One- to four- family first liens	199	972	1,182	2,353
One- to four- family junior liens	—	13	281	294
Total residential real estate	199	985	1,463	2,647
Consumer	5	15	11	31

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Total                                   \$ 284     \$ 7,232     \$ 4,012     \$ 11,528

Not included in the loans above as of September 30, 2016, were purchased credit impaired loans with an outstanding balance of \$2.8 million, net of a discount of \$0.9 million.

Our nonperforming assets (which include nonperforming loans and OREO) totaled \$27.1 million as of September 30, 2016, an increase of \$6.8 million, or 33.2%, from December 31, 2015. The balance of OREO at September 30, 2016 was \$3.5 million, a decrease of \$5.4 million, from \$8.8 million of OREO at December 31, 2015. All of the OREO property was acquired through foreclosures, and we are actively working to sell all properties held as of September 30, 2016. OREO is carried at appraised value less estimated cost of disposal at the date of acquisition. Additional discounts could be required to market and sell the properties, resulting in a write down through expense.

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Nonperforming loans increased from \$11.5 million, or 0.54% of total loans, at December 31, 2015, to \$23.7 million, or 1.11% of total loans, at September 30, 2016. At September 30, 2016, nonperforming loans consisted of \$15.4 million in nonaccrual loans, \$7.4 million in TDRs and \$0.9 million in loans past due 90 days or more and still accruing. This compares to nonaccrual loans of \$4.0 million, TDRs of \$7.2 million, and loans past due 90 days or more and still accruing of \$0.3 million at December 31, 2015. Nonaccrual loans increased \$11.4 million between December 31, 2015, and September 30, 2016, due primarily to the addition of one commercial loan customer with four loans totaling \$10.4 million. The Company is actively working to resolve the issues with these four loans. The balance of TDRs increased \$0.1 million between these two dates, as the addition of four loans totaling \$0.5 million were partially offset by payments collected from TDR-status borrowers and the charge-off of two TDRs totaling \$0.2 million. Loans 90 days or more past due and still accruing interest increased \$0.7 million between December 31, 2015 and September 30, 2016. Loans past due 30 to 89 days and still accruing interest (not included in the nonperforming loan totals) increased to \$11.6 million at September 30, 2016, compared with \$8.5 million at December 31, 2015. At September 30, 2016, other real estate owned (not included in nonperforming loans) was \$3.5 million, down from \$8.8 million of other real estate owned at December 31, 2015. During the first nine months of 2016, the Company had a net decrease of 29 properties in other real estate owned. As of September 30, 2016, the allowance for loan losses was \$21.4 million, or 1.00% of total loans, compared with \$19.4 million, or 0.90% of total loans at December 31, 2015. The allowance for loan losses represented 90.36% of nonperforming loans at September 30, 2016, compared with 168.52% of nonperforming loans at December 31, 2015. The Company had net loan charge-offs of \$1.3 million in the nine months ended September 30, 2016, or an annualized 0.08% of average loans outstanding, compared to net charge-offs of \$1.1 million, or an annualized 0.08% of average loans outstanding, for the same period of 2015. Loan Review and Classification Process for Agricultural, Commercial and Industrial, and Commercial Real Estate Loans:

The Bank maintains a loan review and classification process which involves multiple officers of the Bank and is designed to assess the general quality of credit underwriting and to promote early identification of potential problem loans. All commercial and agricultural loan officers are charged with the responsibility of risk rating all loans in their portfolios and updating the ratings, positively or negatively, on an ongoing basis as conditions warrant. A monthly loan officer validation worksheet documents this process. Risk ratings are selected from an 8-point scale with ratings as follows: ratings 1- 4 Satisfactory (pass), rating 5 Watch (potential weakness), rating 6 Substandard (well-defined weakness), rating 7 Doubtful, and rating 8 Loss.

When a loan officer originates a new loan, based upon proper loan authorization, he or she documents the credit file with an offering sheet summary, supplemental underwriting analysis, relevant financial information and collateral evaluations. All of this information is used in the determination of the initial loan risk rating. The Bank's loan review department undertakes independent credit reviews of relationships based on either criteria established by loan policy, risk-focused sampling, or random sampling. Loan policy requires all lending relationships with total exposure of \$5.0 million or more as well as all classified (loan grades 6 through 8) and Watch (loan grade 5) rated credits over \$1.0 million be reviewed no less than annually. The individual loan reviews consider such items as: loan type; nature, type and estimated value of collateral; borrower and/or guarantor estimated financial strength; most recently available financial information; related loans and total borrower exposure; and current/anticipated performance of the loan. The results of such reviews are presented to executive management.

Through the review of delinquency reports, updated financial statements or other relevant information, the lending officer and/or loan review personnel may determine that a loan relationship has weakened to the point that a watch (loan grade 5) or classified (loan grades 6 through 8) status is warranted. When a loan relationship with total related exposure of \$1.0 million or greater is adversely graded (loan grade 5 or above), or is classified as a TDR (regardless of size), the lending officer is then charged with preparing a loan strategy summary worksheet that outlines the background of the credit problem, current repayment status of the loans, current collateral evaluation and a workout plan of action. This plan may include goals to improve the credit rating, assist the borrower in moving the loans to another institution and/or collateral liquidation. All such reports are first presented to regional management and then to the loan strategy committee. Copies of the minutes of these Committee meetings are presented to the board of directors of the Bank.

Depending upon the individual facts and circumstances and the result of the Classified/Watch review process, loan officers and/or loan review personnel may categorize the loan relationship as impaired. Once that determination has occurred, the credit analyst will complete an evaluation of the collateral (for collateral-dependent loans) based upon the estimated collateral value, adjusting for current market conditions and other local factors that may affect collateral value. Loan review personnel may also complete an independent impairment analysis when deemed necessary. These judgmental evaluations may produce an initial specific allowance for placement in the Company's allowance for loan and lease losses calculation. Impairment analysis for the underlying collateral value is completed in the last month of the quarter. The impairment analysis worksheets are reviewed by the Credit Administration department prior to quarter-end. The board of directors of the Bank on a quarterly basis reviews the Classified/Watch reports including changes in credit grades of 5 or higher as well as all impaired loans, the related allowances and OREO.

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In general, once the specific allowance has been finalized, regional and executive management will consider a charge-off prior to the calendar quarter-end in which that reserve calculation is finalized.

The review process also provides for the upgrade of loans that show improvement since the last review. All requests for an upgrade of a credit are approved by the loan strategy committee before the rating can be changed.

**Restructured Loans**

We restructure loans for our customers who appear to be able to meet the terms of their loan over the long term, but who may be unable to meet the terms of the loan in the near term due to individual circumstances. We consider the customer's past performance, previous and current credit history, the individual circumstances surrounding the current difficulties and their plan to meet the terms of the loan in the future prior to restructuring the terms of the loan. The following factors are indicators that a concession has been granted (one or multiple items may be present):

• The borrower receives a reduction of the stated interest rate for the remaining original life of the debt.

• The borrower receives an extension of the maturity date or dates at a stated interest rate lower than the current market interest rate for new debt with similar risk characteristics.

• The borrower receives a reduction of the face amount or maturity amount of the debt as stated in the instrument or other agreement.

• The borrower receives a deferral of required payments (principal and/or interest).

• The borrower receives a reduction of the accrued interest.

Generally, loans are restructured through short-term interest rate relief, short-term principal payment relief or short-term principal and interest payment relief. Once a restructured loan has gone 90 days or more past due or is placed on nonaccrual status, it is included in the 90 days and over past due or nonaccrual totals.

During the nine months ended September 30, 2016, the Company restructured five loans by granting concessions to borrowers experiencing financial difficulties.

A loan classified as a troubled debt restructuring will no longer be included in the troubled debt restructuring disclosures in the periods after the restructuring if the loan performs in accordance with the terms specified by the restructuring agreement and the interest rate specified in the restructuring agreement represents a market rate at the time of modification. The specified interest rate is considered a market rate when the interest rate is equal to or greater than the rate the Company is willing to accept at the time of restructuring for a new loan with comparable risk. If there are concerns that the borrower will not be able to meet the modified terms of the loan, the loan will continue to be included in the troubled debt restructuring disclosures.

We consider all TDRs, regardless of whether they are performing in accordance with their modified terms, to be impaired loans when determining our allowance for loan losses. A summary of restructured loans as of September 30, 2016 and December 31, 2015 is as follows:

	September 30, 2016	December 31, 2015
(in thousands)		
<b>Restructured Loans (TDRs):</b>		
In compliance with modified terms	\$ 7,358	\$ 7,232
Not in compliance with modified terms - on nonaccrual status	1,092	458
<b>Total restructured loans</b>	<b>\$ 8,450</b>	<b>\$ 7,690</b>

**Allowance for Loan Losses**

Our ALLL as of September 30, 2016 was \$21.4 million, which was 1.00% of total loans and 1.30% of purchased non-credit impaired loans as of that date. This compares with an ALLL of \$19.4 million as of December 31, 2015, which was 0.90% of total loans and 1.32% of purchased non-credit impaired loans as of that date. Gross charge-offs for the first nine months of 2016 totaled \$1.7 million, while recoveries of previously charged-off loans totaled \$0.5 million. The ratio of annualized net loan charge offs to average loans for the first nine months of 2016 was 0.08% compared to 0.11% for the year ended December 31, 2015. As of September 30, 2016, the ALLL was 90.4% of nonperforming loans compared with 168.5% as of December 31, 2015. Based on the inherent risk in the loan portfolio, we believed that as of September 30, 2016, the ALLL was adequate; however, there is no assurance losses

will not exceed the allowance, and any growth in the loan portfolio or uncertainty in the general economy may require that management continue to evaluate the adequacy of the ALLL and make additional provisions in future periods as deemed necessary.

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Non-acquired loans with a balance of \$1.61 billion at September 30, 2016, had \$20.9 million of the allowance for loan losses allocated to them, providing an allocated allowance for loan loss to non-acquired loan ratio of 1.30%.

Non-acquired loans are total loans minus those loans acquired in the Central merger. New loans and loans renewed after the merger are considered non-acquired loans.

At September 30, 2016

	Gross Loans (A)	Discount (B)	Loans, Net of Discount (A-B)	Allowance (C)	Allowance/Gross Loans (C/A)		Allowance + Discount/Gross Loans ((B+C)/A)	
Total Non-Acquired Loans	\$ 1,613,618	\$—	\$ 1,613,618	\$ 20,941	1.30	%	1.30	%
Total Acquired Loans	543,418	15,204	528,214	454	0.08		2.88	
Total Loans	\$ 2,157,036	\$ 15,204	\$ 2,141,832	\$ 21,395	1.00	%	1.70	%

As part of the merger between MidWestOne Bank and Central Bank, management developed a single methodology for determining the amount of the ALLL that would be needed at the combined bank. The new methodology is a hybrid of the methods used at MidWestOne Bank and Central Bank prior to the bank merger, and the results from the new ALLL model are consistent with the results that the two banks calculated individually.

During the first quarter of 2016 we changed the historical charge-off component of the ALLL calculation to include both Central Bank and MidWestOne Bank in the 20-quarter annual average. A separate qualitative factor table is now being maintained for each region MidWestOne Bank services (Iowa, Minnesota/Wisconsin, and Florida), all with a similar methodology, but adjusted based on the economic/business conditions in each region. Loans below \$250,000 continue to be evaluated solely based on delinquency status, but no longer receive an increased allocation of between 25% and 50% of the loss given default. Instead they receive the normal ASC 450 allocation based on the type of loan and the risk rating. To streamline the ALLL process, a number of low-balance loan types that do not have a material impact on the overall calculation are now excluded. As of the first quarter 2016, overdrafts are no longer included in the ALLL calculation. Additionally, the guaranteed portion of government guaranteed loans is no longer being adjusted out of the calculation, and as a result, the entire loan balance is subject to reserve requirements. Special mention/watch and substandard rated credits not individually reviewed for impairment previously received an allocation of 2 times and 6 times, respectively, of the pass allocation. Due to the inherent risks associated with special mention/watch risk rated loans (i.e. early stages of financial deterioration, technical exceptions, etc.), this subset is reserved at a level that will cover losses above a pass allocation for loans that had a loss in the last 20 quarters in which the loan was risk rated special mention/watch at the time of the loss. Substandard loans carry greater risk than special mention/watch loans, and as such, this subset is reserved at a level that covers losses above a pass allocation for loans that had a loss in the last 20 quarters in which the loan was risk rated substandard at the time of the loss. Classified and impaired loans are reviewed per the requirements of FASB ASC Topic 310.

We currently track the loan to value (“LTV”) ratio of loans in our portfolio, and those loans in excess of internal and supervisory guidelines are presented to the Bank’s board of directors on a quarterly basis. At September 30, 2016, there were 31 owner-occupied 1-4 family loans with a LTV ratio of 100% or greater. In addition, there were 224 home equity loans without credit enhancement that had a LTV ratio of 100% or greater. We have the first lien on 15 of these equity loans and other financial institutions have the first lien on the remaining 209. Additionally, there were 172 commercial real estate loans without credit enhancement that exceeded the supervisory LTV guidelines.

We review all impaired and nonperforming loans individually on a quarterly basis to determine their level of impairment due to collateral deficiency or insufficient cash-flow based on a discounted cash-flow analysis. At September 30, 2016, TDRs were not a material portion of the loan portfolio. We review loans 90 days or more past due that are still accruing interest no less than quarterly to determine if there is a strong reason that the credit should not be placed on non-accrual.

#### Capital Resources

Total shareholders’ equity was \$309.6 million as of September 30, 2016, compared to \$296.2 million as of December 31, 2015, an increase of \$13.4 million, or 4.5%. This increase was primarily attributable to net income of \$16.5 million for the first nine months of 2016, a \$1.8 million increase in accumulated other comprehensive income



due to market value adjustments on investment securities available for sale, and a \$0.6 million decrease in treasury stock due to the issuance of 27,067 shares of Company common stock in connection with stock compensation plans. These increases were partially offset by the payment of \$5.5 million in common stock dividends. No shares of Company common stock were repurchased in the third quarter of 2016.

Total shareholders' equity was 10.31% of total assets as of September 30, 2016 and was 9.94% of total assets as of December 31, 2015. The ratio of tangible equity to tangible assets was 7.94% as of September 30, 2016 and 7.51% as of December 31, 2015. Our Tier 1 capital to risk-weighted assets ratio was 10.90% as of September 30, 2016 and was 10.63% as of December 31, 2015. Risk-based capital guidelines require the classification of assets and some off-balance-sheet items in terms

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of credit-risk exposure and the measuring of capital as a percentage of the risk-adjusted asset totals. We believed that, as of September 30, 2016, the Company and the Bank met all capital adequacy requirements to which we were subject. As of that date, the Bank was “well capitalized” under regulatory prompt corrective action provisions. In July 2013, the U.S. federal banking agencies approved the implementation of the Basel III regulatory capital reforms in pertinent part (the “Basel III Rules”), and, at the same time, promulgated rules effecting certain changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). In contrast to capital requirements historically, which were in the form of guidelines, Basel III was released in the form of regulations by each of the regulatory agencies. The Basel III Rules are applicable to all banking organizations that are subject to minimum capital requirements, including federal and state banks and savings and loan associations, as well as to bank and savings and loan holding companies, other than “small bank holding companies” (generally bank holding companies with consolidated assets of less than \$1 billion which are not publicly traded companies). The Basel III Rules not only increased most of the required minimum regulatory capital ratios, but they also introduced a Common Equity Tier 1 capital ratio and the concept of a capital conservation buffer. The Basel III Rules also expanded the definition of capital as in effect previously by establishing criteria that instruments must meet to be considered Additional Tier 1 capital (Tier 1 capital in addition to Common Equity) and Tier 2 capital. A number of instruments that previously generally qualified as Tier 1 capital now do not qualify, or their qualifications changed. The Basel III Rules also permitted banking organizations with less than \$250.0 billion in assets to retain, through a one-time election, the existing treatment for accumulated other comprehensive income, which previously did not affect regulatory capital. The Company elected to retain this treatment, which reduces the volatility of regulatory capital levels. The Basel III Rules have maintained the general structure of the prompt corrective action framework, while incorporating the increased requirements. The prompt corrective action guidelines were also revised to add the Common Equity Tier 1 capital ratio. In order to be a “well-capitalized” depository institution under the new regime, a bank must maintain a Common Equity Tier 1 capital ratio of 6.5% or more; a Tier 1 capital ratio of 8% or more; a Total capital ratio of 10% or more; and a leverage ratio of 5% or more. A new capital conservation buffer, comprised of Common Equity Tier 1 capital, is also established above the regulatory minimum capital requirements. This capital conservation buffer is being phased in, which began January 1, 2016, at 0.625% of risk-weighted assets and increases each subsequent year by an additional 0.625% until reaching the final level of 2.5% on January 1, 2019. Generally, financial institutions became subject to the new Basel III Rules on January 1, 2015, with phase-in periods for many of the changes.

We have traditionally disclosed certain non-GAAP ratios and amounts to evaluate and measure our financial condition, including our Tier 1 capital to risk-weighted assets ratio. We believe this ratio provides investors with information regarding our financial condition and how we evaluate our financial condition internally. The following table provides a reconciliation of this non-GAAP measure to the most comparable GAAP equivalent.

	At September 30, 2016	At December 31, 2015		
(in thousands)				
Tier 1 capital				
Total shareholders' equity	\$309,584	\$296,178		
Less: Net unrealized gains on securities available for sale	(5,220 )	(3,408 )		
Disallowed Intangibles	(72,247 )	(72,203 )		
Common equity tier 1 capital	\$232,117	220,567		
Plus: Junior subordinated notes issued to capital trusts (qualifying restricted core capital)	23,667	23,587		
Tier 1 capital	\$255,784	\$244,154		
Risk-weighted assets	\$2,347,320	\$2,296,478		
Tier 1 capital to risk-weighted assets	10.90	% 10.63	%	
Common equity tier 1 capital to risk-weighted assets	9.89	% 9.60	%	



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The following table provides the capital levels and minimum required capital levels for the Company, MidWestOne Bank and, at December 31, 2015 only, Central Bank:

	Actual		For Capital Adequacy Purposes*		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(dollars in thousands)						
At September 30, 2016						
Consolidated:						
Total capital/risk based assets	\$277,477	11.82%	\$202,456	8.625%	N/A	N/A
Tier 1 capital/risk based assets	255,784	10.90	155,510	6.625	N/A	N/A
Common equity tier 1 capital/risk based assets	232,118	9.89	120,300	5.125	N/A	N/A
Tier 1 capital/adjusted average assets	255,784	8.76	116,846	4.000	N/A	N/A
MidWestOne Bank:						
Total capital/risk based assets	\$284,339	12.15%	\$201,827	8.625%	\$234,002	10.00%
Tier 1 capital/risk based assets	262,656	11.22	155,026	6.625	140,401	8.00
Common equity tier 1 capital/risk based assets	262,656	11.22	119,926	5.125	152,101	6.50
Tier 1 capital/adjusted average assets	262,656	8.99	116,872	4.000	146,090	5.00
At December 31, 2015						
Consolidated:						
Total capital/risk based assets	\$263,717	11.48%	\$183,718	8.00%	N/A	N/A
Tier 1 capital/risk based assets	244,154	10.63	137,789	6.00	N/A	N/A
Common equity tier 1 capital/risk based assets	220,567	9.60	103,342	4.50	N/A	N/A
Tier 1 capital/adjusted average assets	244,154	8.34	117,123	4.00	N/A	N/A
MidWestOne Bank:						
Total capital/risk based assets	\$171,583	12.53%	\$109,578	8.00%	\$136,972	10.00%
Tier 1 capital/risk based assets	154,726	11.30	82,183	6.00	109,578	8.00
Common equity tier 1 capital/risk based assets	154,726	11.30	61,638	4.50	89,032	6.50
Tier 1 capital/adjusted average assets	154,726	8.90	69,501	4.00	86,876	5.00
Central Bank:						
Total capital/risk based assets	\$102,718	11.14%	\$73,792	8.00%	\$92,240	10.00%
Tier 1 capital/risk based assets	100,017	10.84	55,344	6.00	73,792	8.00
Common equity tier 1 capital/risk based assets	100,017	10.84	41,508	4.50	59,956	6.50
Tier 1 capital/adjusted average assets	100,017	8.44	47,412	4.00	59,265	5.00

\* The ratios for September 30, 2016 include a capital conservation buffer of 0.625%

On February 15, 2016, 30,200 restricted stock units were granted to certain officers of the Company. Additionally, during the first nine months of 2016, 25,633 shares of common stock were issued in connection with the vesting of previously awarded grants of restricted stock units, of which 1,466 shares were surrendered by grantees to satisfy tax requirements, and 6,875 nonvested restricted stock units were forfeited. 2,900 shares of common stock were issued in connection with the exercise of previously issued stock options, and 950 options were forfeited.

**Liquidity**

Liquidity management involves meeting the cash flow requirements of depositors and borrowers. We conduct liquidity management on both a daily and long-term basis, and adjust our investments in liquid assets based on expected loan demand, projected loan maturities and payments, expected deposit flows, yields available on interest-bearing deposits, and the objectives of our asset/liability management program. We had liquid assets (cash and cash equivalents) of \$52.0 million as of September 30, 2016, compared with \$47.1 million as of December 31, 2015. Interest-bearing deposits in banks at September 30, 2016, increased to \$6.3 million, an increase of \$3.6 million from December 31, 2015. Investment securities classified as available for sale, totaling \$436.2 million and \$427.2

million as of September 30, 2016 and December 31, 2015, respectively, could be sold to meet liquidity needs if necessary. Additionally, the Bank maintains unsecured lines of credit with several correspondent banks and secured lines with the Federal Reserve Bank Discount Window and the FHLB that would allow us to borrow funds on a short-term basis, if necessary. Management believed that the Company had sufficient liquidity as of September 30, 2016 to meet the needs of borrowers and depositors.

Our principal sources of funds between December 31, 2015 and September 30, 2016 were proceeds from the maturity and sale of investment securities, and FHLB borrowings. While scheduled loan amortization and maturing interest-bearing deposits in banks are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by economic

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conditions, the general level of interest rates, and competition. We utilize particular sources of funds based on comparative costs and availability. This includes fixed-rate FHLB borrowings that can generally be obtained at a more favorable cost than deposits of comparable maturity. We generally manage the pricing of our deposits to maintain a steady deposit base but from time to time may decide, as we have done in the past, not to pay rates on deposits as high as our competition.

As of September 30, 2016, we had \$18.8 million of long-term debt outstanding to an unaffiliated banking organization. See Note 11. “Long-Term Borrowings” to our consolidated financial statements for additional information related to our long-term debt. We also have \$23.7 million of indebtedness payable under junior subordinated debentures issued to subsidiary trusts that issued trust preferred securities in pooled offerings. See Note 10. “Subordinated Notes Payable” to our consolidated financial statements for additional information related to our junior subordinated notes.

**Inflation**

The effects of price changes and inflation can vary substantially for most financial institutions. While management believes that inflation affects the growth of total assets, it is difficult to assess its overall impact on the Company. The price of one or more of the components of the Consumer Price Index (“CPI”) may fluctuate considerably and thereby influence the overall CPI without having a corresponding effect on interest rates or upon the cost of those goods and services normally purchased by us. In years of high inflation and high interest rates, intermediate and long-term interest rates tend to increase, thereby adversely impacting the market values of investment securities, mortgage loans and other long-term fixed rate loans held by financial institutions. In addition, higher short-term interest rates caused by inflation tend to increase financial institutions’ cost of funds. In other years, the reverse situation may occur.

**Off-Balance-Sheet Arrangements**

We are a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers, which include commitments to extend credit, standby and performance letters of credit, and commitments to originate residential mortgage loans held for sale. Commitments to extend credit are agreements to lend to customers at predetermined interest rates, as long as there is no violation of any condition established in the contracts. Our exposure to credit loss in the event of nonperformance by the other party to the commitments to extend credit is represented by the contractual amount of those instruments. We use the same credit policies in making off-balance-sheet commitments as we do for on-balance-sheet instruments.

Commitments to extend credit 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 drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer’s creditworthiness on a case-by-case basis. As of September 30, 2016, outstanding commitments to extend credit totaled approximately \$439.1 million. We have established a reserve of \$0.3 million, which represents our estimate of probable losses as a result of these transactions. This reserve is not part of our allowance for loan losses.

Commitments under standby and performance letters of credit outstanding totaled \$12.7 million as of September 30, 2016. We do not anticipate any losses as a result of these transactions.

Residential mortgage loans sold to others are predominantly conventional residential first lien mortgages originated under our usual underwriting procedures, and are most often sold on a nonrecourse basis. At September 30, 2016, there were approximately \$2.7 million of mandatory commitments with investors to sell not yet originated residential mortgage loans. We do not anticipate any losses as a result of these transactions.

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

In general, market risk is the risk of change in asset values due to movements in underlying market rates and prices. Interest rate risk is the risk to earnings and capital arising from movements in interest rates. Interest rate risk is the most significant market risk affecting the Company as other types of market risk, such as foreign currency exchange rate risk and commodity price risk, play a lesser role in the normal course of our business activities.

In addition to interest rate risk, economic conditions in recent years have made liquidity risk (in particular, funding liquidity risk) a more prevalent concern among financial institutions. In general, liquidity risk is the risk of being unable to fund an entity’s obligations to creditors (including, in the case of banks, obligations to depositors) as such

obligations become due and/or fund its acquisition of assets.

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Liquidity refers to our ability to fund operations, to meet depositor withdrawals, to provide for our customers' credit needs, and to meet maturing obligations and existing commitments. Our liquidity principally depends on cash flows from operating activities, investment in and maturity of assets, changes in balances of deposits and borrowings, and our ability to borrow funds.

Net cash inflows from operating activities were \$31.7 million in the first nine months of 2016, compared with \$22.1 million in the first nine months of 2015. Net income before depreciation, amortization, and accretion is generally the primary contributor for net cash inflows from operating activities.

Net cash outflows from investing activities were \$26.8 million in the first nine months of 2016, compared to net cash inflows of \$53.1 million in the comparable nine-month period of 2015. In the first nine months of 2016, investment securities transactions resulted in net cash outflows of \$39.4 million, compared to inflows of \$155.8 million during the same period of 2015. The sale of our Rice Lake and Barron, Wisconsin and Davenport, Iowa branch offices contributed to net cash inflows related to the net decrease in loans of \$7.1 million for the first nine months of 2016, compared with \$89.5 million of net cash outflows related to the net increase in loans for the same period of 2015.

Purchases of premises and equipment resulted in \$4.6 million cash outflows in the first nine months of 2016, compared to outflows of \$11.6 million in the comparable period of 2015, reflecting the finalization of the construction of a new Home Mortgage and Operations Center, which was complete at the end of 2015, at a total cost of \$16.0 million, and the restoration and remodeling of the building that serves as the main office of the Bank and headquarters of the Company, which was completed in April 2016 at a cost of \$13.8 million. There were no cash inflows from loan pool participations during the first nine months of 2016 compared to \$19.3 million during the same period of 2015, as we sold our interest in these instruments in the second quarter of 2015.

Net cash inflows from financing activities in the first nine months of 2016 was \$2.0 thousand, compared with net cash outflows of \$6.3 million for the same period of 2015. The largest financing cash outflows during the nine months ended September 30, 2016 was a decrease of \$17.6 million in deposits, the use of \$5.5 million to pay dividends, a \$4.0 million and decrease in securities sold under agreement to repurchase, and \$3.8 million of payments on long-term debt. Sources of cash inflows during the first nine months of 2016 were an increase of \$17.8 million in federal funds purchased, and a net increase of \$13.0 million in FHLB borrowings.

To further mitigate liquidity risk, the Bank has several sources of liquidity in place to maximize funding availability and increase the diversification of funding sources. The criteria for evaluating the use of these sources include volume concentration (percentage of liabilities), cost, volatility, and the fit with the current asset/liability management plan.

These acceptable sources of liquidity include:

- Federal Funds Lines
- FHLB Borrowings
- Brokered Deposits
- Brokered Repurchase Agreements
- Federal Reserve Bank Discount Window

**Federal Funds Lines:**

Routine liquidity requirements are met by fluctuations in the federal funds position of the Bank. The principal function of these funds is to maintain short-term liquidity. Unsecured federal funds purchased lines are viewed as a volatile liability and are not used as a long-term funding solution, especially when used to fund long-term assets.

Multiple correspondent relationships are preferable and federal funds sold exposure to any one customer is continuously monitored. The current federal funds purchased limit is 10% of total assets, or the amount of established federal funds lines, whichever is smaller. Currently, the Bank has unsecured federal funds lines totaling \$95.0 million, which lines are tested annually to ensure availability.

**FHLB Borrowings:**

FHLB borrowings provide both a source of liquidity and long-term funding for the Bank. Use of this type of funding is coordinated with both the strategic balance sheet growth projections and interest rate risk profile of the Bank.

Factors that are taken into account when contemplating use of FHLB borrowings are the effective interest rate, the collateral requirements, community investment program credits, and the implications and cost of having to purchase



incremental FHLB stock. The current FHLB borrowing limit is 35% of total assets. As of September 30, 2016, the Bank had \$100.0 million in outstanding FHLB borrowings, leaving \$226.5 million available for liquidity needs, based on collateral capacity. These borrowings are secured by various real estate loans (residential, commercial and agricultural).

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### Brokered Deposits:

The Bank has brokered certificate of deposit lines/deposit relationships available to help diversify its various funding sources. Brokered deposits offer several benefits relative to other funding sources, such as: maturity structures which cannot be duplicated in the current deposit market, deposit gathering which does not cannibalize the existing deposit base, the unsecured nature of these liabilities, and the ability to quickly generate funds. However, brokered deposits are often viewed as a volatile liability by banking regulators and market participants. This viewpoint, and the desire to not develop a large funding concentration in any one area outside of the Bank's core market area, is reflected in an internal policy stating that the Bank limit the use of brokered deposits as a funding source to no more than 10% of total assets. Board approval is required to exceed this limit. the Bank will also have to maintain a "well capitalized" standing to access brokered deposits, as an "adequately capitalized" rating would require an FDIC waiver to do so, and an "undercapitalized" rating would prohibit it from using brokered deposits altogether.

### Brokered Repurchase Agreements:

Brokered repurchase agreements may be established with approved brokerage firms and banks. Repurchase agreements create rollover risk (the risk that a broker will discontinue the relationship due to market factors) and are not used as a long-term funding solution, especially when used to fund long-term assets. Collateral requirements and availability are evaluated and monitored. The current policy limit for brokered repurchase agreements is 10% of total assets. There were no outstanding brokered repurchase agreements at September 30, 2016.

### Federal Reserve Bank Discount Window:

The Federal Reserve Bank Discount Window is another source of liquidity, particularly during difficult economic times. the Bank has a borrowing capacity with the Federal Reserve Bank of Chicago limited by the amount of municipal securities pledged against the line. As of September 30, 2016, the Bank had municipal securities with an approximate market value of \$13.2 million pledged for liquidity purposes.

### Interest Rate Risk

Interest rate risk is defined as the exposure of net interest income and fair value of financial instruments (interest-earning assets, deposits and borrowings) to movements in interest rates. The Company's results of operations depend to a large degree on its net interest income and its ability to manage interest rate risk. The Company considers interest rate risk to be one of its more significant market risks. The major sources of the Company's interest rate risk are timing differences in the maturity and re-pricing characteristics of assets and liabilities, changes in the shape of the yield curve, changes in customer behavior and changes in relationships between rate indices (basis risk). Management measures these risks and their impact in various ways, including through the use of income simulation and valuation analyses. The interest rate scenarios used in such analysis may include gradual or rapid changes in interest rates, spread narrowing and widening, yield curve twists and changes in assumptions about customer behavior in various interest rate scenarios. A mismatch between maturities, interest rate sensitivities and prepayment characteristics of assets and liabilities results in interest-rate risk. Like most financial institutions, we have material interest-rate risk exposure to changes in both short-term and long-term interest rates, as well as variable interest rate indices (e.g., the prime rate or LIBOR). There has been very little change in the Company's interest rate profile between September 30, 2016 and December 31, 2015. The mix of earning assets and interest-bearing liabilities has remained stable over the period.

The Bank's asset and liability committee meets regularly and is responsible for reviewing its interest rate sensitivity position and establishing policies to monitor and limit exposure to interest rate risk. Our asset and liability committee seeks to manage interest rate risk under a variety of rate environments by structuring our balance sheet and off-balance-sheet positions in such a way that changes in interest rates do not have a large negative impact. The risk is monitored and managed within approved policy limits.

We use a third-party service to model and measure our exposure to potential interest rate changes. For various assumed hypothetical changes in market interest rates, numerous other assumptions are made, such as prepayment speeds on loans and securities backed by mortgages, the slope of the Treasury yield-curve, the rates and volumes of our deposits, and the rates and volumes of our loans. There are two primary tools used to evaluate interest rate risk: net interest income simulation and economic value of equity ("EVE"). In addition, interest rate gap is reviewed to monitor asset and liability repricing over various time periods.

Net Interest Income Simulation:

Management utilizes net interest income simulation models to estimate the near-term effects of changing interest rates on its net interest income. Net interest income simulation involves forecasting net interest income under a variety of scenarios, which include varying the level of interest rates and the shape of the yield curve. Management exercises its best judgment in making assumptions regarding events that management can influence, such as non-contractual deposit re-pricings, and events outside management's control, such as customer behavior on loan and deposit activity and the effect that competition has on both loan

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and deposit pricing. These assumptions are subjective and, as a result, net interest income simulation results will differ from actual results due to the timing, magnitude and frequency of interest rate changes, changes in market conditions, customer behavior and management strategies, among other factors. We perform various sensitivity analyses on assumptions of deposit attrition and deposit re-pricing.

The following table presents the anticipated effect on net interest income over a twelve month period if short- and long-term interest rates were to sustain an immediate increase of 100 basis points and 200 basis points:

	Immediate		Change in Rates	
	+100	+200		
(dollars in thousands)				
September 30, 2016				
Dollar change	\$766	\$1,848		
Percent change	0.8 %	1.9 %		
December 31, 2015				
Dollar change	\$636	\$1,616		
Percent change	0.7 %	1.7 %		

As of September 30, 2016, 40.3% of the Company's earning asset balances will reprice or are expected to pay down in the next twelve months, and 45.6% of the Company's deposit balances are low cost or no cost deposits.

**Economic Value of Equity:**

Management also uses EVE to measure risk in the balance sheet that might not be taken into account in the net interest income simulation analysis. Net interest income simulation highlights exposure over a relatively short time period, while EVE analysis incorporates all cash flows over the estimated remaining life of all balance sheet positions. The valuation of the balance sheet, at a point in time, is defined as the discounted present value of asset cash flows minus the discounted present value of liability cash flows. EVE analysis addresses only the current balance sheet and does not incorporate the run-off replacement assumptions that are used in the net interest income simulation model. As with the net interest income simulation model, EVE analysis is based on key assumptions about the timing and variability of balance sheet cash flows and does not take into account any potential responses by management to anticipated changes in interest rates.

**Interest Rate Gap:**

The interest rate gap is the difference between earning assets and interest-bearing liabilities re-pricing within a given period and represents the net asset or liability sensitivity at a point in time. An interest rate gap measure could be significantly affected by external factors such as loan prepayments, early withdrawals of deposits, changes in the correlation of various interest-bearing instruments, competition, or a rise or decline in interest rates.

**Item 4. Controls and Procedures.****Disclosure Controls and Procedures**

Under supervision and with the participation of certain members of our management, including our chief executive officer and chief financial officer, we completed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of September 30, 2016. Based on this evaluation, our chief executive officer and chief financial officer have concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report with respect to timely communication to them and other members of management responsible for preparing periodic reports of material information required to be disclosed in this report as it relates to the Company and our consolidated subsidiaries.

The effectiveness of our or any system of disclosure controls and procedures is subject to certain limitations, including the exercise of judgment in designing, implementing, and evaluating the controls and procedures, the assumptions used in identifying the likelihood of future events, and the inability to eliminate misconduct completely. As a result, there can be no assurance that our disclosure controls and procedures will prevent all errors or fraud or ensure that all material information will be made known to appropriate management in a timely fashion. By their nature, our or any

system of disclosure controls and procedures can provide only reasonable assurance regarding management's control objectives.

**Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## Special Cautionary Note Regarding Forward-Looking Statements

This report contains certain “forward-looking statements” within the meaning of such term in the Private Securities Litigation Reform Act of 1995. We and our representatives may, from time to time, make written or oral statements that are “forward-looking” and provide information other than historical information. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from any results, levels of activity, performance or achievements expressed or implied by any forward-looking statement. These factors include, among other things, the factors listed below.

Forward-looking statements, which may be based upon beliefs, expectations and assumptions of our management and on information currently available to management, are generally identifiable by the use of words such as “believe,” “expect,” “anticipate,” “should,” “could,” “would,” “plans,” “goals,” “intend,” “project,” “estimate,” “forecast,” “may” or similar. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those expressed in, or implied by, these statements. Readers are cautioned not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Additionally, we undertake no obligation to update any statement in light of new information or future events, except as required under federal securities law.

Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have an impact on our ability to achieve operating results, growth plan goals and future prospects include, but are not limited to, the following:

- credit quality deterioration or pronounced and sustained reduction in real estate market values that cause an increase in our allowance for credit losses and a reduction in net earnings;
- our management’s ability to reduce and effectively manage interest rate risk and the impact of interest rates in general on the volatility of our net interest income;
- changes in the economic environment, competition, or other factors that may affect our ability to acquire loans or influence the anticipated growth rate of loans and deposits and the quality of the loan portfolio and loan and deposit pricing;
- fluctuations in the value of our investment securities;
- governmental monetary and fiscal policies;
- legislative and regulatory changes, including changes in banking, securities and tax laws and regulations and their application by our regulators (particularly with respect to the Dodd-Frank Act and the extensive regulations promulgated and to be promulgated thereunder, as well as the Basel III Rules and changes in the scope and cost of FDIC insurance and other coverages);
- the ability to attract and retain key executives and employees experienced in banking and financial services;
- the sufficiency of the allowance for loan losses to absorb the amount of actual losses inherent in our existing loan portfolio;
- our ability to adapt successfully to technological changes to compete effectively in the marketplace;
- credit risks and risks from concentrations (by geographic area and by industry) within our loan portfolio;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds, and other financial institutions operating in our markets or elsewhere or providing similar services;
- the failure of assumptions underlying the establishment of allowances for loan losses and estimation of values of collateral and various financial assets and liabilities;
- the risks of mergers, including, without limitation, the related time and costs of implementing such transactions, integrating operations as part of these transactions and possible failures to achieve expected gains, revenue growth and/or expense savings from such transactions;
- volatility of rate-sensitive deposits;
- operational risks, including data processing system failures or fraud;
- asset/liability matching risks and liquidity risks;
- the costs, effects and outcomes of existing or future litigation;
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changes in general economic or industry conditions, internationally, nationally or in the communities in which we conduct business;

changes in accounting policies and practices, as may be adopted by state and federal regulatory agencies and the FASB;

the effects of cyber-attacks; and

other factors and risks described under “Risk Factors” in our Annual Report on Form 10-K for the period ended December 31, 2015.

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We qualify all of our forward-looking statements by the foregoing cautionary statements. Because of these risks and other uncertainties, our actual future results, performance or achievement, or industry results, may be materially different from the results indicated by these forward-looking statements. In addition, our past results of operations are not necessarily indicative of our future results.

**PART II – OTHER INFORMATION**

**Item 1. Legal Proceedings.**

The Company and its subsidiaries are from time to time parties to various legal actions arising in the normal course of business. We believe that there are no threatened or pending proceedings, other than ordinary routine litigation incidental to the Company's business, against the Company or its subsidiaries or of which any of their property is the subject, which, if determined adversely, would have a material adverse effect on the business or financial condition of the Company.

**Item 1A. Risk Factors.**

There have been no material changes from the risk factors set forth in Part I, Item 1A. "Risk Factors" of our Annual Report on Form 10-K for the period ended December 31, 2015. Please refer to that section of our Form 10-K for disclosures regarding the risks and uncertainties related to our business.

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

We did not repurchase any of our equity securities during the third quarter of 2016.

On July 21, 2016, the board of directors of the Company approved a new share repurchase program, allowing for the repurchase of up to \$5.0 million of stock through December 31, 2018. The new repurchase program replaced the Company's prior repurchase program, pursuant to which the Company had repurchased \$1.2 million of common stock since the plan was announced in July 2014. Pursuant to the repurchase program, the Company may continue to repurchase shares from time to time in the open market, and the method, timing and amounts of repurchase will be solely in the discretion of the Company's management. The repurchase program does not require the Company to acquire a specific number of shares. Therefore, the amount of shares repurchased pursuant to the program will depend on several factors, including market conditions, capital and liquidity requirements, and alternative uses for cash available. Of the \$5.0 million of stock authorized under the repurchase plan, \$5.0 million remained available for possible future repurchases as of September 30, 2016.

**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	Incorporated by Reference to:
10.1	Employment Agreement between MidWestOne Financial Group, Inc. and Kurt Weise, dated December 12, 2014	Current Report on Form 8-K filed October 3, 2016
10.2	Letter of Amendment to Employment Agreement between MidWestOne Financial Group, Inc. and Kurt Weise, effective as of September 30, 2016	Current Report on Form 8-K filed October 3, 2016
10.3	Employment Agreement between MidWestOne Financial Group, Inc. and Kevin Kramer, effective October 4, 2016	Current Report on Form 8-K filed October 4, 2016
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a)	Filed herewith
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a)	Filed herewith
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
101.INS	XBRL Instance Document	Filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith

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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.

MIDWESTONE FINANCIAL GROUP,  
INC.

Dated: November 3, 2016 By: /s/ CHARLES N. FUNK  
Charles N. Funk  
President and Chief  
Executive Officer

By: /s/ KATIE A. LORENSON  
Katie A. Lorensen  
Senior Vice President and  
Chief Financial Officer