

Section 1: 10-Q (10-Q)

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United States Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2020

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

For the transition period from _____ to _____

Commission File Number: **001-37661**



SmartFinancial, Inc.

(Exact name of registrant as specified in its charter)

Tennessee

(State or other jurisdiction of incorporation or organization)

5401 Kingston Pike, Suite 600 Knoxville, Tennessee

(Address of principal executive offices)

865-437-5700

(Registrant's telephone number, including area code)

62-1173944

(I.R.S. Employer Identification No.)

37919

(Zip Code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Trading symbol(s) | Name of Exchange on which Registered |
|--------------------------------|-------------------|--------------------------------------|
| Common Stock, par value \$1.00 | SMBK | The Nasdaq Stock Market |

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such period that the registrant was required to submit 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 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

As of August 03, 2020, there were 15,216,932 shares of common stock, \$1.00 par value per share, issued and outstanding.

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PART I – FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

SMARTFINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except for share data)

| | | (Unaudited) June 30, 2020 | |
|--|----|---------------------------------|----|
| ASSETS: | | | |
| Cash and due from banks | \$ | 57,045 | \$ |
| Interest-bearing deposits with banks | | 258,271 | |
| Federal funds sold | | 84,151 | |
| Total cash and cash equivalents | | 399,467 | |
| Securities available-for-sale, at fair value | | 219,631 | |
| Other investments | | 14,829 | |
| Loans held for sale | | 6,330 | |
| Loans | | 2,408,284 | |
| Less: Allowance for loan losses | | (16,254) | |
| Loans, net | | 2,392,030 | |
| Premises and equipment, net | | 73,868 | |
| Other real estate owned | | 5,524 | |
| Goodwill and core deposit intangible, net | | 86,327 | |
| Bank owned life insurance | | 30,853 | |
| Other assets | | 37,126 | |
| Total assets | \$ | 3,265,985 | \$ |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | | |
| Deposits: | | | |
| Noninterest-bearing demand | \$ | 645,650 | \$ |
| Interest-bearing demand | | 479,212 | |
| Money market and savings | | 762,246 | |
| Time deposits | | 652,581 | |
| Total deposits | | 2,539,689 | |
| Borrowings | | 318,855 | |
| Subordinated debt | | 39,304 | |
| Other liabilities | | 24,649 | |
| Total liabilities | | 2,922,497 | |
| Shareholders' equity: | | | |
| Preferred stock, \$1 par value; 2,000,000 shares authorized; No shares issued and outstanding | | — | |
| Common stock, \$1 par value; 40,000,000 shares authorized; 15,216,932 and 14,008,233 shares issued and outstanding, respectively | | 15,217 | |
| Additional paid-in capital | | 254,396 | |
| Retained earnings | | 73,283 | |
| Accumulated other comprehensive income | | 592 | |
| Total shareholders' equity | | 343,488 | |
| Total liabilities and shareholders' equity | \$ | 3,265,985 | \$ |

The accompanying notes are an integral part of the financial statements.



SMARTFINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(Dollars in thousands, except share and per share data)

| | Three Months Ended | | Six Months | |
|--|--------------------|-----------------|-----------------|-----------------|
| | June 30, | | June 30 | |
| | 2020 | 2019 | 2020 | 2019 |
| Interest income: | | | | |
| Loans, including fees | \$ 28,663 | \$ 25,278 | \$ 55,097 | \$ 50,811 |
| Securities available-for-sale: | | | | |
| Taxable | 589 | 871 | 1,268 | 1,268 |
| Tax-exempt | 416 | 411 | 699 | 699 |
| Federal funds sold and other earning assets | 277 | 743 | 879 | 879 |
| Total interest income | <u>29,945</u> | <u>27,303</u> | <u>57,943</u> | <u>54,376</u> |
| Interest expense: | | | | |
| Deposits | 3,366 | 5,788 | 8,120 | 8,120 |
| Borrowings | 249 | 123 | 339 | 339 |
| Subordinated debt | 584 | 590 | 1,167 | 1,167 |
| Total interest expense | <u>4,199</u> | <u>6,501</u> | <u>9,626</u> | <u>9,626</u> |
| Net interest income | <u>25,746</u> | <u>20,802</u> | <u>48,317</u> | <u>44,750</u> |
| Provision for loan losses | <u>2,850</u> | <u>393</u> | <u>6,049</u> | <u>6,049</u> |
| Net interest income after provision for loan losses | <u>22,896</u> | <u>20,409</u> | <u>42,268</u> | <u>38,701</u> |
| Noninterest income: | | | | |
| Service charges on deposit accounts | 709 | 707 | 1,479 | 1,479 |
| Gain on sale of securities | 16 | 33 | 16 | 16 |
| Mortgage banking | 931 | 392 | 1,515 | 1,515 |
| Investment services | 363 | 255 | 801 | 801 |
| Insurance commissions | 473 | — | 742 | 742 |
| Interchange and debit card transaction fees | 508 | 143 | 784 | 784 |
| Merger termination fee | — | 6,400 | — | — |
| Other | 511 | 486 | 993 | 993 |
| Total noninterest income | <u>3,511</u> | <u>8,416</u> | <u>6,330</u> | <u>6,330</u> |
| Noninterest expense: | | | | |
| Salaries and employee benefits | 10,357 | 8,984 | 20,363 | 20,363 |
| Occupancy and equipment | 1,996 | 1,658 | 3,906 | 3,906 |
| FDIC insurance | 180 | 180 | 360 | 360 |
| Other real estate and loan related expense | 346 | 242 | 892 | 892 |
| Advertising and marketing | 202 | 259 | 400 | 400 |
| Data processing | 594 | 577 | 1,132 | 1,132 |
| Professional services | 868 | 489 | 1,578 | 1,578 |
| Amortization of intangibles | 405 | 342 | 767 | 767 |
| Software as service contracts | 561 | 568 | 1,031 | 1,031 |
| Merger related and restructuring expenses | 1,477 | 1,796 | 3,573 | 3,573 |
| Other | 1,820 | 1,714 | 3,598 | 3,598 |
| Total noninterest expense | <u>18,806</u> | <u>16,809</u> | <u>37,600</u> | <u>37,600</u> |
| Income before income tax expense | <u>7,601</u> | <u>12,016</u> | <u>10,998</u> | <u>11,101</u> |
| Income tax expense | 1,427 | 2,895 | 2,091 | 2,091 |
| Net income | <u>\$ 6,174</u> | <u>\$ 9,121</u> | <u>\$ 8,907</u> | <u>\$ 9,010</u> |
| Earnings per common share: | | | | |
| Basic | <u>\$ 0.41</u> | <u>\$ 0.65</u> | <u>\$ 0.60</u> | <u>\$ 0.60</u> |
| Diluted | <u>0.41</u> | <u>0.65</u> | <u>0.60</u> | <u>0.60</u> |
| Weighted average common shares outstanding: | | | | |
| Basic | 15,152,768 | 13,951,643 | 14,773,935 | 14,773,935 |
| Diluted | 15,202,335 | 14,046,500 | 14,842,486 | 14,842,486 |

The accompanying notes are an integral part of the financial statements.

SMARTFINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(Dollars in thousands)

| | Three Months Ended | | S |
|--|--------------------|----------|----|
| | June 30, | | |
| | 2020 | 2019 | 20 |
| Net income | \$ 6,174 | \$ 9,121 | \$ |
| Other comprehensive income: | | | |
| Unrealized holding gains and hedge effects on securities available-for-sale arising during the period | 1,808 | 2,610 | |
| Tax effect | (394) | (683) | |
| Reclassification adjustment for realized gains included in net income | 16 | 33 | |
| Tax effect | (4) | (9) | |
| Unrealized gains on securities available-for-sale arising during the period, net of tax | 1,426 | 1,951 | |
| Unrealized gains (losses) on fair value municipal security hedges | 691 | (2,830) | |
| Tax effect | (278) | 742 | |
| Unrealized gains (losses) on fair value municipal security hedge instruments arising during the period, net of tax | 413 | (2,088) | |
| Total other comprehensive income (loss) | 1,839 | (137) | |
| Comprehensive income | \$ 8,013 | \$ 8,984 | \$ |

The accompanying notes are an integral part of the financial statements.



SMARTFINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY - (Unaudited)
For the Three and Six Months Ended June 30, 2020 and 2019
(Dollars in thousands, except for share data)

| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive (Loss) Income |
|---|-------------------|------------------|-------------------------------|----------------------|--|
| | Shares | Amount | | | |
| Balance, December 31, 2018 | 13,933,504 | \$ 13,933 | \$ 231,852 | \$ 39,991 | \$ (2,765) |
| Net income | — | — | — | 13,852 | — |
| Other comprehensive income | — | — | — | — | 2,194 |
| Common stock issued pursuant to: | | | | | |
| Stock awards | 3,298 | 3 | 61 | — | — |
| Exercise of stock options | 16,407 | 16 | 196 | — | — |
| Stock compensation expense | — | — | 276 | — | — |
| Balance, June 30, 2019 | <u>13,953,209</u> | <u>\$ 13,953</u> | <u>\$ 232,386</u> | <u>\$ 53,843</u> | <u>\$ (571)</u> |
| Balance, December 31, 2019 | 14,008,233 | \$ 14,008 | \$ 232,732 | \$ 65,839 | \$ 168 |
| Net income | — | — | — | 8,907 | — |
| Other comprehensive loss | — | — | — | — | 424 |
| Common stock issued pursuant to: | | | | | |
| Exercise of stock options | 15,358 | 16 | 162 | — | — |
| Restricted stock, net of forfeitures | 32,318 | 32 | (32) | — | — |
| Shareholders of Progressive Financial Group, Inc. | 1,292,578 | 1,293 | 23,254 | — | — |
| Stock compensation expense | — | — | 223 | — | — |
| Common stock dividend (\$0.10 per share) | — | — | — | (1,463) | — |
| Repurchase of common stock | (131,555) | (132) | (1,943) | — | — |
| Balance, June 30, 2020 | <u>15,216,932</u> | <u>\$ 15,217</u> | <u>\$ 254,396</u> | <u>\$ 73,283</u> | <u>\$ 592</u> |
| Balance, March 31, 2019 | 13,951,590 | \$ 13,952 | \$ 232,241 | \$ 44,722 | \$ (434) |
| Net income | — | — | — | 9,121 | — |
| Other comprehensive gain | — | — | — | — | (137) |
| Common stock issued pursuant to: | | | | | |
| Exercise of stock options | 1,619 | 2 | 12 | — | — |
| Restricted stock | — | — | — | — | — |
| Stock compensation expense | — | — | 133 | — | — |
| Balance, June 30, 2019 | <u>13,953,209</u> | <u>\$ 13,953</u> | <u>\$ 232,386</u> | <u>\$ 53,843</u> | <u>\$ (571)</u> |
| Balance, March 31, 2020 | 15,221,990 | \$ 15,222 | \$ 254,356 | \$ 67,869 | \$ (1,247) |
| Net income | — | — | — | 6,174 | — |
| Other comprehensive gain | — | — | — | — | 1,839 |
| Common stock issued pursuant to: | | | | | |
| Exercise of stock options | 500 | 1 | 4 | — | — |
| Restricted stock | 418 | — | — | — | — |
| Stock compensation expense | — | — | 113 | — | — |
| Common stock dividends (\$0.05 per share) | — | — | — | (760) | — |
| Repurchase of common stock | (5,976) | (6) | (77) | — | — |
| Balance, June 30, 2020 | <u>15,216,932</u> | <u>\$ 15,217</u> | <u>\$ 254,396</u> | <u>\$ 73,283</u> | <u>\$ 592</u> |

The accompanying notes are an integral part of the financial statements.

SMARTFINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

| | Six Months Ended Ju | |
|---|---------------------|-----------|
| | 2020 | |
| | \$ | \$ |
| Cash flows from operating activities: | | |
| Net income | 8,907 | \$ |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 2,788 | |
| Accretion of fair value purchase accounting adjustments, net | (2,729) | |
| Provision for loan losses | 6,049 | |
| Stock compensation expense | 223 | |
| Gain from redemption and sale of securities available-for-sale | (16) | |
| Deferred income tax expense | 209 | |
| Increase in cash surrender value of bank owned life insurance | (345) | |
| Loss on disposal of fixed assets | — | |
| Net (gains) losses from sale of other real estate owned | 81 | |
| Net gains from sale of loans | (1,515) | |
| Origination of loans held for sale | (49,888) | |
| Proceeds from sales of loans held for sale | 50,929 | |
| Net change in: | | |
| Accrued interest receivable | (5,236) | |
| Accrued interest payable | 318 | |
| Other assets | (10,018) | |
| Other liabilities | 1,523 | |
| Net cash provided by operating activities | 1,280 | |
| Cash flows from investing activities: | | |
| Proceeds from sales of securities available-for-sale | 6,875 | |
| Proceeds from maturities and calls of securities available-for-sale | 15,450 | |
| Proceeds from paydowns of securities available-for-sale | 9,144 | |
| Purchases of securities available-for-sale | (41,958) | |
| Purchases of other investments | (1,223) | |
| Net increase in loans | (321,192) | |
| Purchases of premises and equipment | (3,417) | |
| Proceeds from sale of other real estate owned | 406 | |
| Net cash and cash equivalents received from business combination | 46,132 | |
| Net cash used in investing activities | (289,783) | |
| Cash flows from financing activities: | | |
| Net increase in deposits | 220,128 | |
| Net decrease in securities sold under agreements to repurchase | (527) | |
| Proceeds from borrowings | 338,340 | |
| Repayment borrowings | (50,581) | |
| Cash dividends paid | (1,463) | |
| Issuance of common stock | 178 | |
| Purchase of common stock | (2,075) | |
| Net cash provided by financing activities | 504,000 | |
| Net change in cash and cash equivalents | 215,497 | |
| Cash and cash equivalents, beginning of period | 183,970 | |
| Cash and cash equivalents, end of period | \$ 399,467 | \$ |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period for interest | 9,308 | \$ |
| Cash paid during the period for income taxes | 2,948 | |
| Noncash investing and financing activities: | | |
| Acquisition of real estate through foreclosure | 971 | |
| Change in goodwill due to acquisitions | 8,532 | |
| Initial recognition of operating lease right-of-use assets | 484 | |
| Initial recognition of operating lease liabilities | 484 | |

The accompanying notes are an integral part of the financial statements.

SMARTFINANCIAL, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. Presentation of Financial Information

Nature of Business:

SmartFinancial, Inc. (the "Company") is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, SmartBank (the "Bank"). The Company provides a variety of financial services to individuals and corporate customers through its offices in East and Middle Tennessee, Alabama, and the Florida Panhandle. The Bank's primary deposit products are noninterest-bearing and interest-bearing demand deposits, savings and money market deposits, and time deposits. Its primary lending products are commercial, residential, and consumer loans.

Basis of Presentation and Accounting Estimates:

The accounting and financial reporting policies of the Company and its wholly-owned subsidiary conform to U.S. generally accepted accounting principles ("GAAP") and reporting guidelines of banking regulatory authorities and regulators. The accompanying interim consolidated financial statements for the Company and its wholly-owned subsidiary have not been audited. All material intercompany balances and transactions have been eliminated.

In management's opinion, all accounting adjustments necessary to accurately reflect the financial position and results of operations on the accompanying financial statements have been made. These adjustments are normal and recurring accruals considered necessary for a fair and accurate presentation. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of foreclosed assets and deferred taxes, other than temporary impairments of securities, the fair value of financial instruments, goodwill, and the fair value of assets acquired and liabilities assumed in acquisitions. The results for interim periods are not necessarily indicative of results for the full year or any other interim periods. The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes appearing in the Company's annual report on Form 10-K for the year ended December 31, 2019.

Recently Issued and Adopted Accounting Pronouncements:

As of January 1, 2020, the Company adopted ASU 2019-01, *Leases: Codification Improvements* ("ASU 2019-01"). ASU 2019-01 provides clarification to increase transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet and disclosing essential information about leasing transactions. Specifically, ASU 2019-01 (i) allows the fair value of the underlying asset reported by lessors that are not manufacturers or dealers to continue to be its cost and not fair value as measured under the fair value definition, (ii) allows for the cash flows received for sales-type and direct financing leases to continue to be presented as results from investing, and (iii) clarifies that entities do not have to disclose the effect of the lease standard on adoption year interim amounts. The adoption of ASU 2019-01 did not have a material impact on the Company's consolidated financial statements.

Recently Issued Not Yet Effective Accounting Pronouncements:

During interim periods, the Company follows the accounting policies set forth in its annual audited financial statements for the year ended December 31, 2019 as filed in its Annual Report on Form 10-K with the Securities and Exchange Commission ("SEC"). The following is a summary of recent authoritative pronouncements issued but not yet effective that could impact the accounting, reporting, and/or disclosure of financial information by the Company.

In October 2019, the Financial Accounting Standards Board approved a delay for the implementation of ASU 2016-13, *Financial Instruments - Credit Losses* (Topic 326). The Board decided that CECL will be effective for larger Public Business Entities ("PBEs") that are SEC filers, excluding Smaller Reporting Companies ("SRCs") as currently defined by the SEC, for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. For calendar-year-end companies, this will be January 1, 2020. The determination of whether an entity is an SRC will be based on an entity's most recent assessment in accordance with SEC regulations and the Company meets the regulations as an SRC.



SMARTFINANCIAL, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

For all other entities, the Board decided that CECL will be effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. For all entities, early adoption will continue to be permitted; that is, early adoption is allowed for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years (that is, effective January 1, 2019, for calendar-year-end companies). The Company does not plan to adopt this standard early and being that the Company is an SRC, adoption is required for fiscal years beginning after December 15, 2022.

In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*. The amendments in this update simplify various aspects of the current guidance to promote consistent application of the standard among reporting entities by moving certain exceptions to the general principles. The amendments are effective for fiscal years beginning after December 15, 2020, with early adoption permitted. The Company does not plan to adopt this standard early and adoption should not have a material impact on the Company's consolidated financial statements.

In March 2020, the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, which provides temporary optional guidance to ease the potential burden in accounting for reference rate reform. The ASU provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference London Interbank Offered Rate ("LIBOR"). It is intended to help stakeholders during the global market-wide reference rate transition period. The guidance is effective for all entities as of March 12, 2020 through December 31, 2022. The Company is implementing a transition plan to identify and modify its loans and other financial instruments, including certain indebtedness, with attributes that are either directly or indirectly influenced by LIBOR. The Company is assessing ASU 2020-04 and its impact on the transition away from LIBOR for its loan and other financial instruments.

In March 2020, various regulatory agencies, including the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation, ("the agencies") issued an interagency statement on loan modifications and reporting for financial institutions working with customers affected by COVID-19. The interagency statement was effective immediately and impacted accounting for loan modifications. Under Accounting Standards Codification 310-40, "Receivables – Troubled Debt Restructurings by Creditors," ("ASC 310-40"), a restructuring of debt constitutes a troubled debt restructuring ("TDR") if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. The agencies confirmed with the staff of the FASB that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not to be considered TDRs. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented. In regard to loans not otherwise reportable as past due, financial institutions are not expected to designate loans with deferrals granted due to COVID-19 as past due because of the deferral. A loan's payment date is governed by the due date stipulated in the legal agreement. If a financial institution agrees to a payment deferral, these loans would not be considered past due during the period of the deferral. In regard to nonaccrual and charge-offs of loans, during short-term COVID-19 modifications, these loans generally should not be reported as nonaccrual or classified.

Reclassifications:

Certain captions and amounts in the 2019 consolidated financial statements were reclassified to conform to the 2020 financial statement presentation. These reclassifications had no impact on net income or shareholders' equity as previously reported.



SMARTFINANCIAL, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 2. Business Combinations

Acquisition of Progressive Financial Inc.

On March 1, 2020, the Company completed the merger of Progressive Financial Group, Inc., a Tennessee corporation (“PFG”), pursuant to an Agreement and Plan of Merger dated October 29, 2019 (the “Merger Agreement”).

In connection with the merger, the Company acquired \$301 million of assets and assumed \$272 million of liabilities. Pursuant to the Merger Agreement, each outstanding share of Progressive common stock was converted into and cancelled in exchange to the right to receive \$474.82 in cash, and 62,3808 shares of SmartFinancial common stock. SmartFinancial issued 1,292,578 shares of SmartFinancial common stock and paid \$9.8 million in cash as consideration for the Merger. The fair value of consideration paid exceeded the fair value of the identifiable assets and liabilities acquired and resulted in the establishment of goodwill in the amount of \$8.5 million, representing the intangible value of Progressive’s business and reputation within the markets it served. None of the goodwill recognized is expected to be deductible for income tax purposes. The Company is amortizing the related core deposit intangible of \$1.4 million using the effective yield method over 120 months (10 years), which represents the expected useful life of the asset.

The Company’s operating results for the three and six month periods ended June 30, 2020, include the operating results of the acquired business for the period subsequent to the merger date of March 1, 2020.

The purchased assets and assumed liabilities were recorded at their acquisition date fair values ⁽¹⁾ and are summarized in the table below (*in thousands*).

| | As recorded by PFG | Fair value adjustments ⁽¹⁾ | b |
|---|-----------------------|--|-----------|
| Assets: | | | |
| Cash & cash equivalents | \$ 55,971 | \$ — | \$ |
| Investment securities available-for-sale | 27,054 | 203 | |
| Restricted investments | 692 | | |
| Loans | 191,672 | (3,691) | |
| Allowance for loan losses | (2,832) | 2,832 | |
| Premises and equipment, net | 15,681 | (2,919) | |
| Bank owned life insurance | 5,560 | — | |
| Deferred tax asset, net | — | 813 | |
| Intangibles | — | 1,370 | |
| Other real estate owned | 3,695 | (329) | |
| Interest Receivable | 1,061 | (280) | |
| Prepays | 375 | (174) | |
| Goodwill | 231 | (231) | |
| Other assets | 1,881 | — | |
| Total assets acquired | <u>\$ 301,041</u> | <u>\$ (2,406)</u> | <u>\$</u> |
| Liabilities: | | | |
| Deposits | \$ 271,276 | \$ — | \$ |
| Time deposit premium | — | 729 | |
| Payables and other liabilities | 776 | — | |
| Total liabilities assumed | <u>272,052</u> | <u>729</u> | |
| Excess of assets assumed over liabilities assumed | <u>\$ 28,989</u> | | |
| Aggregate fair value adjustments | | <u>\$ (3,135)</u> | |
| Total identifiable net assets | | | |
| Consideration transferred: | | | |
| Cash | | | |
| Common stock issued (1,292,578 shares) | | | |
| Total fair value of consideration transferred | | | |
| Goodwill | | | <u>\$</u> |

⁽¹⁾ Fair values are preliminary and are subject to refinement for a period of one year after the closing date of an acquisition as information relative to the closing date fair value becomes available.

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The following table presents additional information related to the purchased credit impaired loans of the acquired loan portfolio at the acquisition date (*in thousands*):

| | |
|---|----|
| Accounted for pursuant to ASC 310-30: | |
| Contractually required principal and interest | \$ |
| Non-accretable differences | |
| Cash flows expected to be collected | |
| Accretable yield | |
| Fair value | \$ |

The following table discloses the impact of the merger with PFG since the acquisition date through the three and six month periods ended June 30, 2020. The table also presents certain pro-forma information (net interest income and noninterest income ("Revenue") and net income) as if the PFG acquisition had occurred on January 1, 2019. The pro-forma financial information is not necessarily indicative of the results of operations had the acquisitions been effective as of these dates.

Merger-related costs from the PFG acquisition for the three and six month periods ended June 30, 2020, were \$1.5 million and \$3.6 million, respectively, have been excluded from the pro-forma information presented below. Merger related costs for the same periods of 2019 are included in pro-forma information. The actual results and pro-forma information were as follows (*in thousands*):

| | Three Months Ended June 30, | | Six Month June |
|--|--------------------------------|------------|-------------------|
| | Revenue | Net Income | Revenue |
| 2020: | | | |
| Actual PFG results included in statement of income since acquisition date | \$ 3,655 | \$ 1,362 | \$ 4,160 |
| Supplemental consolidation pro-forma as if PFG had been acquired January 1, 2019 | 29,639 | 7,265 | 57,689 |
| 2019: | | | |
| Supplemental consolidation pro-forma as if PFG had been acquired January 1, 2019 | \$ 33,289 | \$ 8,366 | \$ 60,055 |

Note 3. Earnings Per Share

Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings per common share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding and dilutive common share equivalents using the treasury stock method. Dilutive common share equivalents include common shares issuable upon exercise of outstanding stock options and restricted stock. The effect from the stock options and restricted stock on incremental shares from the assumed conversions for net income per share-basic and net income per share-diluted are



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presented below. There were 116 thousand and 85 thousand antidilutive shares for the three and six month periods ended June 30, 2020, respectively, and none for the three and six month periods ended June 30, 2019.

The following is a summary of the basic and diluted earnings per share computation (*dollars in thousands, except per share data*):

| | Three Months Ended June 30, | | Six Month June |
|--|--------------------------------|------------|-------------------|
| | 2020 | 2019 | 2020 |
| Basic earnings per share computation: | | | |
| Net income available to common stockholders | \$ 6,174 | \$ 9,121 | \$ 8,907 |
| Average common shares outstanding – basic | 15,152,768 | 13,951,643 | 14,773,935 |
| Basic earnings per share | \$ 0.41 | \$ 0.65 | \$ 0.60 |
| Diluted earnings per share computation: | | | |
| Net income available to common stockholders | \$ 6,174 | \$ 9,121 | \$ 8,907 |
| Average common shares outstanding – basic | 15,152,768 | 13,951,643 | 14,773,935 |
| Incremental shares from assumed conversions: | | | |
| Stock options and restricted stock | 49,567 | 94,857 | 68,551 |
| Average common shares outstanding - diluted | 15,202,335 | 14,046,500 | 14,842,486 |
| Diluted earnings per common share | \$ 0.41 | \$ 0.65 | \$ 0.60 |

Note 4. Securities

The amortized cost, gross unrealized gains and losses and fair value of securities available-for-sale are summarized as follows (*in thousands*):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | |
|--|-------------------|------------------------------|-------------------------------|----|
| June 30, 2020: | | | | |
| U.S. Government-sponsored enterprises (GSEs) | \$ 31,337 | \$ 82 | \$ (8) | \$ |
| Municipal securities | 86,469 | 1,716 | (16) | |
| Other debt securities | 9,463 | 38 | (44) | |
| Mortgage-backed securities (GSEs) | 88,913 | 2,034 | (353) | |
| Total | \$ 216,182 | \$ 3,870 | \$ (421) | \$ |
| December 31, 2019: | | | | |
| U.S. Government-sponsored enterprises (GSEs) | \$ 19,015 | \$ 41 | \$ (56) | \$ |
| Municipal securities | 63,792 | 618 | (19) | |
| Other debt securities | 3,481 | 22 | (33) | |
| Mortgage-backed securities (GSEs) | 91,531 | 382 | (426) | |
| Total | \$ 177,819 | \$ 1,063 | \$ (534) | \$ |

At June 30, 2020, and December 31, 2019, securities with a carrying value totaling approximately \$79.5 million and \$92.3 million, respectively, were pledged to secure public funds and securities sold under agreements to repurchase.



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Proceeds from sale of securities available for sale, gross gains and gross losses on sales and redemptions for the three and six months ended June 30, 2020 and 2019 were as follows (*in thousands*):

| | Three Months Ended June 30, | | Six Months June 30 |
|---------------------------|--------------------------------|-----------|-----------------------|
| | 2020 | 2019 | 2020 |
| Proceeds from sales | \$ 4,760 | \$ 13,342 | \$ 6,875 |
| Gross gains | \$ 16 | \$ 34 | \$ 16 |
| Gross losses | \$ - | \$ (1) | \$ - |
| Proceeds from redemptions | \$ 12,200 | \$ 5,000 | \$ 15,450 |

The amortized cost and estimated fair value of securities at June 30, 2020, by contractual maturity for non-mortgage backed securities are shown below (*in thousands*). Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Amortized Cost |
|----------------------------------|-------------------|
| Due in one year or less | \$ 440 |
| Due from one year to five years | 3,874 |
| Due from five years to ten years | 32,291 |
| Due after ten years | 90,664 |
| | 127,269 |
| Mortgage-backed securities | 88,913 |
| Total | \$ 216,182 |

The following tables present the gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities available-for-sale have been in a continuous unrealized loss position (*in thousands*):

| | Less than 12 Months | | 12 Months or Greater | | Fair Value |
|--|---------------------|-------------------------|----------------------|-------------------------|------------|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | |
| June 30, 2020: | | | | | |
| U.S. Government-sponsored enterprises (GSEs) | \$ 6,583 | \$ (8) | \$ — | \$ — | \$ 6,583 |
| Municipal securities | 3,546 | (16) | — | — | 3,546 |
| Other debt securities | 1,966 | (14) | 953 | (30) | 2,919 |
| Mortgage-backed securities (GSEs) | 14,209 | (143) | 11,222 | (210) | 25,431 |
| Total | \$ 26,304 | \$ (181) | \$ 12,175 | \$ (240) | \$ 38,479 |
| December 31, 2019: | | | | | |
| U.S. Government-sponsored enterprises (GSEs) | \$ 2,972 | \$ (43) | \$ 5,987 | \$ (13) | \$ 8,959 |
| Municipal securities | 3,656 | (16) | 527 | (3) | 4,183 |
| Other debt securities | — | — | 947 | (33) | 947 |
| Mortgage-backed securities (GSEs) | 13,208 | (194) | 19,988 | (232) | 33,196 |
| Total | \$ 19,836 | \$ (253) | \$ 27,449 | \$ (281) | \$ 47,285 |

SMARTFINANCIAL, INC. AND SUBSIDIARY
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At June 30, 2020, the categories of temporarily impaired securities in an unrealized loss position twelve months or greater are as follows (*dollars in thousands*):

| | Gross Unrealized Loss |
|---|--------------------------------------|
| U.S. Government- sponsored enterprises (GSEs) | \$ — |
| Municipal securities | — |
| Other debt securities | (30) |
| Mortgage-backed securities (GSEs) | (210) |
| Total | \$ (240) |

The Company reviews the securities portfolio on a quarterly basis to monitor its exposure to other-than-temporary impairment. A determination as to whether a security's decline in fair value is other-than-temporary takes into consideration numerous factors and the relative significance of any single factor can vary by security. Some factors the Company may consider in the other-than-temporary impairment analysis include the length of time and extent to which the security has been in an unrealized loss position, changes in security ratings, financial condition and near-term prospects of the issuer, as well as security and industry specific economic conditions.

Based on this evaluation, the Company concluded that any unrealized losses at June 30, 2020, represented a temporary impairment, as these unrealized losses are primarily attributable to changes in interest rates and current market conditions, and not credit deterioration of the issuers. As of June 30, 2020, the Company does not intend to sell any of the securities, does not expect to be required to sell any of the securities, and expects to recover the entire amortized cost of all of the securities.

The following is the amortized cost and carrying value of other investments (*in thousands*):

| | June 30, 2020 | |
|-----------------------------------|--------------------------|-----------|
| Federal Reserve Bank stock | \$ 8,641 | \$ |
| Federal Home Loan Bank stock | 5,838 | |
| First National Bankers Bank stock | 350 | |
| Total | \$ 14,829 | \$ |

Our restricted investments consist of non-marketable equity securities that have no readily determinable market value. Accordingly, when evaluating these securities for impairment, management considers the ultimate recoverability of the par value rather than recognizing temporary declines in value. As of June 30, 2020, the Company determined that there was no impairment on its other investments.



SMARTFINANCIAL, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 5. Loans and Allowance for Loan Losses

Portfolio Segmentation:

Major categories of loans are summarized as follows (*in thousands*):

| | June 30, 2020 | | | December 31, 2019 | | |
|-----------------------------------|------------------------|-----------------|--------------|------------------------|-----------------|--------------|
| | PCI Loans ¹ | All Other Loans | Total | PCI Loans ¹ | All Other Loans | Total |
| Commercial real estate | \$ 16,517 | \$ 1,000,516 | \$ 1,017,033 | \$ 15,255 | \$ 890,051 | \$ 905,306 |
| Consumer real estate | 11,568 | 448,292 | 459,860 | 6,541 | 410,941 | 417,482 |
| Construction and land development | 6,427 | 272,789 | 279,216 | 4,458 | 223,168 | 227,626 |
| Commercial and industrial | 341 | 637,109 | 637,450 | 407 | 336,668 | 337,075 |
| Consumer and other | 106 | 14,619 | 14,725 | 326 | 9,577 | 9,903 |
| Total loans | 34,959 | 2,373,325 | 2,408,284 | 26,987 | 1,870,405 | 1,897,392 |
| Less: Allowance for loan losses | — | (16,254) | (16,254) | (156) | (10,087) | (10,243) |
| Loans, net | \$ 34,959 | \$ 2,357,071 | \$ 2,392,030 | \$ 26,831 | \$ 1,860,318 | \$ 1,887,149 |

¹ Purchased credit impaired loans ("PCI loans") are loans with evidence of credit deterioration at purchase.

For purposes of the disclosures required pursuant to the adoption of ASC 310, the loan portfolio was disaggregated into segments. A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for credit losses. There are five loan portfolio segments that include commercial real estate, consumer real estate, construction and land development, commercial and industrial, and consumer and other.

The composition of loans by loan classification for impaired and performing loan status is summarized in the tables below (*in thousands*):

| | June 30, 2020: | | December 31, 2019: | | |
|------------------|------------------------|----------------------|-----------------------------------|---------------------------|--------------------|
| | Commercial Real Estate | Consumer Real Estate | Construction and Land Development | Commercial and Industrial | Consumer and Other |
| Performing loans | \$ 999,567 | \$ 446,892 | \$ 272,789 | \$ 636,952 | \$ 14,619 |
| Impaired loans | 949 | 1,400 | — | 157 | — |
| Total loans | \$ 1,000,516 | \$ 448,292 | \$ 272,789 | \$ 637,109 | \$ 14,619 |
| PCI loans | 16,517 | 11,568 | 6,427 | 341 | 106 |
| Total loans | \$ 1,017,033 | \$ 459,860 | \$ 279,216 | \$ 637,450 | \$ 14,725 |
| Performing loans | \$ 889,795 | \$ 409,394 | \$ 222,621 | \$ 336,508 | \$ 9,577 |
| Impaired loans | 256 | 1,547 | 547 | 160 | — |
| Total loans | \$ 890,051 | \$ 410,941 | \$ 223,168 | \$ 336,668 | \$ 9,577 |
| PCI loans | 15,255 | 6,541 | 4,458 | 407 | 326 |
| Total loans | \$ 905,306 | \$ 417,482 | \$ 227,626 | \$ 337,075 | \$ 9,903 |

SMARTFINANCIAL, INC. AND SUBSIDIARY
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

The following tables show the allowance for loan losses allocation by loan classification for impaired, PCI, and performing loans (*in thousands*):

| | Commercial Real Estate | Consumer Real Estate | Construction and Land Development | Commercial and Industrial | Consumer and Other |
|---------------------------|---------------------------|-------------------------|---|---------------------------------|--------------------------|
| June 30, 2020: | | | | | |
| Performing loans | \$ 6,551 | \$ 3,021 | \$ 1,795 | \$ 4,314 | \$ 108 |
| Impaired loans | 44 | 292 | — | 129 | — |
| | 6,595 | 3,313 | 1,795 | 4,443 | 108 |
| PCI loans | — | — | — | — | — |
| Total loans | \$ 6,595 | \$ 3,313 | \$ 1,795 | \$ 4,443 | \$ 108 |
| December 31, 2019: | | | | | |
| Performing loans | \$ 4,491 | \$ 2,159 | \$ 1,127 | \$ 1,766 | \$ 65 |
| Impaired loans | — | 343 | — | 132 | — |
| | 4,491 | 2,502 | 1,127 | 1,898 | 65 |
| PCI loans | 17 | 74 | — | 59 | 6 |
| Total loans | \$ 4,508 | \$ 2,576 | \$ 1,127 | \$ 1,957 | \$ 75 |

The following tables detail the changes in the allowance for loan losses by loan classification (*in thousands*):

| | Three Months Ended June 30, 2020 | | | | |
|---|----------------------------------|----------------------------|---|---------------------------------|-----------------------|
| | Commercial Real Estate | Consumer Real Estate | Construction and Land Development | Commercial and Industrial | Consumer and Other |
| Beginning balance | \$ 5,963 | \$ 3,301 | \$ 1,484 | \$ 2,557 | \$ 12 |
| Charged off loans | — | — | — | (9) | (6) |
| Recoveries of charge-offs | 3 | 11 | — | 6 | 2 |
| Provision (reallocation) charged to expense | 629 | 1 | 311 | 1,889 | 2 |
| Ending balance | \$ 6,595 | \$ 3,313 | \$ 1,795 | \$ 4,443 | \$ 10 |

| | Three Months Ended June 30, 2019 | | | | |
|---|----------------------------------|----------------------------|---|---------------------------------|-----------------------|
| | Commercial Real Estate | Consumer Real Estate | Construction and Land Development | Commercial and Industrial | Consumer and Other |
| Beginning balance | \$ 4,074 | \$ 1,949 | \$ 854 | \$ 1,709 | \$ — |
| Charged off loans | — | — | — | (14) | — |
| Recoveries of charge-offs | 22 | 16 | 2 | 41 | — |
| Provision (reallocation) charged to expense | 6 | 224 | 90 | 10 | — |
| Ending balance | \$ 4,102 | \$ 2,189 | \$ 946 | \$ 1,746 | \$ — |

| | Six Months Ended June 30, 2020 | | | | |
|---|--------------------------------|----------------------------|---|---------------------------------|-----------------------|
| | Commercial Real Estate | Consumer Real Estate | Construction and Land Development | Commercial and Industrial | Consumer and Other |
| Beginning balance | \$ 4,508 | \$ 2,576 | \$ 1,127 | \$ 1,957 | \$ 7 |
| Loans charged off | — | (2) | — | (17) | (14) |
| Recoveries of loans charged off | 5 | 17 | 2 | 49 | 5 |
| Provision (reallocation) charged to expense | 2,082 | 722 | 666 | 2,454 | 12 |
| Ending balance | \$ 6,595 | \$ 3,313 | \$ 1,795 | \$ 4,443 | \$ 10 |

SMARTFINANCIAL, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

| | Six Months Ended June 30, 2019 | | | | |
|---|--------------------------------|----------------------------|---|---------------------------------|-----------------------|
| | Commercial Real Estate | Consumer Real Estate | Construction and Land Development | Commercial and Industrial | Consumer and Other |
| Beginning balance | \$ 3,639 | \$ 1,789 | \$ 795 | \$ 1,746 | \$ — |
| Loans charged off | — | (2) | — | (333) | — |
| Recoveries of loans charged off | 24 | 20 | 4 | 53 | — |
| Provision (reallocation) charged to expense | 439 | 382 | 147 | 280 | — |
| Ending balance | <u>\$ 4,102</u> | <u>\$ 2,189</u> | <u>\$ 946</u> | <u>\$ 1,746</u> | <u>\$ —</u> |

The following tables outline the amount of each loan classification and the amount categorized into each risk rating (*in thousands*):

| | June 30, 2020 | | | | |
|-----------------------|---------------------------|-------------------------|---|---------------------------------|-----------------------|
| | Commercial Real Estate | Consumer Real Estate | Construction and Land Development | Commercial and Industrial | Consumer and Other |
| Non PCI Loans: | | | | | |
| Pass | \$ 526,141 | \$ 390,787 | \$ 227,302 | \$ 573,989 | \$ 14,259 |
| Watch | 462,734 | 55,210 | 45,416 | 61,888 | 288 |
| Special mention | 10,586 | 599 | — | 892 | — |
| Substandard | 1,055 | 1,534 | 71 | 207 | 48 |
| Doubtful | — | 162 | — | 133 | 24 |
| Total | <u>1,000,516</u> | <u>448,292</u> | <u>272,789</u> | <u>637,109</u> | <u>14,619</u> |
| PCI Loans: | | | | | |
| Pass | 8,082 | 9,028 | 1,353 | 249 | 83 |
| Watch | 7,314 | 922 | 4,520 | — | 16 |
| Special mention | 20 | 57 | — | — | — |
| Substandard | 1,101 | 1,561 | 554 | 92 | 7 |
| Doubtful | — | — | — | — | — |
| Total | <u>16,517</u> | <u>11,568</u> | <u>6,427</u> | <u>341</u> | <u>106</u> |
| Total loans | <u>\$ 1,017,033</u> | <u>\$ 459,860</u> | <u>\$ 279,216</u> | <u>\$ 637,450</u> | <u>\$ 14,725</u> |

| | December 31, 2019 | | | | |
|-----------------------|---------------------------|-------------------------|---|---------------------------------|-----------------------|
| | Commercial Real Estate | Consumer Real Estate | Construction and Land Development | Commercial and Industrial | Consumer and Other |
| Non PCI Loans: | | | | | |
| Pass | \$ 860,447 | \$ 407,336 | \$ 216,459 | \$ 328,564 | \$ 9,462 |
| Watch | 25,180 | 989 | 6,089 | 6,786 | 40 |
| Special mention | 4,057 | 738 | — | 1,033 | — |
| Substandard | 367 | 1,713 | 620 | 228 | 51 |
| Doubtful | — | 165 | — | 57 | 24 |
| Total | <u>890,051</u> | <u>410,941</u> | <u>223,168</u> | <u>336,668</u> | <u>9,577</u> |
| PCI Loans: | | | | | |
| Pass | 12,473 | 5,258 | 902 | 41 | 300 |
| Watch | 2,234 | 38 | 3,556 | — | 13 |
| Special mention | 139 | 60 | — | — | — |
| Substandard | 409 | 1,185 | — | 366 | 13 |
| Doubtful | — | — | — | — | — |
| Total | <u>15,255</u> | <u>6,541</u> | <u>4,458</u> | <u>407</u> | <u>326</u> |
| Total loans | <u>\$ 905,306</u> | <u>\$ 417,482</u> | <u>\$ 227,626</u> | <u>\$ 337,075</u> | <u>\$ 9,903</u> |

SMARTFINANCIAL, INC. AND SUBSIDIARY
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Past Due Loans:

A loan is considered past due if any required principal and interest payments have not been received as of the date such payments were required to be made under the terms of the loan agreement. Generally, management places a loan on nonaccrual when there is a clear indicator that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due.

The following tables present an aging analysis of our loan portfolio (*in thousands*):

| | June 30, 2020 | | | | | | |
|-----------------------------------|--|--|---|------------|-------------------------------------|--------------|------------------|
| | 30-60 Days Past Due and Accruing | 61-89 Days Past Due and Accruing | Past Due 90 Days or More and Accruing | Nonaccrual | Total Past Due and Nonaccrual | PCI Loans | Current Loans |
| Commercial real estate | \$ 1,019 | \$ 188 | \$ 1 | \$ 815 | \$ 2,023 | \$ 16,517 | \$ 998,493 |
| Consumer real estate | 1,726 | 457 | 138 | 1,891 | 4,212 | 11,568 | 444,080 |
| Construction and land development | 602 | — | 265 | — | 867 | 6,427 | 271,922 |
| Commercial and industrial | 84 | 93 | 465 | 121 | 763 | 341 | 636,346 |
| Consumer and other | 134 | 2 | 8 | 72 | 216 | 106 | 14,403 |
| Total | \$ 3,565 | \$ 740 | \$ 877 | \$ 2,899 | \$ 8,081 | \$ 34,959 | \$ 2,365,244 |

| | December 31, 2019 | | | | | | |
|-----------------------------------|--|--|---|------------|-------------------------------------|--------------|------------------|
| | 30-60 Days Past Due and Accruing | 61-89 Days Past Due and Accruing | Past Due 90 Days or More and Accruing | Nonaccrual | Total Past Due and Nonaccrual | PCI Loans | Current Loans |
| Commercial real estate | \$ 466 | \$ 22 | \$ — | \$ 124 | \$ 612 | \$ 15,255 | \$ 889,439 |
| Consumer real estate | 1,564 | 30 | — | 1,872 | 3,466 | 6,541 | 407,475 |
| Construction and land development | 507 | — | 607 | 620 | 1,734 | 4,458 | 221,434 |
| Commercial and industrial | 559 | 53 | — | 57 | 669 | 407 | 335,999 |
| Consumer and other | 86 | 14 | — | 70 | 170 | 326 | 9,407 |
| Total | \$ 3,182 | \$ 119 | \$ 607 | \$ 2,743 | \$ 6,651 | \$ 26,987 | \$ 1,863,754 |



SMARTFINANCIAL, INC. AND SUBSIDIARY
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Impaired Loans:

The following is an analysis of the impaired loan portfolio, including PCI loans, detailing the related allowance recorded (*in thousands*):

| | June 30, 2020 | | | December 31, 2019 | |
|--|---------------------|--------------------------|-------------------|---------------------|--------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance |
| Impaired loans without a valuation allowance: | | | | | |
| Commercial real estate | \$ 553 | \$ 553 | \$ — | \$ 256 | \$ 261 |
| Consumer real estate | 720 | 721 | — | 553 | 553 |
| Construction and land development | — | — | — | 547 | 547 |
| Commercial and industrial | — | — | — | — | — |
| Consumer and other | — | — | — | — | — |
| | <u>1,273</u> | <u>1,274</u> | <u>—</u> | <u>1,356</u> | <u>1,361</u> |
| Impaired loans with a valuation allowance: | | | | | |
| Commercial real estate | 396 | 402 | 44 | — | — |
| Consumer real estate | 680 | 680 | 292 | 994 | 994 |
| Construction and land development | — | — | — | — | — |
| Commercial and industrial | 157 | 157 | 129 | 160 | 160 |
| Consumer and other | — | — | — | — | — |
| | <u>1,233</u> | <u>1,239</u> | <u>465</u> | <u>1,154</u> | <u>1,154</u> |
| PCI loans: | | | | | |
| Commercial real estate | 16 | 99 | — | 17 | 99 |
| Consumer real estate | 1,870 | 2,138 | — | 1,205 | 1,371 |
| Construction and land development | — | — | — | — | — |
| Commercial and industrial | 303 | 445 | — | 396 | 534 |
| Consumer and other | 30 | 35 | — | 45 | 51 |
| | <u>2,219</u> | <u>2,717</u> | <u>—</u> | <u>1,663</u> | <u>2,055</u> |
| Total impaired loans | <u>\$ 4,725</u> | <u>\$ 5,230</u> | <u>\$ 465</u> | <u>\$ 4,173</u> | <u>\$ 4,570</u> |

SMARTFINANCIAL, INC. AND SUBSIDIARY
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| | Three Months Ended June 30, | | |
|--|-----------------------------------|----------------------------------|-----------------------------------|
| | 2020 | | 2019 |
| | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment |
| Impaired loans without a valuation allowance: | | | |
| Commercial real estate | \$ 345 | \$ 1 | \$ 424 |
| Consumer real estate | 633 | 10 | 624 |
| Construction and land development | 304 | — | 650 |
| Commercial and industrial | — | — | 16 |
| Consumer and other | — | — | 14 |
| | <u>1,282</u> | <u>11</u> | <u>1,728</u> |
| Impaired loans with a valuation allowance: | | | |
| Commercial real estate | 396 | — | 24 |
| Consumer real estate | 827 | 5 | 217 |
| Construction and land development | — | — | 28 |
| Commercial and industrial | 158 | 3 | 293 |
| Consumer and other | — | — | 13 |
| | <u>1,381</u> | <u>8</u> | <u>575</u> |
| PCI loans: | | | |
| Commercial real estate | 490 | — | 2,529 |
| Consumer real estate | 1,168 | 38 | 1,099 |
| Construction and land development | 116 | — | — |
| Commercial and industrial | 338 | 3 | — |
| Consumer real estate | 22 | — | — |
| | <u>2,134</u> | <u>41</u> | <u>3,628</u> |
| Total impaired loans | \$ 4,797 | \$ 60 | \$ 5,931 |

| | Six Months Ended June 30, | | |
|--|-----------------------------------|----------------------------------|-----------------------------------|
| | 2020 | | 2019 |
| | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment |
| Impaired loans without a valuation allowance: | | | |
| Commercial real estate | \$ 315 | \$ 4 | \$ 495 |
| Consumer real estate | 606 | 14 | 774 |
| Construction and land development | 385 | — | 616 |
| Commercial and industrial | — | — | 33 |
| Consumer and other | — | — | 19 |
| | <u>1,306</u> | <u>18</u> | <u>1,937</u> |
| Impaired loans with a valuation allowance: | | | |
| Commercial real estate | 264 | 2 | 16 |
| Consumer real estate | 882 | 14 | 199 |
| Construction and land development | — | — | 19 |
| Commercial and industrial | 158 | 5 | 514 |
| Consumer and other | — | — | 38 |
| | <u>1,304</u> | <u>21</u> | <u>786</u> |
| PCI loans: | | | |
| Commercial real estate | 333 | 1 | 1,686 |
| Consumer real estate | 1,174 | 39 | 732 |
| Construction and land development | 77 | — | — |
| Commercial and industrial | 361 | 3 | — |
| Consumer and other | 31 | — | — |
| | <u>1,976</u> | <u>43</u> | <u>2,418</u> |
| Total impaired loans | \$ 4,586 | \$ 82 | \$ 5,141 |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Troubled Debt Restructurings:

At June 30, 2020, and December 31, 2019, impaired loans included loans that were classified as TDRs. The restructuring of a loan is considered a TDR if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession.

In assessing whether or not a borrower is experiencing financial difficulties, the Company considers information currently available regarding the financial condition of the borrower. This information includes, but is not limited to, whether (i) the debtor is currently in payment default on any of its debt; (ii) a payment default is probable in the foreseeable future without the modification; (iii) the debtor has declared or is in the process of declaring bankruptcy; and (iv) the debtor's projected cash flow is sufficient to satisfy contractual payments due under the original terms of the loan without a modification.

The Company considers all aspects of the modification to loan terms to determine whether or not a concession has been granted to the borrower. Key factors considered by the Company include the debtor's ability to access funds at a market rate for debt with similar risk characteristics, the significance of the modification relative to unpaid principal balance or collateral value of the debt, and the significance of a delay in the timing of payments relative to the original contractual terms of the loan.

The most common concessions granted by the Company generally include one or more modifications to the terms of the debt, such as (i) a reduction in the interest rate for the remaining life of the debt; (ii) an extension of the maturity date at an interest rate lower than the current market rate for new debt with similar risk; (iii) a temporary period of interest-only payments; and (iv) a reduction in the contractual payment amount for either a short period or remaining term of the loan.

As of June 30, 2020, and December 31, 2019, management had approximately \$9 thousand and \$61 thousand, respectively, in loans that met the criteria for TDR, none of which were on nonaccrual. A loan is placed back on accrual status when both principal and interest are current and it is probable that the Company will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

There was one loan that was modified as a TDR during the six month period ended June 30, 2020, and no loans were modified during the six month period ended June 30, 2019. There were no loans that were modified as TDRs during the past six months and for which there was a subsequent payment default.

The Company began offering short-term loan modifications to assist borrowers during the COVID-19 national emergency. The Coronavirus Aid Relief and Economic Security ("CARES") Act along with a joint agency statement issued by banking agencies, provides that short-term modifications made in response to COVID-19 does not need to be accounted for as a TDR. Accordingly, the Company does not account for such loan modifications as TDRs. See Note 1 *Summary of Significant Accounting Policies* for more information.

Foreclosure Proceedings and Balances:

As of June 30, 2020, there were five residential properties secured by real estate included in other real estate owned and there were no consumer mortgage loans collateralized by residential real estate property that were in the process of foreclosure.



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Purchased Credit Impaired Loans:

The Company has acquired loans where there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of those loans are as follows (*in thousands*):

| | June 30, 2020 | I |
|---------------------------------------|------------------|----|
| Commercial real estate | \$ 24,551 | \$ |
| Consumer real estate | 14,191 | |
| Construction and land development | 7,610 | |
| Commercial and industrial | 2,212 | |
| Consumer and other | 240 | |
| Total loans | 48,804 | |
| Less: Remaining purchase discount | (13,845) | |
| Total loans, net of purchase discount | 34,959 | |
| Less: Allowance for loan losses | — | |
| Carrying amount, net of allowance | \$ 34,959 | \$ |

Activity related to the accretable yield on loans acquired with deteriorated credit quality is as follows (*in thousands*):

| | Three Months Ended June 30, | | Six M Ju |
|---------------------------------------|--------------------------------|----------|-------------|
| | 2020 | 2019 | 2020 |
| Accretable yield, beginning of period | \$ 10,979 | \$ 8,644 | \$ 8,454 |
| Additions | — | — | 2,515 |
| Accretion income | (1,057) | (1,026) | (3,134) |
| Reclassification | 247 | 323 | 2,163 |
| Other changes, net | 1,608 | 339 | 1,779 |
| Accretable yield, end of period | \$ 11,777 | \$ 8,280 | \$ 11,777 |

Note 6. Goodwill and Intangible Assets

In accordance with FASB ASC 350, *Goodwill and Other*, regarding testing goodwill for impairment provides an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The Company performs its annual goodwill impairment test as of December 31 of each year and at December 31, 2019, the results of the qualitative assessment provided no indication of potential impairment. Goodwill will continue to be monitored for triggering events that may indicate impairment prior to the next scheduled annual impairment test. Considering the recent economic conditions resulting from the COVID-19 pandemic, as of June 30, 2020, the Company performed a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The results indicated that there was no impairment as of June 30, 2020. Management will continue to evaluate the economic conditions at future reporting periods for applicable changes.

The Company's other intangible assets consist of core deposit intangibles, and is initially recognized based on a valuation performed as of the consummation date. The core deposit intangible is amortized over the average remaining life of the acquired customer deposits.



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The carrying amount of goodwill and other intangible assets as of the dates indicated is summarized below (*in thousands*):

| | June 30, 2020 |
|--|--------------------------|
| Goodwill: | |
| Balance, beginning of period | \$ 65,614 |
| Adjustment to values initially recorded for Acquisition of Foothills Bancorp, Inc. | — |
| Acquisition of PFG | 8,302 |
| Adjustment to values initially recorded for Acquisition of PFG | 229 |
| Balance, end of the period | <u>\$ 74,145</u> |
| Core deposit intangible: | |
| Balance, beginning of period | \$ 14,550 |
| Acquisition of PFG | 1,370 |
| Balance, gross core deposit intangible | 15,920 |
| Less: accumulated amortization | (3,738) |
| Net core deposit intangible, net | <u>\$ 12,182</u> |

The aggregate amortization of core deposit intangibles expense for the three and six month periods ended June 30, 2020, was \$405 thousand and \$767 thousand, respectively, and for the three and six months ended June 30, 2019, was \$342 thousand and \$686 thousand, respectively.

The estimated aggregate amortization expense for future periods for core deposit intangibles is as follows (*in thousands*):

| | |
|-------------------|-----------|
| Remainder of 2020 | \$ |
| 2021 | |
| 2022 | |
| 2023 | |
| 2024 | |
| Thereafter | |
| Total | <u>\$</u> |

Note 7. Borrowings and Line of Credit

Borrowings:

At June 30, 2020, total borrowings were \$318.9 million compared to \$31.6 million at December 31, 2020. The \$287.3 million increase was primarily due to borrowings from the Federal Reserve Bank Payroll Protection Program Liquidity Facility ("PPPLF") of \$237.8 million in the second quarter of 2020 and an increase in Federal Home Loan Bank ("FHLB") borrowings of \$50.0 million. Borrowings consist of the following (*dollars in thousands*):

| | June 30, 2020 | De |
|--|--------------------------|-----------|
| Securities sold under customer repurchase agreements | \$ 5,659 | \$ |
| FHLB borrowings | 75,000 | |
| PPPLF borrowings | 237,778 | |
| Other borrowings | 418 | |
| Total | <u>\$ 318,855</u> | <u>\$</u> |

SMARTFINANCIAL, INC. AND SUBSIDIARY
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Line of Credit:

The Company has a Loan and Security Agreement and revolving note with ServisFirst Bank, pursuant to which ServisFirst Bank has made a \$25.0 million revolving line of credit available to the Company. The maturity of the line of credit is September 24, 2021. At June 30, 2020, there was no outstanding balance under the line of credit, and the entire amount of the line of credit remained available to the Company.

Note 8. Employee Benefit Plans

401(k) Plan:

The Company provides a deferred salary reduction plan ("Plan") under Section 401(k) of the Internal Revenue Code covering substantially all employees. After 90 days of service the Company matches 100% of employee contributions up to 3% of compensation and 50% of employee contributions on the next 2% of compensation. The Company's contribution to the Plan for the three and six month periods ending June 30, 2020, was \$307 thousand and \$558 thousand, respectively. The Company's contribution to the Plan for the three and six months periods ending June 30, 2019, was \$217 thousand and \$415 thousand, respectively.

Equity Incentive Plans:

The Compensation Committee of the Company's Board of Directors may grant or award eligible participants stock options, restricted stock, restricted stock units, stock appreciation rights, and other stock-based awards or any combination of awards (collectively referred to herein as "Rights"). At June 30, 2020, the Company had one active equity incentive plan available for future grants, the 2015 Stock Incentive Plan, which had 30,599 Rights issued and 1,882,689 Rights available for future grants or awards.

In addition, the Company has 38,250 Rights issued from the Cornerstone Bancshares, Inc. 2002 Long Term Incentive Plan, 48,750 Rights issued from the Cornerstone Non-Qualified Plan Options, and 2,266 Rights issued from the Capstone Stock Option Plan. These plans do not have any Rights available for future grants or awards.

Stock Options:

A summary of the status of stock option plans is presented in the following table:

| | <u>Number</u> | |
|----------------------------------|----------------|-----------|
| Outstanding at December 31, 2019 | 136,658 | \$ |
| Granted | — | |
| Exercised | (15,358) | |
| Forfeited | (1,435) | |
| Outstanding at June 30, 2020 | <u>119,865</u> | <u>\$</u> |



SMARTFINANCIAL, INC. AND SUBSIDIARY
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Information pertaining to stock options outstanding at June 30, 2020, is as follows:

| | Options Outstanding | | | Options Exercisable | | |
|----|----------------------------|--------------------|---|---------------------------------|--------------------|----|
| | Exercise Prices | Number Outstanding | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Exercisable | |
| \$ | 6.60 | 25,000 | 1.4 years | \$ 6.60 | 25,000 | \$ |
| | 6.80 | 13,250 | 0.7 years | 6.80 | 13,250 | |
| | 9.48 | 21,000 | 2.4 years | 9.48 | 21,000 | |
| | 9.60 | 27,750 | 2.9 years | 9.60 | 27,750 | |
| | 11.76 | 2,266 | 2.0 years | 11.76 | 2,266 | |
| | 15.05 | 30,599 | 4.8 years | 15.05 | 30,599 | |
| | Outstanding, end of period | 119,865 | 2.7 years | \$ 10.08 | 119,865 | \$ |

The Company did not recognize any stock option-based compensation expense during the three and six months ended June 30, 2020, as all stock options issued are fully vested. During the three and six month periods ended June 30, 2019, stock option-based compensation expense was \$31 thousand and \$62 thousand, respectively.

The intrinsic value of options exercised during the three and six month periods ended June 30, 2020 was \$2 thousand and \$66 thousand, respectively. The intrinsic value of options exercised during the three and six month periods ended June 30, 2019 was \$32 thousand and \$112 thousand, respectively. The aggregate intrinsic value of total options outstanding and exercisable options at June 30, 2020, was \$732 thousand. Cash received from options exercised under all share-based payment arrangements for the six month period ended June 30, 2020 was \$178 thousand.

No options vested during the periods ended June 30, 2020, and 2019, respectively. The income tax expense/benefit recognized for the exercise of options during the three and six months ended June 30, 2020, was an expense of \$2 thousand and a benefit of \$22, thousand, respectively, and for the three and six months ended June 30, 2019, a benefit of \$5 thousand and \$27 thousand, respectively.

As of June 30, 2020, all options were fully vested and currently no future compensation cost will be recognized related to nonvested stock-based compensation arrangements granted under the Plans.

Stock Appreciation Rights ("SARs"):

A summary of the status of SARs plans is presented in the following table:

| | Number | Weighted-Average Exercise Price |
|----------------------------------|--------|---------------------------------|
| Outstanding at December 31, 2019 | 67,000 | \$ |
| Granted | 18,000 | |
| Exercised | — | |
| Forfeited | — | |
| Outstanding at June 30, 2020 | 85,000 | \$ |

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Information pertaining to SARs outstanding at June 30, 2020, is as follows:

| Exercise Prices | Number Outstanding | SARs Outstanding | | SARs Exercisable | |
|----------------------------|--------------------|---|---------------------------------|--------------------|---------------------------------|
| | | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Exercisable | Weighted-Average Exercise Price |
| \$ 15.19 | 18,000 | 3.50 years | \$ 15.19 | — | \$ — |
| 18.12 | 21,000 | 2.50 years | 18.12 | — | — |
| 21.61 | 34,000 | 1.50 years | 21.61 | — | — |
| 21.72 | 12,000 | 0.50 years | 21.72 | 12,000 | — |
| Outstanding, end of period | 85,000 | 2.03 years | \$ 19.40 | 12,000 | \$ — |

SARs compensation expense of \$92 thousand and (\$26) thousand was recognized for the three and six month periods ended June 30, 2020, respectively, and \$60 thousand and \$80 thousand for three and six month periods ended June 30, 2019, respectively. The credit in expense for the six month period ended June 30, 2020, was due to adjustments related to the fair value evaluation of SARs.

Restricted Stock Awards:

A summary of the activity of the Company's unvested restricted stock awards for the period ended June 30, 2020 is presented below:

| | Number | |
|------------------------------|---------|------|
| Balance at December 31, 2019 | 65,400 | \$ — |
| Granted | 37,818 | — |
| Vested | (5,500) | — |
| Forfeited/expired | (1,500) | — |
| Balance at June 30, 2020 | 96,218 | \$ — |

The Company measures the fair value of restricted stock awards based on the price of the Company's common stock on the grant date, and compensation expense is recorded over the vesting period. The compensation expense for restricted stock awards during the three and six months ended June 30, 2020, was \$114 thousand and \$223 thousand, respectively, and was \$102 thousand and \$214 thousand, during the three and six month periods ended June 30, 2019, respectively. As of June 30, 2020, there was \$1.2 million, respectively, of unrecognized compensation cost related to non-vested restricted stock awards granted under the plan. The cost is expected to be recognized over a weighted average period of 3.36 years. The grant-date fair value of restricted stock awards vested was \$105 thousand for the period ended June 30, 2020.

Note 9. Commitments and Contingent Liabilities

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing and depository needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amount recognized on the balance sheet. The majority of all commitments to extend credit are variable rate instruments while the standby letters of credit are primarily fixed rate instruments. The Company's exposure to credit loss is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments.

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A summary of the Company's total contractual amount for all off-balance sheet commitments are as follows (in thousands):

| | June 30, | | I |
|-------------------------------------|-----------------|----------------|-----------|
| | 2020 | | |
| Commitments to extend credit | \$ | 506,720 | \$ |
| Standby letters of credit | | 6,543 | |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate, and income-producing commercial properties.

Standby letters of credit issued by the Company are conditional commitments to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Collateral held varies and is required in instances which the Company deems necessary. At June 30, 2020, and December 31, 2019, the carrying amount of liabilities related to the Company's obligation to perform under standby letters of credit was insignificant.

The Company is subject in the normal course of business to various pending and threatened legal proceedings in which claims for monetary damages are asserted. Management, after consultation with legal counsel, does not anticipate that the aggregate ultimate liability arising out of litigation pending or threatened against the Company will be material to the Company's consolidated financial position. On an on-going basis, the Company assesses any potential liabilities or contingencies in connection with such legal proceedings. For those matters where it is deemed probable that the Company will incur losses and the amount of the losses can be reasonably estimated, the Company would record an expense and corresponding liability in its consolidated financial statements.

Note 10. Fair Value Disclosures

Determination of Fair Value:

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the "Fair Value Measurements and Disclosures" ASC Topic 820, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

ASC Topic 820 provides a consistent definition of fair value, which focuses on exit price in an orderly transaction between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact business at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.



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In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 - Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

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

The tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis are as follows (*in thousands*):

| Description | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) |
|--|-------------------|--|---|
| June 30, 2020: | | | |
| Assets: | | | |
| Securities available-for-sale: | | | |
| U.S. Government-sponsored enterprises (GSEs) | \$ 31,411 | \$ — | \$ 31,411 |
| Municipal securities | 88,169 | — | 88,169 |
| Other debt securities | 9,457 | — | 9,457 |
| Mortgage-backed securities (GSEs) | 90,594 | — | 90,594 |
| Total securities available-for-sale | <u>\$ 219,631</u> | <u>\$ —</u> | <u>\$ 219,631</u> |
| Liabilities: | | | |
| Derivative financial instruments | <u>\$ 7,090</u> | <u>\$ —</u> | <u>\$ 7,090</u> |
| December 31, 2019: | | | |
| Assets: | | | |
| Securities available-for-sale: | | | |
| U.S. Government-sponsored enterprises (GSEs) | \$ 19,000 | \$ — | \$ 19,000 |
| Municipal securities | 64,391 | — | 64,391 |
| Other debt securities | 3,470 | — | 3,470 |
| Mortgage-backed securities (GSEs) | 91,487 | — | 91,487 |
| Total securities available-for-sale | <u>\$ 178,348</u> | <u>\$ —</u> | <u>\$ 178,348</u> |
| Liabilities: | | | |
| Derivative financial instruments | <u>\$ 3,446</u> | <u>\$ —</u> | <u>\$ 3,446</u> |

During the six month period ending June 30, 2020, there were no transfers between Level 1 and Level 2 in the fair value hierarchy.



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Assets Measured at Fair Value on a Nonrecurring Basis:

Under certain circumstances management makes adjustments to fair value for assets and liabilities although they are not measured at fair value on an ongoing basis. The following tables present the financial instruments carried on the consolidated balance sheets by caption and by level in the fair value hierarchy, for which a nonrecurring change in fair value has been recorded (*in thousands*):

| | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) |
|---------------------------|------------|--|---|
| June 30, 2020: | | | |
| Impaired loans | \$ 4,260 | \$ — | \$ — |
| Other real estate owned | 5,524 | — | — |
| December 31, 2019: | | | |
| Impaired loans | \$ 2,185 | \$ — | \$ — |
| Other real estate owned | 1,757 | — | — |

For Level 3 assets measured at fair value on a non-recurring basis, the significant unobservable inputs used in the fair value measurements are presented below (*dollars in thousands*):

| | Fair Value | Valuation Technique | Significant Other Unobservable Input |
|---------------------------|------------|------------------------|--------------------------------------|
| June 30, 2020: | | | |
| Impaired loans | \$ 4,260 | Appraisal and cashflow | Appraisal and cashflow discounts |
| Other real estate owned | 5,524 | Appraisal | Appraisal discounts |
| December 31, 2019: | | | |
| Impaired loans | \$ 2,185 | Appraisal | Appraisal and cashflow discounts |
| Other real estate owned | 1,757 | Appraisal | Appraisal discounts |

Impaired loans: Loans considered impaired under ASC 310-10-35, *Receivables*, are loans for which, based on current information and events, it is probable that the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. An impaired loan can be measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent. The fair value of impaired loans was measured based on the value of the collateral securing these loans or the discounted cash flows of the loans, as applicable. Impaired loans are classified within Level 3 of the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory, and/or accounts receivable. The Company determines the value of the collateral based on independent appraisals performed by qualified licensed appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Appraised values are discounted for costs to sell and may be discounted further based on management's historical knowledge, changes in market conditions from the date of the most recent appraisal, and/or management's expertise and knowledge of the customer and the customer's business. Such discounts by management are subjective and are typically significant unobservable inputs for determining fair value. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors discussed above.

Other real estate owned: Other real estate owned, consisting of properties obtained through foreclosure or in satisfaction of loans, are initially recorded at fair value less estimated costs to sell upon transfer of the loans to other real estate.



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Subsequently, other real estate is carried at the lower of carrying value or fair value less costs to sell. Fair values are generally based on third party appraisals of the property and are classified within Level 3 of the fair value hierarchy. The appraisals are sometimes further discounted based on management's historical knowledge, and/or changes in market conditions from the date of the most recent appraisal, and/or management's expertise and knowledge of the customer and the customer's business. Such discounts are typically significant unobservable inputs for determining fair value. In cases where the carrying amount exceeds the fair value, less estimated costs to sell, a loss is recognized in noninterest expense.

Carrying value and estimated fair value:

The carrying amount and estimated fair value of the Company's financial instruments are as follows (*in thousands*):

| | Carrying Amount | Fair Value Measurements Using | | |
|-------------------------------------|--------------------|-------------------------------|---------|-----------|
| | | Level 1 | Level 2 | Level 3 |
| June 30, 2020: | | | | |
| Assets: | | | | |
| Cash and cash equivalents | \$ 399,467 | \$ 399,467 | \$ — | \$ — |
| Securities available-for-sale | 219,631 | — | 219,631 | — |
| Other investments | 14,829 | N/A | N/A | N/A |
| Loans, net and loans held for sale | 2,398,360 | — | — | 2,385,657 |
| Liabilities: | | | | |
| Noninterest-bearing demand deposits | 645,650 | — | 645,650 | — |
| Interest-bearing demand deposits | 479,212 | — | 497,212 | — |
| Money market and savings deposits | 762,246 | — | 762,246 | — |
| Time deposits | 652,581 | — | 656,885 | — |
| Borrowings | 318,855 | — | 319,666 | — |
| Subordinated debt | 39,304 | — | — | 31,547 |
| Derivative financial instruments | 7,090 | — | 7,090 | — |
| December 31, 2019: | | | | |
| Assets: | | | | |
| Cash and cash equivalents | \$ 183,971 | \$ 183,971 | \$ — | \$ — |
| Securities available-for-sale | 178,348 | — | 178,348 | — |
| Other investments | 12,913 | N/A | N/A | N/A |
| Loans, net and loans held for sale | 1,893,005 | — | — | 1,879,825 |
| Liabilities: | | | | |
| Noninterest-bearing demand deposits | 364,155 | — | 364,155 | — |
| Interest-bearing demand deposits | 380,234 | — | 380,234 | — |
| Money market and savings deposits | 623,284 | — | 623,284 | — |
| Time deposits | 679,541 | — | 681,902 | — |
| Borrowings | 31,623 | — | 31,029 | — |
| Subordinated debt | 39,261 | — | — | 35,868 |
| Derivative financial instruments | 3,446 | — | 3,446 | — |

Limitations:

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments.

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Significant assets and liabilities that are not considered financial instruments include deferred income taxes and premises and equipment. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

Note 11. Derivatives

Financial derivatives are reported at fair value in other assets or other liabilities. The accounting for changes in the fair value of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative net investment hedge instrument as well as the offsetting gain or loss on the hedged asset or liability attributable to the hedged risk are recognized in current earnings. The gain or loss on the derivative instrument is presented on the same income statement line item as the earnings effect of the hedged item. The Company utilizes interest rate swaps designated as fair value hedges to mitigate the effect of changing interest rates on the fair values of fixed rate tax-exempt callable securities available-for-sale. The hedging strategy on securities converts the fixed interest rates to LIBOR-based variable interest rates. These derivatives are designated as partial term hedges of selected cash flows covering specified periods of time prior to the call dates of the hedged securities. The Company has elected early adoption of ASU 2017-12, *Derivatives and Hedging (Topic 815) - Targeted Improvements to Accounting for Hedging Activities*, which allows such partial term hedge designations.

A summary of the Company's fair value hedge relationships for the periods presented are as follows (*dollars in thousands*):

| | Balance Sheet Location | Weighted Average Remaining Maturity (In Years) | Weighted Average Pay Rate | Receive Rate | Notional Amount |
|--|------------------------|--|---------------------------|---------------|-----------------|
| Liability derivatives | | | | | |
| June 30, 2020: | | | | | |
| Interest rate swap agreements - securities | Other liabilities | 7.63 | 3.08 % | 3 month LIBOR | \$ 36,000 |
| December 31, 2019: | | | | | |
| Interest rate swap agreements - securities | Other liabilities | 8.20 | 3.09 % | 3 month LIBOR | \$ 36,000 |

The effects of the Company's fair value hedge relationships reported in interest income on tax-exempt available-for-sale securities on the consolidated income statement were as follows (*in thousands*):

| | Three Months Ended | | Six Mon |
|---|--------------------|------------|------------|
| | June 30, | | Jun |
| | 2020 | 2019 | 2020 |
| Interest income on tax-exempt securities | \$ 580 | \$ 449 | \$ 1,020 |
| Effects of fair value hedge relationships | (164) | (38) | (321) |
| Reported interest income on tax-exempt securities | \$ 416 | \$ 411 | \$ 699 |
| Gain (loss) on fair value hedging relationship | | | |
| Interest rate swap agreements - securities: | | | |
| Hedged items | \$ 205 | \$ 1,348 | \$ 3,644 |
| Derivative designated as hedging instruments | \$ (205) | \$ (1,348) | \$ (3,644) |

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The following amounts were recorded on the balance sheet related to cumulative basis adjustments for fair value hedges (*in thousands*):

| Line item on the balance sheet | Carrying Amount of the Hedged Assets | Cumulative Amount of F Value Hedging Adjustm Included in the Carrying A of the Hedged Assets |
|--------------------------------|---|---|
| June 30, 2020: | | |
| Securities available-for-sale | \$ 46,177 | \$ |
| December 31, 2019: | | |
| Securities available-for-sale | \$ 42,710 | \$ |

Note 12. Leases

A lease is defined as a contract, or part of a contract, that conveys the right to control the use of identified property, plant or equipment for a period of time in exchange for consideration. On January 1, 2019, the Company adopted ASU No. 2016-02 and all subsequent ASUs that modified this topic (collectively referred to as "Topic 842"). For the Company, Topic 842 primarily affected the accounting treatment for operating lease agreements in which the Company is the lessee.

Substantially all of the leases in which the Company is the lessee are comprised of real estate for branches and office space with terms extending through 2034. All of our leases are classified as operating leases, and therefore, were previously not recognized on the Company's consolidated balance sheet. With the adoption of Topic 842, operating lease agreements are required to be recognized on the consolidated balance sheet as a right-of-use ("ROU") asset and a corresponding lease liability.

The following table represents the consolidated balance sheet classification of the Company's ROU assets and lease liabilities. The Company elected not to include short-term leases (i.e., leases with initial terms of twelve months or less), or equipment leases (deemed immaterial) on the consolidated balance sheet (*in thousands*):

| | Classification | June 30, 2020 | D |
|-------------------------------------|-------------------|------------------|----|
| Assets: | | | |
| Operating lease right-of-use assets | Other assets | \$ 5,522 | \$ |
| Liabilities: | | | |
| Operating lease liabilities | Other liabilities | \$ 5,543 | \$ |

The calculated amount of the ROU assets and lease liabilities in the table above are impacted by the length of the lease term and the discount rate used to present value the minimum lease payments. The Company's lease agreements often include one or more options to renew at the Company's discretion. If at lease inception the Company considers the exercising of a renewal option to be reasonably certain, the Company will include the extended term in the calculation of the ROU asset and lease liability. Regarding the discount rate, Topic 842 requires the use of the rate implicit in the lease whenever this rate is readily determinable. As this rate is rarely determinable, the Company utilizes its incremental borrowing rate at lease inception, on a collateralized basis, over a similar term. For operating leases existing prior to January 1, 2019, the rate for the remaining lease term as of January 1, 2019 was used.

As of June 30, 2020, the weighted average remaining lease term was 10.78 years and the weighted average discount rate was 2.71%.

The following table represents lease costs and other lease information, in thousands. As the Company elected, for all classes of underlying assets, not to separate lease and non-lease components and instead to account for them as a single



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lease component, the variable lease cost primarily represents variable payments such as common area maintenance (*in thousands*).

| | Three Months Ended | | Six M |
|---|--------------------|--------|-------|
| | June 30, | | o |
| | 2020 | 2019 | 2020 |
| Lease costs: | | | |
| Operating lease costs | \$ 270 | \$ 157 | \$ 5 |
| Short-term lease costs | — | 5 | — |
| Variable lease costs | 29 | 23 | — |
| Total | \$ 299 | \$ 185 | \$ 5 |
| Other information: | | | |
| Cash paid for amounts included in the measurement of lease liabilities: | | | |
| Operating cash flows from operating leases | \$ 265 | \$ 150 | \$ 4 |

Future minimum payments for operating leases with initial or remaining terms of one year or more as of June 30, 2020, were as follows (*in thousands*):

| | |
|--|----|
| June 30, 2021 | \$ |
| June 30, 2022 | |
| June 30, 2023 | |
| June 30, 2024 | |
| June 30, 2025 | |
| Thereafter | |
| Total future minimum lease payments | — |
| Amounts representing interest | |
| Present value of net future minimum lease payments | \$ |

Note 13. Regulatory Matters

Regulatory Capital Requirements:

The Company and the Bank are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Under the standards initially adopted by the Basel Committee on Banking Supervision in December 2010, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is 2.50%. At June 30, 2020, the Company and the Bank exceeded the minimum regulatory requirements and exceeded the threshold for the "well capitalized" regulatory classification.

Regulatory Restrictions on Dividends:

Pursuant to Tennessee banking law, the Bank may not, without the prior consent of the Commissioner of the Tennessee Department of Financial Institutions (the "TDFI"), pay any dividends to the Company in a calendar year in excess of the total of the Bank's retained net income for that year plus the retained net income for the preceding two years. Because this test involves a measure of net income, any charge on the Bank's income statement, such as an impairment of goodwill, could impair the Bank's ability to pay dividends to the Company. Under Tennessee corporate law, the Company is not permitted to pay dividends if, after giving effect to such payment, it would not be able to pay its debts as they become due in the usual course of business or its total assets would be less than the sum of its total liabilities plus any amounts needed



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to satisfy any preferential rights if it were dissolving. In addition, in deciding whether or not to declare a dividend of any particular size, the Company's board of directors must consider its and the Bank's current and prospective capital, liquidity, and other needs. In addition to state law limitations on the Company's ability to pay dividends, the Federal Reserve imposes limitations on the Company's ability to pay dividends. Federal Reserve regulations limit dividends, stock repurchases and discretionary bonuses to executive officers if the Company's regulatory capital is below the level of regulatory minimums plus the applicable capital conservation buffer.

During the three months ended June 30, 2020, the Bank did not pay dividends to the Company. During the six months ended June 30, 2020, the Bank paid \$7.5 million in dividends to the Company. Since the fourth quarter of 2019, the Company has paid a quarterly common stock dividend of \$0.05 per share. The amount and timing of all future dividend payments by the Company, if any, is subject to discretion of the Company's board of directors and will depend on the Company's earnings, capital position, financial condition and other factors, including new regulatory capital requirements, as they become known to the Company.

Regulatory Capital Levels:

Actual and required capital levels at June 30, 2020, and December 31, 2019 are presented below (*dollars in thousands*):

| | Actual | | Minimum for capital adequacy purposes | | Minimum for prompt corrective action purposes |
|--|------------|---------|---------------------------------------|--------|---|
| | Amount | Ratio | Amount | Ratio | Amount |
| June 30, 2020 | | | | | |
| SmartFinancial: | | | | | |
| Total Capital (to Risk Weighted Assets) | \$ 315,306 | 13.25 % | \$ 190,305 | 8.00 % | |
| Tier 1 Capital (to Risk Weighted Assets) | 259,748 | 10.92 % | 142,729 | 6.00 % | |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 259,748 | 10.92 % | 107,047 | 4.50 % | |
| Tier 1 Capital (to Average Assets) ² | 259,748 | 8.83 % | 117,636 | 4.00 % | |
| SmartBank: | | | | | |
| Total Capital (to Risk Weighted Assets) | \$ 304,993 | 12.82 % | \$ 190,259 | 8.00 % | \$ 237,000 |
| Tier 1 Capital (to Risk Weighted Assets) | 288,739 | 12.14 % | 142,694 | 6.00 % | 190,000 |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 288,739 | 12.14 % | 107,021 | 4.50 % | 150,000 |
| Tier 1 Capital (to Average Assets) ² | 288,739 | 9.82 % | 117,619 | 4.00 % | 147,000 |
| December 31, 2019 | | | | | |
| SmartFinancial: | | | | | |
| Total Capital (to Risk Weighted Assets) | \$ 287,937 | 14.02 % | \$ 164,313 | 8.00 % | |
| Tier 1 Capital (to Risk Weighted Assets) | 238,433 | 11.61 % | 123,235 | 6.00 % | |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 238,433 | 11.61 % | 92,426 | 4.50 % | |
| Tier 1 Capital (to Average Assets) | 238,433 | 10.34 % | 92,258 | 4.00 % | |
| SmartBank: | | | | | |
| Total Capital (to Risk Weighted Assets) | \$ 273,432 | 13.31 % | \$ 164,305 | 8.00 % | \$ 205,000 |
| Tier 1 Capital (to Risk Weighted Assets) | 263,189 | 12.81 % | 123,229 | 6.00 % | 160,000 |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 263,189 | 12.81 % | 92,422 | 4.50 % | 130,000 |
| Tier 1 Capital (to Average Assets) | 263,189 | 11.41 % | 92,254 | 4.00 % | 115,000 |

The prompt corrective action provisions are applicable at the Bank level only.

²Average assets for the above calculations were based on the most recent quarter.

SMARTFINANCIAL, INC. AND SUBSIDIARY
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Note 14. Other Comprehensive (Loss) Income.

The changes in each component of accumulated other comprehensive income (loss), net of tax, were as follows *(in thousands)*:

| | Three Months Ended June 30, 2021 | |
|---|---|---|
| | Securities Available-for- Sale | Fair Value Municipal Security Hedges |
| Beginning balance, April 1, 2020 | \$ 1,242 | \$ (2,489) |
| Other comprehensive income (loss) | 1,414 | 413 |
| Reclassification of amounts included in net income | 12 | — |
| Net other comprehensive income (loss) during period | <u>1,426</u> | <u>413</u> |
| Ending balance, June 30, 2020 | <u>\$ 2,668</u> | <u>\$ (2,076)</u> |
| | Three Months Ended June 30, 2019 | |
| | Securities Available-for- Sale | Fair Value Municipal Security Hedges |
| Beginning balance, April 1, 2019 | \$ 124 | \$ (558) |
| Other comprehensive income (loss) | 1,927 | (2,088) |
| Reclassification of amounts included in net income | 24 | — |
| Net other comprehensive income (loss) during period | <u>1,951</u> | <u>(2,088)</u> |
| Ending balance, June 30, 2019 | <u>\$ 2,075</u> | <u>\$ (2,646)</u> |
| | Six Months Ended June 30, 2020 | |
| | Securities Available-for- Sale | Fair Value Municipal Security Hedges |
| Beginning balance, January 1, 2020 | \$ 391 | \$ (223) |
| Other comprehensive income (loss) | 2,265 | (1,853) |
| Reclassification of amounts included in net income | 12 | — |
| Net other comprehensive income (loss) during period | <u>2,277</u> | <u>(1,853)</u> |
| Ending balance, June 30, 2020 | <u>\$ 2,668</u> | <u>\$ (2,076)</u> |
| | Six Months Ended June 30, 2019 | |
| | Securities Available-for- Sale | Fair Value Municipal Security Hedges |
| Beginning balance, January 1, 2019 | \$ (1,979) | \$ (786) |
| Other comprehensive income (loss) | 4,030 | (1,860) |
| Reclassification of amounts included in net income | 24 | — |
| Net other comprehensive income (loss) during period | <u>4,054</u> | <u>(1,860)</u> |
| Ending balance, June 30, 2019 | <u>\$ 2,075</u> | <u>\$ (2,646)</u> |

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

SmartFinancial, Inc. (the "Company") is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, SmartBank (the "Bank"). SmartBank provides a comprehensive suite of commercial and consumer banking services to clients through 36 full-service bank branches and two loan production offices in select markets in East and Middle Tennessee, Alabama and the Florida Panhandle.

While we offer a wide range of commercial banking services, we focus on making loans secured primarily by commercial real estate and other types of secured and unsecured commercial loans to small and medium-sized businesses in a number of industries, as well as loans to individuals for a variety of purposes. Our principal sources of funds for loans and investing in securities are deposits and, to a lesser extent, borrowings. We offer a broad range of deposit products, including checking ("NOW"), savings, money market accounts and certificates of deposit. We actively pursue business relationships by utilizing the business contacts of our senior management, other bank officers and our directors, thereby capitalizing on our knowledge of our local market areas.

Forward-Looking Statement

SmartFinancial, Inc. ("SmartFinancial") may from time to time make written or oral statements, including statements contained in this report and information incorporated by reference herein (including, without limitation, certain statements in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 2), that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These statements, including statements regarding the potential effects of the COVID-19 pandemic on the Company's business and financial results and conditions, are based on assumptions and estimates and are not guarantees of future performance. Any statements that do not relate to historical or current facts or matters are forward-looking statements. You can identify some of the forward-looking statements by the use of forward-looking words (and their derivatives), such as "may," "will," "could," "project," "believe," "anticipate," "expect," "estimate," "continue," "potential," "plan," "forecast," and the like, the negatives of such expressions, or the use of the future tense. Statements concerning current conditions may also be forward-looking if they imply a continuation of a current condition. These forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, financial condition, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, but are not limited to:

- weakness or a decline in the U.S. economy, in particular in Tennessee, and other markets in which we operate;
- the possibility that our asset quality would decline or that we experience greater loan losses than anticipated;
- the impact of liquidity needs on our results of operations and financial condition;
- competition from financial institutions and other financial service providers;
- the impact of negative developments in the financial industry and U.S. and global capital and credit markets;
- the impact of recently enacted and future legislation and regulation on our business, including changes to statutes, regulations or regulatory policies or practices as a result of, or in response to, the COVID-19 pandemic;
- negative changes in the real estate markets in which we operate and have our primary lending activities, which may result in an unanticipated decline in real estate values in our market area;
- risks associated with our growth strategy, including a failure to implement our growth plans or an inability to manage our growth effectively;
- claims and litigation arising from our business activities and from the companies we acquire, which may relate to contractual issues, environmental laws, fiduciary responsibility, and other matters;
- expected revenue synergies and cost savings from our recently completed acquisition of Progressive Financial Group, Inc. ("PFG") may not be fully realized or may take longer than anticipated to realize;
- disruption from the merger with customers, suppliers or employees or other business partners' relationships;
- the risk of successful integration of the PFG's businesses with our business;
- lower than expected revenue following these mergers;
- SmartFinancial's ability to manage the combined company's growth following the mergers;

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- the dilution caused by SmartFinancial's issuance of additional shares of its common stock in connection with the PFG merger;
- cyber attacks, computer viruses or other malware that may breach the security of our websites or other systems we operate or rely upon for services to obtain unauthorized access to confidential data, disable or degrade service, or sabotage our systems and negatively impact our operations and our reputation in the market;
- results of examinations by our primary regulators, the TDFI, the Board of Governors of the Federal Reserve System (the "Federal Reserve"), and other regulatory authorities, including the such regulatory authority may, among other things, require us to increase our allowance for credit losses, write-down assets, require us to reimburse customers, change the way we do eliminate certain other banking activities;
- government intervention in the U.S. financial system and the effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve;
- our inability to pay dividends at current levels, or at all, because of inadequate future earnings, impairments to goodwill, regulatory restrictions or limitations, and changes in the company's regulatory capital and minimum capital requirements;
- the relatively greater credit risk of commercial real estate loans and construction and land development loans in our loan portfolio;
- unanticipated credit deterioration in our loan portfolio or higher than expected loan losses within one or more segments of our loan portfolio;
- unexpected significant declines in the loan portfolio due to the lack of economic expansion, increased competition, large prepayments, changes in regulatory lending guidance or other factors;
- unanticipated loan delinquencies, loss of collateral, decreased service revenues, and other potential negative effects on our business caused by severe weather or other external events;
- changes in expected income tax expense or tax rates, including changes resulting from revisions in tax laws, regulations and case law;
- our ability to retain the services of key personnel;
- adverse results from current or future litigation, regulatory examinations or other legal and/or regulatory actions, including as a result of the Company's participation in and execution of growth strategies related to the COVID-19 pandemic;
- the impact of the COVID-19 pandemic on the Company's assets, business, cash flows, financial condition, liquidity, prospects and results of operations;
- potential increases in the provision for loan losses resulting from the COVID-19 pandemic; and
- the impact of Tennessee's anti-takeover statutes and certain of our charter provisions on potential acquisitions of us.

These and other factors that could cause results to differ materially from those described in the forward-looking statements can be found in SmartFinancial's most recent annual report on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, in each case filed with or furnished to the Securities and Exchange Commission (the "SEC") and available on the SEC's website (www.sec.gov). Undue reliance should not be placed on forward-looking statements. SmartFinancial disclaims any obligation to update or revise any forward-looking statements contained in this release, which speak only as of the date hereof, whether as a result of new information, future events, or otherwise.

Non-GAAP Financial Measures

Under SEC Regulation G, public companies making disclosures containing financial measures that are not in accordance with GAAP must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure, as well as a statement of the company's reasons for utilizing the non-GAAP financial measure. The SEC has exempted from the definition of non-GAAP financial measures certain commonly used financial measures that are not based on GAAP. However, two non-GAAP financial measures commonly used by financial institutions, namely tax-equivalent net interest income and tax-equivalent net interest margin, have not been specifically exempted by the SEC, and may therefore constitute non-GAAP financial measures under Regulation G. We are unable to state with certainty whether the SEC



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would regard those measures as subject to Regulation G. Management believes that Non-GAAP financial measures provide additional useful information that allows investors to evaluate the ongoing performance of the company and provide meaningful comparisons to its peers. Management believes these non-GAAP financial measures also enhance investors' ability to compare period-to-period financial results and allow investors and company management to view our operating results excluding the impact of items that are not reflective of the underlying operating performance. Non-GAAP financial measures should not be considered as an alternative to any measure of performance or financial condition as promulgated under GAAP, and investors should consider SmartFinancial's performance and financial condition as reported under GAAP and all other relevant information when assessing the performance or financial condition of the company. Non-GAAP financial measures have limitations as analytical tools, and investors should not consider them in isolation or as a substitute for analysis of the results or financial condition as reported under GAAP.

Certain captions and amounts in the prior periods presented were reclassified to conform to the current presentation. Such reclassifications had no effect on net income or shareholders' equity.

Executive Summary

The following is a summary of the Company's financial highlights and significant events during the second quarter and first six months of 2020:

- Completed the acquisition and integration of Progressive Financial Group, Inc. ("PFG").
- Originated approximately 2,800 Paycheck Protection Program ("PPP") loans totaling \$292.8 million during the second quarter of 2020.
- Net income totaled \$6.2 million, or \$0.41 per diluted common share, during the second quarter of 2020 compared to \$9.1 million, or \$0.65 per diluted common share, for the same period in 2019.
- Net income totaled \$8.9 million, or \$0.60 per diluted common share, during the first six months of 2020 compared to \$13.9 million, or \$0.99 per diluted common share, for the same period in 2019.
- Return on average assets was 0.79% at June 30, 2020 compared to 1.56% at June 30, 2019.
- Allowance for loan losses increased to \$16.3 million, an increase of 21.0% from the first quarter of 2020, in response to the current economic conditions related to COVID-19.
- The COVID-19 pandemic has caused economic and social disruption on an unprecedented scale. Congress, the President, and the Federal Reserve have taken several actions designed to combat the fallout. On March 27, 2020, the CARES Act was signed into law. It contained substantial tax and spending provisions intended to address the impact of the COVID-19 pandemic. The CARES Act includes the Paycheck Protection Program ("PPP"), a nearly \$350 billion program designed to aid small- and medium-sized businesses through federally guaranteed loans distributed through banks. These loans were intended to guarantee payroll and other costs to help those businesses remain viable and allow their workers to pay their bills. The initial \$350 billion program was supplemented in late April 2020 with \$310 billion of additional funding. On June 5, 2020, the Paycheck Protection Program Flexibility Act (the "new Act") was signed into law and made significant changes to the PPP to provide additional relief for small businesses. The new Act increased flexibility for small businesses that have been unable to rehire employees due to lack of employee availability or have been unable to operate as normal due to COVID-19. It extended the period that businesses have to use PPP funds to qualify for loan forgiveness to 24 weeks, up from 8 weeks under the original rules. The new Act also relaxed the requirement that businesses must adhere to in order to qualify for loan forgiveness. In addition, the new Act extended the payment deferral period for PPP loans until the date when the amount of loan forgiveness is remitted to the lender. For PPP recipients who do not apply for forgiveness, the loan deferral period is 10 months after the applicable forgiveness period ends. The new Act did not extend the deadline for PPP loans, which closed on June 30, 2020.

Analysis of Results of Operations

Second quarter of 2020 compared to 2019

Net income was \$6.2 million, or \$0.41 per diluted common share, for the second quarter of 2020, compared to \$9.1 million, or \$0.65 per diluted common share, for the second quarter of 2019. The decrease in net income for this period was primarily from the \$6.4 million termination fee recognized in the second quarter of 2019. The tax equivalent net interest margin was 3.63% for the second quarter of 2020 compared to 3.94% for the second quarter of 2019. Noninterest income to average assets was 0.45% for the second quarter of 2020, decreasing from 1.44% for the second quarter of 2019.



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Noninterest expense to average assets decreased to 2.41% in the second quarter of 2020, from 2.88% in the second quarter of 2019. The results above include a full-quarters of operating effects of the PFG acquisition, which was completed on March 1, 2020.

First six months of 2020 compared to 2019

Net income was \$8.9 million, or \$0.60 per diluted common share, for the first six months of 2020, compared to \$13.9 million, or \$0.99 per diluted common share, for the first six months of 2019. The decrease in net income for this period was primarily from the \$6.4 million termination fee recognized in the second quarter of 2019. The tax equivalent net interest margin was 3.75% for the first six months of 2020 compared to 4.04% for the first six months of 2019. Noninterest income to average assets was 0.45% for the first six months of 2020, decreasing from 0.88% for the first six months of 2019. Noninterest expense to average assets decreased to 2.66% in the first six months of 2020, from 2.82% in the first six months of 2019. The results above include a full-quarters of operating effects of the PFG acquisition, which was completed on March 1, 2020.

Net Interest Income and Yield Analysis

Second quarter of 2020 compared to 2019

Net interest income, taxable equivalent, increased to \$25.9 million for the second quarter of 2020, up from \$20.9 million for the second quarter of 2019. Net interest income was positively impacted, compared to the prior year, primarily by the full-quarters effects of the Company's March 1, 2020 acquisition of PFG, the increase in loan balances and the reduction in interest expense on interest bearing liabilities. Average interest-earning assets increased from \$2.13 billion for the second quarter of 2019, to \$2.87 billion for the second quarter of 2020, primarily as a result of the acquisition of PFG being completed on March 1, 2020, and the Company's participation in the PPP. Over this period, average loan balances increased by \$530.2 million, average interest-bearing deposits increased by \$271.3 million, average noninterest-bearing deposits increased \$250.5 million and average borrowings increased \$213.5 million. The tax equivalent net interest margin decreased to 3.63% for the second quarter of 2020, compared to 3.94% for the second quarter of 2019. The yield on earning assets decreased from 5.17% for the second quarter of 2019, to 4.22% for the second quarter of 2020, primarily due to rate cuts by the Federal Reserve over the past year and, to a lesser extent loan yields declining from market competition. The cost of average interest-bearing deposits decreased from 1.42% for the second quarter of 2019, to 0.71% for the second quarter of 2020, primarily due to a lower interest rate environment during the period.



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The following tables summarizes the major components of net interest income and the related yields and costs for the periods presented (*dollars in thousands*):

| | Three Months Ended June 30, | | | | |
|---|-----------------------------|-----------|------------|-----------------|-----------|
| | 2020 | | | 2019 | |
| | Average Balance | Interest | Yield/Rate | Average Balance | Interest |
| Assets: | | | | | |
| Loans, including fees ¹ | \$ 2,359,101 | 28,590 | 4.87 % | \$ 1,828,884 | 25,233 |
| Loans held for sale | 6,868 | 73 | 4.28 % | 3,755 | 45 |
| Taxable securities | 122,135 | 589 | 1.94 % | 136,859 | 871 |
| Tax-exempt securities ² | 86,227 | 570 | 2.66 % | 56,475 | 527 |
| Federal funds sold and other earning assets | 297,696 | 277 | 0.37 % | 102,253 | 743 |
| Total interest-earning assets | 2,872,027 | 30,099 | 4.22 % | 2,128,226 | 27,419 |
| Noninterest-earning assets | 260,089 | | | 215,010 | |
| Total assets | \$ 3,132,116 | | | \$ 2,343,236 | |
| Liabilities and Stockholders' Equity: | | | | | |
| Interest-bearing demand deposits | \$ 453,795 | \$ 148 | 0.13 % | \$ 329,556 | \$ 464 |
| Money market and savings deposits | 748,673 | 614 | 0.33 % | 673,502 | 2,272 |
| Time deposits | 701,390 | 2,604 | 1.49 % | 629,480 | 3,052 |
| Total interest-bearing deposits | 1,903,858 | 3,366 | 0.71 % | 1,632,538 | 5,788 |
| Borrowings | 237,143 | 249 | 0.42 % | 23,685 | 123 |
| Subordinated debt | 39,290 | 584 | 5.98 % | 39,205 | 590 |
| Total interest-bearing liabilities | 2,180,291 | 4,199 | 0.77 % | 1,695,428 | 6,501 |
| Noninterest-bearing deposits | 587,322 | | | 336,871 | |
| Other liabilities | 24,642 | | | 14,367 | |
| Total liabilities | 2,792,255 | | | 2,046,666 | |
| Stockholders' equity | 339,861 | | | 296,570 | |
| Total liabilities and stockholders' equity | \$ 3,132,116 | | | \$ 2,343,236 | |
| Net interest income, taxable equivalent | | \$ 25,900 | | | \$ 20,918 |
| Interest rate spread | | | 3.44 % | | |
| Tax equivalent net interest margin | | | 3.63 % | | |
| Percentage of average interest-earning assets to average interest-bearing liabilities | | | 131.73 % | | |
| Percentage of average equity to average assets | | | 10.85 % | | |

¹Includes nonaccrual loans and accretion income on acquired loans of \$888 thousand and \$1.4 million for the quarters ended June 30, 2020 and 2019, respectively.

²Yields related to investment securities exempt from income taxes are stated on a taxable-equivalent basis assuming a federal income tax rate of 21.0%. The taxable-equivalent adjustment was \$154 thousand for the three month period ended June 30, 2020 and \$116 thousand for the three month period ended June 30, 2019.

First six months of 2020 compared to 2019

Net interest income, taxable equivalent, increased to \$48.6 million for the first six months of 2020, up from \$42.0 million for the first six months of 2019. Net interest income was positively impacted, compared to the prior year, primarily due to increases in loan balances. Average interest-earning assets increased from \$2.10 billion for the first six months of 2019, to \$2.60 billion for the first six months of 2020, primarily as a result of the acquisition of PFG completed March 1, 2020, and continued organic growth. Over this period, average loan balances increased by \$358.0 million, average interest-bearing deposits increased by \$200.9 million, average noninterest-bearing deposits increased \$152.9 million and average borrowings increased \$123.6 million. The tax equivalent net interest margin decreased to 3.75% for the first six months of 2020, compared to 4.04% for the first six months of 2019. The yield on earning assets decreased from 5.23% for the first six months of 2019, to 4.50% for the first six months of 2020, primarily due to rate cuts by the Federal Reserve over the past year and, to a lesser extent loan yields declining from market competition. The cost of average interest-bearing deposits decreased from 1.37% for the first six months of 2019, to 0.90% for the first six months of 2020, primarily due to a lower interest rate environment during the period.

| | Six Months Ended June 30, | | | | |
|---|---------------------------|-----------|-------------|-----------------|-----------|
| | 2020 | | | 2019 | |
| | Average Balance | Interest | Yield/ Cost | Average Balance | Interest |
| Assets: | | | | | |
| Loans, including fees ¹ | \$ 2,172,158 | \$ 54,979 | 5.09 % | \$ 1,814,127 | \$ 50,174 |
| Loans held for sale | 5,581 | 118 | 4.26 % | 3,284 | 79 |
| Taxable Securities | 119,474 | 1,268 | 2.13 % | 141,994 | 1,842 |
| Tax-exempt securities ² | 78,306 | 970 | 2.49 % | 55,070 | 1,065 |
| Federal funds and other earning assets | 226,726 | 879 | 0.78 % | 85,798 | 1,315 |
| Total interest-earning assets | 2,602,245 | 58,214 | 4.50 % | 2,100,273 | 54,475 |
| Noninterest-earning assets | 238,749 | | | 213,122 | |
| Total assets | \$ 2,840,994 | | | \$ 2,313,395 | |
| Liabilities and Stockholders' Equity: | | | | | |
| Interest-bearing demand deposits | \$ 421,288 | 583 | 0.28 % | \$ 318,091 | 887 |
| Money market and savings deposits | 707,003 | 2,003 | 0.57 % | 669,067 | 4,302 |
| Time deposits | 693,382 | 5,534 | 1.61 % | 633,601 | 5,850 |
| Total interest-bearing deposits | 1,821,673 | 8,120 | 0.90 % | 1,620,759 | 11,039 |
| Borrowings | 144,532 | 339 | 0.47 % | 20,951 | 235 |
| Subordinated debt | 39,279 | 1,167 | 5.97 % | 39,195 | 1,173 |
| Total interest-bearing liabilities | 2,005,484 | 9,626 | 0.97 % | 1,680,905 | 12,447 |
| Noninterest-bearing deposits | 481,432 | | | 328,549 | |
| Other liabilities | 22,812 | | | 12,589 | |
| Total liabilities | 2,509,728 | | | 2,022,043 | |
| Stockholders' equity | 331,266 | | | 291,352 | |
| Total liabilities and stockholders' equity | \$ 2,840,994 | | | \$ 2,313,395 | |
| Net interest income, taxable equivalent | | \$ 48,588 | | | \$ 42,028 |
| Interest rate spread | | | 3.53 % | | |
| Tax equivalent net interest margin | | | 3.75 % | | |
| Percentage of average interest-earning assets to average interest-bearing liabilities | | | 129.76 % | | |
| Percentage of average equity to average assets | | | 11.66 % | | |

¹Includes nonaccrual loans and accretion income on acquired loans of \$2.7 million and \$3.3 million for the six months ended June 30, 2020 and 2019, respectively.

²Yields related to investment securities exempt from income taxes are stated on a taxable-equivalent basis assuming a federal income tax rate of 21.0%. The taxable-equivalent adjustment was \$271 thousand for the six month period ended June 30, 2020 and \$229 thousand for the six month period ended June 30, 2019.

Noninterest Income

The following table summarizes noninterest income by category (*in thousands*):

| | Three Months Ended | | Six Month |
|---|--------------------|----------|-----------|
| | 2020 | 2019 | 2020 |
| Service charges on deposit accounts | \$ 709 | \$ 707 | \$ 1,479 |
| Gain on sale of securities, net | 16 | 33 | 16 |
| Mortgage banking | 931 | 392 | 1,515 |
| Investment services | 363 | 255 | 801 |
| Insurance commissions | 473 | — | 742 |
| Interchange and debit card transaction fees | 508 | 143 | 784 |
| Merger termination fee | — | 6,400 | — |
| Other | 511 | 486 | 993 |
| Total noninterest income | \$ 3,511 | \$ 8,416 | \$ 6,330 |

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Second quarter of 2020 compared to 2019

Noninterest income decreased by \$4.9 million, or 58.3%, during the second quarter of 2020 compared to the same period in 2019. This quarterly change in total noninterest income primarily resulted from the following:

- Increase in mortgage banking, from increased volume;
- Increase in investment services, stemming from increased production from personnel hires in 2019;
- Increase in interchange and debit card transaction fees, related to the PFG acquisition;
- Addition of insurance commissions from the PFG acquisition; and
- Increases offset by merger termination fee in the second quarter of 2019.

First six months of 2020 compared to 2019

Noninterest income decreased by \$3.8 million, or 37.4%, during the first six months of 2020 compared to the same period in 2019. This change in total noninterest income primarily resulted from the following:

- Increase in mortgage banking, from increased volume;
- Increase in investment services, stemming from increased production from personnel hires in 2019;
- Increase in interchange and debit card transaction fees, related to the PFG acquisition;
- Addition of insurance commissions from the PFG acquisition; and
- Increases offset by merger termination fee in the second quarter of 2019.

Noninterest Expense

The following table summarizes noninterest expense by category (*in thousands*):

| | Three Months Ended June 30, | | Six Month June |
|--|--------------------------------|------------------|-------------------|
| | 2020 | 2019 | 2020 |
| Salaries and employee benefits | \$ 10,357 | \$ 8,984 | \$ 20,363 |
| Occupancy and equipment | 1,996 | 1,658 | 3,906 |
| FDIC insurance | 180 | 180 | 360 |
| Other real estate and loan related expense | 346 | 242 | 892 |
| Advertising and marketing | 202 | 259 | 400 |
| Data processing | 594 | 577 | 1,132 |
| Professional services | 868 | 489 | 1,578 |
| Amortization of intangibles | 405 | 342 | 767 |
| Software as service contracts | 561 | 568 | 1,031 |
| Merger related and restructuring expenses | 1,477 | 1,796 | 3,573 |
| Other | 1,820 | 1,714 | 3,598 |
| Total noninterest expense | <u>\$ 18,806</u> | <u>\$ 16,809</u> | <u>\$ 37,600</u> |

Second quarter of 2020 compared to 2019

Noninterest expense increased by \$2.0 million, or 11.9%, in the second quarter of 2020 as compared to the same period in 2019. The quarterly increase in total noninterest expense primarily resulted from the following:

- Increase is salary and employee benefits from the acquisition of PFG and the addition of staff throughout 2019;
- Increase in occupancy and equipment associated with ongoing infrastructure and facilities added to accommodate our growth in operations and the additional branches of the PFG acquisition;
- Increase in professional services from increases in legal and auditing services; and
- Offset by a decrease in merger related and restructuring expenses.



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First six months of 2020 compared to 2019

Noninterest expense increased by \$5.2 million, or 16.1%, in the first six months of 2020 as compared to the same period in 2019. The quarterly increase in total noninterest expense primarily resulted from the following:

- Increase in salary and employee benefits from the acquisition of PFG and the addition of staff throughout 2019;
- Increase in occupancy and equipment associated with ongoing infrastructure and facilities added to accommodate our growth in operations and the additional branches of the PFG acquisition;
- Increase in merger related and restructuring expenses from the PFG acquisition.

Taxes

Second quarter of 2020 compared to 2019

In the second quarter of 2020 income tax expense totaled \$1.4 million compared to \$2.9 million a year ago. The effective tax rate was approximately 18.8% in the second quarter of 2020 compared to 24.1% a year ago. The lower effective tax rate for the second quarter of 2020 compared to same quarter in 2019 was due to having a proportionately higher amount of non-taxable income in relation to income before taxes, as well as tax benefit derived from the reconciliation of our tax rates from operations.

First six months of 2020 compared to 2019

In the first six months of 2020 income tax expense totaled \$2.1 million compared to \$4.5 million a year ago. The effective tax rate was approximately 19.0% for first six months of 2020 compared to 24.5% a year ago. The lower effective tax rate for the first six months of 2020 compared to same period in 2019 was due to having a proportionately higher amount of non-taxable income in relation to income before taxes and, as part of the CARES Act legislation, a tax benefit realized from the recognition of net operating loss carryforwards from past acquisitions.

Loan Portfolio

The Company had total net loans outstanding, including organic and purchased loans, of approximately \$2.39 billion at June 30, 2020 compared to \$1.89 billion at December 31, 2019. Loans secured by real estate, consisting of commercial or residential property, are the principal component of our loan portfolio.

Organic Loans

Our organic net loans, which excludes loans purchased through acquisitions, increased by \$406.7 million, or 26.9%, from December 31, 2019, to \$1.92 billion at June 30, 2020. Included in the growth was \$292.8 of PPP loans that were funded/originated during the second quarter of 2020. Total deferred fees associated with the PPP loans was approximately \$11.0 million and \$1.9 million was accreted into income during the quarter ending June 30, 2020.

Purchased Loans

Purchased non-credit impaired loans of \$439.1 million at June 30, 2020 increased by \$90.0 million from December 31, 2019. Since December 31, 2019, our net purchased credit impaired ("PCI") loans increased by \$8.1 million to \$35.0 million at June 30, 2020. The increase in purchased non-credit impaired loans and PCI loans is related to the acquisition of PFG and offset by maturities, paydowns and payoffs.



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The following tables summarize the composition of our loan portfolio for the periods presented (*dollars in thousands*):

| | June 30, 2020 | | | |
|--|---------------------|--|--|---------------------|
| | Organic Loans | Purchased Non-Credit Impaired Loans | Purchased Credit Impaired Loans | Total Amount |
| Commercial real estate-mortgage | \$ 779,131 | \$ 221,385 | \$ 16,517 | \$ 1,017,033 |
| Consumer real estate-mortgage | 296,548 | 151,744 | 11,568 | 459,860 |
| Construction and land development | 247,383 | 25,406 | 6,427 | 279,216 |
| Commercial and industrial | 600,270 | 36,839 | 341 | 637,450 |
| Consumer and other | 9,247 | 5,372 | 106 | 14,725 |
| Total gross loans receivable, net of deferred fees | 1,932,579 | 440,746 | 34,959 | 2,408,284 |
| Allowance for loan losses | (14,590) | (1,664) | — | (16,254) |
| Total loans, net | <u>\$ 1,917,989</u> | <u>\$ 439,082</u> | <u>\$ 34,959</u> | <u>\$ 2,392,030</u> |

| | December 31, 2019 | | | |
|--|---------------------|--|--|---------------------|
| | Organic Loans | Purchased Non-Credit Impaired Loans | Purchased Credit Impaired Loans | Total Amount |
| Commercial real estate-mortgage | \$ 705,691 | \$ 184,360 | \$ 15,255 | \$ 905,306 |
| Consumer real estate-mortgage | 295,915 | 115,026 | 6,541 | 417,482 |
| Construction and land development | 210,421 | 12,747 | 4,458 | 227,626 |
| Commercial and industrial | 306,521 | 30,147 | 407 | 337,075 |
| Consumer and other | 2,817 | 6,760 | 326 | 9,903 |
| Total gross loans receivable, net of deferred fees | 1,521,365 | 349,040 | 26,987 | 1,897,392 |
| Allowance for loan losses | (10,087) | — | (156) | (10,243) |
| Total loans, net | <u>\$ 1,511,278</u> | <u>\$ 349,040</u> | <u>\$ 26,831</u> | <u>\$ 1,887,149</u> |

Loan Portfolio Maturities

The following table sets forth the maturity distribution of our loans at June 30, 2020, including the interest rate sensitivity for loans maturing after one year (*in thousands*):

| | One Year or Less | One through Five Years | Over Five Years | Total | Rate Structure Maturing Over |
|-----------------------------------|---------------------|---------------------------|--------------------|---------------------|---------------------------------|
| | | | | | Fixed Rate |
| Commercial real estate-mortgage | \$ 111,355 | \$ 409,592 | \$ 496,779 | \$ 1,017,726 | \$ 667,884 |
| Consumer real estate-mortgage | 33,994 | 175,642 | 250,224 | 459,860 | 209,176 |
| Construction and land development | 73,826 | 108,435 | 96,955 | 279,216 | 101,257 |
| Commercial and industrial | 68,536 | 481,552 | 88,940 | 639,028 | 526,982 |
| Consumer and other | 4,601 | 7,710 | 143 | 12,454 | 7,479 |
| Total Loans | <u>\$ 292,312</u> | <u>\$ 1,182,931</u> | <u>\$ 933,041</u> | <u>\$ 2,408,284</u> | <u>\$ 1,512,778</u> |

Nonaccrual, Past Due, and Restructured Loans

Nonperforming loans as a percentage of total gross loans, net of deferred fees, was 0.16% as of June 30, 2020, which decreased from 0.18% as of December 31, 2019. Total nonperforming assets as a percentage of total assets as of June 30, 2020 totaled 0.28% compared to 0.21% as of December 31, 2019. The increase was primarily the result of the addition of other real estate owned from the PFG acquisition. Acquired PCI loans that are included in loan pools are reclassified at acquisition to accrual status and thus are not included as nonperforming assets.

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The following table summarizes the Company's nonperforming assets for the periods presented (*in thousands*):

| | June 30, 2020 | I |
|---|------------------|----|
| Nonaccrual loans | \$ 2,899 | \$ |
| Accruing loans past due 90 days or more | 877 | \$ |
| Total nonperforming loans | 3,776 | \$ |
| Other real estate owned | 5,524 | \$ |
| Total nonperforming assets | \$ 9,300 | \$ |
| Restructured loans not included above | \$ 9 | \$ |

Potential Problem Loans

At June 30, 2020 potential problem loans amounted to approximately \$551 thousand or 0.02% of total loans outstanding. Potential problem loans, which are not included in nonperforming loans, represent those loans with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have doubts about the borrower's ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by the Bank's primary regulators for loans classified as substandard or worse, but not considered nonperforming loans.

COVID-19 Loan Modifications

As a result of the CARES Act, the Company began offering short-term loan modifications to assist borrowers during the COVID-19 pandemic. At June 30, 2020, COVID-19 modified loans amounted to \$616.7 million, or 25.6% of the total loans outstanding.

The Company offered deferrals options of: 1) three months deferral of payment and then three months of interest only, 2) three months of interest only, 3) three months deferral of payment, 4) six months of interest only, and expects \$340.6 million to mature during the third quarter of 2020, with the remainder of the balance maturing during the fourth quarter of 2020.

Included in the COVID-19 modified loans were \$145.4 million and \$69.3 million of hospitality and restaurant loans, respectively. These sectors had increased vulnerability from COVID-19. At June 30, 2020, the short-term loan modifications were still expected to mature on the original maturity schedule. All of the COVID-19 modified loans were transitioned into watchlist categories internally.

Allocation of the Allowance for Loan Losses

We maintain the allowance at a level that we deem appropriate to adequately cover the probable losses inherent in the loan portfolio. Our provision for loan losses for the six months ended June 30, 2020, is \$6.1 million compared to \$1.2 million in the same period of 2019, an increase of \$4.9 million. As of June 30, 2020, and December 31, 2019, our allowance for loan losses was \$16.3 million and \$10.2 million, respectively, which we deemed to be adequate at each of the respective dates. The increase in the allowance for loan losses at June 30, 2020, as compared to December 31, 2019, is primarily due to the deterioration in the qualitative factors, such as unemployment and GDP, in our loan loss allowance methodology caused by the economic conditions related to the challenges being faced with the world wide COVID-19 pandemic. Our allowance for loan loss as a percentage of total loans was 0.67% at June 30, 2020 and 0.54% at December 31, 2019.

Our purchased loans were recorded at fair value upon acquisition. The fair value adjustments on the performing purchased loans will be accreted into income over the life of the loans. A provision for loan losses is recorded for any deterioration in these loans subsequent to the acquisition. As of June 30, 2020, the notional balances on PCI loans was \$48.8 million while the carrying value was \$35.0 million. At June 30, 2020, there were no loan loss allowances on PCI loans.



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The following table sets forth, based on our best estimate, the allocation of the allowance to types of loans for the periods presented, and the percentage of loans in each category to total loans (*dollars in thousands*):

| | June 30, 2020 | | December 31, | |
|-----------------------------------|---------------|---------|--------------|--|
| | Amount | Percent | Amount | |
| Commercial real estate-mortgage | \$ 6,595 | 42.2 % | \$ 4,508 | |
| Consumer real estate-mortgage | 3,313 | 19.1 % | 2,576 | |
| Construction and land development | 1,795 | 11.6 % | 1,127 | |
| Commercial and industrial | 4,443 | 26.5 % | 1,957 | |
| Consumer and other | 108 | 0.6 % | 75 | |
| Total allowance for loan losses | \$ 16,254 | 100.0 % | \$ 10,243 | |

The allocation by category is determined based on the loans individually assigned risk rating, if applicable, and environmental factors applicable to each category of loans. For impaired loans, those loans are reviewed for a specific allowance allocation. Specific valuation allowances related to impaired, non PCI, loans were approximately \$475 thousand at December 31, 2019 compared to \$465 thousand at June 30, 2020.

Analysis of the Allowance for Loan Losses

The following is a summary of changes in the allowance for loan losses for the periods presented including the ratio of the allowance for loan losses to total loans as of the end of each period (*dollars in thousands*):

| | Three Months Ended June 30, | | Six Months Ended June | |
|--|-----------------------------|----------|-----------------------|-----------|
| | 2020 | 2019 | 2020 | 2019 |
| Balance at beginning of period | \$ 13,431 | \$ 8,704 | \$ 10,243 | \$ 10,243 |
| Provision for loan losses | 2,850 | 393 | 6,049 | — |
| Charged-off loans: | | | | |
| Commercial real estate-mortgage | — | — | — | — |
| Consumer real estate-mortgage | — | — | (2) | — |
| Construction and land development | — | — | — | — |
| Commercial and industrial | (9) | (14) | (17) | — |
| Consumer and other | (66) | (80) | (142) | — |
| Total charged-off loans | (75) | (94) | (161) | — |
| Recoveries of previously charged-off loans: | | | | |
| Commercial real estate-mortgage | 3 | 22 | 5 | — |
| Consumer real estate-mortgage | 11 | 16 | 17 | — |
| Construction and land development | — | 2 | 2 | — |
| Commercial and industrial | 6 | 41 | 49 | — |
| Consumer and other | 28 | 13 | 50 | — |
| Total recoveries of previously charged-off loans | 48 | 94 | 123 | — |
| Net loan charge-offs | (27) | — | (38) | — |
| Balance at end of period | \$ 16,254 | \$ 9,097 | \$ 16,254 | \$ 10,243 |
| Ratio of allowance for loan losses to total loans outstanding at end of period | 0.67 % | 0.50 % | 0.67 % | 0.67 % |
| Ratio of net loan charge-offs to average loans outstanding for the period (annualized) | — % | — % | — % | — % |

We assess the adequacy of the allowance at the end of each calendar quarter. This assessment includes procedures to estimate the allowance and test the adequacy and appropriateness of the resulting balance. The level of the allowance is based upon our evaluation of the loan portfolio, past loan loss experience, known and inherent risks in the portfolio, the views of the Bank's regulators, adverse situations that may affect borrowers' ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indications and other pertinent factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change.

Securities Portfolio

Our securities portfolio, consisting primarily of Federal agency bonds, state and municipal securities, and mortgage-backed securities, amounted to fair values of \$219.6 million and \$178.3 million at June 30, 2020 and December 31, 2019, respectively. Our investments to assets ratio decreased from 7.3% at December 31, 2019 to 6.7% at June 30, 2020. Our securities portfolio serves many purposes including serving as a potential liquidity source, collateral for public funds, and as a stable source of income. All of the Company's securities are designated as available-for-sale.

The following table shows the amortized cost of the Company's securities by investment categories (*in thousands*):

| | June 30, 2020 | I |
|--|-------------------|-----------|
| U.S. Government-sponsored enterprises (GSEs) | \$ 31,337 | \$ |
| Municipal securities | 86,469 | |
| Other debt securities | 9,463 | |
| Mortgage-backed securities | 88,913 | |
| Total securities | \$ 216,182 | \$ |

The following table presents the contractual maturity of the Company's securities by contractual maturity date and average yields based on amortized cost (for all obligations on a fully taxable basis) at June 30, 2020. The composition and maturity / repricing distribution of the securities portfolio is subject to change depending on rate sensitivity, capital and liquidity needs (*dollars in thousands*):

| | Maturity By Years | | | |
|---------------------------------------|-------------------|-----------------|------------------|-------------------|
| | 1 or Less | 1 to 5 | 5 to 10 | Over 10 |
| U.S. Government agencies | \$ — | \$ 149 | \$ 17,473 | \$ 13,715 |
| State and political subdivisions | 440 | 2,743 | 6,338 | 76,950 |
| Other debt securities | — | 982 | 8,480 | — |
| Mortgage-backed securities | — | 4,156 | 13,340 | 71,416 |
| Total securities | \$ 440 | \$ 8,030 | \$ 45,631 | \$ 162,081 |
| Weighted average yield ⁽¹⁾ | 1.65 % | 1.50 % | 2.58 % | 2.53 % |

(1) Based on amortized cost, taxable equivalent basis

Deposits

Deposits are the primary source of funds for the Company's lending and investing activities. The Company provides a range of deposit services to businesses and individuals, including noninterest-bearing checking accounts, interest-bearing checking accounts, savings accounts, money market accounts, IRAs and CDs. These accounts generally earn interest at rates the Company establishes based on market factors and the anticipated amount and timing of funding needs. The establishment or continuity of a core deposit relationship can be a factor in loan pricing decisions. While the Company's primary focus is on establishing customer relationships to attract core deposits, at times, the Company uses brokered deposits and other wholesale deposits to supplement its funding sources. As of June 30, 2020, brokered deposits represented approximately 7.7% of total deposits.

The Company believes its deposit product offerings are properly structured to attract and retain core low-cost deposit relationships. The average cost of interest-bearing deposits for the three months ended June 30, 2020 was 0.71% compared to 1.42% for the same period in 2019 and 0.90% and 1.37% for the six months ended June 30, 2020 and June 2019, respectively. The decreased cost of interest-bearing deposits was due to changes in rates caused by federal rate-changes during the periods.

Total deposits as of June 30, 2020 were \$2.5 billion, which was an increase of \$492.5 million from December 31, 2019. This increase was primarily from the completed acquisition of PFG and deposits related to the PPP loans. As of June 30,

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2020, the Company had outstanding time deposits under \$250,000 with balances of \$512.1 million and time deposits over \$250,000 with balances of \$140.5 million.

The following table summarizes the maturities of time deposits \$250,000 or more (*in thousands*).

| | |
|-------------------------|----|
| Three months or less | \$ |
| Three to six months | |
| Six to twelve months | |
| More than twelve months | |
| Total | \$ |

Borrowings

The Company uses short-term borrowings and long-term debt to provide both funding and, to a lesser extent, regulatory capital using debt at the Company level which can be downstemed as Tier 1 capital to the Bank. Borrowings totaled \$318.9 million at June 30, 2020, and primarily consisted of \$75.0 million in FHLB borrowings, \$237.8 million from the PPPLF and short-term borrowings totaled \$5.7 million and consisted entirely of securities sold under repurchase agreements. Long-term debt totaled \$39.3 million at June 30, 2020 and December 31, 2019, respectively and consisted entirely of subordinated debt. For more information regarding our borrowings, see "Part I - Item 1. Consolidated Financial Statements - Note 7 – Borrowings and Line of Credit."

Capital Resources

The Company uses leverage analysis to examine the potential of the institution to increase assets and liabilities using the current capital base. The key measurements included in this analysis are the Bank's Common Equity Tier 1 capital, Tier 1 capital, leverage and total capital ratios. At June 30, 2020 and December 31, 2019, our capital ratios, including our Bank's capital ratios, exceeded regulatory minimum capital requirements. From time to time we may be required to support the capital needs of our bank subsidiary. We believe we have various capital raising techniques available to us to provide for the capital needs of our bank, if necessary. For more information regarding our capital, leverage and total capital ratios, see "Part I - Item 1. Consolidated Financial Statements - Note 13 - Regulatory Matters."

Liquidity and Off-Balance Sheet Arrangements

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing and depository needs of its customers. At June 30, 2020, we had \$506.7 million of pre-approved but unused lines of credit and \$6.5 million of standby letters of credit. These commitments generally have fixed expiration dates and many will expire without being drawn upon. The total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, the Bank has the ability to liquidate Federal funds sold or securities available-for-sale, or on a short-term basis to borrow and purchase Federal funds from other financial institutions. For more information regarding our off-balance sheet arrangements, see "Part I - Item 1. Consolidated Financial Statements - Note 9 – Commitments and Contingent Liabilities."

Market Risk and Liquidity Risk Management

The Bank's Asset Liability Management Committee ("ALCO") is responsible for making decisions regarding liquidity and funding solutions based upon approved liquidity, loan, capital and investment policies. The ALCO must consider interest rate sensitivity and liquidity risk management when rendering a decision on funding solutions and loan pricing. To assist in this process the Bank has contracted with an independent third party to prepare quarterly reports that summarize several key asset-liability measurements. In addition, the third party will also provide recommendations to the Bank's ALCO regarding future balance sheet structure, earnings and liquidity strategies. Two critical areas of focus for ALCO are interest rate sensitivity and liquidity risk management.



Interest Rate Sensitivity

Interest rate sensitivity refers to the responsiveness of interest-earning assets and interest-bearing liabilities to changes in market interest rates. In the normal course of business, we are exposed to market risk arising from fluctuations in interest rates. ALCO measures and evaluates the interest rate risk so that we can meet customer demands for various types of loans and deposits. ALCO determines the most appropriate amounts of on-balance sheet and off-balance sheet items. The primary measurements we use to help us manage interest rate sensitivity are an earnings simulation model and an economic value of equity model. These measurements are used in conjunction with competitive pricing analysis and are further described below.

Earnings Simulation Model We believe interest rate risk is effectively measured by our earnings simulation modeling. Earning assets, interest-bearing liabilities and off-balance sheet financial instruments are combined with simulated forecasts of interest rates for the next 12 months and 24 months. To limit interest rate risk, we have guidelines for our earnings at risk which seek to limit the variance of net interest income in instantaneous changes to interest rates. We also periodically monitor simulations based on various rate scenarios such as non-parallel shifts in market interest rates over time. For changes up or down in rates from our dynamic interest rate forecast over the next 12 and 24 months, limits in the decline in net interest income are as follows:

| June 30, 2020: | Estimated % Change in Net Interest Income Over 12 Months | | Maximum Percentage in Net Interest Income from the Base Case Projection of Net Interest Income |
|---|--|------------|--|
| | Increase + | Decrease - | Next 12 Months |
| An instantaneous, parallel rate increase or decrease of the following at the beginning of the second quarter: | | | |
| ± 100 basis points | 3.13% | 0.50% | 8% |
| ± 200 basis points | 4.86% | 0.65% | 14% |

Economic Value of Equity Our economic value of equity model measures the extent that estimated economic values of our assets, liabilities and off-balance sheet items will change as a result of interest rate changes. Economic values are determined by discounting expected cash flows from assets, liabilities and off-balance sheet items, which establishes a base case economic value of equity.

To help monitor our related risk, we've established the following policy limits regarding simulated changes in our economic value of equity:

| June 30, 2020: | Current Estimated Instantaneous Rate Change | | Economic Value |
|---|---|------------|----------------|
| | Increase + | Decrease - | |
| Instantaneous, Parallel Change in Prevailing Interest Rates Equal to: | | | |
| ±100 basis points | 4.85% | (4.27)% | |
| ±200 basis points | 5.20% | 13.51% | |

At June 30, 2020, our model results indicated that we were within these policy limits.



Liquidity Risk Management

The purpose of liquidity risk management is to ensure that there are sufficient cash flows to satisfy loan demand, deposit withdrawals, and our other needs. Traditional sources of liquidity for a bank include asset maturities and growth in core deposits. A bank may achieve its desired liquidity objectives from the management of its assets and liabilities and by internally generated funding through its operations. Funds invested in marketable instruments that can be readily sold and the continuous maturing of other earning assets are sources of liquidity from an asset perspective. The liability base provides sources of liquidity through attraction of increased deposits and borrowing funds from various other institutions.

Changes in interest rates also affect our liquidity position. We currently price deposits in response to market rates and intend to continue this policy. If deposits are not priced in response to market rates, a loss of deposits could occur which would negatively affect our liquidity position.

Scheduled loan payments are a relatively stable source of funds, but loan payoffs and deposit flows fluctuate significantly, being influenced by interest rates, general economic conditions and competition. Additionally, debt security investments are subject to prepayment and call provisions that could accelerate their payoff prior to stated maturity. We attempt to price our deposit products to meet our asset/liability objectives consistent with local market conditions. Our ALCO is responsible for monitoring our ongoing liquidity needs. Our regulators also monitor our liquidity and capital resources on a periodic basis.

The Company has \$440 thousand in investments that mature throughout the next 12 months. The Company also anticipates \$22.7 million of principal payments from mortgage-backed securities over the same period. The Company also has unused borrowing capacity in the amount of \$312.2 million available with the Federal Reserve, FHLB, several correspondent banks and a line of credit. With these sources of funds, the Company currently anticipates adequate liquidity to meet the expected obligations of its customers.



ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

This item is not required for a Smaller Reporting Company.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of management, including SmartFinancial's Chief Executive Officer and Chief Financial Officer, SmartFinancial has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of June 30, 2020 (the "Evaluation Date"). Based on such evaluation, SmartFinancial's Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, SmartFinancial's disclosure controls and procedures were effective to ensure that information required to be disclosed by SmartFinancial in the reports that it files or submits under the Exchange Act is (i) accumulated and communicated to SmartFinancial's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decision regarding the required disclosure and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

There were no changes in SmartFinancial's internal control over financial reporting during SmartFinancial's fiscal quarter ended June 30, 2020 that have materially affected, or are reasonably likely to materially affect, SmartFinancial's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

SmartFinancial, Inc. and its wholly owned subsidiary, SmartBank, are periodically involved as a plaintiff or a defendant in various legal actions in the ordinary course of business. While the outcome of these matters is not currently determinable, management does not expect the disposition of any of these matters to have a material adverse impact on the Company's financial condition, financial statements or results of operations.

Item 1A. Risk Factors.

The Company disclosed risk factors in its Annual Report on Form 10-K for the year ended December 31, 2019. The risks described may not be the only risks facing us. Additional risks and uncertainties not currently known to us or that are currently considered to not be material also may materially adversely affect our business, financial condition, and/or operating results. The following risk factors have been included in this Quarterly Report on Form 10-Q in response to the global market disruptions that have resulted from the COVID-19 pandemic.

The ongoing COVID-19 pandemic and measures implemented to prevent its spread could have a material adverse effect on our business, results of operations and financial condition, and such effects will depend on future developments, which are highly uncertain and are difficult to predict.

Global health concerns relating to the COVID-19 outbreak and related government actions taken to reduce the spread of the virus have been weighing on the macroeconomic environment, and the outbreak has significantly increased economic uncertainty and reduced economic activity. The outbreak has resulted in authorities implementing numerous measures to try to contain the virus, such as travel bans and restrictions, quarantines, shelter in place or total lock-down orders and business limitations and shutdowns. Such measures have significantly contributed to rising unemployment and negatively impacted consumer and business spending. The United States government has taken steps to attempt to mitigate some of the more severe anticipated economic effects of the virus, including the passage of the CARES Act, but there can be no assurance that such steps will be effective or achieve their desired results in a timely fashion.

The outbreak has adversely impacted and is likely to further adversely impact our workforce and operations and the operations of our borrowers, customers and business partners. In particular, we may experience financial losses due to a number of operational factors impacting us or our borrowers, customers or business partners, including but not limited to:

- credit losses resulting from financial stress being experienced by our borrowers as a result of the outbreak and related governmental actions, particularly in the hospitality, energy, industries;
- declines in collateral values;
- third party disruptions, including outages at network providers and other suppliers;
- increased cyber and payment fraud risk, as cybercriminals attempt to profit from the disruption, given increased online and remote activity;
- risk of litigation or other third-party claims, including with respect to our participation in the Payroll Protection Program and any other government-sponsored stimulus programs; and
- operational failures due to changes in our normal business practices necessitated by the outbreak and related governmental actions.

These factors may remain prevalent for a significant period of time and may continue to adversely affect our business, results of operations and financial condition even after the COVID-19 outbreak has subsided.

The spread of COVID-19 has caused us to modify our business practices (including restricting employee travel, and developing work from home and social distancing plans for our employees), and we may take further actions as may be required by government authorities or as we determine are in the best interests of our employees, customers and business partners. There is no certainty that such measures will be sufficient to mitigate the risks posed by the virus or will otherwise be satisfactory to government authorities.



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The extent to which the coronavirus outbreak impacts our business, results of operations and financial condition will depend on future developments, which are highly uncertain and are difficult to predict, including, but not limited to, the duration and spread of the outbreak, its severity, the actions to contain the virus or treat its impact, and how quickly and to what extent normal economic and operating conditions can resume. Even after the COVID-19 outbreak has subsided, we may continue to experience materially adverse impacts to our business as a result of the virus's global economic impact, including the availability of credit, adverse impacts on our liquidity and any recession that has occurred or may occur in the future.

There are no comparable recent events that provide guidance as to the effect the spread of COVID-19 as a global pandemic may have, and, as a result, the ultimate impact of the outbreak is highly uncertain and subject to change. We do not yet know the full extent of the impacts on our business, our operations or the global economy as a whole. However, the effects could have a material impact on our results of operations and heighten many of our known risks described in the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2019.

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

- (a) Not applicable
- (b) Not applicable
- (c) Issuer Purchases of Registered Equity Securities

On November 20, 2018, the Company announced that its board of directors has authorized a stock repurchase plan pursuant to which the Company may purchase up to \$10.0 million in shares of the Company's outstanding common stock. Stock repurchases under the plan will be made from time to time in the open market, at the discretion of the management of the Company, and in accordance with applicable legal requirements. The stock repurchase plan does not obligate the Company to repurchase any dollar amount or number of shares, and the program may be extended, modified, amended, suspended, or discontinued at any time. As of June 30, 2020, we have purchased \$2.1 million of the authorized \$10.0 million and may purchase up to an additional \$7.9 million in the Company's outstanding common stock.

The following table summarizes the Company's repurchase activity during the three months ended June 30, 2020.

| Period | Total Number of Shares Repurchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | |
|---------------------------------|------------------------------------|------------------------------|--|----|
| April 1, 2020 to April 30, 2020 | 5,976 | \$ 13.99 | 5,976 | \$ |
| May 1, 2020 to May 31, 2020 | — | — | — | — |
| June 1, 2020 to June 30, 2020 | — | — | — | — |
| Total | 5,976 | \$ 13.99 | 5,976 | \$ |

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not Applicable.

Item 5. Other Information.

None.



Item 6. Exhibits

| Exhibit No. | Description | Location |
|-------------|--|---|
| 3.1 | Second Amended and Restated Charter of SmartFinancial, Inc. | Incorporated by reference to Exhibit 3.3 to Form 8-K filed 2/15/2015 |
| 3.2 | Second Amended and Restated Bylaws of SmartFinancial, Inc. | Incorporated by reference to Exhibit 3.1 to Form 8-K filed 2/15/2015 |
| 10.1 | Loan and Security Agreement, dated as of March 30, 2020, by and between SmartFinancial, Inc., as Borrower, and ServisFirst Bank, as Lender | Incorporated by reference to Exhibit 10.1 to Form 8-K filed 3/30/2020 |
| 10.2 | Revolving Note, dated as of March 30, 2020, by and between SmartFinancial, Inc., as Borrower, and ServisFirst Bank, as Lender | Incorporated by reference to Exhibit 10.2 to Form 8-K filed 3/30/2020 |
| 10.3 | Pledge Agreement, dated as of March 30, 2020, by and between SmartFinancial, Inc., as Borrower, and ServisFirst Bank, as Lender | Incorporated by reference to Exhibit 10.3 to Form 8-K filed 3/30/2020 |
| 31.1 | Certification pursuant to Rule 13a -14(a)/15d-14(a) | Filed herewith. |
| 31.2 | Certification pursuant to Rule 13a -14(a)/15d-14(a) | Filed herewith. |
| 32.1 | Certification pursuant to 18 USC Section 1350 -Sarbanes-Oxley Act of 2002 | Furnished herewith. |
| 32.2 | Certification pursuant to 18 USC Section 1350 -Sarbanes-Oxley Act of 2002 | Furnished herewith. |
| 101 | Interactive Data Files (formatted as Inline XBRL) | Filed herewith. |
| 104 | Cover Page Interactive Data File (Formatted as Inline XBRL and contained in Exhibit 101) | Filed herewith |

Certain schedules and similar attachments have been omitted pursuant to Item 601(a)(5) of Regulation S-K. The registrant will furnish a copy of any omitted schedule to the Securities and Exchange Commission upon request.

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.

| | | |
|-------|-----------------|---|
| Date: | August 10, 2020 | SmartFinancial, Inc. <u>/s/ William Y. Carroll, Jr.</u> William Y. Carroll, Jr. President and Chief Executive Officer (principal executive officer) |
| Date: | August 10, 2020 | <u>/s/ Ronald J. Gorczynski</u> Ronald J. Gorczynski Executive Vice President and Chief Financial Officer (principal financial officer and accounting officer) |

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Section 2: EX-31.1 (EX-31.1)

EXHIBIT 31.1

CERTIFICATION

I, William Y. Carroll, certify that:

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

Date: August 10, 2020

/s/ William Y. Carroll
William Y. Carroll
President and Chief Executive Officer

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Section 3: EX-31.2 (EX-31.2)

EXHIBIT 31.2

CERTIFICATION

I, Ronald J. Gorczynski, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SmartFinancial, Inc. (the "Registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

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

Date: August 10, 2020

/s/ Ronald J. Gorczynski
Ronald J. Gorczynski
Executive Vice President and Chief Financial Officer

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Section 4: EX-32.1 (EX-32.1)

EXHIBIT 32.1

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

In connection with the Quarterly Report of SmartFinancial, Inc., (the "Company") on Form 10-Q for the quarter ended June 30, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William Y. Carroll, Jr., President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 10, 2020

/s/ William Y. Carroll, Jr.
William Y. Carroll, Jr.
President and Chief Executive Officer

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Section 5: EX-32.2 (EX-32.2)

EXHIBIT 32.2

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

In connection with the Quarterly Report of SmartFinancial, Inc., (the "Company") on Form 10-Q for the quarter ended June 30, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ronald J. Gorczynski, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 10, 2020

/s/ Ronald J. Gorczynski
Ronald J. Gorczynski
Executive Vice President and Chief Financial Officer

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