

CVB FINANCIAL CORP  
Form 10-Q  
November 09, 2018  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D. C. 20549**  
**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2018

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-10140

**CVB FINANCIAL CORP.**

(Exact name of registrant as specified in its charter)

**California**  
(State or other jurisdiction of  
Incorporation or organization)

**701 North Haven Ave., Suite 350**  
**Ontario, California**  
(Address of principal executive  
offices)

**95-3629339**  
(I.R.S. Employer  
Identification No.)

**91764**  
(Zip Code)

**(909) 980-4030**

(Registrant's telephone number,  
including area code)

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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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

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

Number of shares of common stock of the registrant: 140,333,375 outstanding as of October 31, 2018.

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*Certain matters set forth herein (including the exhibits hereto) constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including forward-looking statements relating to the Company's current business plans and expectations and our future financial position and operating results. Words such as will likely result, aims, anticipates, believes, could, estimates, expects, hopes, intends, may, plans, projects, seeks, should, will, strategy, possibility, and variations of these words and similar expressions help to identify these forward looking statements, which involve risks and uncertainties. These forward-looking statements are subject to risks and uncertainties that could cause actual results, performance and/or achievements to differ materially from those projected. These risks and uncertainties include, but are not limited to:*

*local, regional, national and international economic and market conditions and events and the impact they may have on us, our customers and our assets and liabilities;*

*our ability to attract deposits and other sources of funding or liquidity;*

*supply and demand for real estate and periodic deterioration in real estate prices and/or values in California or other states where we lend, including both residential and commercial real estate;*

*a prolonged slowdown or decline in real estate construction, sales or leasing activities;*

*changes in the financial performance and/or condition of our borrowers, key vendors or counterparties;*

*changes in our levels of delinquent loans, nonperforming assets, allowance for loan losses and charge-offs;*

*the costs or effects of mergers, acquisitions or dispositions we may make, including the recent merger of Community Bank with and into Citizens Business Bank, whether we are able to obtain any required governmental approvals in connection with any such mergers, acquisitions or dispositions, and/or our ability to realize the contemplated financial or business benefits, including any anticipated cost savings or synergies, associated with any such mergers, acquisitions or dispositions;*

*the effect of changes in laws, regulations and applicable judicial decisions (including laws, regulations and judicial decisions concerning financial reforms, taxes, bank capital levels, consumer, commercial or secured lending, securities and securities trading and hedging, compliance, fair lending, employment, executive compensation, insurance, vendor management and information privacy and security) with which we and our subsidiaries must comply or believe we should comply, including additional legal and regulatory requirements to which we have or will become subject as a result of our total assets exceeding \$10 billion, which first occurred in the third quarter of 2018 due to the closing of our merger transaction with Community Bank;*

*changes in estimates of future reserve requirements and minimum capital requirements based upon the periodic review thereof under relevant regulatory and accounting requirements, including changes in the Basel Committee framework establishing capital standards for credit, operations and market risk;*

*the accuracy of the assumptions and estimates and the absence of technical error in implementation or calibration of models used to estimate the fair value of financial instruments or expected credit losses;*

*inflation, interest rate, securities market and monetary fluctuations;*

*changes in government interest rates or monetary or tax policies;*

*changes in the amount and availability of deposit insurance;*  
*political developments, uncertainties or instability;*  
*disruptions in the infrastructure that supports our business and the communities where we are located,*  
*which are concentrated in California, involving or related to physical site access, cyber incidents,*  
*terrorist and political activities, disease pandemics, catastrophic events, natural disasters such as*  
*earthquakes, extreme weather events, electrical, facilities, computer servers, and communications or*  
*other services we use, or that affect our employees or third parties with whom we conduct business;*  
*our timely development and acceptance of new banking products and services and the perceived*  
*overall value of these products and services by customers and potential customers;*  
*the Company's relationships with and reliance upon outside vendors with respect to certain of the*  
*Company's key internal and external systems and applications;*  
*changes in commercial or consumer spending, borrowing and savings preferences or behaviors;*

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*technological changes and the expanding use of technology in banking (including the adoption of mobile banking, funds transfer applications and electronic marketplaces for loans and other banking products or services);*

*our ability to retain and increase market share, retain and grow customers and control expenses;*

*changes in the competitive environment among financial and bank holding companies, banks and other financial service providers;*

*competition and innovation with respect to financial products and services by banks, financial institutions and non-traditional providers including retail businesses and technology companies;*

*volatility in the credit and equity markets and its effect on the general economy or local or regional business conditions;*

*fluctuations in the price of the Company's common stock or other securities, and the resulting impact on the Company's ability to raise capital or make acquisitions;*

*the effect of changes in accounting policies and practices, as may be adopted from time-to-time by the regulatory agencies, as well as by the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard-setters;*

*changes in our organization, management, compensation and benefit plans, and our ability to retain or expand our workforce, management team and/or board of directors;*

*the costs and effects of legal, compliance and regulatory actions, changes and developments, including the initiation and resolution of legal proceedings (such as securities, bank operations, consumer or employee class action litigation and any litigation which we inherited from our recent merger with Community Bank);*

*regulatory or other governmental inquiries or investigations, and/or the results of regulatory examinations or reviews;*

*our ongoing relations with our various federal and state regulators, including the SEC, Federal Reserve Board, FDIC and California DBO;*

*our success at managing the risks involved in the foregoing items; and*

*all other factors set forth in the Company's public reports including its Annual Report on Form 10-K for the year ended December 31, 2017, and particularly the discussion of risk factors within that document.*

*The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements except as required by law. Any statements about future operating results, such as those concerning accretion and dilution to the Company's earnings or shareholders, are for illustrative purposes only, are not forecasts, and actual results may differ.*

**Table of Contents****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
CVB FINANCIAL CORP. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS***(Dollars in thousands, except share amounts)**(Unaudited)*

|  | <b>September 30,<br/>2018</b> | <b>December 31,<br/>2017</b> |
|--|-------------------------------|------------------------------|
| <b>Assets</b>  |                               |                              |
| Cash and due from banks  | \$ 174,083                    | \$ 119,841                   |
| Interest-earning balances due from Federal Reserve   | 20,392                        | 24,536                       |
| Total cash and cash equivalents  | 194,475                       | 144,377                      |
| Interest-earning balances due from depository institutions   | 8,812                         | 17,952                       |
| Investment securities available-for-sale, at fair value (with amortized cost of \$1,850,723 at September 30, 2018, and \$2,078,131 at December 31, 2017) | 1,806,231                     | 2,080,985                    |
| Investment securities held-to-maturity (with fair value of \$726,755 at September 30, 2018, and \$819,215 at December 31, 2017)                          | 759,029                       | 829,890                      |
| Total investment securities  | 2,565,260                     | 2,910,875                    |
| Investment in stock of Federal Home Loan Bank (FHLB)   | 17,688                        | 17,688                       |
| Loans and lease finance receivables  | 7,582,459                     | 4,830,631                    |
| Allowance for loan losses  | (60,007)                      | (59,585)                     |
| Net loans and lease finance receivables  | 7,522,452                     | 4,771,046                    |
| Premises and equipment, net  | 59,256                        | 46,166                       |
| Bank owned life insurance (BOLI)   | 219,561                       | 146,486                      |
| Accrued interest receivable  | 30,097                        | 22,704                       |
| Intangibles  | 56,643                        | 6,838                        |
| Goodwill   | 662,888                       | 116,564                      |
| Other real estate owned (OREO)   | 420                           | 4,527                        |
| Income taxes   | 75,432                        | 40,046                       |
| Other assets   | 67,357                        | 25,317                       |
| <b>Total assets</b>  | <b>\$ 11,480,341</b>          | <b>\$ 8,270,586</b>          |

**Liabilities and Stockholders Equity**

Liabilities:

Deposits:

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|                                |                  |                  |
|--------------------------------|------------------|------------------|
| Noninterest-bearing            | \$ 5,224,154     | \$ 3,846,436     |
| Interest-bearing               | 3,885,672        | 2,700,417        |
| <b>Total deposits</b>          | <b>9,109,826</b> | <b>6,546,853</b> |
| Customer repurchase agreements | 399,477          | 553,773          |
| Other borrowings               | 30,000           | -                |
| Deferred compensation          | 19,159           | 18,223           |
| Junior subordinated debentures | 25,774           | 25,774           |
| Other liabilities              | 77,525           | 56,697           |
| <b>Total liabilities</b>       | <b>9,661,761</b> | <b>7,201,320</b> |

**Commitments and Contingencies**

**Stockholders Equity**

|  |                      |                     |
|--|----------------------|---------------------|
| Common stock, authorized, 225,000,000 shares without par; issued and outstanding 140,334,671 at September 30, 2018, and 110,184,922 at December 31, 2017 | 1,299,052            | 573,453             |
| Retained earnings  | 552,343              | 494,361             |
| Accumulated other comprehensive (loss) income, net of tax  | (32,815)             | 1,452               |
| <b>Total stockholders equity</b>   | <b>1,818,580</b>     | <b>1,069,266</b>    |
| <b>Total liabilities and stockholders equity</b>   | <b>\$ 11,480,341</b> | <b>\$ 8,270,586</b> |

See accompanying notes to the unaudited condensed consolidated financial statements.



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## CVB FINANCIAL CORP. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

*(Dollars in thousands, except per share amounts)**(Unaudited)*

|   | For the Three Months Ended<br>September 30, |           | For the Nine Months Ended<br>September 30, |            |
|---|---|-----------|--|------------|
|   | 2018  | 2017      | 2018                                       | 2017       |
| Interest income:  |   |           |  |            |
| <b>Loans and leases, including fees</b>                                   | \$ 79,818                                   | \$ 55,998 | \$ 192,382                                 | \$ 158,253 |
| Investment securities:  |   |           |  |            |
| Investment securities available-for-sale                                  | 11,521                                      | 12,240    | 35,086                                     | 37,887     |
| Investment securities held-to-maturity                                    | 4,666                                       | 5,184     | 14,238                                     | 16,014     |
| <b>Total investment income</b>  | 16,187                                      | 17,424    | 49,324                                     | 53,901     |
| Dividends from FHLB stock   | 329   | 318       | 959  | 1,070      |
| Interest-earning deposits with other institutions and federal funds sold  | 304   | 130       | 1,475                                      | 683        |
| <b>Total interest income</b>  | 96,638                                      | 73,870    | 244,140                                    | 213,907    |
| Interest expense:   |   |           |  |            |
| Deposits  | 2,967                                       | 1,555     | 6,041                                      | 4,547      |
| Borrowings and customer repurchase agreements                             | 606   | 402       | 1,396                                      | 1,213      |
| Junior subordinated debentures  | 245   | 174       | 674  | 492        |
| <b>Total interest expense</b>   | 3,818                                       | 2,131     | 8,111                                      | 6,252      |
| Net interest income before (recapture of) provision for loan losses       | 92,820                                      | 71,739    | 236,029                                    | 207,655    |
| (Recapture of) provision for loan losses                                  | 500   | (1,500)   | (1,500)                                    | (7,000)    |
| <b>Net interest income after (recapture of) provision for loan losses</b> | 92,320                                      | 73,239    | 237,529                                    | 214,655    |
| Noninterest income:   |   |           |  |            |
| Service charges on deposit accounts                                       | 4,295                                       | 4,085     | 12,431                                     | 11,794     |
| Trust and investment services   | 2,182                                       | 2,523     | 6,738                                      | 7,432      |
| Bankcard services   | 875   | 927       | 2,637                                      | 2,563      |
| BOLI income   | 936   | 692       | 2,984                                      | 2,904      |

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|   |                  |                  |                   |                  |
|---|------------------|------------------|-------------------|------------------|
| Gain on OREO, net   | -                | 2                | 3,540             | 4                |
| Other   | 1,824            | 1,809            | 4,393             | 4,839            |
| <b>Total noninterest income</b>   | <b>10,112</b>    | <b>10,038</b>    | <b>32,723</b>     | <b>29,536</b>    |
| Noninterest expense:  |                  |                  |                   |                  |
| Salaries and employee benefits  | 26,319           | 21,835           | 69,684            | 65,116           |
| Occupancy and equipment   | 5,324            | 4,400            | 13,834            | 12,638           |
| Professional services   | 1,154            | 1,091            | 4,374             | 4,191            |
| Software licenses and maintenance   | 2,317            | 1,510            | 5,836             | 4,698            |
| Marketing and promotion   | 1,134            | 1,055            | 3,638             | 3,484            |
| Amortization of intangible assets   | 1,736            | 343              | 2,395             | 991              |
| Acquisition related expenses  | 6,645            | 250              | 7,942             | 2,176            |
| Other   | 4,251            | 4,222            | 11,377            | 12,402           |
| <b>Total noninterest expense</b>  | <b>48,880</b>    | <b>34,706</b>    | <b>119,080</b>    | <b>105,696</b>   |
| Earnings before income taxes  | 53,552           | 48,571           | 151,172           | 138,495          |
| Income taxes  | 14,994           | 18,888           | 42,328            | 51,935           |
| <b>Net earnings</b>   | <b>\$ 38,558</b> | <b>\$ 29,683</b> | <b>\$ 108,844</b> | <b>\$ 86,560</b> |
| Other comprehensive income (loss):  |                  |                  |                   |                  |
| Unrealized (loss) gain on securities arising during the period, before tax          | \$ (10,387)      | \$ 1,221         | \$ (49,155)       | \$ 3,287         |
| Less: Reclassification adjustment for net gain on securities included in net income | -                | -                | -                 | (402)            |
| Other comprehensive (loss) income, before tax                                       | (10,387)         | 1,221            | (49,155)          | 2,885            |
| Less: Income tax benefit (expense) related to items of other comprehensive income   | 3,070            | (513)            | 14,532            | (1,212)          |
| Other comprehensive (loss) income, net of tax                                       | (7,317)          | 708              | (34,623)          | 1,673            |
| <b>Comprehensive income</b>   | <b>\$ 31,241</b> | <b>\$ 30,391</b> | <b>\$ 74,221</b>  | <b>\$ 88,233</b> |
| Basic earnings per common share   | \$ 0.30          | \$ 0.27          | \$ 0.94           | \$ 0.79          |
| Diluted earnings per common share   | \$ 0.30          | \$ 0.27          | \$ 0.94           | \$ 0.79          |

See accompanying notes to the unaudited condensed consolidated financial statements.

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**CVB FINANCIAL CORP. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

**Three months ended September 30, 2018 and 2017**

*(Dollars and shares in thousands)*

*(Unaudited)*

|   | Common<br>Shares<br><br>Outstanding | Common<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total        |
|---|-------------------------------------|-----------------|----------------------|---|--------------|
| <b>Balance, January 1, 2017</b>                                     | 108,252                             | \$ 531,192      | \$ 449,499           | \$ 10,171   | \$ 990,862   |
| Cumulative adjustment upon adoption of ASU 2016-09                  | -                                   | 116             | (66)                 | -   | 50           |
| Repurchase of common stock  | (45)                                | (997)           | -                    | -   | (997)        |
| Issuance of common stock for acquisition of Valley Commerce Bancorp | 1,634                               | 37,637          | -                    | -   | 37,637       |
| Exercise of stock options   | 270                                 | 2,537           | -                    | -   | 2,537        |
| Shares issued pursuant to stock-based compensation plan             | 46                                  | 2,200           | -                    | -   | 2,200        |
| Cash dividends declared on common stock (\$0.40 per share)          | -                                   | -               | (44,058)             | -   | (44,058)     |
| Net earnings  | -                                   | -               | 86,560               | -   | 86,560       |
| Other comprehensive income  | -                                   | -               | -                    | 1,673   | 1,673        |
| <b>Balance, September 30, 2017</b>                                  | 110,157                             | \$ 572,685      | \$ 491,935           | \$ 11,844   | \$ 1,076,464 |
| <b>Balance, January 1, 2018</b>                                     | 110,185                             | \$ 573,453      | \$ 494,361           | \$ 1,452  | \$ 1,069,266 |
| Cumulative adjustment upon adoption of ASU 2018-02                  | -                                   | -               | (356)                | 356   | -            |
| Repurchase of common stock  | (42)                                | (988)           | -                    | -   | (988)        |
| Issuance of common stock for acquisition of Community Bank          | 29,842                              | 722,767         | -                    | -   | 722,767      |
| Exercise of stock options   | 145                                 | 1,504           | -                    | -   | 1,504        |
| Shares issued pursuant to stock-based compensation plan             | 205                                 | 2,316           | -                    | -   | 2,316        |
| Cash dividends declared on common stock (\$0.42 per share)          | -                                   | -               | (50,506)             | -   | (50,506)     |
| Net earnings  | -                                   | -               | 108,844              | -   | 108,844      |
| Other comprehensive income  | -                                   | -               | -                    | (34,623)  | (34,623)     |

|                                    |         |              |            |             |              |
|------------------------------------|---------|--------------|------------|-------------|--------------|
| <b>Balance, September 30, 2018</b> | 140,335 | \$ 1,299,052 | \$ 552,343 | \$ (32,815) | \$ 1,818,580 |
|------------------------------------|---------|--------------|------------|-------------|--------------|

See accompanying notes to the unaudited condensed consolidated financial statements.

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**CVB FINANCIAL CORP. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

*(Dollars in thousands)*

*(Unaudited)*

|  | <b>For the Nine Months Ended</b> |             |
|--|----------------------------------|-------------|
|  | <b>September 30,</b>             |             |
|  | <b>2018</b>                      | <b>2017</b> |
| <b>Cash Flows from Operating Activities</b>                                    |                                  |             |
| Interest and dividends received  | \$ 245,842                       | \$ 223,172  |
| Service charges and other fees received  | 26,107                           | 26,769      |
| Interest paid  | (8,642)                          | (6,279)     |
| Net cash paid to vendors, employees and others                                 | (110,799)                        | (83,610)    |
| Income taxes   | (35,879)                         | (53,278)    |
| Payments to FDIC, loss share agreement   | (65)                             | (498)       |
| Net cash provided by operating activities                                      | 116,564                          | 106,276     |
| <b>Cash Flows from Investing Activities</b>                                    |                                  |             |
| Proceeds from redemption of FHLB stock   | 17,250                           | 1,952       |
| Net change in interest-earning balances from depository institutions           | 11,934                           | 27,806      |
| Proceeds from sale of investment securities held-for-sale                      | 716,996                          | 5,403       |
| Proceeds from repayment of investment securities available-for-sale            | 296,922                          | 320,599     |
| Proceeds from maturity of investment securities available-for-sale             | 20,260                           | 20,937      |
| Purchases of investment securities available-for-sale                          | (98,709)                         | (280,365)   |
| Proceeds from repayment and maturity of investment securities held-to-maturity | 67,861                           | 96,447      |
| Purchases of investment securities held-to-maturity                            | -                                | (36,166)    |
| Net increase in equity investments   | (24,054)                         | (1,454)     |
| Net increase in loan and lease finance receivables                             | (6,806)                          | (29,713)    |
| Proceeds from BOLI death benefit   | 882                              | 2,653       |
| Proceeds from sale of asset held-for-sale                                      | -                                | 4,012       |
| Purchase of premises and equipment   | (3,483)                          | (3,129)     |
| Proceeds from sales of other real estate owned                                 | 8,067                            | -           |
| Cash acquired from acquisition, net of cash paid                               | (132,918)                        | 28,325      |
| Net cash provided by investing activities                                      | 874,202                          | 157,307     |
| <b>Cash Flows from Financing Activities</b>                                    |                                  |             |
| Net increase in other deposits   | (241,934)                        | (23,896)    |
| Net decrease in time deposits  | (65,079)                         | (39,485)    |
| Repayment of FHLB advances   | (297,571)                        | -           |
| Net (decrease) increase in other borrowings                                    | (136,000)                        | 10,000      |
| Net decrease in customer repurchase agreements                                 | (154,296)                        | (147,959)   |

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|   |                   |                   |
|---|-------------------|-------------------|
| Cash dividends on common stock                        | (46,304)          | (41,626)          |
| Repurchase of common stock                            | (988)             | (997)             |
| Proceeds from exercise of stock options               | 1,504             | 2,537             |
| <b>Net cash used in financing activities</b>          | <b>(940,668)</b>  | <b>(241,426)</b>  |
| <b>Net increase in cash and cash equivalents</b>      | <b>50,098</b>     | <b>22,157</b>     |
| <b>Cash and cash equivalents, beginning of period</b> | <b>144,377</b>    | <b>121,633</b>    |
| <b>Cash and cash equivalents, end of period</b>       | <b>\$ 194,475</b> | <b>\$ 143,790</b> |

See accompanying notes to the unaudited condensed consolidated financial statements.

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**CVB FINANCIAL CORP. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

*(Dollars in thousands)*

*(Unaudited)*

|   | <b>For the Nine Months Ended</b> |             |
|---|----------------------------------|-------------|
|   | <b>September 30,</b>             | <b>2017</b> |
|   | <b>2018</b>                      | <b>2017</b> |
| <b>Reconciliation of Net Earnings to Net Cash Provided by Operating Activities</b>  |                                  |             |
| Net earnings  | \$ 108,844                       | \$ 86,560   |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                                  |             |
| Gain loss on sale of investment securities  | -                                | (402)       |
| Gain on sale of other real estate owned   | (3,540)                          | -           |
| Increase in BOLI  | (3,053)                          | (4,416)     |
| Net amortization of premiums and discounts on investment securities                 | 10,661                           | 13,585      |
| Accretion of PCI discount   | (2,137)                          | (756)       |
| Recapture of provision for loan losses  | (1,500)                          | (7,000)     |
| Payments to FDIC, loss share agreement  | (65)                             | (498)       |
| Stock-based compensation  | 2,316                            | 2,200       |
| Depreciation and amortization, net  | (582)                            | (433)       |
| Change in other assets and liabilities  | 5,620                            | 17,436      |
| Total adjustments   | 7,720                            | 19,716      |
| Net cash provided by operating activities   | \$ 116,564                       | \$ 106,276  |

**Supplemental Disclosure of Non-cash Investing Activities**

|  |            |           |
|--|------------|-----------|
| Securities purchased and not settled         | \$ -       | \$ 1,625  |
| Transfer of loans to other real estate owned | \$ 420     | \$ -      |
| Issuance of common stock for acquisition     | \$ 722,767 | \$ 37,637 |

See accompanying notes to the unaudited condensed consolidated financial statements.

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**CVB FINANCIAL CORP. AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

*(Unaudited)*

**1. BUSINESS**

The condensed consolidated financial statements include CVB Financial Corp. (referred to herein on an unconsolidated basis as CVB and on a consolidated basis as we, our or the Company ) and its wholly owned subsidiary, Citizens Business Bank (the Bank or CBB ), after elimination of all intercompany transactions and balances. The Company has one inactive subsidiary, Chino Valley Bancorp. The Company is also the common stockholder of CVB Statutory Trust III. CVB Statutory Trust III was created in January 2006 to issue trust preferred securities in order to raise capital for the Company. In accordance with Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 810, Consolidation, this trust does not meet the criteria for consolidation.

The Company's primary operations are related to traditional banking activities. This includes the acceptance of deposits and the lending and investing of money through the operations of the Bank. The Bank also provides trust and investment-related services to customers through CitizensTrust. The Bank's customers consist primarily of small to mid-sized businesses and individuals located in the Inland Empire, Los Angeles County, Orange County, San Diego County, Ventura County, Santa Barbara County, and the Central Valley area of California. The Bank operates 68 banking centers and three trust office locations. The Company is headquartered in the city of Ontario, California.

On August 10, 2018, we completed the acquisition of Community Bank ( CB ), headquartered in Pasadena, California with 16 banking centers located throughout the greater Los Angeles and Orange County areas and total assets of approximately \$4.09 billion. Our condensed consolidated financial statements for 2018 include CB operations, post-merger. See Note 4 *Business Combinations*, included herein.

**2. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements and notes thereto have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ( SEC ) for Form 10-Q and conform to practices within the banking industry and include all of the information and disclosures required by accounting principles generally accepted in the United States of America ( GAAP ) for interim financial reporting. The accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments), which are necessary for a fair presentation of financial results for the interim periods presented. The results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of the results for the full year. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements, accounting policies and financial notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed with the SEC. A summary of the significant accounting policies consistently applied in the preparation of the accompanying unaudited condensed consolidated financial statements follows.



**Reclassification** Certain amounts in the prior periods unaudited condensed consolidated financial statements and related footnote disclosures have been reclassified to conform to the current presentation with no impact on previously reported net income or stockholders' equity. The operating segments previously reported have been aggregated into one segment to conform to the current period's presentation format. These reclassifications do not affect previously reported net earnings.

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Except as discussed below, our accounting policies are described in Note 3 *Summary of Significant Accounting Policies*, of our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 as filed with the SEC ( Form 10-K ).

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***Business Segments*** We regularly assess our strategic plans, operations and reporting structures to identify our reportable segments. Changes to our reportable segments are expected to be infrequent. For the years ended December 31, 2016 through June 30, 2018, we operated as two reportable segments: Banking Centers and Dairy & Livestock and Agribusiness. As a result of the Community Bank acquisition, along with changes in personnel, reporting structure, and operations, we re-evaluated our segment reporting for the third quarter ended September 30, 2018.

As of September 30, 2018, we operated as one reportable segment. The factors considered in making this determination include the nature of products and offered services, geographic regions in which we operate, the applicable regulatory environment, and the materiality of discrete financial information reviewed by our key decision makers. Through our network of banking centers, we provide relationship-based banking products, services and solutions for small to mid-sized companies, real estate investors, non-profit organizations, professionals and other individuals. Our products include loans for commercial businesses, commercial real estate, multi-family, construction, land, dairy & livestock and agribusiness, consumer and government-guaranteed small business loans. We also provide business deposit products and treasury cash management services, as well as deposit products to the owners and employees of the businesses we serve. The decision to combine our two reportable segments was made to align the segment reporting with the changes in our operations and reporting structure, and to be consistent with the level and materiality of information reviewed by our key decision makers.

***Use of Estimates in the Preparation of Financial Statements*** The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses. Other significant estimates, which may be subject to change, include fair value determinations and disclosures, impairment of investments, goodwill, loans, as well as valuation of deferred tax assets.

***Adoption of New Accounting Standards*** In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which provides revenue recognition guidance that is intended to create greater consistency with respect to how and when revenue from contracts with customers is shown in the income statement. This update to the ASC requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaces most existing revenue recognition guidance in U.S. GAAP. In applying the revenue model to contracts within its scope, an entity should apply the following steps: (1) Identify the contract(s) with a customer, (2) Identify the performance obligations in the contract, (3) Determine the transaction price, (4) Allocate the transaction price to the performance obligations in the contract, and (5) Recognize revenue when (or as) the entity satisfies a performance obligation. The standard applies to all contracts with customers except those that are within the scope of other topics in the FASB Codification. The standard also requires significantly expanded disclosures about revenue recognition. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606) - Deferral of the Effective Date, which deferred the effective date of ASU No. 2014-09 to January 1, 2018. The Company adopted the ASU during the first quarter of 2018, as required, using the modified retrospective approach. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements, as substantially all of the Company's revenues are excluded from the scope of the new standard. Since there was no net income impact upon adoption of this ASU, a cumulative effect adjustment to opening retained earnings was not deemed necessary. See Note 14 *Revenue Recognition* for more information.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The guidance in this ASU among other things, (i) requires equity investments with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the change in fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or in the accompanying notes to the financial statements and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities. This amendment is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Entities are required to apply the amendment by means of a cumulative-effect adjustment as of the beginning of the fiscal year of adoption, with the exception of the amendment related to equity securities without readily determinable fair values, which should be applied prospectively to equity investments that exist as of the date of adoption. The Company adopted ASU 2016-01 effective January 1, 2018 and it did not have a material impact on the Company's consolidated financial statements. In accordance with (iv) above, the Company measured the fair value of its loan portfolio at September 30, 2018 using an exit price notion. See Note 9 *Fair Value Information*.

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In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. The new guidance clarifies the classification within the statement of cash flows for certain transactions, including debt extinguishment costs, zero-coupon debt, and contingent consideration related to business combinations, insurance proceeds, equity method distributions and beneficial interests in securitizations. The guidance also clarifies that cash flows with aspects of multiple classes of cash flows, or that cannot be separated by source or use, should be classified based on the activity that is likely to be the predominant source or use of cash flows for the item. This guidance is effective for fiscal years beginning after December 15, 2017 and will require application using a retrospective transition method. The Company adopted this ASU retrospectively effective January 1, 2018 and it did not have a material impact on the Company's consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, *Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting*. The amendments in ASU 2017-09 provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. An entity should account for the effects of a modification unless all the following are met: (1) the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification. (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified. (3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments in ASU No. 2017-09 are effective for annual periods, and interim within those annual reporting periods, beginning after December 15, 2017; early adoption is permitted. The amendments in this ASU should be applied prospectively to an award modified on or after the adoption date. The Company adopted this ASU and it did not have a material impact on the Company's consolidated financial statements.

In February 2018, the FASB issued ASU No. 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The amendments in ASU 2018-02 allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Job Act (Tax Reform Act). The amendments in this update also require entities to disclose their accounting policy for releasing income tax effects from accumulated other comprehensive income. The ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted, and the provisions of the amendment should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Reform Act is recognized. The Company elected to early adopt ASU 2018-02 in the first quarter of 2018 and reclassified \$356,000 related to the stranded tax effects from accumulated other comprehensive income to retained earnings within our consolidated statements of stockholders' equity.

***Recent Accounting Pronouncements*** In February 2016, FASB issued ASU No. 2016-02, *Leases (Topic 842)*. ASU 2016-02 establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. In July 2018, the FASB issued ASU 2018-10, *Codification Improvements to Topic 842, Leases*,

which clarifies and corrects errors in ASC 842. The effective date and transition requirements of ASU 2018-10 are the same as the effective date and transition requirements of 2016-02.

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In July 2018, the FASB issued ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*, which creates a new optional transition method for implementing the new standard on leases, ASU No. 2016-02, and provides lessors with a practical expedient for separating lease and non-lease components. Specifically, under the amendments in ASU 2018-11: (1) the transition option allows entities to not apply the new leases standard in the comparative periods presented when transitioning to the new accounting standard for leases, and (2) lessors may elect not to separate lease and non-lease components when certain conditions are met. The amendments have the same effective date as ASU 2016-02.

The Company established a project to consider the impact of Topic 842. The leasing portfolio consists of real estate leases, which are used for the banking operations of the Company. All leases in the current portfolio have been classified as operating leases, although this may change in the future. Management does not anticipate a material impact to the consolidated statement of earnings. Management estimates the ROU asset and liability to be between \$15 million and \$20 million. This amount is based on the present value of currently-committed cash flows from leases discounted at the Company's incremental rate of borrowing on an arms-length basis. This liability includes the non-lease components as the Company has elected to include these components as a practical expedient.

In addition, there are a number of practical expedients that have been elected, which included electing not to adjust comparative financial statements at the effective date of the new accounting standard, with the effect of initially applying ASC 842 recognized as a cumulative-effect adjustment to retained earnings in the period of adoption.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. The standard will replace the current *incurred loss* approach with an *expected loss* model. The new model, referred to as the *Current Expected Credit Loss (CECL)* model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). The Company is currently evaluating the impact of adoption of this ASU on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. ASU 2017-04 eliminates the second step in the goodwill impairment test, which requires an entity to determine the implied fair value of the reporting unit's goodwill. Instead, an entity should recognize an impairment loss if the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, with the impairment loss not to exceed the amount of goodwill allocated to the reporting unit. The standard will be effective for the Company beginning January 1, 2020, with early adoption permitted for goodwill impairment tests performed after January 1, 2017. The Company does not expect this ASU to have a material impact on the Company's consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. ASU 2017-12 changes the recognition and presentation requirements of hedge accounting and makes certain targeted improvements to simplify the application of the hedge accounting guidance in

current GAAP. The amendments in this ASU better align an entity's financial reporting and risk management activities for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. To meet that objective, the amendments expand and refine hedge accounting for both non-financial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. ASU No. 2017-12 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The Company currently does not designate any derivative financial instruments as qualifying hedging relationships, and therefore, does not utilize hedge accounting. The Company does not expect this ASU to have a material impact on the Company's consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-07, Compensation - Stock Compensation (Topic 718): Improvements to Nonemployees Share-Based Payment Accounting. The intention of ASU 2018-07 is to expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. These share-based payments will now be measured at grant-date fair value of the equity instrument issued. Upon adoption, only liability-classified awards that have not been settled and equity-classified awards for which a measurement date has not been established should be re-measured through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. ASU 2018-07 is effective for fiscal years beginning after December 15, 2019 and is applied retrospectively. The Company does not expect this ASU to have a material impact on the Company's consolidated financial statements.

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In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. ASU No. 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted. Entities may early adopt any eliminated or modified disclosure requirements and delay adoption of the additional disclosure requirements until their effective date. The Company does not expect this ASU to have a material impact on the Company's consolidated financial statements.

**4. BUSINESS COMBINATIONS**

***Community Bank Acquisition***

On August 10, 2018, the Company completed the acquisition of CB, headquartered in Pasadena, California. The Company acquired all of the assets and assumed all of the liabilities of CB for \$180.7 million in cash and \$722.8 million in stock. As a result, CB was merged with the Bank, the principal subsidiary of CVB. The primary reason for the acquisition was to further strengthen the Company's presence in Southern California. At close, CB had 16 banking centers located throughout the greater Los Angeles and Orange County areas.

The assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of August 10, 2018. As the final CB tax return has not yet been completed, initial accounting for taxes was incomplete as of September 30, 2018. These fair values are estimates and are subject to adjustment for up to one year after the acquisition date or when additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier. The application of the acquisition method of accounting resulted in the recognition of goodwill of \$546.3 million and a core deposit intangible ( CDI ) of \$52.2 million, or 2.26% of core deposits. Goodwill represents the excess purchase price over the fair value of the net assets acquired. Goodwill is not deductible for income tax purposes.



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The table below summarizes the amounts recognized for the estimated fair value of assets acquired and the liabilities assumed as of the acquisition date.

|  | <b>August 10, 2018</b>        |                |
|--|-------------------------------|----------------|
|  | <i>(Dollars in thousands)</i> |                |
| <b>Merger Consideration</b>                                |                               |                |
| Cash paid  | \$                            | 180,719        |
| CVBF common stock issued                                   |                               | 722,767        |
| Total merger consideration                                 | \$                            | 903,486        |
| <b>Identifiable net assets acquired, at fair value</b>     |                               |                |
| Assets Acquired  |                               |                |
| Cash and cash equivalents                                  |                               | 47,802         |
| Investment securities                                      |                               | 716,996        |
| FHLB stock   |                               | 17,250         |
| Loans  |                               | 2,734,081      |
| Accrued interest receivable                                |                               | 7,916          |
| Premises and equipment                                     |                               | 14,632         |
| BOLI   |                               | 70,904         |
| Core deposit intangible                                    |                               | 52,200         |
| Other assets   |                               | 58,130         |
| Total assets acquired                                      |                               | 3,719,911      |
| Liabilities assumed  |                               |                |
| Deposits   | 2,869,986                     |                |
| FHLB advances  | 297,571                       |                |
| Other borrowings   | 166,000                       |                |
| Other liabilities  | 29,192                        |                |
| Total liabilities assumed                                  |                               | 3,362,749      |
| Total fair value of identifiable net assets, at fair value |                               | 357,162        |
| <b>Goodwill</b>  | <b>\$</b>                     | <b>546,324</b> |

We have included the financial results of the business combination in the condensed consolidated statement of earnings and comprehensive income beginning on the acquisition date.

For the three and nine months ended September 30, 2018, the Company incurred \$6.6 million and \$7.9 million, respectively, in merger related expenses associated with the CB acquisition.

For illustrative purposes only, the following table presents certain unaudited pro forma information for the nine months ended September 30, 2018 and 2017. This unaudited estimated pro forma financial information was calculated as if CB had been acquired as of the beginning of the year prior to the date of acquisition. This unaudited pro forma

information combines the historical results of CB with the Company's consolidated historical results and includes certain adjustments reflecting the estimated impact of certain fair value adjustments for the respective periods. The pro forma information is not indicative of what would have occurred had the acquisition occurred as of the beginning of the year prior to the acquisition. The unaudited pro forma information does not consider any changes to the provision for credit losses resulting from recording loan assets at fair value, cost savings, or business synergies. As a result, actual amounts would have differed from the unaudited pro forma information presented.

**Unaudited Pro Forma**

**Nine Months Ended September 30,**

**2018                      2017**

*(Dollars in thousands)*

|  |            |            |
|--|------------|------------|
| Total revenues (net interest income plus noninterest income) | \$ 364,846 | \$ 354,990 |
| Net Income   | \$ 138,274 | \$ 118,419 |
| Earnings per share - basic                                   | \$ 0.99    | \$ 0.85    |
| Earnings per share - diluted                                 | \$ 0.99    | \$ 0.85    |

**Table of Contents****Valley Commerce Bancorp Acquisition**

On March 10, 2017, the Company completed the acquisition of Valley Commerce Bancorp ( VCBP ), the holding company for Valley Business Bank ( VBB ), headquartered in the Central Valley area of California. The Company acquired all of the assets and assumed all of the liabilities of VCBP for \$23.2 million in cash and \$37.6 million in stock. As a result, VBB was merged with the Bank, the principal subsidiary of CVB. The Company believes this transaction serves to further strengthen its presence in the Central Valley area of California. At close, VBB had four branches located in Visalia, Tulare, Fresno, and Woodlake. The systems integration of VCBP and CBB was completed in May 2017. Three of these center locations were consolidated with nearby CBB locations in the third quarter of 2017 and the Company sold the Woodlake branch in the fourth quarter of 2017.

Goodwill of \$27.0 million from the acquisition represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired.

The total fair value of assets acquired approximated \$405.9 million, which included \$28.3 million in cash and cash equivalents net of cash paid, \$2.0 million in FHLB stock, \$309.7 million in loans and lease finance receivables, \$5.3 million in fixed assets, \$9.4 million in BOLI, \$3.2 million in core deposit intangible assets acquired and \$21.0 million in other assets. The total fair value of liabilities assumed was \$368.3 million, which included \$361.8 million in deposits, and \$6.5 million in other liabilities. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of March 10, 2017. The assets acquired and liabilities assumed have been accounted for under the acquisition method of accounting. The purchase price allocation was finalized in the third quarter of 2017.

We have included the financial results of the business combination in the condensed consolidated statement of earnings and comprehensive income beginning on the acquisition date.

For the nine months ended September 30, 2018, the Company did not incur any merger related expenses associated with the VCBP acquisition and incurred \$250,000 and \$2.2 million for the three and nine months ended September 30, 2017, respectively.

**5. INVESTMENT SECURITIES**

The amortized cost and estimated fair value of investment securities are summarized below. The majority of securities held are available-for-sale securities with fair value based on quoted prices for similar assets in active markets or quoted prices for identical assets in markets that are not active. Estimated fair values were obtained from an independent pricing service based upon market quotes.

|  | Amortized<br>Cost | September 30, 2018                     |  | Fair Value | Total Percent |
|--|-------------------|--|--|------------|---------------|
|  |                   | Gross<br>Unrealized<br>Holding<br>Gain | Gross<br>Unrealized<br>Holding<br>Loss |            |               |
| Investment securities<br>available-for-sale: |                   |  |  |            |               |

*(Dollars in thousands)*

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|   |              |          |             |              |         |
|---|--------------|----------|-------------|--------------|---------|
| Residential mortgage-backed securities  | \$ 1,570,072 | \$ 1,014 | \$ (38,208) | \$ 1,532,878 | 84.87%  |
| CMO/REMIC - residential                 | 229,832      | 152      | (6,167)     | 223,817      | 12.39%  |
| Municipal bonds                         | 50,022       | 308      | (1,591)     | 48,739       | 2.70%   |
| Other securities                        | 797          | -        | -           | 797          | 0.04%   |
| Total available-for-sale securities     | \$ 1,850,723 | \$ 1,474 | \$ (45,966) | \$ 1,806,231 | 100.00% |
| Investment securities held-to-maturity: |              |          |             |              |         |
| Government agency/GSE                   | \$ 144,871   | \$ -     | \$ (5,129)  | \$ 139,742   | 19.09%  |
| Residential mortgage-backed securities  | 158,769      | -        | (5,502)     | 153,267      | 20.92%  |
| CMO                                     | 216,980      | -        | (13,960)    | 203,020      | 28.58%  |
| Municipal bonds                         | 238,409      | 225      | (7,908)     | 230,726      | 31.41%  |
| Total held-to-maturity securities       | \$ 759,029   | \$ 225   | \$ (32,499) | \$ 726,755   | 100.00% |

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December 31, 2017

|  | Amortized<br>Cost   | Gross<br>Unrealized<br>Holding<br>Gain | Gross<br>Unrealized<br>Holding Loss | Fair Value          | Total<br>Percent |
|--|---------------------|--|-------------------------------------|---------------------|------------------|
| <i>(Dollars in thousands)</i>                    |                     |  |                                     |                     |                  |
| <b>Investment securities available-for-sale:</b> |                     |  |                                     |                     |                  |
| Residential mortgage-backed securities           | \$ 1,747,780        | \$ 11,231                              | \$ (8,102)                          | \$ 1,750,909        | 84.14%           |
| CMO/REMIC-residential                            | 274,634             | 1,277                                  | (2,082)                             | 273,829             | 13.16%           |
| Municipal bonds                                  | 54,966              | 774                                    | (244)                               | 55,496              | 2.66%            |
| Other securities                                 | 751                 | -                                      | -                                   | 751                 | 0.04%            |
| <b>Total available-for-sale securities</b>       | <b>\$ 2,078,131</b> | <b>\$ 13,282</b>                       | <b>\$ (10,428)</b>                  | <b>\$ 2,080,985</b> | <b>100.00%</b>   |
| <b>Investment securities held-to-maturity:</b>   |                     |  |                                     |                     |                  |
| Government agency/GSE                            | \$ 159,716          | \$ 854                                 | \$ (2,134)                          | \$ 158,436          | 19.25%           |
| Residential mortgage-backed securities           | 176,427             | 667                                    | (382)                               | 176,712             | 21.26%           |
| CMO  | 225,072             | -                                      | (8,641)                             | 216,431             | 27.12%           |
| Municipal bonds                                  | 268,675             | 2,751                                  | (3,790)                             | 267,636             | 32.37%           |
| <b>Total held-to-maturity securities</b>         | <b>\$ 829,890</b>   | <b>\$ 4,272</b>                        | <b>\$ (14,947)</b>                  | <b>\$ 819,215</b>   | <b>100.00%</b>   |

The following table provides information about the amount of interest income earned on investment securities which is fully taxable and which is exempt from regular federal income tax.

**For the Three Months Ended September 30, 2018**      **For the Nine Months Ended September 30, 2017**

**2018**      **2017**      **2018**      **2017**

*(Dollars in thousands)*

|   |               |               |               |               |
|---|---------------|---------------|---------------|---------------|
| <b>Investment securities available-for-sale:</b>                |               |               |               |               |
| Taxable   | \$ 11,126     | \$ 11,767     | \$ 33,861     | \$ 36,113     |
| Tax-advantaged  | 395           | 473           | 1,225         | 1,774         |
| <b>Total interest income from available-for-sale securities</b> | <b>11,521</b> | <b>12,240</b> | <b>35,086</b> | <b>37,887</b> |
| <b>Investment securities held-to-maturity:</b>                  |               |               |               |               |
| Taxable   | 2,961         | 3,111         | 8,887         | 9,591         |
| Tax-advantaged  | 1,705         | 2,073         | 5,351         | 6,423         |

|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Total interest income from held-to-maturity securities | 4,666     | 5,184     | 14,238    | 16,014    |
| Total interest income from investment securities       | \$ 16,187 | \$ 17,424 | \$ 49,324 | \$ 53,901 |

Approximately 89% of the total investment securities portfolio at September 30, 2018 represents securities issued by the U.S. government or U.S. government-sponsored enterprises, with the implied guarantee of payment of principal and interest.

The tables below show the Company's investment securities' gross unrealized losses and fair value by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2018 and December 31, 2017. Management has reviewed individual securities to determine whether a decline in fair value below the amortized cost basis is other-than-temporary. The unrealized losses on these securities were primarily attributed to changes in interest rates. The issuers of these securities have not, to our knowledge, evidenced any cause for default on these securities. These securities have fluctuated in value since their purchase dates as market rates have fluctuated. However, we have the ability to hold and do not have the intent to sell these securities. As such, management does not deem these securities to be Other-Than-Temporarily-Impaired ( OTTI ).

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|  | Less Than 12 Months |  | September 30, 2018<br>12 Months or Longer |  | Total               |  |
|--|---------------------|--|---|--|---------------------|--|
|  | Fair Value          | Gross<br>Unrealized<br>Holding<br>Losses | Fair Value                                | Gross<br>Unrealized<br>Holding<br>Losses | Fair Value          | Gross<br>Unrealized<br>Holding<br>Losses |
| <i>(Dollars in thousands)</i>              |                     |  |   |  |                     |  |
| Investment securities available-for-sale:  |                     |  |   |  |                     |  |
| Residential mortgage-backed securities     | \$ 1,193,435        | \$ (24,475)                              | \$ 287,707                                | \$ (13,733)                              | \$ 1,481,142        | \$ (38,208)                              |
| CMO/REMIC - residential                    | 139,064             | (3,053)                                  | 60,925                                    | (3,114)                                  | 199,989             | (6,167)                                  |
| Municipal bonds                            | 11,257              | (389)                                    | 12,987                                    | (1,202)                                  | 24,244              | (1,591)                                  |
| <b>Total available-for-sale securities</b> | <b>\$ 1,343,756</b> | <b>\$ (27,917)</b>                       | <b>\$ 361,619</b>                         | <b>\$ (18,049)</b>                       | <b>\$ 1,705,375</b> | <b>\$ (45,966)</b>                       |

|  |                   |                   |                   |                    |                   |                    |
|--|-------------------|-------------------|-------------------|--------------------|-------------------|--------------------|
| Investment securities held-to-maturity:  |                   |                   |                   |                    |                   |                    |
| Government agency/GSE                    | \$ 99,203         | \$ (2,326)        | \$ 40,539         | \$ (2,803)         | \$ 139,742        | \$ (5,129)         |
| Residential mortgage-backed securities   | 101,083           | (3,206)           | 52,184            | (2,296)            | 153,267           | (5,502)            |
| CMO                                      | -                 | -                 | 203,020           | (13,960)           | 203,020           | (13,960)           |
| Municipal bonds                          | 116,918           | (2,143)           | 67,284            | (5,765)            | 184,202           | (7,908)            |
| <b>Total held-to-maturity securities</b> | <b>\$ 317,204</b> | <b>\$ (7,675)</b> | <b>\$ 363,027</b> | <b>\$ (24,824)</b> | <b>\$ 680,231</b> | <b>\$ (32,499)</b> |

|   | Less Than 12 Months |  | December 31, 2017<br>12 Months or Longer |  | Total      |  |
|---|---------------------|--|--|--|------------|--|
|   | Fair Value          | Gross<br>Unrealized<br>Holding<br>Losses | Fair Value                               | Gross<br>Unrealized<br>Holding<br>Losses | Fair Value | Gross<br>Unrealized<br>Holding<br>Losses |
| <i>(Dollars in thousands)</i>             |                     |  |  |  |            |  |
| Investment securities available-for-sale: |                     |  |  |  |            |  |
| Residential mortgage-backed securities    | \$ 414,091          | \$ (1,828)                               | \$ 303,746                               | \$ (6,274)                               | \$ 717,837 | \$ (8,102)                               |
| CMO/REMIC - residential                   | 95,137              | (487)                                    | 71,223                                   | (1,595)                                  | 166,360    | (2,082)                                  |

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|  |                   |                   |                   |                    |                   |                    |
|--|-------------------|-------------------|-------------------|--------------------|-------------------|--------------------|
| Municipal bonds                            | 946               | (4)               | 13,956            | (240)              | 14,902            | (244)              |
| <b>Total available-for-sale securities</b> | <b>\$ 510,174</b> | <b>\$ (2,319)</b> | <b>\$ 388,925</b> | <b>\$ (8,109)</b>  | <b>\$ 899,099</b> | <b>\$ (10,428)</b> |
| Investment securities held-to-maturity:    |                   |                   |                   |                    |                   |                    |
| Government agency/GSE                      | \$ 18,950         | \$ (27)           | \$ 43,495         | \$ (2,107)         | \$ 62,445         | \$ (2,134)         |
| Residential mortgage-backed securities     | 51,297            | (188)             | 55,306            | (194)              | 106,603           | (382)              |
| CMO  | -                 | -                 | 216,431           | (8,641)            | 216,431           | (8,641)            |
| Municipal bonds                            | 32,069            | (492)             | 66,217            | (3,298)            | 98,286            | (3,790)            |
| <b>Total held-to-maturity securities</b>   | <b>\$ 102,316</b> | <b>\$ (707)</b>   | <b>\$ 381,449</b> | <b>\$ (14,240)</b> | <b>\$ 483,765</b> | <b>\$ (14,947)</b> |

At September 30, 2018 and December 31, 2017, investment securities having a carrying value of approximately \$1.60 billion and \$1.91 billion, respectively, were pledged to secure public deposits, short and long-term borrowings, and for other purposes as required or permitted by law.

The amortized cost and fair value of debt securities at September 30, 2018, by contractual maturity, are shown in the table below. Although mortgage-backed and CMO/REMIC securities have contractual maturities through 2057, expected maturities will differ from contractual maturities because borrowers may have the right to prepay such obligations without penalty. Mortgage-backed and CMO/REMIC securities are included in maturity categories based upon estimated average lives which incorporate estimated prepayment speeds.



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|  | <b>September 30, 2018</b> |                               |                         |                   |
|--|---------------------------|-------------------------------|-------------------------|-------------------|
|  | <b>Available-for-sale</b> |                               | <b>Held-to-maturity</b> |                   |
|  | <b>Amortized</b>          | <b>Fair Value</b>             | <b>Amortized</b>        | <b>Fair Value</b> |
|  | <b>Cost</b>               | <b>(Dollars in thousands)</b> | <b>Cost</b>             | <b>Fair Value</b> |
| Due in one year or less                | \$ 19,806                 | \$ 19,964                     | \$ -                    | \$ -              |
| Due after one year through five years  | 1,676,348                 | 1,637,053                     | 315,036                 | 298,729           |
| Due after five years through ten years | 113,539                   | 109,910                       | 172,281                 | 167,824           |
| Due after ten years                    | 41,030                    | 39,304                        | 271,712                 | 260,202           |
| <b>Total investment securities</b>     | <b>\$ 1,850,723</b>       | <b>\$ 1,806,231</b>           | <b>\$ 759,029</b>       | <b>\$ 726,755</b> |

The investment in FHLB stock is periodically evaluated for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through September 30, 2018.

**6. ACQUIRED SJB ASSETS AND FDIC LOSS SHARING ASSET*****FDIC Assisted Acquisition***

On October 16, 2009, the Bank acquired San Joaquin Bank ( SJB ) and entered into loss sharing agreements with the Federal Deposit Insurance Corporation ( FDIC ) that is more fully discussed in Note 3 *Summary of Significant Accounting Policies*, included in our Annual Report on Form 10-K for the year ended December 31, 2017. The acquisition has been accounted for under the purchase method of accounting. The assets and liabilities were recorded at their estimated fair values as of the October 16, 2009 acquisition date. The acquired loans were accounted for as Purchase Credit Impaired ( PCI ) loans.

At September 30, 2018, the remaining discount associated with the PCI loans was zero. The loss sharing agreement for commercial loans expired October 16, 2014. The loss sharing agreement with the FDIC for single-family residential loans, which would have expired on October 16, 2019, was terminated by the Bank on July 20, 2018.

The following table provides a summary of PCI loans and lease finance receivables by type and by internal risk ratings (credit quality indicators) for the periods indicated.

|                                    | <b>September 30, 2018</b>     |        | <b>December 31, 2017</b> |  |
|------------------------------------|-------------------------------|--------|--------------------------|--|
|                                    | <i>(Dollars in thousands)</i> |        |                          |  |
| Commercial and industrial          | \$ 459                        | \$ 934 |                          |  |
| SBA                                | 1,286                         | 1,383  |                          |  |
| Real estate:                       |                               |        |                          |  |
| Commercial real estate             | 14,979                        | 27,431 |                          |  |
| Construction                       | -                             | -      |                          |  |
| SFR mortgage                       | 150                           | 162    |                          |  |
| Dairy & livestock and agribusiness | 200                           | 770    |                          |  |

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|                                     |           |           |
|-------------------------------------|-----------|-----------|
| Municipal lease finance receivables | -         | -         |
| Consumer and other loans            | 186       | 228       |
| Gross PCI loans                     | 17,260    | 30,908    |
| Less: Purchase accounting discount  | -         | (2,026)   |
| Gross PCI loans, net of discount    | 17,260    | 28,882    |
| Less: Allowance for PCI loan losses | (205)     | (367)     |
| Net PCI loans                       | \$ 17,055 | \$ 28,515 |

**Table of Contents*****Credit Quality Indicators***

The following table summarizes gross PCI loans by internal risk ratings for the periods indicated.

|                              | <b>September 30, 2018</b>     | <b>September 31, 2017</b> |
|------------------------------|-------------------------------|---------------------------|
|                              | <i>(Dollars in thousands)</i> |                           |
| Pass                         | \$ 15,775                     | \$ 26,439                 |
| Special mention              | 1,251                         | 1,088                     |
| Substandard                  | 234                           | 3,381                     |
| Doubtful & loss              | -                             | -                         |
| <b>Total gross PCI loans</b> | <b>\$ 17,260</b>              | <b>\$ 30,908</b>          |

**Table of Contents****7. LOANS AND LEASE FINANCE RECEIVABLES AND ALLOWANCE FOR LOAN LOSSES**

The following table provides a summary of the Company's total loans and lease finance receivables, excluding PCI loans, by type.

|   | September 30, 2018            | December 31, 2017 |
|---|-------------------------------|-------------------|
|   | <i>(Dollars in thousands)</i> |                   |
| Commercial and industrial                                   | \$ 1,021,906                  | \$ 513,325        |
| SBA   | 357,052                       | 122,055           |
| Real estate:  |                               |                   |
| Commercial real estate                                      | 5,268,740                     | 3,376,713         |
| Construction  | 123,274                       | 77,982            |
| SFR mortgage  | 292,516                       | 236,202           |
| Dairy & livestock and agribusiness                          | 304,598                       | 347,289           |
| Municipal lease finance receivables                         | 67,581                        | 70,243            |
| Consumer and other loans                                    | 134,796                       | 64,229            |
| Gross loans, excluding PCI loans                            | 7,570,463                     | 4,808,038         |
| Less: Deferred loan fees, net                               | (5,264)                       | (6,289)           |
| Gross loans, excluding PCI loans, net of deferred loan fees | 7,565,199                     | 4,801,749         |
| Less: Allowance for loan losses                             | (59,802)                      | (59,218)          |
| Net loans, excluding PCI loans                              | 7,505,397                     | 4,742,531         |
| PCI Loans   | 17,260                        | 30,908            |
| Discount on PCI loans                                       | -                             | (2,026)           |
| Less: Allowance for loan losses                             | (205)                         | (367)             |
| PCI loans, net  | 17,055                        | 28,515            |
| Total loans and lease finance receivables                   | \$ 7,522,452                  | \$ 4,771,046      |

As of September 30, 2018, 75.09% of the Company's total gross loan portfolio (excluding PCI loans) consisted of real estate loans, 69.60% of which consisted of commercial real estate loans. Substantially all of the Company's real estate loans and construction loans are secured by real properties located in California. As of September 30, 2018, \$219.6 million, or 4.17% of the total commercial real estate loans included loans secured by farmland, compared to \$206.1 million, or 6.10%, at December 31, 2017. The loans secured by farmland included \$128.8 million for loans secured by dairy & livestock land and \$90.8 million for loans secured by agricultural land at September 30, 2018, compared to \$118.2 million for loans secured by dairy & livestock land and \$87.9 million for loans secured by agricultural land at December 31, 2017. As of September 30, 2018, dairy & livestock and agribusiness loans of \$304.6 million were comprised of \$251.4 million for dairy & livestock loans and \$53.2 million for agribusiness loans, compared to \$310.6 million for dairy & livestock loans and \$36.7 million for agribusiness loans at December 31, 2017.

At September 30, 2018, the Company held approximately \$3.70 billion of total fixed rate loans, including PCI loans.

At September 30, 2018 and December 31, 2017, loans totaling \$5.53 billion and \$3.68 billion, respectively, were pledged to secure the borrowings and available lines of credit from the FHLB and the Federal Reserve Bank.

There were no outstanding loans held-for-sale as of September 30, 2018 and December 31, 2017.

***Credit Quality Indicators***

An important element of our approach to credit risk management is our loan risk rating system. The originating officer assigns each loan an initial risk rating, which is reviewed and confirmed or changed, as appropriate, by credit management. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by senior line and credit management personnel. Credits are monitored by line and credit management personnel for deterioration or improvement in a borrower's financial condition, which would impact the ability of the borrower to perform under the contract. Risk ratings are adjusted as necessary.

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Loans are risk rated into the following categories (Credit Quality Indicators): Pass, Special Mention, Substandard, Doubtful and Loss. Each of these groups is assessed for the proper amount to be used in determining the adequacy of our allowance for losses. These categories can be described as follows:

**Pass** These loans, including loans on the Bank's internal watch list, range from minimal credit risk to lower than average, but still acceptable, credit risk. Watch list loans usually require more than normal management attention. Loans on the watch list may involve borrowers with adverse financial trends, higher debt/equity ratios, or weaker liquidity positions, but not to the degree of being considered a defined weakness or problem loan where risk of loss may be apparent.

**Special Mention** Loans assigned to this category have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the repayment prospects for the asset or the Company's credit position at some future date. Special mention assets are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

**Substandard** Loans classified as substandard are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Company will sustain some loss if deficiencies are not corrected.

**Doubtful** Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or the liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

**Loss** Loans classified as loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this asset with insignificant value even though partial recovery may be affected in the future.

The following table summarizes loans by type, excluding PCI loans, according to our internal risk ratings for the periods presented.

|                           | <b>September 30, 2018</b>     |                            |                        |                                |              |
|---------------------------|-------------------------------|----------------------------|------------------------|--------------------------------|--------------|
|                           | <b>Pass</b>                   | <b>Special<br/>Mention</b> | <b>Substandard (1)</b> | <b>Doubtful &amp;<br/>Loss</b> | <b>Total</b> |
|                           | <i>(Dollars in thousands)</i> |                            |                        |                                |              |
| Commercial and industrial | \$ 980,421                    | \$ 33,628                  | \$ 7,857               | \$ -                           | \$ 1,021,906 |
| SBA                       | 345,126                       | 5,469                      | 6,457                  | -                              | 357,052      |
| Real estate:              |                               |                            |                        |                                |              |
| Commercial real estate    |                               |                            |                        |                                |              |
| Owner occupied            | 1,931,062                     | 97,990                     | 12,079                 | -                              | 2,041,131    |
| Non-owner occupied        | 3,215,070                     | 5,582                      | 6,957                  | -                              | 3,227,609    |
| Construction              |                               |                            |                        |                                |              |
| Speculative               | 32,081                        | -                          | -                      | -                              | 32,081       |
| Non-speculative           | 91,193                        | -                          | -                      | -                              | 91,193       |
| SFR mortgage              | 284,852                       | 4,047                      | 3,617                  | -                              | 292,516      |

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|  |              |            |           |      |              |
|--|--------------|------------|-----------|------|--------------|
| Dairy & livestock and agribusiness     | 268,328      | 26,877     | 9,393     | -    | 304,598      |
| Municipal lease finance receivables    | 67,045       | 536        | -         | -    | 67,581       |
| Consumer and other loans               | 132,637      | 740        | 1,419     | -    | 134,796      |
| Total gross loans, excluding PCI loans | \$ 7,347,815 | \$ 174,869 | \$ 47,779 | \$ - | \$ 7,570,463 |

(1) Includes \$15.1 million of classified loans acquired from CB in the third quarter of 2018.

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|  | December 31, 2017             |                    |             |                    |              | Total |
|--|-------------------------------|--------------------|-------------|--------------------|--------------|-------|
|  | Pass                          | Special<br>Mention | Substandard | Doubtful &<br>Loss |              |       |
|  | <i>(Dollars in thousands)</i> |                    |             |                    |              |       |
| Commercial and industrial              | \$ 483,641                    | \$ 19,566          | \$ 10,118   | \$ -               | \$ 513,325   |       |
| SBA                                    | 112,835                       | 5,358              | 3,862       | -                  | 122,055      |       |
| Real estate:                           |                               |                    |             |                    |              |       |
| Commercial real estate                 |                               |                    |             |                    |              |       |
| Owner occupied                         | 1,009,199                     | 76,111             | 10,970      | -                  | 1,096,280    |       |
| Non-owner occupied                     | 2,257,130                     | 16,434             | 6,869       | -                  | 2,280,433    |       |
| Construction                           |                               |                    |             |                    |              |       |
| Speculative                            | 60,042                        | -                  | -           | -                  | 60,042       |       |
| Non-speculative                        | 17,940                        | -                  | -           | -                  | 17,940       |       |
| SFR mortgage                           | 229,032                       | 3,124              | 4,046       | -                  | 236,202      |       |
| Dairy & livestock and agribusiness     | 321,413                       | 9,047              | 16,829      | -                  | 347,289      |       |
| Municipal lease finance receivables    | 69,644                        | 599                | -           | -                  | 70,243       |       |
| Consumer and other loans               | 61,715                        | 1,255              | 1,259       | -                  | 64,229       |       |
| Total gross loans, excluding PCI loans | \$ 4,622,591                  | \$ 131,494         | \$ 53,953   | \$ -               | \$ 4,808,038 |       |

**Allowance for Loan Losses ( ALLL )**

The Bank's Audit and Director Loan Committees provide Board oversight of the ALLL process and approves the ALLL on a quarterly basis.

Our methodology for assessing the appropriateness of the allowance is conducted on a regular basis and considers the Bank's overall loan portfolio. Refer to Note 3 *Summary of Significant Accounting Policies* of the 2017 Annual Report on Form 10-K for the year ended December 31, 2017 for a more detailed discussion concerning the allowance for loan losses.

Management believes that the ALLL was appropriate at September 30, 2018 and December 31, 2017. No assurance can be given that economic conditions which adversely affect the Company's service areas or other circumstances will not be reflected in increased provisions for loan losses in the future.

The following tables present the balance and activity related to the allowance for loan losses for held-for-investment loans by type for the periods presented.

|                           | For the Three Months Ended September 30, 2018 |             |            |                                 |   |
|---------------------------|---|-------------|------------|---------------------------------|---|
|                           | Ending Balance<br>June 30,<br>2018            | Charge-offs | Recoveries | Provision<br>for<br>Loan Losses | Ending Balance<br>September 30,<br>2018 |
|                           | <i>(Dollars in thousands)</i>                 |             |            |                                 |   |
| Commercial and industrial | \$ 6,970                                      | \$ -        | \$ 44      | \$ 477                          | \$ 7,491                                |
| SBA                       | 841   | (257)       | 5          | 369                             | 958                                     |
| Real estate:              |   |             |            |                                 |   |



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|  |                  |                 |               |               |                  |
|--|------------------|-----------------|---------------|---------------|------------------|
| Commercial real estate                 | 42,597           | -               | -             | (1,056)       | 41,541           |
| Construction                           | 1,003            | -               | 15            | 115           | 1,133            |
| SFR mortgage                           | 2,155            | -               | -             | (30)          | 2,125            |
| Dairy & livestock and agribusiness     | 4,351            | -               | -             | 673           | 5,024            |
| Municipal lease finance receivables    | 808              | -               | -             | 7             | 815              |
| Consumer and other loans               | 642              | (1)             | 118           | (44)          | 715              |
| PCI loans                              | 216              | -               | -             | (11)          | 205              |
| <b>Total allowance for loan losses</b> | <b>\$ 59,583</b> | <b>\$ (258)</b> | <b>\$ 182</b> | <b>\$ 500</b> | <b>\$ 60,007</b> |

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|  | <b>For the Three Months Ended September 30, 2017</b> |                    |                   |   |  |
|--|--|--------------------|-------------------|---|--|
|  | <b>Ending Balance<br/>June 30,<br/>2017</b>          | <b>Charge-offs</b> | <b>Recoveries</b> | <b>(Recapture of)<br/>Provision for<br/>Loan Losses</b> | <b>Ending Balance<br/>September 30,<br/>2017</b> |
|  | <i>(Dollars in thousands)</i>                        |                    |                   |   |  |
| Commercial and industrial              | \$ 8,060   | \$ (138)           | \$ 12             | \$ 129  | \$ 8,063   |
| SBA                                    | 913  | -                  | 5                 | (54)  | 864  |
| Real estate:                           |  |                    |                   |   |  |
| Commercial real estate                 | 39,927   | -                  | -                 | 943   | 40,870   |
| Construction                           | 1,059  | -                  | 2,055             | (2,181)   | 933  |
| SFR mortgage                           | 2,369  | -                  | -                 | (49)  | 2,320  |
| Dairy & livestock and agribusiness     | 5,440  | -                  | -                 | (66)  | 5,374  |
| Municipal lease finance receivables    | 852  | -                  | -                 | 54  | 906  |
| Consumer and other loans               | 922  | (9)                | 5                 | (48)  | 870  |
| PCI loans                              | 659  | -                  | -                 | (228)   | 431  |
| <b>Total allowance for loan losses</b> | <b>\$ 60,201</b>                                     | <b>\$ (147)</b>    | <b>\$ 2,077</b>   | <b>\$ (1,500)</b>                                       | <b>\$ 60,631</b>                                 |

|  | <b>For the Nine Months Ended September 30, 2018</b> |                    |                   |   |  |
|--|---|--------------------|-------------------|---|--|
|  | <b>Ending Balance<br/>December 31,<br/>2017</b>     | <b>Charge-offs</b> | <b>Recoveries</b> | <b>(Recapture of)<br/>Provision for<br/>Loan Losses</b> | <b>Ending Balance<br/>September 30,<br/>2018</b> |
|  | <i>(Dollars in thousands)</i>                       |                    |                   |   |  |
| Commercial and industrial              | \$ 7,280  | \$ -               | \$ 81             | \$ 130  | \$ 7,491   |
| SBA                                    | 869   | (257)              | 15                | 331   | 958  |
| Real estate:                           |   |                    |                   |   |  |
| Commercial real estate                 | 41,722  | -                  | -                 | (181)   | 41,541   |
| Construction                           | 984   | -                  | 1,945             | (1,796)   | 1,133  |
| SFR mortgage                           | 2,112   | -                  | -                 | 13  | 2,125  |
| Dairy & livestock and agribusiness     | 4,647   | -                  | 19                | 358   | 5,024  |
| Municipal lease finance receivables    | 851   | -                  | -                 | (36)  | 815  |
| Consumer and other loans               | 753   | (10)               | 129               | (157)   | 715  |
| PCI loans                              | 367   | -                  | -                 | (162)   | 205  |
| <b>Total allowance for loan losses</b> | <b>\$ 59,585</b>                                    | <b>\$ (267)</b>    | <b>\$ 2,189</b>   | <b>\$ (1,500)</b>                                       | <b>\$ 60,007</b>                                 |





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|                                     | September 30, 2017                          |   |   |   |   |   |
|-------------------------------------|---|---|---|---|---|---|
|                                     | Recorded Investment in Loans                |   |   | Allowance for Loan Losses                   |   |   |
|                                     | Individually<br>Evaluated for<br>Impairment | Collectively<br>Evaluated for<br>Impairment | Acquired with<br>Deteriorated<br>Credit Quality | Individually<br>Evaluated for<br>Impairment | Collectively<br>Evaluated for<br>Impairment | Acquired with<br>Deteriorated<br>Credit Quality |
|                                     | (Dollars in thousands)                      |   |   |   |   |   |
| Commercial and industrial           | \$ 745                                      | \$ 527,914                                  | \$ -  | \$ 2  | \$ 8,061                                    | \$ -  |
| SBA                                 | 2,273                                       | 121,818                                     | -   | 3   | 861   | -   |
| Real estate:                        |   |   |   |   |   |   |
| Commercial real estate              | 8,168                                       | 3,324,349                                   | -   | -   | 40,870                                      | -   |
| Construction                        | -   | 74,148                                      | -   | -   | 933   | -   |
| SFR mortgage                        | 4,550                                       | 240,112                                     | -   | -   | 2,320                                       | -   |
| Dairy & livestock and agribusiness  | 829   | 269,653                                     | -   | -   | 5,374                                       | -   |
| Municipal lease finance receivables | -   | 71,352                                      | -   | -   | 906   | -   |
| Consumer and other loans            | 743   | 69,672                                      | -   | 83  | 787   | -   |
| PCI loans                           | -   | -   | 36,548  | -   | -   | 431   |
| <b>Total</b>                        | <b>\$ 17,308</b>                            | <b>\$ 4,699,018</b>                         | <b>\$ 36,548</b>                                | <b>\$ 88</b>                                | <b>\$ 60,112</b>                            | <b>\$ 431</b>                                   |

**Past Due and Nonperforming Loans**

We seek to manage asset quality and control credit risk through diversification of the loan portfolio and the application of policies designed to promote sound underwriting and loan monitoring practices. The Bank's Credit Management Division is in charge of monitoring asset quality, establishing credit policies and procedures and enforcing the consistent application of these policies and procedures across the Bank. Reviews of nonperforming, past due loans and larger credits, designed to identify potential charges to the allowance for loan losses, and to determine the adequacy of the allowance, are conducted on an ongoing basis. These reviews consider such factors as the financial strength of borrowers and any guarantors, the value of the applicable collateral, loan loss experience, estimated loan losses, growth in the loan portfolio, prevailing economic conditions and other factors. Refer to Note 3 *Summary of Significant Accounting Policies*, included in our Annual Report on Form 10-K for the year ended December 31, 2017, for additional discussion concerning the Bank's policy for past due and nonperforming loans.

A loan is reported as a Troubled Debt Restructuring (TDR) when the Bank grants a concession(s) to a borrower experiencing financial difficulties that the Bank would not otherwise consider. Examples of such concessions include a reduction in the interest rate, deferral of principal or accrued interest, extending the payment due dates or loan maturity date(s), or providing a lower interest rate than would be normally available for new debt of similar risk. As a result of one or more of these concessions, restructured loans are classified as impaired. Impairment reserves on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the carrying value of the loan. These impairment reserves are recognized as a specific component to be provided for in the allowance for loan losses.

Generally, when loans are identified as impaired they are moved to our Special Assets Department. When we identify a loan as impaired, we measure the loan for potential impairment using discounted cash flows, unless the loan is determined to be collateral dependent. In these cases, we use the current fair value of collateral, less selling costs. Generally, the determination of fair value is established through obtaining external appraisals of the collateral.



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The following tables present the recorded investment in, and the aging of, past due and nonaccrual loans, excluding PCI loans, by type of loans for the periods presented.

|   | <b>September 30, 2018</b>      |                                |  |                               |                     | <b>Total Loans<br/>and Financing<br/>Receivables</b> |
|---|--------------------------------|--------------------------------|--|-------------------------------|---------------------|--|
|   | <b>30-59 Days<br/>Past Due</b> | <b>60-89 Days<br/>Past Due</b> | <b>Total Past Due<br/>and Accruing</b> | <b>Nonaccrual<br/>(1) (3)</b> | <b>Current</b>      |  |
|   | <i>(Dollars in thousands)</i>  |                                |  |                               |                     |  |
| Commercial and industrial                     | \$ 274                         | \$ -                           | \$ 274                                 | \$ 3,026                      | \$ 1,018,606        | \$ 1,021,906   |
| SBA   | -                              | 123                            | 123                                    | 3,005                         | 353,924             | 357,052  |
| Real estate:                                  |                                |                                |  |                               |                     |  |
| Commercial real estate                        |                                |                                |  |                               |                     |  |
| Owner occupied                                | -                              | -                              | -                                      | 615                           | 2,040,516           | 2,041,131  |
| Non-owner occupied                            | -                              | -                              | -                                      | 5,241                         | 3,222,368           | 3,227,609  |
| Construction                                  |                                |                                |  |                               |                     |  |
| Speculative (2)                               | -                              | -                              | -                                      | -                             | 32,081              | 32,081   |
| Non-speculative                               | -                              | -                              | -                                      | -                             | 91,193              | 91,193   |
| SFR mortgage                                  | -                              | -                              | -                                      | 2,961                         | 289,555             | 292,516  |
| Dairy & livestock and agribusiness            | -                              | -                              | -                                      | 775                           | 303,823             | 304,598  |
| Municipal lease finance receivables           | -                              | -                              | -                                      | -                             | 67,581              | 67,581   |
| Consumer and other loans                      | 98                             | -                              | 98                                     | 807                           | 133,891             | 134,796  |
| <b>Total gross loans, excluding PCI loans</b> | <b>\$ 372</b>                  | <b>\$ 123</b>                  | <b>\$ 495</b>                          | <b>\$ 16,430</b>              | <b>\$ 7,553,538</b> | <b>\$ 7,570,463</b>                                  |

- (1) As of September 30, 2018, \$2.6 million of nonaccruing loans were current, \$562,000 were 30-59 days past due, \$1.3 million were 60-89 days past due and \$12.0 million were 90+ days past due.
- (2) Speculative construction loans are generally for properties where there is no identified buyer or renter.
- (3) Includes \$8.6 million of nonaccrual loans acquired from CB in the third quarter of 2018.

|                           | <b>December 31, 2017</b>       |                                |  |                           |                | <b>Total Loans<br/>and Financing<br/>Receivables</b> |
|---------------------------|--------------------------------|--------------------------------|--|---------------------------|----------------|--|
|                           | <b>30-59 Days<br/>Past Due</b> | <b>60-89 Days<br/>Past Due</b> | <b>Total Past Due<br/>and Accruing</b> | <b>Nonaccrual<br/>(1)</b> | <b>Current</b> |  |
|                           | <i>(Dollars in thousands)</i>  |                                |  |                           |                |  |
| Commercial and industrial | \$ 768                         | \$ -                           | \$ 768                                 | \$ 250                    | \$ 512,307     | \$ 513,325   |
| SBA                       | 403                            | -                              | 403                                    | 906                       | 120,746        | 122,055  |
| Real estate:              |                                |                                |  |                           |                |  |
| Commercial real estate    |                                |                                |  |                           |                |  |
| Owner occupied            | -                              | -                              | -                                      | 4,365                     | 1,091,915      | 1,096,280  |
| Non-owner occupied        | -                              | -                              | -                                      | 2,477                     | 2,277,956      | 2,280,433  |
| Construction              |                                |                                |  |                           |                |  |
| Speculative (2)           | -                              | -                              | -                                      | -                         | 60,042         | 60,042   |
| Non-speculative           | -                              | -                              | -                                      | -                         | 17,940         | 17,940   |

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|  |          |      |          |           |              |              |
|--|----------|------|----------|-----------|--------------|--------------|
| SFR mortgage                           | -        | -    | -        | 1,337     | 234,865      | 236,202      |
| Dairy & livestock and agribusiness     | -        | -    | -        | 829       | 346,460      | 347,289      |
| Municipal lease finance receivables    | -        | -    | -        | -         | 70,243       | 70,243       |
| Consumer and other loans               | 1        | -    | 1        | 552       | 63,676       | 64,229       |
| Total gross loans, excluding PCI loans | \$ 1,172 | \$ - | \$ 1,172 | \$ 10,716 | \$ 4,796,150 | \$ 4,808,038 |

- (1) As of December 31, 2017, \$3.6 million of nonaccruing loans were current, \$376,000 were 60-89 days past due and \$6.8 million were 90+ days past due.
- (2) Speculative construction loans are generally for properties where there is no identified buyer or renter.



**Table of Contents****Impaired Loans**

At September 30, 2018, the Company had impaired loans, excluding PCI loans, of \$20.2 million. Impaired loans included \$5.9 million of nonaccrual commercial real estate loans, \$3.0 million of nonaccrual commercial and industrial loans, \$3.0 million of nonaccrual Small Business Administration ( SBA ) loans, \$3.0 million of nonaccrual single-family residential ( SFR ) mortgage loans, \$807,000 of nonaccrual consumer and other loans, and \$775,000 of nonaccrual dairy & livestock and agribusiness loans. These impaired loans included \$7.3 million of loans whose terms were modified in a troubled debt restructuring, of which \$3.5 million were classified as nonaccrual. The remaining balance of \$3.8 million consisted of 14 loans performing according to the restructured terms. The impaired loans had a specific allowance of \$83,000 at September 30, 2018. At December 31, 2017, the Company had classified as impaired, loans, excluding PCI loans, with a balance of \$15.5 million with a related allowance of \$75,000.

The following tables present information for held-for-investment loans, excluding PCI loans, individually evaluated for impairment by type of loans, as and for the periods presented.

|  | <b>As of and For the Nine Months Ended<br/>September 30, 2018</b> |   |                              |  |   |
|--|---|---|------------------------------|--|---|
|  | <b>Recorded<br/>Investment</b>                                    | <b>Unpaid<br/>Principal<br/>Balance</b> | <b>Related<br/>Allowance</b> | <b>Average<br/>Recorded<br/>Investment</b> | <b>Interest<br/>Income<br/>Recognized</b> |
| <i>(Dollars in thousands)</i>              |   |   |                              |  |   |
| <b>With no related allowance recorded:</b> |   |   |                              |  |   |
| Commercial and industrial                  | \$ 3,168  | \$ 3,829                                | \$ -                         | \$ 3,439                                   | \$ 6                                      |
| SBA  | 3,593   | 5,779                                   | -                            | 4,457                                      | 34  |
| Real estate:                               |   |   |                              |  |   |
| Commercial real estate                     |   |   |                              |  |   |
| Owner occupied                             | 615   | 726                                     | -                            | 644  | -   |
| Non-owner occupied                         | 5,733   | 6,385                                   | -                            | 5,904                                      | 24  |
| Construction                               |   |   |                              |  |   |
| Speculative                                | -   | -                                       | -                            | -  | -   |
| Non-speculative                            | -   | -                                       | -                            | -  | -   |
| SFR mortgage                               | 5,479   | 6,449                                   | -                            | 5,679                                      | 59  |
| Dairy & livestock and agribusiness         | 775   | 1,091                                   | -                            | 808  | -   |
| Municipal lease finance receivables        | -   | -                                       | -                            | -  | -   |
| Consumer and other loans                   | 737   | 1,025                                   | -                            | 867  | -   |
| <b>Total</b>                               | <b>20,100</b>   | <b>25,284</b>                           | <b>-</b>                     | <b>21,798</b>                              | <b>123</b>                                |
| <b>With a related allowance recorded:</b>  |   |   |                              |  |   |
| Commercial and industrial                  | -   | -                                       | -                            | -  | -   |
| SBA  | -   | -                                       | -                            | -  | -   |
| Real estate:                               |   |   |                              |  |   |
| Commercial real estate                     |   |   |                              |  |   |
| Owner occupied                             | -   | -                                       | -                            | -  | -   |
| Non-owner occupied                         | -   | -                                       | -                            | -  | -   |
| Construction                               |   |   |                              |  |   |

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|                                     |           |           |       |           |        |
|-------------------------------------|-----------|-----------|-------|-----------|--------|
| Speculative                         | -         | -         | -     | -         | -      |
| Non-speculative                     | -         | -         | -     | -         | -      |
| SFR mortgage                        | 13        | 13        | 13    | 13        | -      |
| Dairy & livestock and agribusiness  | -         | -         | -     | -         | -      |
| Municipal lease finance receivables | -         | -         | -     | -         | -      |
| Consumer and other loans            | 70        | 101       | 70    | 85        | -      |
| Total                               | 83        | 114       | 83    | 98        | -      |
| Total impaired loans                | \$ 20,183 | \$ 25,398 | \$ 83 | \$ 21,896 | \$ 123 |

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|  | As of and For the Nine Months Ended<br>September 30, 2017 |                                |                      |                                   |                                  |
|--|---|--------------------------------|----------------------|-----------------------------------|----------------------------------|
|  | Recorded<br>Investment                                    | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|  | <i>(Dollars in thousands)</i>                             |                                |                      |                                   |                                  |
| <b>With no related allowance recorded:</b> |   |                                |                      |                                   |                                  |
| Commercial and industrial                  | \$ 726  | \$ 1,256                       | \$ -                 | \$ 870                            | \$ 15                            |
| SBA  | 2,270   | 2,573                          | -                    | 2,489                             | 38                               |
| Real estate:                               |   |                                |                      |                                   |                                  |
| Commercial real estate                     |   |                                |                      |                                   |                                  |
| Owner occupied                             | 4,313   | 4,625                          | -                    | 4,361                             | 42                               |
| Non-owner occupied                         | 3,855   | 5,155                          | -                    | 4,010                             | 72                               |
| Construction                               |   |                                |                      |                                   |                                  |
| Speculative                                | -   | -                              | -                    | -                                 | -                                |
| Non-speculative                            | -   | -                              | -                    | -                                 | -                                |
| SFR mortgage                               | 4,550   | 5,345                          | -                    | 4,620                             | 109                              |
| Dairy & livestock and agribusiness         | 829   | 1,091                          | -                    | 1,035                             | 1                                |
| Municipal lease finance receivables        | -   | -                              | -                    | -                                 | -                                |
| Consumer and other loans                   | 356   | 571                            | -                    | 381                               | -                                |
| <b>Total</b>                               | <b>16,899</b>   | <b>20,616</b>                  | <b>-</b>             | <b>17,766</b>                     | <b>277</b>                       |
| <b>With a related allowance recorded:</b>  |   |                                |                      |                                   |                                  |
| Commercial and industrial                  | 19  | 20                             | 2                    | 42                                | 1                                |
| SBA  | 3   | 20                             | 3                    | 7                                 | -                                |
| Real estate:                               |   |                                |                      |                                   |                                  |
| Commercial real estate                     |   |                                |                      |                                   |                                  |
| Owner occupied                             | -   | -                              | -                    | -                                 | -                                |
| Non-owner occupied                         | -   | -                              | -                    | -                                 | -                                |
| Construction                               |   |                                |                      |                                   |                                  |
| Speculative                                | -   | -                              | -                    | -                                 | -                                |
| Non-speculative                            | -   | -                              | -                    | -                                 | -                                |
| SFR mortgage                               | -   | -                              | -                    | -                                 | -                                |
| Dairy & livestock and agribusiness         | -   | -                              | -                    | -                                 | -                                |
| Municipal lease finance receivables        | -   | -                              | -                    | -                                 | -                                |
| Consumer and other loans                   | 387   | 394                            | 83                   | 390                               | -                                |
| <b>Total</b>                               | <b>409</b>  | <b>434</b>                     | <b>88</b>            | <b>439</b>                        | <b>1</b>                         |
| <b>Total impaired loans</b>                | <b>\$ 17,308</b>  | <b>\$ 21,050</b>               | <b>\$ 88</b>         | <b>\$ 18,205</b>                  | <b>\$ 278</b>                    |

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| <b>As of December 31, 2017</b>             |                               |                  |                  |
|--|-------------------------------|------------------|------------------|
|  | <b>Recorded</b>               | <b>Unpaid</b>    | <b>Related</b>   |
|  | <b>Investment</b>             | <b>Principal</b> | <b>Allowance</b> |
|  | <i>(Dollars in thousands)</i> |                  |                  |
| <b>With no related allowance recorded:</b> |                               |                  |                  |
| Commercial and industrial                  | \$ 440                        | \$ 980           | \$ -             |
| SBA  | 1,530                         | 1,699            | -                |
| Real estate:                               |                               |                  |                  |
| Commercial real estate                     |                               |                  |                  |
| Owner occupied                             | 4,365                         | 4,763            | -                |
| Non-owner occupied                         | 3,768                         | 5,107            | -                |
| Construction                               |                               |                  |                  |
| Speculative                                | -                             | -                | -                |
| Non-speculative                            | -                             | -                | -                |
| SFR mortgage                               | 4,040                         | 4,692            | -                |
| Dairy & livestock and agribusiness         | 829                           | 1,091            | -                |
| Municipal lease finance receivables        | -                             | -                | -                |
| Consumer and other loans                   | 174                           | 370              | -                |
| <b>Total</b>                               | <b>15,146</b>                 | <b>18,702</b>    | <b>-</b>         |
| <b>With a related allowance recorded:</b>  |                               |                  |                  |
| Commercial and industrial                  | -                             | -                | -                |
| SBA  | 1                             | 18               | 1                |
| Real estate:                               |                               |                  |                  |
| Commercial real estate                     |                               |                  |                  |
| Owner occupied                             | -                             | -                | -                |
| Non-owner occupied                         | -                             | -                | -                |
| Construction                               |                               |                  |                  |
| Speculative                                | -                             | -                | -                |
| Non-speculative                            | -                             | -                | -                |
| SFR mortgage                               | -                             | -                | -                |
| Dairy & livestock and agribusiness         | -                             | -                | -                |
| Municipal lease finance receivables        | -                             | -                | -                |
| Consumer and other loans                   | 378                           | 391              | 74               |
| <b>Total</b>                               | <b>379</b>                    | <b>409</b>       | <b>75</b>        |
| <b>Total impaired loans</b>                | <b>\$ 15,525</b>              | <b>\$ 19,111</b> | <b>\$ 75</b>     |

The Company recognizes the charge-off of the impairment allowance on impaired loans in the period in which a loss is identified for collateral dependent loans. Therefore, the majority of the nonaccrual loans as of September 30, 2018, December 31, 2017 and September 30, 2017 have already been written down to the estimated net realizable value. An allowance is recorded on impaired loans for the following: nonaccrual loans where a charge-off is not yet processed, nonaccrual SFR mortgage loans where there is a potential modification in process, or on smaller balance non-collateral dependent loans.

***Reserve for Unfunded Loan Commitments***

The allowance for off-balance sheet credit exposure relates to commitments to extend credit, letters of credit and undisbursed funds on lines of credit. The Company evaluates credit risk associated with the off-balance sheet loan commitments at the same time it evaluates credit risk associated with the loan and lease portfolio. There was no provision or recapture of provision for unfunded loan commitments for the three and nine months ended September 30, 2018, and 2017. As a result of the acquisition of CB, the reserve for unfunded loan commitments increased by \$2.9 million in the third quarter of 2018. As of September 30, 2018 and December 31, 2017, the balance in this reserve was \$9.2 million and \$6.3 million, respectively, and was included in other liabilities.

**Table of Contents****Troubled Debt Restructurings ( TDRs )**

Loans that are reported as TDRs are considered impaired and charge-off amounts are taken on an individual loan basis, as deemed appropriate. The majority of restructured loans are loans for which the terms of repayment have been renegotiated, resulting in a reduction in interest rate or deferral of principal. Refer to Note 3 *Summary of Significant Accounting Policies*, included in our Annual Report on Form 10-K for the year ended December 31, 2017 for a more detailed discussion regarding TDRs.

As of September 30, 2018, there were \$7.3 million of loans classified as a TDR, of which \$3.5 million were nonperforming and \$3.8 million were performing. TDRs on accrual status are comprised of loans that were accruing interest at the time of restructuring or have demonstrated repayment performance in compliance with the restructured terms for a sustained period and for which the Company anticipates full repayment of both principal and interest. At September 30, 2018, performing TDRs were comprised of 10 SFR mortgage loans of \$2.5 million, one SBA loan of \$588,000, one commercial real estate loan of \$492,000, and two commercial and industrial loans of \$142,000.

The majority of TDRs have no specific allowance allocated as any impairment amount is normally charged off at the time a probable loss is determined. We have allocated zero and \$1,000 of specific allowance to TDRs as of September 30, 2018 and December 31, 2017, respectively.

The following table provides a summary of the activity related to TDRs for the periods presented.

|                                  | For the Three Months Ended    |                       | For the Nine Months Ended |                       |
|----------------------------------|-------------------------------|-----------------------|---------------------------|-----------------------|
|                                  | September 30,<br>2018         | September 30,<br>2017 | September 30,<br>2018     | September 30,<br>2017 |
|                                  | <i>(Dollars in thousands)</i> |                       |                           |                       |
| <b>Performing TDRs:</b>          |                               |                       |                           |                       |
| Beginning balance                | \$ 4,530                      | \$ 16,574             | \$ 4,809                  | \$ 19,233             |
| New modifications                | -                             | -                     | 311                       | 3,143                 |
| Payoffs/payments, net and other  | (777)                         | (10,839)              | (1,367)                   | (13,826)              |
| TDRs returned to accrual status  | -                             | -                     | -                         | 329                   |
| TDRs placed on nonaccrual status | -                             | -                     | -                         | (3,144)               |
| Ending balance                   | \$ 3,753                      | \$ 5,735              | \$ 3,753                  | \$ 5,735              |
| <b>Nonperforming TDRs:</b>       |                               |                       |                           |                       |
| Beginning balance                | \$ 3,892                      | \$ 4,391              | \$ 4,200                  | \$ 1,626              |
| New modifications                | 278                           | -                     | 316                       | 2,066                 |
| Charge-offs                      | -                             | -                     | -                         | -                     |
| Payoffs/payments, net and other  | (650)                         | (81)                  | (996)                     | (2,197)               |
| TDRs returned to accrual status  | -                             | -                     | -                         | (329)                 |
| TDRs placed on nonaccrual status | -                             | -                     | -                         | 3,144                 |
| Ending balance                   | \$ 3,520                      | \$ 4,310              | \$ 3,520                  | \$ 4,310              |
| Total TDRs                       | \$ 7,273                      | \$ 10,045             | \$ 7,273                  | \$ 10,045             |



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The following table summarizes loans modified as troubled debt restructurings for the period presented.

**Modifications (1)**

|  | <b>For the Three Months Ended September 30, 2018</b> |                   |                          |                   |                               |                           |                         |
|--|--|-------------------|--------------------------|-------------------|-------------------------------|---------------------------|-------------------------|
|  | <b>Pre-Modification</b>                              |                   | <b>Post-Modification</b> |                   | <b>Outstanding Investment</b> |                           | <b>Financial Effect</b> |
|  | <b>Number of</b>                                     | <b>Recorded</b>   | <b>Recorded</b>          | <b>Recorded</b>   | <b>at</b>                     | <b>September 30, 2018</b> | <b>Resulting From</b>   |
|  | <b>Loans</b>   | <b>Investment</b> | <b>Investment</b>        | <b>Investment</b> | <b>September 30, 2018</b>     | <b>Modifications (2)</b>  |                         |
|  |  |                   |                          |                   |                               |                           |                         |
|  | <i>(Dollars in thousands)</i>                        |                   |                          |                   |                               |                           |                         |
| <b>Commercial and industrial:</b>              |  |                   |                          |                   |                               |                           |                         |
| Interest rate reduction                        | -  | \$ -              | \$ -                     | \$ -              | \$ -                          | \$ -                      | -                       |
| Change in amortization period or maturity      | -  | -                 | -                        | -                 | -                             | -                         | -                       |
| <b>Real estate:</b>                            |  |                   |                          |                   |                               |                           |                         |
| <b>Commercial real estate:</b>                 |  |                   |                          |                   |                               |                           |                         |
| Owner occupied                                 |  |                   |                          |                   |                               |                           |                         |
| Interest rate reduction                        | -  | -                 | -                        | -                 | -                             | -                         | -                       |
| Change in amortization period or maturity      | -  | -                 | -                        | -                 | -                             | -                         | -                       |
| Non-owner occupied                             |  |                   |                          |                   |                               |                           |                         |
| Interest rate reduction                        | -  | -                 | -                        | -                 | -                             | -                         | -                       |
| Change in amortization period or maturity      | -  | -                 | -                        | -                 | -                             | -                         | -                       |
| <b>SFR mortgage:</b>                           |  |                   |                          |                   |                               |                           |                         |
| Interest rate reduction                        | -  | -                 | -                        | -                 | -                             | -                         | -                       |
| Change in amortization period or maturity      | -  | -                 | -                        | -                 | -                             | -                         | -                       |
| <b>Dairy &amp; livestock and agribusiness:</b> |  |                   |                          |                   |                               |                           |                         |
| Interest rate reduction                        | -  | -                 | -                        | -                 | -                             | -                         | -                       |
| Change in amortization period or maturity      | -  | -                 | -                        | -                 | -                             | -                         | -                       |
| <b>Consumer:</b>                               |  |                   |                          |                   |                               |                           |                         |
| Interest rate reduction                        | -  | -                 | -                        | -                 | -                             | -                         | -                       |
| Change in amortization period or maturity      | 1  | 278               | 278                      | 278               | 272                           | -                         | -                       |
| <b>Total loans</b>                             | <b>1</b>   | <b>\$ 278</b>     | <b>\$ 278</b>            | <b>\$ 278</b>     | <b>\$ 272</b>                 | <b>\$ -</b>               | <b>-</b>                |



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|  | For the Three Months Ended September 30, 2017 |                   |                        |                    |                   |
|--|---|-------------------|------------------------|--------------------|-------------------|
|  | Outstanding                                   |                   | Outstanding            |                    | Financial Effect  |
|  | Pre-Modification                              | Post-Modification | Pre-Modification       | Post-Modification  | Resulting From    |
|  | Number of                                     | Number of         | Investment             | Investment         | Modifications (2) |
|  | Loans   | Loans             | at                     | at                 |                   |
|  |   |                   | September 30, 2017     | September 30, 2017 |                   |
|  |   |                   | (Dollars in thousands) |                    |                   |
| <b>Commercial and industrial:</b>              |   |                   |                        |                    |                   |
| Interest rate reduction                        | -   | \$ -              | \$ -                   | \$ -               | \$ -              |
| Change in amortization period or maturity      | -   | -                 | -                      | -                  | -                 |
| <b>Real estate:</b>                            |   |                   |                        |                    |                   |
| <b>Commercial real estate:</b>                 |   |                   |                        |                    |                   |
| Owner occupied                                 |   |                   |                        |                    |                   |
| Interest rate reduction                        | -   | -                 | -                      | -                  | -                 |
| Change in amortization period or maturity      | -   | -                 | -                      | -                  | -                 |
| Non-owner occupied                             |   |                   |                        |                    |                   |
| Interest rate reduction                        | -   | -                 | -                      | -                  | -                 |
| Change in amortization period or maturity      | -   | -                 | -                      | -                  | -                 |
| <b>SFR mortgage:</b>                           |   |                   |                        |                    |                   |
| Interest rate reduction                        | -   | -                 | -                      | -                  | -                 |
| Change in amortization period or maturity      | -   | -                 | -                      | -                  | -                 |
| <b>Dairy &amp; livestock and agribusiness:</b> |   |                   |                        |                    |                   |
| Interest rate reduction                        | -   | -                 | -                      | -                  | -                 |
| Change in amortization period or maturity      | -   | -                 | -                      | -                  | -                 |
| <b>Consumer:</b>                               |   |                   |                        |                    |                   |
| Interest rate reduction                        | -   | -                 | -                      | -                  | -                 |
| Change in amortization period or maturity      | -   | -                 | -                      | -                  | -                 |
| Total loans                                    | -   | \$ -              | \$ -                   | \$ -               | \$ -              |

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|  | For the Nine Months Ended September 30, 2018 |               |                                      |  |   |
|--|--|---------------|--------------------------------------|--|---|
|  | Pre-Modification                             |               | Outstanding                          |  | Financial Effect<br>Resulting From<br>Modifications (2) |
|  | Number of<br>Loans                           | Investment    | Number of<br>Recorded<br>Investments | Investment<br>at<br>September 30, 2018 |   |
|  |  |               |                                      |  |   |
|  |  |               |                                      |  |   |
| <b>Commercial and industrial:</b>              |  |               |                                      |  |   |
| Interest rate reduction                        | -  | \$ -          | -                                    | \$ -                                   | -   |
| Change in amortization period or maturity      | 1  | 38            | 38                                   | 27                                     | -   |
| <b>Real estate:</b>                            |  |               |                                      |  |   |
| <b>Commercial real estate:</b>                 |  |               |                                      |  |   |
| Owner occupied                                 |  |               |                                      |  |   |
| Interest rate reduction                        | -  | -             | -                                    | -                                      | -   |
| Change in amortization period or maturity      | -  | -             | -                                    | -                                      | -   |
| Non-owner occupied                             |  |               |                                      |  |   |
| Interest rate reduction                        | -  | -             | -                                    | -                                      | -   |
| Change in amortization period or maturity      | -  | -             | -                                    | -                                      | -   |
| <b>SFR mortgage:</b>                           |  |               |                                      |  |   |
| Interest rate reduction                        | -  | -             | -                                    | -                                      | -   |
| Change in amortization period or maturity      | 1  | 311           | 311                                  | 304                                    | -   |
| <b>Dairy &amp; livestock and agribusiness:</b> |  |               |                                      |  |   |
| Interest rate reduction                        | -  | -             | -                                    | -                                      | -   |
| Change in amortization period or maturity      | -  | -             | -                                    | -                                      | -   |
| <b>Consumer:</b>                               |  |               |                                      |  |   |
| Interest rate reduction                        | -  | -             | -                                    | -                                      | -   |
| Change in amortization period or maturity      | 1  | 278           | 278                                  | 272                                    | -   |
| <b>Total loans</b>                             | <b>3</b>                                     | <b>\$ 627</b> | <b>\$ 627</b>                        | <b>\$ 603</b>                          | <b>\$ -</b>   |

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|  | For the Nine Months Ended September 30, 2017 |                 |                   |                    |                   |
|--|--|-----------------|-------------------|--------------------|-------------------|
|  | Pre-Modification                             |                 | Post-Modification |                    | Outstanding       |
|  | Number of                                    | Recorded        | Recorded          | Investment         | Financial Effect  |
|  | Loans  | Investment      | Investment        | at                 | Resulting From    |
|  |  |                 |                   | September 30, 2017 | Modifications (2) |
|  | <i>(Dollars in thousands)</i>                |                 |                   |                    |                   |
| <b>Commercial and industrial:</b>              |  |                 |                   |                    |                   |
| Interest rate reduction                        | -  | \$ -            | \$ -              | \$ -               | \$ -              |
| Change in amortization period or maturity      | -  | -               | -                 | -                  | -                 |
| <b>Real estate:</b>                            |  |                 |                   |                    |                   |
| <b>Commercial real estate:</b>                 |  |                 |                   |                    |                   |
| Owner occupied                                 |  |                 |                   |                    |                   |
| Interest rate reduction                        | -  | -               | -                 | -                  | -                 |
| Change in amortization period or maturity      | 1  | 3,143           | 3,143             | 3,143              | -                 |
| Non-owner occupied                             |  |                 |                   |                    |                   |
| Interest rate reduction                        | -  | -               | -                 | -                  | -                 |
| Change in amortization period or maturity      | -  | -               | -                 | -                  | -                 |
| <b>SFR mortgage:</b>                           |  |                 |                   |                    |                   |
| Interest rate reduction                        | -  | -               | -                 | -                  | -                 |
| Change in amortization period or maturity      | -  | -               | -                 | -                  | -                 |
| <b>Dairy &amp; livestock and agribusiness:</b> |  |                 |                   |                    |                   |
| Interest rate reduction                        | -  | -               | -                 | -                  | -                 |
| Change in amortization period or maturity      | 1  | 1,984           | 1,984             | 78                 | -                 |
| <b>Consumer:</b>                               |  |                 |                   |                    |                   |
| Interest rate reduction                        | -  | -               | -                 | -                  | -                 |
| Change in amortization period or maturity      | 1  | 82              | 82                | 76                 | -                 |
| <b>Total loans</b>                             | <b>3</b>                                     | <b>\$ 5,209</b> | <b>\$ 5,209</b>   | <b>\$ 3,297</b>    | <b>\$ -</b>       |

- (1) The tables above exclude modified loans that were paid off prior to the end of the period.
- (2) Financial effects resulting from modifications represent charge-offs and specific allowance recorded at modification date.

As of September 30, 2018, there were no loans that were previously modified as a TDR within the previous 12 months that subsequently defaulted during the three and nine months ended September 30, 2018.

As of September 30, 2017, there was one commercial real estate loan with an outstanding balance of \$3.1 million and one dairy & livestock and agribusiness loan with an outstanding balance of \$78,000 that was modified as a TDR within the previous 12 months that subsequently defaulted during the nine months ended September 30, 2017.

**Table of Contents****8. EARNINGS PER SHARE RECONCILIATION**

Basic earnings per common share are computed by dividing income allocated to common stockholders by the weighted-average number of common shares outstanding during each period. The computation of diluted earnings per common share considers the number of shares issuable upon the assumed exercise of outstanding common stock options. Antidilutive common shares are not included in the calculation of diluted earnings per common share. For the three and nine months ended September 30, 2018, shares deemed to be antidilutive, and thus excluded from the computation of earnings per common share, were 56,000 and 50,000, respectively. For the three and nine months ended September 30, 2017, shares deemed to be antidilutive, and thus excluded from the computation of earnings per common share, were 15,000 and 10,000, respectively.

The table below shows earnings per common share and diluted earnings per common share, and reconciles the numerator and denominator of both earnings per common share calculations.

|   | <b>For the Three Months<br/>Ended September 30,</b> |             | <b>For the Nine Months Ended<br/>September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2018</b>   | <b>2017</b> | <b>2018</b>  | <b>2017</b> |
|   | <i>(In thousands, except per share amounts)</i>     |             |  |             |
| <b>Earnings per common share:</b>                               |   |             |  |             |
| Net earnings  | \$ 38,558   | \$ 29,683   | \$ 108,844   | \$ 86,560   |
| Less: Net earnings allocated to restricted stock                | 96  | 107         | 298  | 325         |
| Net earnings allocated to common shareholders                   | \$ 38,462   | \$ 29,576   | \$ 108,546   | \$ 86,235   |
| Weighted average shares outstanding                             | 126,574   | 109,754     | 115,533  | 109,280     |
| Basic earnings per common share                                 | \$ 0.30   | \$ 0.27     | \$ 0.94  | \$ 0.79     |
| <b>Diluted earnings per common share:</b>                       |   |             |  |             |
| Net income allocated to common shareholders                     | 38,462  | 29,576      | 108,546  | 86,235      |
| Weighted average shares outstanding                             | 126,574   | 109,754     | 115,533  | 109,280     |
| Incremental shares from assumed exercise of outstanding options | 363   | 365         | 397  | 392         |
| Diluted weighted average shares outstanding                     | 126,937   | 110,119     | 115,930  | 109,672     |
| Diluted earnings per common share                               | \$ 0.30   | \$ 0.27     | \$ 0.94  | \$ 0.79     |



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**9. FAIR VALUE INFORMATION**

***Fair Value Hierarchy***

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The following disclosure provides the fair value information for financial assets and liabilities as of September 30, 2018. The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels (Level 1, Level 2 and Level 3).

*Level 1* Quoted prices in active markets for identical assets or liabilities in active markets that are accessible at the measurement date.

*Level 2* Observable inputs other than Level 1, including quoted prices for similar assets and liabilities in active markets, quoted prices in less active markets, or other observable inputs or model derived valuations that can be corroborated by observable market data, either directly or indirectly, for substantially the full term of the financial instrument.

*Level 3* Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable. These valuation methodologies generally include pricing models, discounted cash flow models, or a determination of fair value that requires significant management judgment or estimation.

There were no transfers in and out of Level 1 and Level 2 during the nine months ended September 30, 2018 and 2017.

**Table of Contents****Assets and Liabilities Measured at Fair Value on a Recurring Basis**

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis for the periods presented.

| Description of assets                  | Quoted Prices in Active Markets for Identical Assets or Significant Other Observable Inputs |   |   |      |
|--|---|---|---|------|
|  | Carrying Value at September 30, 2018 (Level 1)  | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |      |
| Investment securities - AFS:           |   |   |   |      |
| Residential mortgage-backed securities | \$ 1,532,878  | \$ -  | \$ 1,532,878                              | \$ - |
| CMO/REMIC - residential                | 223,817   | -   | 223,817                                   | -    |
| Municipal bonds                        | 48,739  | -   | 48,739                                    | -    |
| Other securities                       | 797   | -   | 797                                       | -    |
| Total investment securities - AFS      | 1,806,231   | -   | 1,806,231                                 | -    |
| Interest rate swaps                    | 944   | -   | 944                                       | -    |
| Total assets                           | \$ 1,807,175  | \$ -  | \$ 1,807,175                              | \$ - |
| Description of liability               |   |   |   |      |
| Interest rate swaps                    | \$ 944  | \$ -  | \$ 944                                    | \$ - |
| Total liabilities                      | \$ 944  | \$ -  | \$ 944                                    | \$ - |

| Description of assets                  | Quoted Prices in Active Markets for Identical Assets or Significant Other Observable Inputs |   |   |      |
|--|---|---|---|------|
|  | Carrying Value at December 31, 2017 (Level 1)   | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |      |
| Investment securities - AFS:           |   |   |   |      |
| Residential mortgage-backed securities | \$ 1,750,909  | \$ -  | \$ 1,750,909                              | \$ - |
| CMO/REMIC - residential                | 273,829   | -   | 273,829                                   | -    |
| Municipal bonds                        | 55,496  | -   | 55,496                                    | -    |
| Other securities                       | 751   | -   | 751                                       | -    |

|                                   |                     |             |                     |             |
|-----------------------------------|---------------------|-------------|---------------------|-------------|
| Total investment securities - AFS | 2,080,985           | -           | 2,080,985           | -           |
| Interest rate swaps               | 3,211               | -           | 3,211               | -           |
| <b>Total assets</b>               | <b>\$ 2,084,196</b> | <b>\$ -</b> | <b>\$ 2,084,196</b> | <b>\$ -</b> |
| <b>Description of liability</b>   |                     |             |                     |             |
| Interest rate swaps               | \$ 3,211            | \$ -        | \$ 3,211            | \$ -        |
| <b>Total liabilities</b>          | <b>\$ 3,211</b>     | <b>\$ -</b> | <b>\$ 3,211</b>     | <b>\$ -</b> |



**Table of Contents****Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis**

We may be required to measure certain assets at fair value on a non-recurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower of cost or fair value accounting or impairment write-downs of individual assets.

For assets measured at fair value on a non-recurring basis that were held on the balance sheet at September 30, 2018 and December 31, 2017, respectively, the following tables provide the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets that had losses during the period.

| Description of assets                | Quoted Prices in Active Markets for Significant Other Significant |                            |                             |                               | Total Losses For the Nine Months Ended September 30, 2018 |
|--------------------------------------|---|----------------------------|-----------------------------|-------------------------------|---|
|                                      | Carrying Value at September 30, 2018                              | Identical Assets (Level 1) | Observable Inputs (Level 2) | Unobservable Inputs (Level 3) |   |
| Impaired loans, excluding PCI loans: |   |                            |                             |                               |   |
| Commercial and industrial            | \$ -  | \$ -                       | \$ -                        | \$ -                          | \$ -  |
| SBA                                  | -   | -                          | -                           | -                             | -   |
| Real estate:                         |   |                            |                             |                               |   |
| Commercial real estate               | -   | -                          | -                           | -                             | -   |
| Construction                         | -   | -                          | -                           | -                             | -   |
| SFR mortgage                         | 13  | -                          | -                           | 13                            | 13  |
| Dairy & livestock and agribusiness   | -   | -                          | -                           | -                             | -   |
| Consumer and other loans             | 1   | -                          | -                           | 1                             | 1   |
| Other real estate owned              | -   | -                          | -                           | -                             | -   |
| Asset held-for-sale                  | -   | -                          | -                           | -                             | -   |
| <b>Total assets</b>                  | <b>\$ 14</b>  | <b>\$ -</b>                | <b>\$ -</b>                 | <b>\$ 14</b>                  | <b>\$ 14</b>  |

| Description of assets                | Quoted Prices in Active Markets for Significant Other Significant |                            |                             |                               | Total Losses For the Year Ended December 31, 2017 |
|--------------------------------------|---|----------------------------|-----------------------------|-------------------------------|---|
|                                      | Carrying Value at December 31, 2017                               | Identical Assets (Level 1) | Observable Inputs (Level 2) | Unobservable Inputs (Level 3) |   |
| Impaired loans, excluding PCI loans: |   |                            |                             |                               |   |

**Description of assets**

Impaired loans, excluding PCI loans:

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|                                    |               |             |             |               |              |
|------------------------------------|---------------|-------------|-------------|---------------|--------------|
| Commercial and industrial          | \$ -          | \$ -        | \$ -        | \$ -          | \$ -         |
| SBA                                | -             | -           | -           | -             | -            |
| Real estate:                       |               |             |             |               |              |
| Commercial real estate             | -             | -           | -           | -             | -            |
| Construction                       | -             | -           | -           | -             | -            |
| SFR mortgage                       | -             | -           | -           | -             | -            |
| Dairy & livestock and agribusiness | -             | -           | -           | -             | -            |
| Consumer and other loans           | 378           | -           | -           | 378           | 74           |
| Other real estate owned            | -             | -           | -           | -             | -            |
| Asset held-for-sale                | -             | -           | -           | -             | -            |
| <b>Total assets</b>                | <b>\$ 378</b> | <b>\$ -</b> | <b>\$ -</b> | <b>\$ 378</b> | <b>\$ 74</b> |

**Table of Contents****Fair Value of Financial Instruments**

The following disclosure presents estimated fair value of our financial instruments. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to develop the estimates of fair value. Accordingly, the estimates presented below are not necessarily indicative of the amounts the Company may realize in a current market exchange as of September 30, 2018 and December 31, 2017, respectively. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

|  | Carrying<br>Amount | September 30, 2018<br>Estimated Fair Value |              |           | Total        |
|--|--------------------|--|--------------|-----------|--------------|
|  |                    | Level 1                                    | Level 2      | Level 3   |              |
| <i>(Dollars in thousands)</i>                              |                    |  |              |           |              |
| <b>Assets</b>  |                    |  |              |           |              |
| Total cash and cash equivalents                            | \$ 194,475         | \$ 194,475                                 | \$ -         | \$ -      | \$ 194,475   |
| Interest-earning balances due from depository institutions | 8,812              | -  | 8,723        | -         | 8,723        |
| Investment securities available-for-sale                   | 1,806,231          | -  | 1,806,231    | -         | 1,806,231    |
| Investment securities held-to-maturity                     | 759,029            | -  | 726,755      | -         | 726,755      |
| Total loans, net of allowance for loan losses (1)          | 7,522,452          | -  | -            | 7,218,542 | 7,218,542    |
| Swaps  | 944                | -  | 944          | -         | 944          |
| <b>Liabilities</b>   |                    |  |              |           |              |
| Deposits:  |                    |  |              |           |              |
| Interest-bearing   | \$ 3,885,672       | \$ -                                       | \$ 3,875,171 | \$ -      | \$ 3,875,171 |
| Borrowings   | 429,477            | -  | 429,092      | -         | 429,092      |
| Junior subordinated debentures                             | 25,774             | -  | -            | 21,218    | 21,218       |
| Swaps  | 944                | -  | 944          | -         | 944          |

(1) The fair value of loans as of September 30, 2018 was measured using an exit price notion.

|  | Carrying<br>Amount | December 31, 2017<br>Estimated Fair Value |         |         | Total      |
|--|--------------------|---|---------|---------|------------|
|  |                    | Level 1                                   | Level 2 | Level 3 |            |
| <i>(Dollars in thousands)</i>                              |                    |   |         |         |            |
| <b>Assets</b>  |                    |   |         |         |            |
| Total cash and due from banks                              | \$ 144,377         | \$ 144,377                                | \$ -    | \$ -    | \$ 144,377 |
| Interest-earning balances due from depository institutions | 17,952             | -   | 17,951  | -       | 17,951     |

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|   |              |              |           |           |              |
|---|--------------|--------------|-----------|-----------|--------------|
| FHLB stock                                    | 17,688       | -            | 17,688    | -         | 17,688       |
| Investment securities available-for-sale      | 2,080,985    | -            | 2,080,985 | -         | 2,080,985    |
| Investment securities held-to-maturity        | 829,890      | -            | 819,215   | -         | 819,215      |
| Total loans, net of allowance for loan losses | 4,771,046    | -            | -         | 4,678,402 | 4,678,402    |
| Swaps   | 3,211        | -            | 3,211     | -         | 3,211        |
| <b>Liabilities</b>                            |              |              |           |           |              |
| Deposits:                                     |              |              |           |           |              |
| Noninterest-bearing                           | \$ 3,846,436 | \$ 3,846,436 | \$ -      | \$ -      | \$ 3,846,436 |
| Interest-bearing                              | 2,700,417    | -            | 2,697,781 | -         | 2,697,781    |
| Borrowings                                    | 553,773      | -            | 553,416   | -         | 553,416      |
| Junior subordinated debentures                | 25,774       | -            | -         | 18,070    | 18,070       |
| Swaps   | 3,211        | -            | 3,211     | -         | 3,211        |

The fair value estimates presented herein are based on pertinent information available to management as of September 30, 2018 and December 31, 2017. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date, and therefore, current estimates of fair value may differ significantly from the amounts presented above.

**Table of Contents****10. DERIVATIVE FINANCIAL INSTRUMENTS**

The Bank is exposed to certain risks relating to its ongoing business operations and utilizes interest rate swap agreements ( swaps ) as part of its asset/liability management strategy to help manage its interest rate risk position. As of September 30, 2018, the Bank has entered into 76 interest-rate swap agreements with customers. The Bank then entered into identical offsetting swaps with a counterparty bank. The swap agreements are not designated as hedging instruments. The purpose of entering into offsetting derivatives not designated as a hedging instrument is to provide the Bank a variable-rate loan receivable and to provide the customer the financial effects of a fixed-rate loan without creating significant volatility in the Bank's earnings.

The structure of the swaps is as follows. The Bank enters into an interest rate swap with its customers in which the Bank pays the customer a variable rate and the customer pays the Bank a fixed rate, therefore allowing customers to convert variable rate loans to fixed rate loans. At the same time, the Bank enters into a swap with the counterparty bank in which the Bank pays the counterparty a fixed rate and the counterparty in return pays the Bank a variable rate, which has the effect of passing on the interest-rate risk associated with the customer's fixed rate swap to the counterparty bank. The net effect of the transaction allows the Bank to receive interest on the loan from the customer at a variable rate based on LIBOR plus a spread. The changes in the fair value of the swaps primarily offset each other and therefore should not have a significant impact on the Company's results of operations, although the Company does incur credit and counterparty risk with respect to performance on the swap agreements by the Bank's customer and counterparty, respectively. Our interest rate swap derivatives are subject to a master netting arrangement with one counterparty bank. None of our derivative assets and liabilities are offset in the balance sheet.

We believe our risk of loss associated with our counterparty borrowers related to interest rate swaps is mitigated as the loans with swaps are underwritten to take into account potential additional exposure, although there can be no assurances in this regard since the performance of our swaps is subject to market and counterparty risk.

***Balance Sheet Classification of Derivative Financial Instruments***

As of September 30, 2018 and December 31, 2017, the total notional amount of the Company's swaps was \$204.1 million, and \$198.5 million, respectively. The location of the asset and liability, and their respective fair values are summarized in the tables below.

|   | <b>September 30, 2018</b> |               |                              |               |
|---|---------------------------|---------------|------------------------------|---------------|
|   | <b>Asset Derivatives</b>  |               | <b>Liability Derivatives</b> |               |
|   | <b>Balance Sheet</b>      | <b>Fair</b>   | <b>Balance Sheet</b>         | <b>Fair</b>   |
|   | <b>Location</b>           | <b>Value</b>  | <b>Location</b>              | <b>Value</b>  |
| <i>(Dollars in thousands)</i>                             |                           |               |                              |               |
| <b>Derivatives not designated as hedging instruments:</b> |                           |               |                              |               |
| Interest rate swaps                                       | Other assets              | \$ 944        | Other liabilities            | \$ 944        |
| <b>Total derivatives</b>                                  |                           | <b>\$ 944</b> |                              | <b>\$ 944</b> |

| <b>December 31, 2017</b> |                              |
|--------------------------|------------------------------|
| <b>Asset Derivatives</b> | <b>Liability Derivatives</b> |

|  | <b>Balance Sheet Location</b> | <b>Fair Value</b> | <b>Balance Sheet Location</b> | <b>Fair Value</b> |
|--|-------------------------------|-------------------|-------------------------------|-------------------|
| <i>(Dollars in thousands)</i>                      |                               |                   |                               |                   |
| Derivatives not designated as hedging instruments: |                               |                   |                               |                   |
| Interest rate swaps                                | Other assets                  | \$ 3,211          | Other liabilities             | \$ 3,211          |
| <b>Total derivatives</b>                           |                               | <b>\$ 3,211</b>   |                               | <b>\$ 3,211</b>   |

**Table of Contents*****The Effect of Derivative Financial Instruments on the Condensed Consolidated Statements of Earnings***

The following table summarizes the effect of derivative financial instruments on the condensed consolidated statement of earnings for the periods presented.

| Derivatives Not Designated as<br>Hedging Instruments | Location of Gain Recognized in<br>Income on Derivative Instruments | Amount of Gain Recognized in Income on<br>Derivative Instruments |        |  |        |
|--|--|--|--------|--|--------|
|  |  | For the Three Months Ended<br>September 30,<br>2018              |        | For the Nine Months Ended<br>September 30,<br>2017 |        |
|  |  | <i>(Dollars in thousands)</i>                                    |        |  |        |
| Interest rate swaps                                  | Other income   | \$ 73  | \$ 198 | \$ 340   | \$ 592 |
| Total  |  | \$ 73  | \$ 198 | \$ 340   | \$ 592 |

**11. OTHER COMPREHENSIVE INCOME**

The table below provides a summary of the components of other comprehensive income ( OCI ) for the periods presented.

|   | For the Three Months Ended September 30, |            |            |            |            |           |
|---|--|------------|------------|------------|------------|-----------|
|   | 2018                                     |            |            | 2017       |            |           |
|   | Before-tax                               | Tax effect | After-tax  | Before-tax | Tax effect | After-tax |
| <i>(Dollars in thousands)</i>   |  |            |            |            |            |           |
| <b>Investment securities:</b>   |  |            |            |            |            |           |
| Net change in fair value recorded in accumulated OCI  | \$ (10,235)                              | \$ 3,025   | \$ (7,210) | \$ 2,083   | \$ (875)   | \$ 1,208  |
| Amortization of unrealized gains (losses) on securities transferred from available-for-sale to held-to-maturity | (152)                                    | 45         | (107)      | (862)      | 362        | (500)     |
| Net realized gain reclassified into earnings (1)  | -  | -          | -          | -          | -          | -         |
| Net change  | \$ (10,387)                              | \$ 3,070   | \$ (7,317) | \$ 1,221   | \$ (513)   | \$ 708    |

|                               | For the Nine Months Ended September 30, |            |           |            |            |           |
|-------------------------------|---|------------|-----------|------------|------------|-----------|
|                               | 2018                                    |            |           | 2017       |            |           |
|                               | Before-tax                              | Tax effect | After-tax | Before-tax | Tax effect | After-tax |
| <i>(Dollars in thousands)</i> |   |            |           |            |            |           |

|   |             |           |             |          |            |          |
|---|-------------|-----------|-------------|----------|------------|----------|
| Investment securities:  |             |           |             |          |            |          |
| Net change in fair value recorded in accumulated OCI  | \$ (47,346) | \$ 13,997 | \$ (33,349) | \$ 6,128 | \$ (2,574) | \$ 3,554 |
| Amortization of unrealized gains (losses) on securities transferred from available-for-sale to held-to-maturity | (1,809)     | 535       | (1,274)     | (2,841)  | 1,193      | (1,648)  |
| Net realized gain reclassified into earnings (1)  | -           | -         | -           | (402)    | 169        | (233)    |
| Net change  | \$ (49,155) | \$ 14,532 | \$ (34,623) | \$ 2,885 | \$ (1,212) | \$ 1,673 |

(1) Included in other noninterest income.



**Table of Contents****12. BALANCE SHEET OFFSETTING**

Assets and liabilities relating to certain financial instruments, including, derivatives and securities sold under repurchase agreements ( repurchase agreements ), may be eligible for offset in the condensed consolidated balance sheets as permitted under accounting guidance. As noted above, our interest rate swap derivatives are subject to a master netting arrangement with one counterparty bank. Our interest rate swap derivatives require the Company to pledge investment securities as collateral based on certain risk thresholds. Investment securities that have been pledged by the Company to the counterparty bank continue to be reported in the Company's condensed consolidated balance sheets unless the Company defaults. We offer a repurchase agreement product to our customers, which include master netting agreements that allow for the netting of collateral positions. This product, known as Citizens Sweep Manager, sells certain of our securities overnight to our customers under an agreement to repurchase them the next day. The repurchase agreements are not offset in the condensed consolidated balances.

|   | <b>Gross Amounts<br/>Recognized<br/>in<br/>the Condensed</b> | <b>Gross Amounts<br/>Offset in<br/>the Condensed</b> | <b>Gross Amounts<br/>Not Offset in the<br/>Condensed</b> | <b>Gross Amounts<br/>Not Offset in the<br/>Condensed</b> | <b>Collateral<br/>Pledged</b> | <b>Net Amount</b> |
|---|--|--|--|--|-------------------------------|-------------------|
|   | <b>Balance Sheet</b>   | <b>Balance Sheet</b>                                 | <b>Balance Sheet</b>                                     | <b>Financial<br/>Instruments</b>                         |                               |                   |
|   | <i>(Dollars in thousands)</i>                                |  |  |  |                               |                   |
| <b>September 30, 2018</b>                         |  |  |  |  |                               |                   |
| <b>Financial assets:</b>                          |  |  |  |  |                               |                   |
| Derivatives not designated as hedging instruments | \$ 944   | \$ -   | \$ -   | \$ 944   | \$ -                          | \$ 944            |
| Total   | \$ 944   | \$ -   | \$ -   | \$ 944   | \$ -                          | \$ 944            |
| <b>Financial liabilities:</b>                     |  |  |  |  |                               |                   |
| Derivatives not designated as hedging instruments | \$ 6,797   | \$ (5,853)   | \$ 944   | \$ 5,853   | \$ -                          | \$ 6,797          |
| Repurchase agreements                             | 399,477  | -  | 399,477  | -  | (441,848)                     | (42,371)          |
| Total   | \$ 406,274   | \$ (5,853)   | \$ 400,421   | \$ 5,853   | \$ (441,848)                  | \$ (35,574)       |
| <b>December 31, 2017</b>                          |  |  |  |  |                               |                   |
| <b>Financial assets:</b>                          |  |  |  |  |                               |                   |
| Derivatives not designated as hedging instruments | \$ 3,211   | \$ -   | \$ -   | \$ 3,211   | \$ -                          | \$ 3,211          |
| Total   | \$ 3,211   | \$ -   | \$ -   | \$ 3,211   | \$ -                          | \$ 3,211          |
| <b>Financial liabilities:</b>                     |  |  |  |  |                               |                   |
| Derivatives not designated as hedging instruments | \$ 4,495   | \$ (1,284)   | \$ 3,211   | \$ 1,284   | \$ (12,760)                   | \$ (8,265)        |
| Repurchase agreements                             | 553,773  | -  | 553,773  | -  | (573,759)                     | (19,986)          |

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|       |            |            |            |          |              |             |
|-------|------------|------------|------------|----------|--------------|-------------|
| Total | \$ 558,268 | \$ (1,284) | \$ 556,984 | \$ 1,284 | \$ (586,519) | \$ (28,251) |
|-------|------------|------------|------------|----------|--------------|-------------|

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**Table of Contents****13. REVENUE RECOGNITION**

On January 1, 2018, the Company adopted ASU No. 2014-09 Revenue from Contracts with Customers (Topic 606) and all subsequent ASUs that modified Topic 606. As stated in Note 3 *Summary of Significant Accounting Policies*, the implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as trust and asset management income, deposit related fees, interchange fees, and merchant income. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company's revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

*Trust and Investment Services*

Trust and asset management income is primarily comprised of fees earned from the management and administration of trusts and customer assets. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based upon the monthly market value of the assets under management and the applicable fee rate. Payment is generally received at month end through a direct charge to customers' accounts. The Company does not earn performance-based incentives. Other services related to real estate and tax return preparation services are also provided to existing trust and asset management customers. The Company's performance obligation for these transactional-based services is generally satisfied, and related revenue recognized, at a point in time (i.e., as incurred). Payment is received shortly after services are rendered.

Wealth Management contracts with customers have no clauses that would entitle customers to additional services. Fees are generally earned based on market value of assets under management (AUM) and miscellaneous fees are transaction driven and are charged based on an agreed upon fee schedule. Performance obligation is satisfied upon execution of the transaction and there is no need to allocate transaction price to the performance obligation(s) in the contract. Wealth Management customers can also terminate the contract at will. Based on our review, we did not find provisions in the contracts that will require changes to the current accounting under Topic 606.

For Investment Services, the fees are earned based on services performed for customers as provided through an affiliated broker-dealer. Fees are earned from gross dealer commission based on trade date. Performance obligation is satisfied upon execution of the transaction and there is no need to allocate transaction price to the performance obligation(s) in the contract. Based on our review, we did not find provisions in the contracts that will require changes to the current accounting under Topic 606.

*Deposit-related Fees*

Service charges on deposit accounts consist of account analysis fees earned on analyzed business checking accounts, monthly service fees, and other deposit account related fees. The Company's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to

customers' accounts.

*Bankcard Services*

The Bank generates revenues from merchant servicing to its clients. A fee schedule is part of the contract and is calculated based on sales of merchants on a monthly basis. There is no future promise or claim to deliver services as merchant fees are based on monthly merchant transactions. The Company's performance obligations are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month. Therefore, the new revenue standard has no impact on revenues generated from bankcard services.

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The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three and nine months ended September 30, 2018 and 2017.

|  | For the Three Months Ended    |                  | For the Nine Months Ended |                  |
|--|-------------------------------|------------------|---------------------------|------------------|
|  | September 30,                 |                  | September 30,             |                  |
|  | 2018                          | 2017             | 2018                      | 2017             |
|  | <i>(Dollars in thousands)</i> |                  |                           |                  |
| <b>Noninterest income:</b>                     |                               |                  |                           |                  |
| <i>In-scope of Topic 606:</i>                  |                               |                  |                           |                  |
| Service charges on deposit accounts            | \$ 4,295                      | \$ 4,085         | \$ 12,431                 | \$ 11,794        |
| Trust and investment services                  | 2,182                         | 2,523            | 6,738                     | 7,432            |
| Bankcard services                              | 875                           | 927              | 2,637                     | 2,563            |
| Gain on OREO, net                              | -                             | 2                | 3,540                     | 4                |
| Other  | 1,824                         | 1,267            | 4,393                     | 3,895            |
| Noninterest Income (in-scope of Topic 606)     | 9,176                         | 8,804            | 29,739                    | 25,688           |
| Noninterest Income (out-of-scope of Topic 606) | 936                           | 1,234            | 2,984                     | 3,848            |
| <b>Total noninterest income</b>                | <b>\$ 10,112</b>              | <b>\$ 10,038</b> | <b>\$ 32,723</b>          | <b>\$ 29,536</b> |

*Contract Balances*

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of September 30, 2018 and December 31, 2017, the Company did not have any significant contract balances.

*Contract Acquisition Costs*

In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). The Company utilizes the practical expedient, which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Company did not capitalize any contract acquisition costs.

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion provides information about the results of operations, financial condition, liquidity and capital resources of CVB Financial Corp. (referred to herein on an unconsolidated basis as "CVB" and on a consolidated basis as "we," "our" or the "Company") and its wholly owned bank subsidiary, Citizens Business Bank (the "Bank" or "CB"). This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of our operations. This discussion and analysis should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017, and the unaudited condensed consolidated financial statements and accompanying notes presented elsewhere in this report.

**CRITICAL ACCOUNTING POLICIES**

The discussion and analysis of the Company's unaudited condensed consolidated financial statements are based upon its unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these unaudited condensed consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and are essential to understanding Management's Discussion and Analysis of Financial Condition and Results of Operations. The following is a summary of the more judgmental and complex accounting estimates and principles. In each area, we have identified the variables we believe are most important in our estimation process. We utilize information available to us to make the necessary estimates to value the related assets and liabilities. Actual performance that differs from our estimates and future changes in the key variables and information could change future valuations and impact the results of operations.

Allowance for Loan Losses ( "ALLL" )  
Income Taxes

Our significant accounting policies are described in greater detail in our 2017 Annual Report on Form 10-K in the "Critical Accounting Policies" section of Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 3 "Summary of Significant Accounting Policies," included in our Annual Report on Form 10-K for the year ended December 31, 2017, which are essential to understanding Management's Discussion and Analysis of Financial Condition and Results of Operations.

**OVERVIEW**

For the third quarter of 2018, we reported net earnings of \$38.6 million, compared with \$35.4 million for the second quarter of 2018 and \$29.7 million for the third quarter of 2017. Diluted earnings per share were \$0.30 for the third quarter, compared to \$0.32 for the prior quarter and \$0.27 for the same period last year.

On August 10, 2018, we completed the acquisition of Community Bank ("CB"). Our financial statements for the third quarter include 51 days of CB operations, post-merger. At close, Citizens Business Bank acquired \$2.73 billion of loans and assumed \$2.87 billion of total deposits, including \$1.26 billion of noninterest-bearing deposits.

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At September 30, 2018, total assets of \$11.48 billion increased \$3.21 billion, or 38.81%, from total assets of \$8.27 billion at December 31, 2017. Interest-earning assets of \$10.19 billion at September 30, 2018 increased \$2.39 billion, or 30.67%, when compared with \$7.80 billion at December 31, 2017. The increase in interest-earning assets was primarily due to a \$2.75 billion increase in total loans. This increase was partially offset by a decrease of \$345.6 million in investment securities. The increase in total loans included \$2.73 billion of loans acquired from CB in the third quarter of 2018.

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Total investment securities were \$2.57 billion at September 30, 2018, a decrease of \$345.6 million, or 11.87%, from \$2.91 billion at December 31, 2017. At September 30, 2018, investment securities held-to-maturity ( HTM ) totaled \$759.0 million. At September 30, 2018, investment securities available-for-sale ( AFS ) totaled \$1.81 billion, inclusive of a pre-tax unrealized loss of \$44.5 million. HTM securities declined by \$70.9 million, or 8.54%, and AFS securities declined by \$274.8 million, or 13.20%, from December 31, 2017.

Total loans and leases, net of deferred fees and discounts, of \$7.58 billion at September 30, 2018 increased by \$2.75 billion, or 56.97%, from December 31, 2017. Excluding the \$2.73 billion of acquired CB loans, total loans increased by \$17.7 million or 0.37% for the first nine months of 2018. Commercial real estate loans grew by \$98.2 million and construction loans increased by \$16.7 million. This growth was partially offset by a decrease of \$27.0 million in commercial and industrial loans and a decrease of \$55.7 million in dairy & livestock and agribusiness loans. The decline in dairy & livestock and agribusiness loans was due to seasonal dairy borrowings at year end, December 31, 2017.

Noninterest-bearing deposits were \$5.22 billion at September 30, 2018, an increase of \$1.38 billion, or 35.82%, when compared to December 31, 2017. At September 30, 2018, noninterest-bearing deposits were 57.35% of total deposits, compared to 58.75% at December 31, 2017. Our average cost of total deposits was 0.15% for the quarter ended September 30, 2018, compared with 0.09% for both the second quarter of 2018 and the third quarter of 2017.

Customer repurchase agreements totaled \$399.5 million at September 30, 2018, compared to \$553.8 million at December 31, 2017. Our average cost of total deposits including customer repurchase agreements was 0.15% for the quarter ended September 30, 2018, compared with 0.11% for the second quarter of 2018 and 0.10% for the third quarter of 2017.

At September 30, 2018, we had \$30.0 million in short-term borrowings compared to zero at December 31, 2017. At September 30, 2018, we had \$25.8 million of junior subordinated debentures, unchanged from December 31, 2017. These debentures bear interest at three-month LIBOR plus 1.38% and mature in 2036. Our average cost of funds was 0.18% for the quarter ended September 30, 2018, compared to 0.12% for the second quarter of 2018 and 0.12% for the third quarter of 2017.

The allowance for loan losses totaled \$60.0 million at September 30, 2018, compared to \$59.6 million at December 31, 2017. The allowance for loan losses for the first nine months of 2018 was increased by net recoveries on loans of \$1.9 million and was reduced by a \$1.5 million loan loss provision recapture. The allowance for loan losses was 0.79% and 1.23% of total loans and leases outstanding, at September 30, 2018 and December 31, 2017, respectively. The ratio as of the most recent quarter was impacted by the \$2.73 billion in loans acquired from Community Bank that are recorded at fair market value, without a corresponding loan loss allowance.

Our capital ratios under the revised capital framework referred to as Basel III remain well-above regulatory standards. As of September 30, 2018, the Company's Tier 1 leverage capital ratio totaled 12.52%, our common equity Tier 1 ratio totaled 12.94%, our Tier 1 risk-based capital ratio totaled 13.22%, and our total risk-based capital ratio totaled 14.00%. Refer to our *Analysis of Financial Condition - Capital Resources* for discussion of the new capital rules, which were effective beginning with the first quarter ended March 31, 2015.

**Recent Acquisition**

On August 10, 2018, we completed the acquisition of CB with approximately \$4.09 billion in total assets and 16 banking centers. The increase in total assets at September 30, 2018 included \$2.73 billion of acquired loans, net of an \$86.7 million discount, \$717.0 million of investment securities, and \$70.9 million in bank-owned life insurance. The



acquisition resulted in approximately \$546.3 million of goodwill and \$52.2 million in core deposit premium. At the close of the merger, the entire CB security portfolio was liquidated at fair market value, as was \$297.6 million of FHLB term advances and \$166.0 million of overnight borrowings assumed from CB. These fair values are estimates and are subject to adjustment for up to one year after the acquisition date or when additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier.

We have included the financial results of the business combination in the condensed consolidated statement of earnings and comprehensive income beginning on the acquisition date

**Table of Contents****Business Segments**

For the years ended December 31, 2016 through June 30, 2018, we operated as two reportable segments: Banking Centers and Dairy & Livestock and Agribusiness. As a result of the Community Bank acquisition, along with changes in personnel, reporting structure, and operations, we re-evaluated our segment reporting for the third quarter ended September 30, 2018.

As of September 30, 2018, we operated as one reportable segment. The factors considered in making this determination include the nature of products and offered services, geographic regions in which we operate, the applicable regulatory environment, and the materiality of discrete financial information reviewed by our key decision makers.

**ANALYSIS OF THE RESULTS OF OPERATIONS****Financial Performance**

|   | For the Three Months Ended |                  | Variance  |          |
|---|----------------------------|------------------|-----------|----------|
|   | September 30,<br>2018      | June 30,<br>2018 | \$        | %        |
| <i>(Dollars in thousands, except per share amounts)</i> |                            |                  |           |          |
| Net interest income                                     | \$ 92,820                  | \$ 72,688        | \$ 20,132 | 27.70%   |
| Provision for credit losses                             | (500)                      | 1,000            | (1,500)   | -150.00% |
| Noninterest income                                      | 10,112                     | 9,695            | 417       | 4.30%    |
| Noninterest expense                                     | (48,880)                   | (34,254)         | (14,626)  | -42.70%  |
| Income taxes  | (14,994)                   | (13,756)         | (1,238)   | -9.00%   |
| Net earnings  | \$ 38,558                  | \$ 35,373        | \$ 3,185  | 9.00%    |
| Earnings per common share:                              |                            |                  |           |          |
| Basic   | \$ 0.30                    | \$ 0.32          | \$ (0.02) |          |
| Diluted   | \$ 0.30                    | \$ 0.32          | \$ (0.02) |          |
| Return on average assets                                | 1.52%                      | 1.73%            | -0.21%    |          |
| Return on average shareholders' equity                  | 10.17%                     | 13.08%           | -2.91%    |          |

|  |   |             |                 |          |                                  |             |                 |          |  |
|--|---|-------------|-----------------|----------|----------------------------------|-------------|-----------------|----------|--|
| Efficiency ratio                       | 47.49%  | 41.58%      | 5.91%           |          |                                  |             |                 |          |  |
| Noninterest expense to average assets  | 1.93%   | 1.68%       | 0.25%           |          |                                  |             |                 |          |  |
|  | <b>For the Three Months Ended</b>                       |             |                 |          | <b>For the Nine Months Ended</b> |             |                 |          |  |
|  | <b>September 30,</b>                                    |             | <b>Variance</b> |          | <b>September 30,</b>             |             | <b>Variance</b> |          |  |
|  | <b>2018</b>   | <b>2017</b> | <b>\$</b>       | <b>%</b> | <b>2018</b>                      | <b>2017</b> | <b>\$</b>       | <b>%</b> |  |
|  | <i>(Dollars in thousands, except per share amounts)</i> |             |                 |          |                                  |             |                 |          |  |
| Net interest income                    | \$ 92,820   | \$ 71,739   | \$ 21,081       | 29.39%   | \$ 236,029                       | \$ 207,655  | \$ 28,374       | 13.66%   |  |
| Provision for loan losses              | (500)   | 1,500       | (2,000)         | -133.33% | 1,500                            | 7,000       | (5,500)         | -78.57%  |  |
| Noninterest income                     | 10,112  | 10,038      | 74              | 0.74%    | 32,723                           | 29,536      | 3,187           | 10.79%   |  |
| Noninterest expense                    | (48,880)  | (34,706)    | (14,174)        | -40.84%  | (119,080)                        | (105,696)   | (13,384)        | -12.66%  |  |
| Income taxes                           | (14,994)  | (18,888)    | 3,894           | 20.62%   | (42,328)                         | (51,935)    | 9,607           | 18.50%   |  |
| Net earnings                           | \$ 38,558   | \$ 29,683   | \$ 8,875        | 29.90%   | \$ 108,844                       | \$ 86,560   | \$ 22,284       | 25.74%   |  |
| Earnings per common share:             |   |             |                 |          |                                  |             |                 |          |  |
| Basic                                  | \$ 0.30   | \$ 0.27     | \$ 0.03         |          | \$ 0.94                          | \$ 0.79     | \$ 0.15         |          |  |
| Diluted                                | \$ 0.30   | \$ 0.27     | \$ 0.03         |          | \$ 0.94                          | \$ 0.79     | \$ 0.15         |          |  |
| Return on average assets               | 1.52%   | 1.41%       | 0.11%           |          | 1.65%                            | 1.40%       | 0.25%           |          |  |
| Return on average shareholders' equity | 10.17%  | 10.93%      | -0.76%          |          | 11.86%                           | 11.01%      | 0.85%           |          |  |
| Efficiency ratio                       | 47.49%  | 42.44%      | 5.05%           |          | 44.31%                           | 44.56%      | -0.25%          |          |  |
| Noninterest expense to average assets  | 1.93%   | 1.65%       | 0.28%           |          | 1.80%                            | 1.70%       | 0.10%           |          |  |

**Table of Contents*****Return on Average Tangible Common Equity Reconciliation (Non-GAAP)***

The return on average tangible common equity is a non-GAAP disclosure. The Company uses certain non-GAAP financial measures to provide supplemental information regarding the Company's performance. The following is a reconciliation of net income, adjusted for tax-effected amortization of intangibles, to net income computed in accordance with GAAP; a reconciliation of average tangible common equity to the Company's average stockholders equity computed in accordance with GAAP; as well as a calculation of return on average tangible common equity.

|   | <b>Three Months Ended</b>     |              | <b>Nine Months Ended</b> |              |
|---|-------------------------------|--------------|--------------------------|--------------|
|   | <b>September 30,</b>          |              | <b>September 30,</b>     |              |
|   | <b>2018</b>                   | <b>2017</b>  | <b>2018</b>              | <b>2017</b>  |
|   | <i>(Dollars in thousands)</i> |              |                          |              |
| Net Income  | \$ 38,558                     | \$ 29,683    | \$ 108,844               | \$ 86,560    |
| Add: Amortization of intangible assets                | 1,736                         | 343          | 2,395                    | 991          |
| Less: Tax effect of amortization of intangible assets | (486)                         | (133)        | (671)                    | (372)        |
| Adjusted net income                                   | \$ 39,808                     | \$ 29,893    | \$ 110,568               | \$ 87,179    |
| Average stockholders' equity                          | \$ 1,503,643                  | \$ 1,077,303 | \$ 1,226,848             | \$ 1,051,159 |
| Less: Average goodwill                                | (419,418)                     | (119,164)    | (218,625)                | (111,687)    |
| Less: Average intangible assets                       | (34,811)                      | (7,401)      | (16,078)                 | (6,923)      |
| Average tangible common equity                        | \$ 1,049,414                  | \$ 950,738   | \$ 992,145               | \$ 932,549   |
| Return on average equity, annualized                  | 10.17%                        | 10.93%       | 11.86%                   | 11.01%       |
| Return on average tangible common equity, annualized  | 15.05%                        | 12.47%       | 14.90%                   | 12.50%       |

***Net Interest Income***

The principal component of our earnings is net interest income, which is the difference between the interest and fees earned on loans and investments (interest-earning assets) and the interest paid on deposits and borrowed funds (interest-bearing liabilities). Net interest margin is net interest income as a percentage of average interest-earning assets for the period. The level of interest rates and the volume and mix of interest-earning assets and interest-bearing liabilities impact net interest income and net interest margin. The net interest spread is the yield on average interest-earning assets minus the cost of average interest-bearing liabilities. Net interest margin and net interest spread are included on a tax equivalent (TE) basis by adjusting interest income utilizing the federal statutory tax rates of 21% and 35% in effect for the three and nine months ended September 30, 2018 and 2017, respectively. The substantial change in rates were due to the Tax Reform Act. Our net interest income, interest spread, and net interest margin are sensitive to general business and economic conditions. These conditions include short-term and long-term interest rates, inflation, monetary supply, and the strength of the international, national and state economies, in general, and more specifically, the local economies in which we conduct business. Our ability to manage net interest income during changing interest rate environments will have a significant impact on our overall performance. We manage net interest

income through affecting changes in the mix of interest-earning assets as well as the mix of interest-bearing liabilities, changes in the level of interest-bearing liabilities in proportion to interest-earning assets, and in the growth and maturity of earning assets. See Item 2 *Management's Discussion and Analysis of Financial Condition and Results of Operations* *Asset/Liability and Market Risk Management* *Interest Rate Sensitivity Management* included herein.

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The table below presents the interest rate spread, net interest margin and the composition of average interest-earning assets and average interest-bearing liabilities by category for the periods indicated, including the changes in average balance, composition, and average yield/rate between these respective periods.

|   | <b>For the Three Months Ended September 30,</b> |                 |                        |                            |                 |                        |
|---|---|-----------------|------------------------|----------------------------|-----------------|------------------------|
|   | <b>2018</b>                                     |                 |                        | <b>2017</b>                |                 |                        |
|   | <b>Average<br/>Balance</b>                      | <b>Interest</b> | <b>Yield/<br/>Rate</b> | <b>Average<br/>Balance</b> | <b>Interest</b> | <b>Yield/<br/>Rate</b> |
|   | <i>(Dollars in thousands)</i>                   |                 |                        |                            |                 |                        |
| <b>INTEREST-EARNING ASSETS</b>                    |   |                 |                        |                            |                 |                        |
| Investment securities                             |   |                 |                        |                            |                 |                        |
| (1)   |   |                 |                        |                            |                 |                        |
| Available-for-sale securities:                    |   |                 |                        |                            |                 |                        |
| Taxable   | \$ 1,863,399                                    | \$ 11,126       | 2.39%                  | \$ 2,124,093               | \$ 11,767       | 2.22%                  |
| Tax-advantaged                                    | 55,020  | 395             | 3.86%                  | 64,839                     | 473             | 4.39%                  |
| Held-to-maturity securities:                      |   |                 |                        |                            |                 |                        |
| Taxable   | 527,688   | 2,961           | 2.24%                  | 578,450                    | 3,111           | 2.15%                  |
| Tax-advantaged                                    | 237,933   | 1,705           | 3.47%                  | 277,920                    | 2,073           | 4.04%                  |
| Investment in FHLB stock                          | 24,645  | 329             | 5.30%                  | 17,688                     | 318             | 7.03%                  |
| Interest-earning deposits with other institutions | 63,572  | 304             | 1.90%                  | 44,758                     | 130             | 1.16%                  |
| Loans (2)   | 6,350,240                                       | 79,818          | 4.99%                  | 4,710,900                  | 55,998          | 4.72%                  |
| Total interest-earning assets                     | 9,122,497                                       | 96,638          | 4.23%                  | 7,818,648                  | 73,870          | 3.81%                  |
| Total noninterest-earning assets                  | 935,028   |                 |                        | 520,728                    |                 |                        |
| Total assets                                      | \$ 10,057,525                                   |                 |                        | \$ 8,339,376               |                 |                        |
| <b>INTEREST-BEARING LIABILITIES</b>               |   |                 |                        |                            |                 |                        |
| Savings deposits (3)                              | \$ 2,850,169                                    | 2,101           | 0.29%                  | \$ 2,352,971               | 1,261           | 0.21%                  |
| Time deposits                                     | 503,649   | 866             | 0.68%                  | 398,810                    | 294             | 0.29%                  |
| Total interest-bearing deposits                   | 3,353,818                                       | 2,967           | 0.35%                  | 2,751,781                  | 1,555           | 0.22%                  |
|   | 478,538   | 851             | 0.70%                  | 551,193                    | 576             | 0.41%                  |

FHLB advances, other borrowings, and customer repurchase agreements

|                              |           |       |       |           |       |       |
|------------------------------|-----------|-------|-------|-----------|-------|-------|
| Interest-bearing liabilities | 3,832,356 | 3,818 | 0.39% | 3,302,974 | 2,131 | 0.26% |
|------------------------------|-----------|-------|-------|-----------|-------|-------|

|                              |           |  |  |           |  |  |
|------------------------------|-----------|--|--|-----------|--|--|
| Noninterest-bearing deposits | 4,651,127 |  |  | 3,891,381 |  |  |
| Other liabilities            | 70,399    |  |  | 67,718    |  |  |
| Stockholders equity          | 1,503,643 |  |  | 1,077,303 |  |  |

|   |               |  |  |              |  |  |
|---|---------------|--|--|--------------|--|--|
| Total liabilities and stockholders equity | \$ 10,057,525 |  |  | \$ 8,339,376 |  |  |
|---|---------------|--|--|--------------|--|--|

|                     |           |  |  |           |  |  |
|---------------------|-----------|--|--|-----------|--|--|
| Net interest income | \$ 92,820 |  |  | \$ 71,739 |  |  |
|---------------------|-----------|--|--|-----------|--|--|

|                                      |  |  |       |  |  |       |
|--------------------------------------|--|--|-------|--|--|-------|
| Net interest spread - tax equivalent |  |  | 3.84% |  |  | 3.55% |
| Net interest margin                  |  |  | 4.04% |  |  | 3.65% |
| Net interest margin - tax equivalent |  |  | 4.06% |  |  | 3.70% |

- (1) Includes tax equivalent (TE) adjustments utilizing federal statutory rates of 21% and 35% in effect for the three months ended September 30, 2018 and 2017, respectively. The non TE rates were 2.41% and 2.29% for the three months ended September 30, 2018 and 2017, respectively.
- (2) Includes loan fees of \$865,000 and \$885,000 for the three months ended September 30, 2018 and 2017, respectively. Prepayment penalty fees of \$674,000 and \$903,000 are included in interest income for the three months ended September 30, 2018 and 2017, respectively.
- (3) Includes interest-bearing demand and money market accounts.

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|   | For the Nine Months Ended September 30, |            |                |                    |            |                |
|---|---|------------|----------------|--------------------|------------|----------------|
|   | 2018                                    |            |                | 2017               |            |                |
|   | Average<br>Balance                      | Interest   | Yield/<br>Rate | Average<br>Balance | Interest   | Yield/<br>Rate |
|   | <i>(Dollars in thousands)</i>           |            |                |                    |            |                |
| <b>INTEREST-EARNING ASSETS</b>                                      |   |            |                |                    |            |                |
| Investment securities (1)   |   |            |                |                    |            |                |
| Available-for-sale securities:                                      |   |            |                |                    |            |                |
| Taxable   | \$ 1,920,942                            | \$ 33,861  | 2.36%          | \$ 2,161,151       | \$ 36,113  | 2.24%          |
| Tax-advantaged  | 54,517                                  | 1,225      | 3.99%          | 71,528             | 1,774      | 4.84%          |
| Held-to-maturity securities:  |   |            |                |                    |            |                |
| Taxable   | 540,952                                 | 8,887      | 2.19%          | 593,357            | 9,591      | 2.16%          |
| Tax-advantaged  | 246,270                                 | 5,351      | 3.50%          | 279,947            | 6,423      | 4.14%          |
| Investment in FHLB stock  | 20,032                                  | 959        | 6.40%          | 18,167             | 1,070      | 7.77%          |
| Interest-earning deposits with other institutions                   | 115,200                                 | 1,475      | 1.71%          | 90,125             | 683        | 1.01%          |
| Loans (2)   | 5,312,557                               | 192,382    | 4.84%          | 4,579,054          | 158,253    | 4.62%          |
| Total interest-earning assets                                       | 8,210,470                               | 244,140    | 4.00%          | 7,793,329          | 213,907    | 3.72%          |
| Total noninterest-earning assets                                    | 626,966                                 |            |                | 501,209            |            |                |
| Total assets  | \$ 8,837,436                            |            |                | \$ 8,294,538       |            |                |
| <b>INTEREST-BEARING LIABILITIES</b>                                 |   |            |                |                    |            |                |
| Savings deposits (3)  | \$ 2,460,390                            | 4,667      | 0.25%          | \$ 2,345,105       | 3,684      | 0.21%          |
| Time deposits   | 416,754                                 | 1,374      | 0.44%          | 403,701            | 863        | 0.29%          |
| Total interest-bearing deposits                                     | 2,877,144                               | 6,041      | 0.28%          | 2,748,806          | 4,547      | 0.22%          |
| FHLB advances, other borrowings, and customer repurchase agreements | 507,755                                 | 2,070      | 0.54%          | 595,415            | 1,705      | 0.38%          |
| Interest-bearing liabilities  | 3,384,899                               | 8,111      | 0.32%          | 3,344,221          | 6,252      | 0.25%          |
| Noninterest-bearing deposits  | 4,158,365                               |            |                | 3,828,235          |            |                |
| Other liabilities   | 67,324                                  |            |                | 70,923             |            |                |
| Stockholders equity   | 1,226,848                               |            |                | 1,051,159          |            |                |
| Total liabilities and stockholders equity                           | \$ 8,837,436                            |            |                | \$ 8,294,538       |            |                |
| Net interest income   |   | \$ 236,029 |                |                    | \$ 207,655 |                |



|                                      |       |       |
|--------------------------------------|-------|-------|
| Net interest spread - tax equivalent | 3.68% | 3.47% |
| Net interest margin                  | 3.84% | 3.56% |
| Net interest margin - tax equivalent | 3.87% | 3.62% |

- (1) Includes tax equivalent (TE) adjustments utilizing federal statutory rates of 21% and 35% in effect for the nine months ended September 30, 2018 and 2017, respectively. The non TE rates were 2.38% and 2.32% for the nine months ended September 30, 2018 and 2017, respectively.
- (2) Includes loan fees of \$2,616,000 and \$2,682,000 for the nine months ended September 30, 2018 and 2017, respectively. Prepayment penalty fees of \$2,120,000 and \$1,958,000 are included in interest income for the nine months ended September 30, 2018 and 2017, respectively.
- (3) Includes interest-bearing demand and money market accounts.

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The following table presents a comparison of interest income and interest expense resulting from changes in the volumes and rates on average interest-earning assets and average interest-bearing liabilities for the periods indicated. Changes in interest income or expense attributable to volume changes are calculated by multiplying the change in volume by the initial average interest rate. The change in interest income or expense attributable to changes in interest rates is calculated by multiplying the change in interest rate by the initial volume. The changes attributable to interest rate and volume changes are calculated by multiplying the change in rate times the change in volume.

**Rate and Volume Analysis for Changes in Interest Income, Interest Expense and Net Interest Income**

|   | <b>Comparison of Three Months Ended September 30,<br/>2018 Compared to 2017<br/>Increase (Decrease) Due to</b> |              |                         |               |
|---|--|--------------|-------------------------|---------------|
|   | <b>Volume</b>  | <b>Rate</b>  | <b>Rate/<br/>Volume</b> | <b>Total</b>  |
|   | <i>(Dollars in thousands)</i>  |              |                         |               |
| <b>Interest income:</b>   |  |              |                         |               |
| Available-for-sale securities:                                      |  |              |                         |               |
| Taxable investment securities                                       | \$ (1,417)   | \$ 883       | \$ (107)                | \$ (641)      |
| Tax-advantaged investment securities                                | (70)   | (7)          | (1)                     | (78)          |
| Held-to-maturity securities:  |  |              |                         |               |
| Taxable investment securities                                       | (277)  | 139          | (12)                    | (150)         |
| Tax-advantaged investment securities                                | (272)  | (84)         | (12)                    | (368)         |
| Investment in FHLB stock  | 88   | (55)         | (22)                    | 11            |
| Interest-earning deposits with other institutions                   | 55   | 84           | 35                      | 174           |
| Loans   | 19,531   | 3,182        | 1,107                   | 23,820        |
| <b>Total interest income</b>  | <b>17,638</b>  | <b>4,142</b> | <b>988</b>              | <b>22,768</b> |
| <b>Interest expense:</b>  |  |              |                         |               |
| Savings deposits  | 259  | 480          | 101                     | 840           |
| Time deposits   | 76   | 393          | 103                     | 572           |
| FHLB advances, other borrowings, and customer repurchase agreements | (74)   | 402          | (53)                    | 275           |
| <b>Total interest expense</b>                                       | <b>261</b>   | <b>1,275</b> | <b>151</b>              | <b>1,687</b>  |

|                     |    |        |    |       |    |     |    |        |
|---------------------|----|--------|----|-------|----|-----|----|--------|
| Net interest income | \$ | 17,377 | \$ | 2,867 | \$ | 837 | \$ | 21,081 |
|---------------------|----|--------|----|-------|----|-----|----|--------|

**Comparison of Nine Months Ended September 30,  
2018 Compared to 2017**

**Increase (Decrease) Due to**

|   | <b>Volume</b>                 |               | <b>Rate</b> |              | <b>Rate/<br/>Volume</b> |              | <b>Total</b> |               |
|---|-------------------------------|---------------|-------------|--------------|-------------------------|--------------|--------------|---------------|
|   | <i>(Dollars in thousands)</i> |               |             |              |                         |              |              |               |
| <b>Interest income:</b>   |                               |               |             |              |                         |              |              |               |
| Available-for-sale securities:                                      |                               |               |             |              |                         |              |              |               |
| Taxable investment securities                                       | \$                            | (3,883)       | \$          | 1,831        | \$                      | (200)        | \$           | (2,252)       |
| Tax-advantaged investment securities                                |                               | (423)         |             | (166)        |                         | 40           |              | (549)         |
| Held-to-maturity securities:  |                               |               |             |              |                         |              |              |               |
| Taxable investment securities                                       |                               | (824)         |             | 132          |                         | (12)         |              | (704)         |
| Tax-advantaged investment securities                                |                               | (757)         |             | (357)        |                         | 42           |              | (1,072)       |
| Investment in FHLB stock  |                               | 124           |             | (213)        |                         | (22)         |              | (111)         |
| Interest-earning deposits with other institutions                   |                               | 189           |             | 472          |                         | 131          |              | 792           |
| Loans   |                               | 25,346        |             | 7,571        |                         | 1,212        |              | 34,129        |
| <b>Total interest income</b>  |                               | <b>19,772</b> |             | <b>9,270</b> |                         | <b>1,191</b> |              | <b>30,233</b> |
| <b>Interest expense:</b>  |                               |               |             |              |                         |              |              |               |
| Savings deposits  |                               | 181           |             | 765          |                         | 37           |              | 983           |
| Time deposits   |                               | 29            |             | 467          |                         | 15           |              | 511           |
| FHLB advances, other borrowings, and customer repurchase agreements |                               | (243)         |             | 713          |                         | (105)        |              | 365           |
| <b>Total interest expense</b>                                       |                               | <b>(33)</b>   |             | <b>1,945</b> |                         | <b>(53)</b>  |              | <b>1,859</b>  |
| <b>Net interest income</b>  | <b>\$</b>                     | <b>19,805</b> | <b>\$</b>   | <b>7,325</b> | <b>\$</b>               | <b>1,244</b> | <b>\$</b>    | <b>28,374</b> |

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**Table of Contents***Third Quarter of 2018 Compared to the Third Quarter of 2017*

Net interest income, before (recapture of) provision for loan losses, of \$92.8 million for the third quarter of 2018 increased \$21.1 million, or 29.39%, compared to \$71.7 million for the third quarter of 2017. Interest-earning assets increased on average by \$1.30 billion, or 16.68%, from \$7.82 billion for the third quarter of 2017 to \$9.12 billion for the third quarter of 2018. Our net interest margin (TE) was 4.06% for the third quarter of 2018, compared to 3.70% for the third quarter of 2017. On a nominal basis, excluding the impact from tax-exempt interest, the net interest margin for the third quarter of 2018 grew by 39 basis points over the third quarter of 2017. The increase in our net interest margin was primarily the result of loan growth from the acquisition of CB and a higher level of discount accretion from the acquired loans.

Interest income for the third quarter of 2018 was \$96.6 million, which represented a \$22.8 million, or 30.82%, increase when compared to the same period of 2017. Average interest-earning assets increased by \$1.30 billion and the average interest-earning asset yield of 4.23%, increased by 42 basis points compared to the third quarter of 2017, primarily due to loans acquired from CB. The 42 basis point increase in the interest-earning asset yield over the third quarter of 2017 resulted from the combination of a 27 basis point increase in loan yield and the change in mix of earning assets, represented by an increase in average loans as a percentage of earning assets from 60.3% in the third quarter of 2017 to 69.6% in the third quarter of 2018. Conversely, average investment securities declined as a percentage of earning assets from 39.0% in the prior year to 29.4% in the third quarter of 2018.

Interest income and fees on loans for the third quarter of 2018 of \$79.8 million increased \$23.8 million, or 42.54%, when compared to the third quarter of 2017 primarily due to loans acquired from CB. Average loans increased \$1.64 billion for the third quarter of 2018 when compared with the same period of 2017. As a result of higher levels of discount accretion on acquired loans and nonaccrual interest paid, third quarter interest income increased by \$3.2 million in comparison to the third quarter of 2017. Also contributing to the 27 basis point increase in loan yield were increases in the rate on loans indexed to variable interest rates, such as the Bank's Prime rate, which increased by 1.00% when compared to the third quarter of 2017. Excluding discount accretion on acquired loans and nonaccrual interest paid, our loan yields grew by 12 basis points over the prior year.

In general, we stop accruing interest on a loan after its principal or interest becomes 90 days or more past due. When a loan is placed on nonaccrual, all interest previously accrued but not collected is charged against earnings. There was no interest income that was accrued and not reversed on nonaccrual loans at September 30, 2018 and 2017. As of September 30, 2018 and 2017, we had \$16.4 million and \$11.6 million of nonaccrual loans (excluding PCI loans), respectively.

Interest income from investment securities was \$16.2 million for the third quarter of 2018, a \$1.2 million, or 7.10%, decrease from \$17.4 million for the third quarter of 2017. This decrease was primarily the result of a \$361.3 million decrease in the average investment securities for the third quarter of 2018, compared to the same period of 2017. The nominal yield on investments increased by 12 basis points compared to the third quarter of 2017, while the tax equivalent yield increased by only seven basis points due to the reduction of the federal tax rate on tax-exempt investments resulting from the Tax Reform Act.

Interest expense of \$3.8 million for the third quarter of 2018, increased \$1.7 million, or 79.16%, compared to the third quarter of 2017. The average rate paid on interest-bearing liabilities increased 13 basis points, to 0.39% for the third quarter of 2018, from 0.26% for the third quarter of 2017. Average interest-bearing liabilities were \$529.4 million higher during the third quarter of 2018, compared to the third quarter of 2017, as we assumed \$1.61 billion interest-bearing deposits from CB during the third quarter of 2018. The interest-bearing deposits acquired from CB had an average cost of approximately 0.68%. Average noninterest-bearing deposits represented 58.10% of our total

deposits for the third quarter of 2018, compared to 58.58% for the third quarter of 2017. Our total cost of funds for the third quarter of 2018 was 0.18%, compared to 0.12% for the third quarter of 2017.

*Nine Months of 2018 Compared to the Nine Months of 2017*

Net interest income, before recapture of provision for loan losses, was \$236.0 million for the nine months ended September 30, 2018, an increase of \$28.4 million, or 13.66%, compared to \$207.7 million for the same period of 2017. Interest-earning assets increased on average by \$417.1 million, or 5.35%, from \$7.79 billion for the nine months ended September 30, 2017 to \$8.21 billion for the current year. Our net interest margin (TE) was 3.87% during the first nine months of 2018, compared to 3.62% for the same period of 2017. On a nominal basis, excluding the impact from tax-exempt interest, the net interest margin for the first nine months of 2018 grew by 28 basis points over the same period of 2017.

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Interest income for the nine months ended September 30, 2018 was \$244.1 million, which represented a \$30.2 million, or 14.13%, increase when compared to the same period of 2017. Compared to the first nine months of 2017, average interest-earning assets increased by \$417.1 million primarily due to loans acquired from CB, and the yield on interest-earning assets increased by 28 basis points.

The 28 basis points increase in the earning asset yield over the first nine months of 2018, resulted from a 22 basis point increase in loan yields and a change in the mix of earning assets. Average loans as a percentage of earning assets grew from 58.8% for the first nine months of 2017 to 64.7% for the first nine months of 2018. Conversely, average investment securities declined as a percentage of earning assets from 39.9% in the prior year to 33.7% for the first nine months of 2018.

Interest income and fees on loans for the first nine months of 2018 of \$192.4 million increased \$34.1 million, or 21.57%, when compared to the same period of 2017. Average loans increased \$733.5 million for the first nine months of 2018 when compared with the same period of 2017, primarily due to loans acquired from CB. The first nine months of 2018 reflected a \$5.8 million increase in discount accretion on acquired loans and nonaccrual interest paid when compared to the same period of 2017. Excluding discount accretion on acquired loans and nonaccrual interest paid, our loan yields grew from 4.48% for the nine months ended September 30, 2017 to 4.58% for the same period in 2018.

Interest income from investment securities was \$49.3 million for the nine months ended September 30, 2018, a \$4.6 million decrease from \$53.9 million for the first nine months of 2017. This decrease was the net result of a \$343.3 million decrease in the average investment securities for the first nine months of 2018, compared to the same period of 2017, partially offset by a six basis points increase in the non tax-equivalent yield on securities.

Interest expense of \$8.1 million for the nine months ended September 30, 2018, increased by \$1.9 million from the same period of 2017. The average rate paid on interest-bearing liabilities increased by 7 basis points, to 0.32% for the first nine months of 2018, from 0.25% for the same period of 2017. The rate on interest-bearing deposits for the first nine months of 2018 increased by six basis points from the same period in 2017. Average interest-bearing liabilities were \$40.7 million higher during the first nine months of 2018 when compared with the same period of 2017, primarily due to deposits assumed from CB. Average interest-bearing deposit growth of \$128.3 million was partially offset by a \$97.6 million decline in customer repurchase agreements. Average noninterest-bearing deposits represented 59.11% of our total deposits for the nine months ended September 30 2018, compared to 58.21% for the same period of 2017. Total cost of funds for the first nine months of 2018 was 0.14%, compared with 0.12% for the same period of 2017.

***Provision for Loan Losses***

The allowance for loan losses is increased by the provision for loan losses and recoveries of prior losses, and is decreased by recapture of provisions and by charge-offs taken when management believes the uncollectability of any loan is confirmed. The provision for loan losses is determined by management as the amount to be added to (subtracted from) the allowance for loan losses after net charge-offs have been deducted to bring the allowance to an appropriate level which, in management's best estimate, is necessary to absorb probable loan losses within the existing loan portfolio.

The allowance for loan losses totaled \$60.0 million at September 30, 2018, compared to \$59.6 million at December 31, 2017. The allowance for loan losses was increased by net recoveries on loans of \$1.9 million and was reduced by a \$1.5 million loan loss provision recapture for the nine months ended September 30, 2018. This compares to a \$7.0 million loan loss provision recapture and net recoveries of \$6.1 million for the same period of 2017. We

believe the allowance is appropriate at September 30, 2018. We periodically assess the quality of our portfolio to determine whether additional provisions for loan losses are necessary. The ratio of the allowance for loan losses to total loans and leases outstanding, net of deferred fees and discount, as of September 30, 2018 and December 31, 2017 was 0.79% and 1.23%, respectively. The ratio as of the most recent quarter was impacted by the \$2.73 billion in loans acquired from Community Bank that are recorded at fair market value, without a corresponding loan loss allowance. Refer to the discussion of *Allowance for Loan Losses* in Item 2 *Management's Discussion and Analysis of Financial Condition and Results of Operations* contained herein for discussion concerning observed changes in the credit quality of various components of our loan portfolio as well as changes and refinements to our methodology.

No assurance can be given that economic conditions which adversely affect the Company's service areas or other circumstances will not be reflected in increased provisions for loan losses in the future, as the nature of this process requires considerable judgment. Net recoveries totaled \$1.9 million for the nine months ended September 30, 2018, compared to \$6.1 million for the same period of 2017. See *Allowance for Loan Losses* under *Analysis of Financial Condition* herein.

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PCI loans acquired in the FDIC-assisted transaction were initially recorded at their fair value and were covered by loss sharing agreements with the FDIC. The loss sharing agreement with the FDIC for single-family residential loans, which would have expired on October 16, 2019, was terminated by the Bank on July 20, 2018. Refer to Note 3 *Summary of Significant Accounting Policies* included in our Annual Report on Form 10-K for the year ended December 31, 2017 for a more detailed discussion about the FDIC loss sharing asset/liability. For the nine months ended September 30, 2018 and 2017, there were zero in net charge-offs for loans in excess of the amount originally expected in the fair value of the loans at acquisition.

**Noninterest Income**

Noninterest income includes income derived from financial services offered, such as CitizensTrust, BankCard services, international banking, and other business services. Also included in noninterest income are service charges and fees, primarily from deposit accounts, gains (net of losses) from the disposition of investment securities, loans, other real estate owned, and fixed assets, and other revenues not included as interest on earning assets.

The following table sets forth the various components of noninterest income for the periods presented.

|  | For the Three Months Ended |          |          |          | For the Nine Months Ended |           |          |           |
|--|----------------------------|----------|----------|----------|---------------------------|-----------|----------|-----------|
|  | September 30,              |          | Variance |          | September 30,             |           | Variance |           |
|  | 2018                       | 2017     | \$       | %        | 2018                      | 2017      | \$       | %         |
| <i>(Dollars in thousands)</i>              |                            |          |          |          |                           |           |          |           |
| Noninterest income:                        |                            |          |          |          |                           |           |          |           |
| Service charges on deposit accounts        | \$ 4,295                   | \$ 4,085 | \$ 210   | 5.14%    | \$ 12,431                 | \$ 11,794 | \$ 637   | 5.40%     |
| Trust and investment services              | 2,182                      | 2,523    | (341)    | -13.52%  | 6,738                     | 7,432     | (694)    | -9.34%    |
| Bankcard services                          | 875                        | 927      | (52)     | -5.61%   | 2,637                     | 2,563     | 74       | 2.89%     |
| BOLI income                                | 936                        | 692      | 244      | 35.26%   | 2,984                     | 2,904     | 80       | 2.75%     |
| Gain on sale of investment securities, net | -                          | -        | -        | -        | -                         | 402       | (402)    | -100.00%  |
| Gain on OREO, net                          | -                          | 2        | (2)      | -100.00% | 3,540                     | 4         | 3,536    | 88400.00% |
| Gain on sale of asset held-for-sale, net   | -                          | 542      | (542)    | -100.00% | -                         | 542       | (542)    | -100.00%  |



|                          |           |           |       |        |           |           |          |        |
|--------------------------|-----------|-----------|-------|--------|-----------|-----------|----------|--------|
| Other                    | 1,824     | 1,267     | 557   | 43.96% | 4,393     | 3,895     | 498      | 12.79% |
| Total noninterest income | \$ 10,112 | \$ 10,038 | \$ 74 | 0.74%  | \$ 32,723 | \$ 29,536 | \$ 3,187 | 10.79% |

*Third Quarter of 2018 Compared to the Third Quarter of 2017*

The third quarter included approximately \$1.0 million in noninterest income as a result of the acquisition of CB. The \$74,000 increase in noninterest income was primarily due to a \$244,000 increase in Bank-Owned Life Insurance ( BOLI ) income, a \$210,000 increase in service charges on deposits, a \$260,000 increase in other banking services fee income, and \$95,000 increase in international banking income, partially offset by a \$341,000 decrease in trust and wealth management fees and a \$542,000 net gain on the sale of our former operations/technology center in the third quarter of 2017.

CitizensTrust consists of Wealth Management and Investment Services income. The Wealth Management group provides a variety of services, which include asset management, financial planning, estate planning, retirement planning, private, and corporate trustee services, and probate services. Investment Services provides self-directed brokerage, 401(k) plans, mutual funds, insurance and other non-insured investment products. At September 30, 2018, CitizensTrust had approximately \$2.58 billion in assets under management and administration, including \$1.79 billion in assets under management. CitizensTrust generated fees of \$2.2 million for the third quarter of 2018, a decrease of \$341,000 compared to the third quarter of 2017, due to the decline in assets under management.

The Bank's investment in BOLI includes life insurance policies acquired through acquisitions and the purchase of life insurance by the Bank on a selected group of employees. The Bank is the owner and beneficiary of these policies. BOLI is recorded as an asset at its cash surrender value. Increases in the cash value of these policies, as well as insurance proceeds received, are recorded in noninterest income and are not subject to income tax, as long as they are held for the life of the covered parties. The \$244,000 increase in BOLI income was due to a \$242,000 BOLI income from \$70.9 million BOLI policies acquired from CB in the third quarter of 2018.

**Table of Contents***Nine Months of 2018 Compared to the Nine Months of 2017*

The \$3.2 million increase in noninterest income for the nine months ended September 30, 2018, was the result of a \$3.5 million net gain on the sale of one OREO property and a \$637,000 increase in service charges on deposits, partially offset by a \$694,000 decrease in trust and wealth management fees. The first nine months of 2018 also included recoveries of \$475,000 and \$190,000 on a Valley Business Bank ( VBB ) and an American Security Bank ( ASB ) loan, respectively, that were fully charged off prior to acquisition, compared to \$443,000 of recoveries on ASB loans that were fully charged off prior to the acquisition for the first nine months of 2017. 2017 also included a \$542,000 net gain on the sale of our former operations/technology center in the third quarter of 2017 and a \$402,000 gain on sale of an investment security in the second quarter of 2017.

**Noninterest Expense**

The following table summarizes the various components of noninterest expense for the periods presented.

|                                   | For the Three Months Ended |           | Variance |          | For the Nine Months Ended |           | Variance |         |
|-----------------------------------|----------------------------|-----------|----------|----------|---------------------------|-----------|----------|---------|
|                                   | September 30,<br>2018      | 2017      | \$       | %        | September 30,<br>2018     | 2017      | \$       | %       |
| <i>(Dollars in thousands)</i>     |                            |           |          |          |                           |           |          |         |
| Noninterest expense:              |                            |           |          |          |                           |           |          |         |
| Salaries and employee benefits    | \$ 26,319                  | \$ 21,835 | \$ 4,484 | 20.54%   | \$ 69,684                 | \$ 65,116 | \$ 4,568 | 7.02%   |
| Occupancy                         | 4,168                      | 3,514     | 654      | 18.61%   | 10,924                    | 9,964     | 960      | 9.63%   |
| Equipment                         | 1,156                      | 886       | 270      | 30.47%   | 2,910                     | 2,674     | 236      | 8.83%   |
| Professional services             | 1,154                      | 1,091     | 63       | 5.77%    | 4,374                     | 4,191     | 183      | 4.37%   |
| Software licenses and maintenance | 2,317                      | 1,510     | 807      | 53.44%   | 5,836                     | 4,698     | 1,138    | 24.22%  |
| Stationery and supplies           | 251                        | 254       | (3)      | -1.18%   | 795                       | 917       | (122)    | -13.30% |
| Telecommunications expense        | 622                        | 581       | 41       | 7.06%    | 1,711                     | 1,763     | (52)     | -2.95%  |
| Marketing and promotion           | 1,134                      | 1,055     | 79       | 7.49%    | 3,638                     | 3,484     | 154      | 4.42%   |
| Amortization of intangible assets | 1,736                      | 343       | 1,393    | 406.12%  | 2,395                     | 991       | 1,404    | 141.68% |
| Regulatory assessments            | 896                        | 776       | 120      | 15.46%   | 2,276                     | 2,361     | (85)     | -3.60%  |
| Insurance                         | 432                        | 446       | (14)     | -3.14%   | 1,278                     | 1,349     | (71)     | -5.26%  |
| Loan expense                      | 274                        | 234       | 40       | 17.09%   | 678                       | 642       | 36       | 5.61%   |
| OREO expense                      | -                          | 8         | (8)      | -100.00% | 7                         | 75        | (68)     | -90.67% |
| Directors expenses                | 275                        | 251       | 24       | 9.56%    | 785                       | 719       | 66       | 9.18%   |
| Acquisition related expenses      | 6,645                      | 250       | 6,395    | 2558.00% | 7,942                     | 2,176     | 5,766    | 264.98% |

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|   |           |           |           |         |            |            |           |         |
|---|-----------|-----------|-----------|---------|------------|------------|-----------|---------|
| Other   | 1,501     | 1,672     | (171)     | -10.23% | 3,847      | 4,576      | (729)     | -15.93% |
| Total noninterest expense   | \$ 48,880 | \$ 34,706 | \$ 14,174 | 40.84%  | \$ 119,080 | \$ 105,696 | \$ 13,384 | 12.66%  |
| Noninterest expense to average assets   | 1.93%     | 1.65%     |           |         | 1.80%      | 1.70%      |           |         |
| Noninterest expense to average assets, excluding acquisition related expenses | 1.67%     | 1.64%     |           |         | 1.68%      | 1.67%      |           |         |
| Efficiency ratio (1)  | 47.49%    | 42.44%    |           |         | 44.31%     | 44.56%     |           |         |
| Efficiency ratio, excluding acquisition related expenses (1)                  | 41.03%    | 42.13%    |           |         | 41.35%     | 43.64%     |           |         |

(1) Noninterest expense divided by net interest income before provision for loan losses plus noninterest income.  
*Third Quarter of 2018 Compared to the Third Quarter of 2017*

Our ability to control noninterest expenses in relation to asset growth can be measured in terms of total noninterest expenses as a percentage of average assets. Noninterest expense measured as a percentage of average assets was 1.93% for the third quarter of 2018, compared to 1.65% for the third quarter of 2017. If acquisition related expenses are excluded, noninterest expense as a percentage of average assets was 1.67% for the third quarter of 2018, compared to 1.64% for the third quarter of 2017.

Our ability to control noninterest expenses in relation to the level of total revenue (net interest income before provision for loan losses plus noninterest income) is measured by the efficiency ratio and indicates the percentage of net revenue that is used to cover expenses. For the third quarter of 2018, the efficiency ratio was 47.49%, compared to 42.44% for the third quarter of 2017. If acquisition related expenses are excluded, the efficiency ratio was 41.03% for the third quarter of 2018, compared to 42.13% for the same quarter of 2017.

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The \$14.2 million, or 40.84%, increase in noninterest expense for the third quarter of 2018 was primarily due to a \$6.4 million increase in acquisition related expenses in connection with the acquisition of CB. Salaries and benefit costs for the third quarter of 2018 increased by \$4.5 million principally due to additional compensation related costs for the newly hired and former CB employees. Occupancy and equipment increased by \$924,000 due to the addition of 16 banking centers and an administrative office from CB. Software expense increased by \$807,000, including \$500,000 related to the acquisition of CB. Amortization of core deposit intangible ( CDI ) increased by \$1.4 million as a result of the core deposits assumed from CB.

*Nine Months of 2018 Compared to the Nine Months of 2017*

Noninterest expense of \$119.1 million for the first nine months of 2018 was \$13.4 million higher than the prior year period. The year-over-year increase included a \$7.7 million increase in merger related expenses for the acquisition of CB in 2018, compared to \$1.9 million in acquisition costs related to the integration and systems conversion of VBB for the same period of 2017. Salaries and benefit costs increased by \$4.6 million due to additional compensation related expenses for the newly hired and former CB employees. CB related expenses were the primary driver of a \$1.1 million increase in software licenses and maintenance, and a \$960,000 increase in occupancy expense. The year-over-year increase also included a \$1.4 million increase in amortization of intangible assets due to core deposits assumed from CB. As a percentage of average assets, noninterest expense was 1.80% for the nine months ended September 30, 2018, compared to 1.70% for the same period of 2017. For the nine months ended 2018, the efficiency ratio was 44.31%, compared to 44.56% for the same period of 2017. If acquisition related expenses are excluded, noninterest expense as a percentage of average assets and the efficiency ratio was 1.68% and 41.35%, respectively, for the nine months ended September 30, 2018, compared to 1.67% and 43.64%, for the same period of 2017.

*Income Taxes*

The Company's effective tax rate for the three and nine months ended September 30, 2018 was 28.00%, compared to 38.89% and 37.50% for the three and nine months ended September 30, 2017, respectively. On December 22, 2017, the Tax Reform Act was enacted into law. Beginning in 2018, the Tax Reform Act reduces the federal tax rate for corporations from 35% to 21% and changes or limits certain tax deductions. During the fourth quarter of 2017, we recorded a \$13.2 million one-time charge to income tax expense due to the tax rate reduction and re-measurement of our net DTA. Our estimated annual effective tax rate also varies depending upon the level of tax-advantaged income as well as available tax credits.

The Company's effective tax rates are below the nominal combined Federal and State tax rate primarily as a result of tax-advantaged income from certain municipal security investments, municipal loans and leases and BOLI, as well as available tax credits for each period.

**Table of Contents****ANALYSIS OF FINANCIAL CONDITION**

The Company reported total assets of \$11.48 billion at September 30, 2018. This represented an increase of \$3.21 billion, or 38.81%, from total assets of \$8.27 billion at December 31, 2017. Interest-earning assets of \$10.19 billion at September 30, 2018 increased \$2.39 billion, or 30.67%, when compared with \$7.80 billion at December 31, 2017. The increase in interest-earning assets was primarily due to a \$2.75 billion increase in total loans. This increase was partially offset by a decrease of \$345.6 million in investment securities. The increase in total loans included \$2.73 billion of loans acquired from CB in the third quarter of 2018. Total liabilities were \$9.66 billion at September 30, 2018, an increase of \$2.46 billion, or 34.17%, from total liabilities of \$7.20 billion at December 31, 2017. The increase in total liabilities included \$2.87 billion of total deposits assumed from CB during the third quarter of 2018. Total equity increased \$749.3 million, or 70.08%, to \$1.82 billion at September 30, 2018, compared to total equity of \$1.07 billion at December 31, 2017. The \$749.3 million increase in equity was due to \$722.8 million for the issuance of common stock for the acquisition of CB, \$108.8 million in net earnings and \$2.8 million for various stock based compensation items. This was offset by \$50.5 million in cash dividends declared and a \$34.6 million decrease in other comprehensive income, net of tax, resulting from the net change in fair value of our investment securities portfolio.

**Investment Securities**

The Company maintains a portfolio of investment securities to provide interest income and to serve as a source of liquidity for its ongoing operations. At September 30, 2018, we reported total investment securities of \$2.57 billion. This represented a decrease of \$345.6 million, or 11.87%, from total investment securities of \$2.91 billion at December 31, 2017. At September 30, 2018, investment securities HTM totaled \$759.0 million. At September 30, 2018, our AFS investment securities totaled \$1.81 billion, inclusive of a pre-tax unrealized loss of \$44.5 million. The after-tax unrealized loss reported in AOCI on AFS investment securities was \$31.3 million.

As of September 30, 2018, the Company had a pre-tax net unrealized holding loss on AFS investment securities of \$44.5 million, compared to a pre-tax net unrealized holding gain of \$2.9 million at December 31, 2017. The changes in the net unrealized holding loss resulted primarily from fluctuations in market interest rates. For the nine months ended September 30, 2018 and 2017, repayments/maturities of investment securities totaled \$385.0 million and \$438.0 million, respectively. The Company purchased additional investment securities totaling \$98.7 million and \$316.5 million for the nine months ended September 30, 2018 and 2017, respectively. At the close of the merger in the third quarter of 2018, we liquidated the entire investment security portfolio of \$717.0 million acquired from CB. No other investment securities were sold during the first nine months ended September 30, 2018. During the first nine months of 2017, we sold one investment security, realizing a gain of \$402,000.

The tables below set forth investment securities AFS and HTM for the periods presented.

| Amortized<br>Cost             | September 30, 2018                     |  | Fair Value | Total Percent |
|-------------------------------|--|--|------------|---------------|
|                               | Gross<br>Unrealized<br>Holding<br>Gain | Gross<br>Unrealized<br>Holding<br>Loss |            |               |
| <i>(Dollars in thousands)</i> |  |  |            |               |

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|   |              |          |             |              |         |
|---|--------------|----------|-------------|--------------|---------|
| Investment securities available-for-sale: |              |          |             |              |         |
| Residential mortgage-backed securities    | \$ 1,570,072 | \$ 1,014 | \$ (38,208) | \$ 1,532,878 | 84.87%  |
| CMO/REMIC - residential                   | 229,832      | 152      | (6,167)     | 223,817      | 12.39%  |
| Municipal bonds                           | 50,022       | 308      | (1,591)     | 48,739       | 2.70%   |
| Other securities                          | 797          | -        | -           | 797          | 0.04%   |
| Total available-for-sale securities       | \$ 1,850,723 | \$ 1,474 | \$ (45,966) | \$ 1,806,231 | 100.00% |

|   |            |        |             |            |         |
|---|------------|--------|-------------|------------|---------|
| Investment securities held-to-maturity: |            |        |             |            |         |
| Government agency/GSE                   | \$ 144,871 | \$ -   | \$ (5,129)  | \$ 139,742 | 19.09%  |
| Residential mortgage-backed securities  | 158,769    | -      | (5,502)     | 153,267    | 20.92%  |
| CMO                                     | 216,980    | -      | (13,960)    | 203,020    | 28.58%  |
| Municipal bonds                         | 238,409    | 225    | (7,908)     | 230,726    | 31.41%  |
| Total held-to-maturity securities       | \$ 759,029 | \$ 225 | \$ (32,499) | \$ 726,755 | 100.00% |

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|  | <b>December 31, 2017</b>      |  |  |                     |                          |
|--|-------------------------------|--|--|---------------------|--------------------------|
|  | <b>Amortized<br/>Cost</b>     | <b>Gross<br/>Unrealized<br/>Holding<br/>Gain</b> | <b>Gross<br/>Unrealized<br/>Holding<br/>Loss</b> | <b>Fair Value</b>   | <b>Total<br/>Percent</b> |
|  | <i>(Dollars in thousands)</i> |  |  |                     |                          |
| <b>Investment securities available-for-sale:</b> |                               |  |  |                     |                          |
| Residential mortgage-backed securities           | \$ 1,747,780                  | \$ 11,231  | \$ (8,102)                                       | \$ 1,750,909        | 84.14%                   |
| CMO/REMIC - residential                          | 274,634                       | 1,277  | (2,082)  | 273,829             | 13.16%                   |
| Municipal bonds                                  | 54,966                        | 774  | (244)  | 55,496              | 2.66%                    |
| Other securities                                 | 751                           | -  | -  | 751                 | 0.04%                    |
| <b>Total available-for-sale securities</b>       | <b>\$ 2,078,131</b>           | <b>\$ 13,282</b>                                 | <b>\$ (10,428)</b>                               | <b>\$ 2,080,985</b> | <b>100.00%</b>           |
| <b>Investment securities held-to-maturity:</b>   |                               |  |  |                     |                          |
| Government agency/GSE                            | \$ 159,716                    | \$ 854   | \$ (2,134)                                       | \$ 158,436          | 19.25%                   |
| Residential mortgage-backed securities           | 176,427                       | 667  | (382)  | 176,712             | 21.26%                   |
| CMO  | 225,072                       | -  | (8,641)  | 216,431             | 27.12%                   |
| Municipal bonds                                  | 268,675                       | 2,751  | (3,790)  | 267,636             | 32.37%                   |
| <b>Total held-to-maturity securities</b>         | <b>\$ 829,890</b>             | <b>\$ 4,272</b>                                  | <b>\$ (14,947)</b>                               | <b>\$ 819,215</b>   | <b>100.00%</b>           |

The weighted-average yield (TE) on the total investment portfolio at September 30, 2018 was 2.53% with a weighted-average life of 4.5 years. This compares to a weighted-average yield of 2.50% at December 31, 2017 with a weighted-average life of 4.3 years. The weighted average life is the average number of years that each dollar of unpaid principal due remains outstanding. Average life is computed as the weighted-average time to the receipt of all future cash flows, using as the weights the dollar amounts of the principal pay-downs.

Approximately 89% of the securities in the total investment portfolio, at September 30, 2018, were issued by the U.S. government or U.S. government-sponsored agencies and enterprises, which have the implied guarantee of payment of principal and interest. As of September 30, 2018, approximately \$92.5 million in U.S. government agency bonds are callable. The Agency CMO/REMIC are backed by agency-pooled collateral. Municipal bonds, which represented approximately 11% of the total investment portfolio, are predominately AA or higher rated securities.

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The tables below show the Company's investment securities' gross unrealized losses and fair value by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2018 and December 31, 2017. The unrealized losses on these securities were primarily attributed to changes in interest rates. The issuers of these securities have not, to our knowledge, evidenced any cause for default on these securities. These securities have fluctuated in value since their purchase dates as market rates have fluctuated. However, we have the ability to hold and do not have the intent to sell these securities. As such, management does not deem these securities to be Other-Than-Temporarily-Impaired ( OTTI ). A summary of our analysis of these securities and the unrealized losses is described more fully in Note 5 *Investment Securities* of the notes to the unaudited condensed consolidated financial statements. Economic trends may adversely affect the value of the portfolio of investment securities that we hold.

|  | Less Than 12 Months           |                    | September 30, 2018<br>12 Months or Longer |                    | Total               |                    |
|--|-------------------------------|--------------------|---|--------------------|---------------------|--------------------|
|  | Gross                         |                    | Gross                                     |                    | Gross               |                    |
|  | Unrealized                    |                    | Unrealized                                |                    | Unrealized          |                    |
|  | Holding                       |                    | Holding                                   |                    | Holding             |                    |
|  | Losses                        |                    | Losses                                    |                    | Losses              |                    |
|  | Fair Value                    |                    | Fair Value                                |                    | Fair Value          |                    |
|  | <i>(Dollars in thousands)</i> |                    |   |                    |                     |                    |
| Investment securities available-for-sale:  |                               |                    |   |                    |                     |                    |
| Residential mortgage-backed securities     | \$ 1,193,435                  | \$ (24,475)        | \$ 287,707                                | \$ (13,733)        | \$ 1,481,142        | \$ (38,208)        |
| CMO/REMIC - residential                    | 139,064                       | (3,053)            | 60,925                                    | (3,114)            | 199,989             | (6,167)            |
| Municipal bonds                            | 11,257                        | (389)              | 12,987                                    | (1,202)            | 24,244              | (1,591)            |
| <b>Total available-for-sale securities</b> | <b>\$ 1,343,756</b>           | <b>\$ (27,917)</b> | <b>\$ 361,619</b>                         | <b>\$ (18,049)</b> | <b>\$ 1,705,375</b> | <b>\$ (45,966)</b> |
| Investment securities held-to-maturity:    |                               |                    |   |                    |                     |                    |
| Government agency/GSE                      | \$ 99,203                     | \$ (2,326)         | \$ 40,539                                 | \$ (2,803)         | \$ 139,742          | \$ (5,129)         |
| Residential mortgage-backed securities     | 101,083                       | (3,206)            | 52,184                                    | (2,296)            | 153,267             | (5,502)            |
| CMO  | -                             | -                  | 203,020                                   | (13,960)           | 203,020             | (13,960)           |
| Municipal bonds                            | 116,918                       | (2,143)            | 67,284                                    | (5,765)            | 184,202             | (7,908)            |
| <b>Total held-to-maturity</b>              | <b>\$ 317,204</b>             | <b>\$ (7,675)</b>  | <b>\$ 363,027</b>                         | <b>\$ (24,824)</b> | <b>\$ 680,231</b>   | <b>\$ (32,499)</b> |



## securities

|  | Less Than 12 Months           |  | December 31, 2017<br>12 Months or Longer |  | Total             |  |
|--|-------------------------------|--|--|--|-------------------|--|
|  | Fair Value                    | Gross<br>Unrealized<br>Holding<br>Losses | Fair Value                               | Gross<br>Unrealized<br>Holding<br>Losses | Fair Value        | Gross<br>Unrealized<br>Holding<br>Losses |
|  | <i>(Dollars in thousands)</i> |  |  |  |                   |  |
| Investment securities available-for-sale:  |                               |  |  |  |                   |  |
| Residential mortgage-backed securities     | \$ 414,091                    | \$ (1,828)                               | \$ 303,746                               | \$ (6,274)                               | \$ 717,837        | \$ (8,102)                               |
| CMO/REMIC - residential                    | 95,137                        | (487)                                    | 71,223                                   | (1,595)                                  | 166,360           | (2,082)                                  |
| Municipal bonds                            | 946                           | (4)                                      | 13,956                                   | (240)                                    | 14,902            | (244)                                    |
| <b>Total available-for-sale securities</b> | <b>\$ 510,174</b>             | <b>\$ (2,319)</b>                        | <b>\$ 388,925</b>                        | <b>\$ (8,109)</b>                        | <b>\$ 899,099</b> | <b>\$ (10,428)</b>                       |
| Investment securities held-to-maturity:    |                               |  |  |  |                   |  |
| Government agency/GSE                      | \$ 18,950                     | \$ (27)                                  | \$ 43,495                                | \$ (2,107)                               | \$ 62,445         | \$ (2,134)                               |
| Residential mortgage-backed securities     | 51,297                        | (188)                                    | 55,306                                   | (194)                                    | 106,603           | (382)                                    |
| CMO  | -                             | -  | 216,431                                  | (8,641)                                  | 216,431           | (8,641)                                  |
| Municipal bonds                            | 32,069                        | (492)                                    | 66,217                                   | (3,298)                                  | 98,286            | (3,790)                                  |
| <b>Total held-to-maturity securities</b>   | <b>\$ 102,316</b>             | <b>\$ (707)</b>                          | <b>\$ 381,449</b>                        | <b>\$ (14,240)</b>                       | <b>\$ 483,765</b> | <b>\$ (14,947)</b>                       |

**Table of Contents****Loans**

Total loans and leases, net of deferred fees and discounts, of \$7.58 billion at September 30, 2018 increased by \$2.75 billion, or 56.97%, from December 31, 2017. The increase in total loans included \$2.73 billion of loans acquired from CB in the third quarter of 2018. Excluding the acquired CB loans, total loans increased by \$17.7 million or 0.37% for the first nine months of 2018. Commercial real estate loans grew by \$98.2 million and construction loans increased by \$16.7 million. This growth was partially offset by a decrease of \$27.0 million in commercial and industrial loans and a decrease of \$55.7 million in dairy & livestock and agribusiness loans. The decline in dairy & livestock and agribusiness loans was due to seasonal dairy borrowings at year end, December 31, 2017.

The following table presents our loan portfolio, excluding PCI loans, by type for the periods presented.

**Distribution of Loan Portfolio by Type**

|   | <b>September 30, 2018</b>     | <b>December 31, 2017</b> |
|---|-------------------------------|--------------------------|
|   | <i>(Dollars in thousands)</i> |                          |
| Commercial and industrial                                   | \$ 1,021,906                  | \$ 513,325               |
| SBA   | 357,052                       | 122,055                  |
| Real estate:  |                               |                          |
| Commercial real estate                                      | 5,268,740                     | 3,376,713                |
| Construction  | 123,274                       | 77,982                   |
| SFR mortgage  | 292,516                       | 236,202                  |
| Dairy & livestock and agribusiness                          | 304,598                       | 347,289                  |
| Municipal lease finance receivables                         | 67,581                        | 70,243                   |
| Consumer and other loans                                    | 134,796                       | 64,229                   |
| Gross loans, excluding PCI loans                            | 7,570,463                     | 4,808,038                |
| Less: Deferred loan fees, net                               | (5,264)                       | (6,289)                  |
| Gross loans, excluding PCI loans, net of deferred loan fees | 7,565,199                     | 4,801,749                |
| Less: Allowance for loan losses                             | (59,802)                      | (59,218)                 |
| Net loans, excluding PCI loans                              | 7,505,397                     | 4,742,531                |
| PCI Loans   | 17,260                        | 30,908                   |
| Discount on PCI loans                                       | -                             | (2,026)                  |
| Less: Allowance for loan losses                             | (205)                         | (367)                    |
| PCI loans, net  | 17,055                        | 28,515                   |
| Total loans and lease finance receivables                   | \$ 7,522,452                  | \$ 4,771,046             |

As of September 30, 2018, \$219.6 million, or 4.17% of the total commercial real estate loans included loans secured by farmland, compared to \$206.1 million, or 6.10%, at December 31, 2017. The loans secured by farmland included \$128.8 million for loans secured by dairy & livestock land and \$90.8 million for loans secured by agricultural land at September 30, 2018, compared to \$118.2 million for loans secured by dairy & livestock land and \$87.9 million for

loans secured by agricultural land at December 31, 2017. As of September 30, 2018, dairy & livestock and agribusiness loans of \$304.6 million were comprised of \$251.4 million for dairy & livestock loans and \$53.2 million for agribusiness loans, compared to \$310.6 million for dairy & livestock loans and \$36.7 million for agribusiness loans at December 31, 2017.

Real estate loans are loans secured by conforming trust deeds on real property, including property under construction, land development, commercial property and single-family and multi-family residences. Our real estate loans are comprised of industrial, office, retail, medical, single-family residences, multi-family residences, and farmland. Consumer loans include auto and equipment leases, installment loans to consumers as well as home equity loans and other loans secured by junior liens on real property. Municipal lease finance receivables are leases to municipalities. Dairy & livestock and agribusiness loans are loans to finance the operating needs of wholesale dairy farm operations, cattle feeders, livestock raisers, and farmers.

As of September 30, 2018, the Company had \$188.7 million of total SBA 504 loans. SBA 504 loans include term loans to finance capital expenditures and for the purchase of commercial real estate. Initially the Bank provides two separate loans to the borrower representing a first and second lien on the collateral. The loan with the first lien is typically at a 50% advance to the acquisition costs and the second lien loan provides the financing for 40% of the acquisition costs with the borrower's down payment of 10%. When the loans are funded the Bank retains the first lien loan for its term and sells the second lien loan to the SBA subordinated debenture program. A majority of the Bank's 504 loans are granted for the purpose of commercial real estate acquisition. As of September 30, 2018, the Company had \$169.7 million of total SBA 7(a) loans. The SBA 7(a) loans include revolving lines of credit (SBA Express) and term loans to finance long term working capital requirements, capital expenditures, and/or for the purchase or refinance of commercial real estate.

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As of September 30, 2018, the Company had \$123.3 million in construction loans. This represents 1.62% of total gross loans held-for-investment. There were no PCI construction loans at September 30, 2018. Although our construction loans are located throughout our market footprint, the majority of construction loans consist of commercial land development and construction projects in Los Angeles County, Orange County, and the Inland Empire region of Southern California. At September 30, 2018, construction loans consisted of \$62.9 million in SFR construction loans and \$60.4 million in commercial construction loans. There were no nonperforming construction loans at September 30, 2018.

***PCI Loans from the SJB Acquisition***

These PCI loans were acquired from SJB on October 16, 2009 and were subject to a loss sharing agreement with the FDIC. Under the terms of such loss sharing agreement, the FDIC absorbed 80% of losses and shared in 80% of loss recoveries up to \$144.0 million in losses with respect to covered assets, after a first loss amount of \$26.7 million. The loss sharing agreement covered 5 years for commercial loans and covers 10 years for single-family residential loans from the October 16, 2009 acquisition date and the loss recovery provisions are in effect for 8 and 10 years, respectively, for commercial and single-family residential loans from the acquisition date. The loss sharing agreement for commercial loans expired October 16, 2014. The loss sharing agreement with the FDIC for single-family residential loans, which would have expired on October 16, 2019, was terminated by the Bank on July 20, 2018.

The PCI loan portfolio included unfunded commitments for commercial lines of credit, construction draws and other lending activity. The total commitments outstanding as of the acquisition date are included under the shared-loss agreement. As such, any additional advances up to the total commitment outstanding at the time of acquisition were covered under the loss sharing agreement.

|                                     | <b>September 30, 2018</b>     |        | <b>September 31, 2017</b> |         |
|-------------------------------------|-------------------------------|--------|---------------------------|---------|
|                                     | <i>(Dollars in thousands)</i> |        |                           |         |
| Commercial and industrial           | \$                            | 459    | \$                        | 934     |
| SBA                                 |                               | 1,286  |                           | 1,383   |
| Real estate:                        |                               |        |                           |         |
| Commercial real estate              |                               | 14,979 |                           | 27,431  |
| Construction                        |                               | -      |                           | -       |
| SFR mortgage                        |                               | 150    |                           | 162     |
| Dairy & livestock and agribusiness  |                               | 200    |                           | 770     |
| Municipal lease finance receivables |                               | -      |                           | -       |
| Consumer and other loans            |                               | 186    |                           | 228     |
| Gross PCI loans                     |                               | 17,260 |                           | 30,908  |
| Less: Purchase accounting discount  |                               | -      |                           | (2,026) |
| Gross PCI loans, net of discount    |                               | 17,260 |                           | 28,882  |
| Less: Allowance for PCI loan losses |                               | (205)  |                           | (367)   |
| Net PCI loans                       | \$                            | 17,055 | \$                        | 28,515  |



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Our loan portfolio is from a variety of areas throughout our marketplace. The following is the breakdown of our total held-for-investment commercial real estate loans, excluding PCI loans, by region as of September 30, 2018.

|                    | <b>September 30, 2018</b>     |               |                                     |               |
|--------------------|-------------------------------|---------------|-------------------------------------|---------------|
|                    | <b>Total Loans</b>            |               | <b>Commercial Real Estate Loans</b> |               |
|                    | <i>(Dollars in thousands)</i> |               |                                     |               |
| Los Angeles County | \$ 3,387,019                  | 44.8%         | \$ 2,329,136                        | 44.2%         |
| Central Valley     | 1,031,876                     | 13.6%         | 756,165                             | 14.4%         |
| Inland Empire      | 1,098,359                     | 14.5%         | 894,096                             | 17.0%         |
| Orange County      | 970,999                       | 12.8%         | 621,192                             | 11.8%         |
| Central Coast      | 426,405                       | 5.6%          | 333,704                             | 6.3%          |
| San Diego          | 224,749                       | 3.0%          | 111,637                             | 2.1%          |
| Other California   | 147,732                       | 2.0%          | 63,650                              | 1.2%          |
| Out of State       | 283,324                       | 3.7%          | 159,160                             | 3.0%          |
|                    | <b>\$ 7,570,463</b>           | <b>100.0%</b> | <b>\$ 5,268,740</b>                 | <b>100.0%</b> |

The following is the breakdown of total PCI held-for-investment commercial real estate loans by region as of September 30, 2018.

|                    | <b>September 30, 2018</b>     |               |                                     |               |
|--------------------|-------------------------------|---------------|-------------------------------------|---------------|
|                    | <b>Total PCI Loans</b>        |               | <b>Commercial Real Estate Loans</b> |               |
|                    | <i>(Dollars in thousands)</i> |               |                                     |               |
| Central Valley     | \$ 17,260                     | 100.0%        | \$ 14,979                           | 100.0%        |
| Los Angeles County | -                             | -             | -                                   | -             |
| Central Coast      | -                             | -             | -                                   | -             |
| Other California   | -                             | -             | -                                   | -             |
| Out of State       | -                             | -             | -                                   | -             |
|                    | <b>\$ 17,260</b>              | <b>100.0%</b> | <b>\$ 14,979</b>                    | <b>100.0%</b> |

The table below breaks down our real estate portfolio, excluding PCI loans.

|               | <b>September 30, 2018</b>     |                |                                   |                             |
|---------------|-------------------------------|----------------|-----------------------------------|-----------------------------|
|               | <b>Loan Balance</b>           | <b>Percent</b> | <b>Percent Owner-Occupied (1)</b> | <b>Average Loan Balance</b> |
|               | <i>(Dollars in thousands)</i> |                |                                   |                             |
| SFR mortgage: |                               |                |                                   |                             |

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|   |              |        |        |        |
|---|--------------|--------|--------|--------|
| SFR mortgage - Direct                               | \$ 275,319   | 5.0%   | 100.0% | \$ 633 |
| SFR mortgage - Mortgage pools                       | 17,197       | 0.3%   | 100.0% | 249    |
| Total SFR mortgage                                  | 292,516      | 5.3%   |        |        |
| <b>Commercial real estate:</b>                      |              |        |        |        |
| Multi-family  | 490,869      | 8.8%   | -      | 1,501  |
| Industrial  | 1,920,929    | 34.5%  | 54.9%  | 1,420  |
| Office  | 909,606      | 16.4%  | 28.5%  | 1,432  |
| Retail  | 802,184      | 14.4%  | 10.9%  | 1,675  |
| Medical   | 263,695      | 4.8%   | 43.6%  | 1,806  |
| Secured by farmland (2)                             | 219,603      | 3.9%   | 98.5%  | 1,996  |
| Other (3)   | 661,854      | 11.9%  | 47.2%  | 1,442  |
| Total commercial real estate                        | 5,268,740    | 94.7%  |        |        |
| Total SFR mortgage and commercial real estate loans | \$ 5,561,256 | 100.0% | 42.0%  | 1,386  |

- (1) Represents percentage of reported owner-occupied at origination in each real estate loan category.
- (1) The loans secured by farmland included \$128.8 million for loans secured by dairy & livestock land and \$90.8 million for loans secured by agricultural land at September 30, 2018.
- (2) Other loans consist of a variety of loan types, none of which exceeds 3.0% of total commercial real estate loans.

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In the table above, SFR mortgage Direct loans include SFR mortgage loans which are currently generated through an internal program in our Centers. This program is focused on owner-occupied SFR s with defined loan-to-value, debt-to-income and other credit criteria, such as FICO credit scores, that we believe are appropriate for loans which are primarily intended for retention in our Bank s loan portfolio. We originated loan volume in the aggregate principal amount of \$8.2 million and \$27.9 million under this program during the three and nine months ended September 30, 2018, respectively.

In addition, we previously purchased pools of owner-occupied single-family loans from real estate lenders, SFR mortgage Mortgage Pools, with a remaining balance totaling \$17.2 million at September 30, 2018. These loans were purchased with average FICO scores predominantly ranging from 700 to over 800 and overall original loan-to-value ratios of 60% to 80%. We have not purchased any mortgage pools since August 2007.

The table below breaks down our PCI real estate portfolio.

|  | <b>September 30, 2018</b>     |                |                           |                             |
|--|-------------------------------|----------------|---------------------------|-----------------------------|
|  | <b>Loan Balance</b>           | <b>Percent</b> | <b>Owner-Occupied (1)</b> | <b>Average Loan Balance</b> |
|  | <i>(Dollars in thousands)</i> |                |                           |                             |
| <b>SFR mortgage</b>  |                               |                |                           |                             |
| SFR mortgage - Direct                                      | \$ 150                        | 1.0%           | 100.0%                    | \$ 150                      |
| SFR mortgage - Mortgage pools                              | -                             | -              | -                         | -                           |
| <b>Total SFR mortgage</b>                                  | <b>150</b>                    | <b>1.0%</b>    |                           |                             |
| <b>Commercial real estate:</b>                             |                               |                |                           |                             |
| Multi-family   | 560                           | 3.7%           | -                         | 560                         |
| Industrial   | 2,607                         | 17.2%          | 78.8%                     | 326                         |
| Office   | 1,300                         | 8.6%           | 100.0%                    | 325                         |
| Retail   | 1,444                         | 9.6%           | 0.6%                      | 289                         |
| Medical  | 2,017                         | 13.3%          | 100.0%                    | 672                         |
| Secured by farmland  | 1,178                         | 7.8%           | 100.0%                    | 295                         |
| Other (2)  | 5,873                         | 38.8%          | 75.7%                     | 452                         |
| <b>Total commercial real estate</b>                        | <b>14,979</b>                 | <b>99.0%</b>   |                           |                             |
| <b>Total SFR mortgage and commercial real estate loans</b> | <b>\$ 15,129</b>              | <b>100.0%</b>  | <b>73.7%</b>              | <b>388</b>                  |

(1) Represents percentage of reported owner-occupied at origination in each real estate loan category.

(2) Includes loans associated with hospitality, churches, and gas stations, which represents approximately 74.5% of other loans.

**Nonperforming Assets**

The following table provides information on nonperforming assets, excluding PCI loans, for the periods presented.



**September 30, 2018**      **December 31, 2017**  
*(Dollars in thousands)*

|   |           |           |
|---|-----------|-----------|
| Nonaccrual loans  | \$ 12,910 | \$ 6,516  |
| Troubled debt restructured loans (nonperforming)  | 3,520     | 4,200     |
| OREO, net   | 420       | 4,527     |
| <br>  |           |           |
| Total nonperforming assets  | \$ 16,850 | \$ 15,243 |
| <br>  |           |           |
| Troubled debt restructured performing loans   | \$ 3,753  | \$ 4,809  |
| <br>  |           |           |
| Percentage of nonperforming assets to total loans outstanding, net of deferred fees, and OREO | 0.22%     | 0.32%     |
| Percentage of nonperforming assets to total assets  | 0.15%     | 0.18%     |

At September 30, 2018, loans classified as impaired, excluding PCI loans, totaled \$20.2 million, or 0.22% of total gross loans, compared to \$15.5 million, or 0.32% of total loans at December 31, 2017. At September 30, 2018, impaired loans which were restructured in a troubled debt restructure represented \$7.3 million, of which \$3.5 million were nonperforming and \$3.8 million were performing.

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Of the \$20.2 million total impaired loans as of September 30, 2018, \$17.6 million were considered collateral dependent and measured using the fair value of the collateral based on current appraisals (obtained within 1 year). The amount of impaired loans measured using the present value of expected future cash flows discounted at the loans effective rate were \$2.6 million.

**Troubled Debt Restructurings**

Total TDRs were \$7.3 million at September 30, 2018, compared to \$9.0 million at December 31, 2017. At September 30, 2018, we had \$3.5 million in nonperforming TDR loans and \$3.8 million of performing TDRs were accruing interest as restructured loans. Performing TDRs were granted in response to borrower financial difficulty and generally provide for a modification of loan repayment terms. The performing restructured loans represent the only impaired loans accruing interest at each respective reporting date. A performing restructured loan is reasonably assured of repayment and is performing in accordance with the modified terms. We have not restructured loans into multiple loans in what is typically referred to as an A/B note structure, where normally the A note meets current underwriting standards and the B note is typically immediately charged off upon restructuring.

The following table provides a summary of TDRs, excluding PCI loans, for the periods presented.

|                                    | September 30, 2018            |                    | December 31, 2017 |                    |
|------------------------------------|-------------------------------|--------------------|-------------------|--------------------|
|                                    | Balance                       | Number of<br>Loans | Balance           | Number of<br>Loans |
|                                    | <i>(Dollars in thousands)</i> |                    |                   |                    |
| <b>Performing TDRs:</b>            |                               |                    |                   |                    |
| Commercial and industrial          | \$ 142                        | 2                  | \$ 190            | 3                  |
| SBA                                | 588                           | 1                  | 625               | 1                  |
| Real Estate:                       |                               |                    |                   |                    |
| Commercial real estate             | 492                           | 1                  | 1,291             | 2                  |
| Construction                       | -                             | -                  | -                 | -                  |
| SFR mortgage                       | 2,531                         | 10                 | 2,703             | 10                 |
| Dairy & livestock and agribusiness | -                             | -                  | -                 | -                  |
| Consumer and other                 | -                             | -                  | -                 | -                  |
| <b>Total performing TDRs</b>       | <b>\$ 3,753</b>               | <b>14</b>          | <b>\$ 4,809</b>   | <b>16</b>          |
| <b>Nonperforming TDRs:</b>         |                               |                    |                   |                    |
| Commercial and industrial          | \$ 27                         | 1                  | \$ 50             | 1                  |
| SBA                                | -                             | -                  | 281               | 2                  |
| Real Estate:                       |                               |                    |                   |                    |
| Commercial real estate             | 3,143                         | 1                  | 3,791             | 2                  |
| Construction                       | -                             | -                  | -                 | -                  |
| SFR mortgage                       | -                             | -                  | -                 | -                  |
| Dairy & livestock and agribusiness | 78                            | 1                  | 78                | 1                  |
| Consumer and other                 | 272                           | 1                  | -                 | -                  |

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|                          |    |       |    |    |       |    |
|--------------------------|----|-------|----|----|-------|----|
| Total nonperforming TDRs | \$ | 3,520 | 4  | \$ | 4,200 | 6  |
| Total TDRs               | \$ | 7,273 | 18 | \$ | 9,009 | 22 |

At September 30, 2018 and December 31, 2017, zero and \$1,000 of the allowance for loan losses was specifically allocated to TDRs, respectively. Impairment amounts identified are typically charged off against the allowance at the time a probable loss is determined. There were no charge-offs on TDRs for the nine months ended September 30, 2018 and 2017.

**Table of Contents****Nonperforming Assets and Delinquencies**

The table below provides trends in our nonperforming assets and delinquencies, excluding PCI loans, for the periods presented.

|                                    | September 30,<br>2018 | June 30,<br>2018 | March 31,<br>2018 | December 31,<br>2017 | September 30,<br>2017 |
|------------------------------------|-----------------------|------------------|-------------------|----------------------|-----------------------|
| <i>(Dollars in thousands)</i>      |                       |                  |                   |                      |                       |
| <b>Nonperforming loans:</b>        |                       |                  |                   |                      |                       |
| Commercial and industrial          | \$ 3,026              | \$ 204           | \$ 272            | \$ 250               | \$ 313                |
| SBA                                | 3,005                 | 574              | 589               | 906                  | 1,611                 |
| Real estate:                       |                       |                  |                   |                      |                       |
| Commercial real estate             | 5,856                 | 6,517            | 6,746             | 6,842                | 6,728                 |
| Construction                       | -                     | -                | -                 | -                    | -                     |
| SFR mortgage                       | 2,961                 | 1,578            | 1,309             | 1,337                | 1,349                 |
| Dairy & livestock and agribusiness | 775                   | 800              | 818               | 829                  | 829                   |
| Consumer and other loans           | 807                   | 509              | 438               | 552                  | 743                   |
| <b>Total</b>                       | <b>\$ 16,430</b>      | <b>\$ 10,182</b> | <b>\$ 10,172</b>  | <b>\$ 10,716</b>     | <b>\$ 11,573</b>      |
| <b>% of Total gross loans</b>      | <b>0.22%</b>          | <b>0.21%</b>     | <b>0.21%</b>      | <b>0.22%</b>         | <b>0.24%</b>          |
| <b>Past due 30-89 days:</b>        |                       |                  |                   |                      |                       |
| Commercial and industrial          | \$ 274                | \$ -             | \$ -              | \$ 768               | \$ 45                 |
| SBA                                | 123                   | -                | -                 | 403                  | -                     |
| Real estate:                       |                       |                  |                   |                      |                       |
| Commercial real estate             | -                     | -                | -                 | -                    | 220                   |
| Construction                       | -                     | -                | -                 | -                    | -                     |
| SFR mortgage                       | -                     | -                | 680               | -                    | -                     |
| Dairy & livestock and agribusiness | -                     | -                | -                 | -                    | -                     |
| Consumer and other loans           | 98                    | 47               | 63                | 1                    | 6                     |
| <b>Total</b>                       | <b>\$ 495</b>         | <b>\$ 47</b>     | <b>\$ 743</b>     | <b>\$ 1,172</b>      | <b>\$ 271</b>         |
| <b>% of Total gross loans</b>      | <b>0.01%</b>          | <b>0.001%</b>    | <b>0.02%</b>      | <b>0.02%</b>         | <b>0.01%</b>          |

**OREO:**

|                           |           |            |           |          |           |          |           |              |           |              |
|---------------------------|-----------|------------|-----------|----------|-----------|----------|-----------|--------------|-----------|--------------|
| Commercial and industrial | \$        | -          | \$        | -        | \$        | -        | \$        | -            | \$        | -            |
| Real estate:              |           |            |           |          |           |          |           |              |           |              |
| Commercial real estate    |           | -          |           | -        |           | -        |           | -            |           | -            |
| Construction              |           | -          |           | -        |           | -        |           | 4,527        |           | 4,527        |
| SFR mortgage              |           | 420        |           | -        |           | -        |           | -            |           | -            |
| <b>Total</b>              | <b>\$</b> | <b>420</b> | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>-</b> | <b>\$</b> | <b>4,527</b> | <b>\$</b> | <b>4,527</b> |

|  |           |               |           |               |           |               |           |               |           |               |
|--|-----------|---------------|-----------|---------------|-----------|---------------|-----------|---------------|-----------|---------------|
| <b>Total nonperforming, past due, and OREO</b> | <b>\$</b> | <b>17,345</b> | <b>\$</b> | <b>10,229</b> | <b>\$</b> | <b>10,915</b> | <b>\$</b> | <b>16,415</b> | <b>\$</b> | <b>16,371</b> |
|--|-----------|---------------|-----------|---------------|-----------|---------------|-----------|---------------|-----------|---------------|

|                               |              |              |              |              |              |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|
| <b>% of Total gross loans</b> | <b>0.23%</b> | <b>0.21%</b> | <b>0.23%</b> | <b>0.34%</b> | <b>0.34%</b> |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|

Nonperforming loans, defined as nonaccrual loans plus nonperforming TDR loans, were \$16.4 million at September 30, 2018, or 0.22% of total loans. Total nonperforming loans at September 30, 2018 included \$8.6 million of nonperforming loans acquired from CB in the third quarter of 2018. This compares to nonperforming loans of \$10.2 million, or 0.21% of total loans, at June 30, 2018, \$10.7 million, or 0.22%, of total loans, at December 31, 2017, and \$11.6 million, or 0.24%, of total loans, at September 30, 2017. The \$6.2 million increase in nonperforming loans quarter-over-quarter was primarily due to a \$2.8 million increase in nonperforming commercial and industrial loans, a \$2.4 million increase in nonperforming SBA loans, a \$1.4 million increase in nonperforming SFR mortgage loans, and a \$298,000 increase in nonperforming consumer and other loans. The overall increase was partially offset by a \$661,000 decrease in nonperforming commercial real estate loans.

At September 30, 2018, we had one OREO property with a carrying value of \$420,000, compared to one property with a carrying value of \$4.5 million at December 31, 2017 and September 30, 2017. During the first quarter of 2018, we sold one OREO property, realizing a net gain on sale of \$3.5 million. There was one addition to OREO for the nine months ended September 30, 2018.

Changes in economic and business conditions have had an impact on our market area and on our loan portfolio. We continually monitor these conditions in determining our estimates of needed reserves. However, we cannot predict the extent to which the deterioration in general economic conditions, real estate values, increases in general rates of interest and changes in the financial conditions or business of a borrower may adversely affect a borrower's ability to pay or the value of our collateral. See *Risk Management Credit Risk Management* contained in our Annual Report on Form 10-K for the year ended December 31, 2017.

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***Acquired SJB Assets***

Loans acquired through the SJB acquisition are accounted for under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* ( ASC 310-30 ). PCI loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of future cash flows is not reasonably estimable, the loans may be classified as nonperforming loans and interest income is not recognized until the timing and amount of future cash flows can be reasonably estimated. As of September 30, 2018, there were no PCI loans considered as nonperforming as described above.

There were no acquired SJB OREO properties remaining as of September 30, 2018 or December 31, 2017.

***Allowance for Loan Losses***

The allowance for loan losses is established as management's estimate of probable losses inherent in the loan and lease receivables portfolio. The allowance is increased (decreased) by the provision for losses and decreased by charge-offs when management believes the uncollectability of a loan is confirmed. Subsequent recoveries, if any, are added to the allowance. The determination of the balance in the allowance for loan losses is based on an analysis of the loan and lease finance receivables portfolio using a systematic methodology and reflects an amount that, in management's judgment, is appropriate to provide for probable credit losses inherent in the portfolio, after giving consideration to the character of the loan portfolio, current economic conditions, past loan loss experience, and such other factors that are considered in estimating inherent credit losses.

The allowance for loan losses totaled \$60.0 million as of September 30, 2018, compared to \$59.6 million as of December 31, 2017. The allowance for loan losses was increased by net recoveries on loans of \$1.9 million and was reduced by a \$1.5 million loan loss provision recapture for the nine months ended September 30, 2018. This compares to a \$7.0 million loan loss provision recapture, offset by net recoveries of \$6.1 million for the same period of 2017.

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The table below presents a summary of net charge-offs and recoveries by type and the resulting allowance for loan losses and (recapture of) provision for loan losses for the periods presented.

|   | <b>As of and For the<br/>Nine Months Ended<br/>September 30,</b> |             |
|---|--|-------------|
|   | <b>2018</b>  | <b>2017</b> |
|   | <i>(Dollars in thousands)</i>                                    |             |
| Allowance for loan losses at beginning of period                          | \$ 59,585  | \$ 61,540   |
| Charge-offs:  |  |             |
| Commercial and industrial   | -  | (138)       |
| SBA   | (257)  | -           |
| Commercial real estate  | -  | -           |
| Construction  | -  | -           |
| SFR mortgage  | -  | -           |
| Dairy & livestock and agribusiness  | -  | -           |
| Consumer and other loans  | (10)   | (11)        |
| Total charge-offs   | (267)  | (149)       |
| Recoveries:   |  |             |
| Commercial and industrial   | 81   | 106         |
| SBA   | 15   | 47          |
| Commercial real estate  | -  | 154         |
| Construction  | 1,945  | 5,774       |
| SFR mortgage  | -  | 64          |
| Dairy & livestock and agribusiness  | 19   | 19          |
| Consumer and other loans  | 129  | 76          |
| Total recoveries  | 2,189  | 6,240       |
| Net recoveries  | 1,922  | 6,091       |
| Recapture of provision for loan losses                                    | (1,500)  | (7,000)     |
| Allowance for loan losses at end of period                                | \$ 60,007  | \$ 60,631   |
| Summary of reserve for unfunded loan commitments:                         |  |             |
| Reserve for unfunded loan commitments at beginning of period              | \$ 6,306   | \$ 6,706    |
| Estimated fair value of reserve for unfunded loan commitment assumed from |  |             |
| Community Bank  | 2,903  | -           |
| Provision for unfunded loan commitments                                   | -  | -           |

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|  |    |           |    |           |
|--|----|-----------|----|-----------|
| Reserve for unfunded loan commitments at end of period                   | \$ | 9,209     | \$ | 6,706     |
| Reserve for unfunded loan commitments to total unfunded loan commitments |    | 0.54%     |    | 0.66%     |
| Amount of total loans at end of period (1)                               | \$ | 7,582,459 | \$ | 4,746,424 |
| Average total loans outstanding (1)                                      | \$ | 5,312,558 | \$ | 4,579,054 |
| Net recoveries to average total loans                                    |    | 0.04%     |    | 0.13%     |
| Net recoveries to total loans at end of period                           |    | 0.03%     |    | 0.13%     |
| Allowance for loan losses to average total loans                         |    | 1.13%     |    | 1.32%     |
| Allowance for loan losses to total loans at end of period                |    | 0.79%     |    | 1.28%     |
| Net recoveries to allowance for loan losses                              |    | 3.20%     |    | 10.05%    |
| Net recoveries to recapture of provision for loan losses                 |    | 128.13%   |    | 87.01%    |

(1) Includes PCI loans and is net of deferred loan origination fees, costs and discounts.



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**Specific allowance:** For impaired loans, we incorporate specific allowances based on loans individually evaluated utilizing one of three valuation methods, as prescribed under ASC 310-10. If the measure of the impaired loan is less than the recorded investment in the loan, the deficiency will be charged off against the ALLL or, alternatively, a specific allocation will be established and included in the overall ALLL balance. The specific allocation represents \$83,000 (0.14%) and \$75,000 (0.13%) of the total allowance as of September 30, 2018 and December 31, 2017, respectively.

**General allowance:** The loan portfolio collectively evaluated for impairment under ASC 450-20 is divided into risk rating classes of loan receivables between classified loans (including substandard and doubtful loans) Special Mention loans and Pass loans, and are further disaggregated into loan segments by loan type with similar risk characteristics. Both the classified and non-classified loan categories are divided into eight (8) specific loan segments. The allowance is provided for each segment based upon that segment's average historical loss experience over an established look back period, adjusted for applicable loss emergence periods (i.e., the amount of time from the point at which a loss is incurred to the point at which the loss is confirmed), and further adjusted for current conditions based on our analysis of specific environmental or qualitative loss factors, as prescribed in the 2006 Interagency Policy Statement on ALLL, affecting the collectability of our loan portfolio that may cause actual loss rates to differ from historical loss experience. The above description reflects certain changes made to the Bank's ALLL methodology in the current period described further below. Beginning with the fourth quarter of 2015 and coinciding with the implementation of the new ALLL methodology, the Bank's previous unallocated reserve was absorbed into the qualitative component of the allowance and eliminated.

There have been no material changes to the Bank's ALLL methodology during 2018. The ALLL balance increased during the nine-month period by \$1.9 million for net loan loss recoveries and decreased by \$1.5 million due to recapture of loan loss provision. The Bank determined that the ALLL balance of \$60.0 million was appropriate as a result of the net effect of additional requirements related to loan growth experienced during the nine month period within the commercial real estate segments of the non-acquired loan portfolio and reduced reserve requirements for (i) continued, moderate reductions in the historical loss rates for all portfolio segments (ii) positive migration in risk grades, and (iii) modest decrease in qualitative factors due to a decrease in the effect from various economic factors and certain factors specific to the loan portfolio.

While we believe that the allowance at September 30, 2018 was appropriate to absorb losses from any known or inherent risks in the portfolio, no assurance can be given that economic conditions, interest rate fluctuations, conditions of our borrowers, or natural disasters, which adversely affect our service areas or other circumstances or conditions, including those defined above, will not be reflected in increased provisions for loan losses in the future.

**Table of Contents****Deposits**

The primary source of funds to support earning assets (loans and investments) is the generation of deposits.

Total deposits were \$9.11 billion at September 30, 2018. This represented an increase of \$2.56 billion, or 39.15%, over total deposits of \$6.55 billion at December 31, 2017. The composition of deposits is summarized for the periods presented in the table below.

|                              | September 30, 2018            |                | December 31, 2017   |                |
|------------------------------|-------------------------------|----------------|---------------------|----------------|
|                              | Balance                       | Percent        | Balance             | Percent        |
|                              | <i>(Dollars in thousands)</i> |                |                     |                |
| Noninterest-bearing deposits | \$ 5,224,154                  | 57.35%         | \$ 3,846,436        | 58.75%         |
| Interest-bearing deposits    |                               |                |                     |                |
| Investment checking          | 455,388                       | 5.00%          | 433,971             | 6.63%          |
| Money market                 | 2,407,331                     | 26.43%         | 1,517,050           | 23.17%         |
| Savings                      | 411,055                       | 4.50%          | 364,049             | 5.56%          |
| Time deposits                | 611,898                       | 6.72%          | 385,347             | 5.89%          |
| <b>Total deposits</b>        | <b>\$ 9,109,826</b>           | <b>100.00%</b> | <b>\$ 6,546,853</b> | <b>100.00%</b> |

The amount of noninterest-bearing deposits in relation to total deposits is an integral element in achieving a low cost of funds. Noninterest-bearing deposits totaled \$5.22 billion at September 30, 2018, representing an increase of \$1.38 billion, or 35.82%, from noninterest-bearing deposits of \$3.85 billion at December 31, 2017.

Noninterest-bearing deposits represented 57.35% of total deposits for September 30, 2018, compared to 58.75% of total deposits for December 31, 2017. The increase included approximately \$1.26 billion of noninterest-bearing deposits assumed from CB during the third quarter of 2018.

Savings deposits, which include savings, interest-bearing demand, and money market accounts, totaled \$3.27 billion at September 30, 2018, representing an increase of \$958.7 million, or 41.41%, from savings deposits of \$2.32 billion at December 31, 2017. The increase included approximately \$1.32 billion of savings deposits assumed from CB during the third quarter of 2018.

Time deposits totaled \$611.9 million at September 30, 2018, representing an increase of \$226.6 million, or 58.79%, from total time deposits of \$385.3 million for December 31, 2017. The increase included approximately \$291.6 million of time deposits assumed from CB during the third quarter of 2018.

**Borrowings**

In order to enhance the Bank's spread between its cost of funds and interest-earning assets, we first seek noninterest-bearing deposits (the lowest cost of funds to the Bank). Next, we pursue growth in interest-bearing deposits, and finally, we supplement the growth in deposits with borrowed funds (borrowings and customer repurchase agreements). Average borrowed funds, as a percent of total funding (total deposits plus borrowed funds), was 5.35% for the third quarter of 2018, compared to 7.33% for the same quarter of 2017.

We offer a repurchase agreement product to our customers. This product, known as Citizens Sweep Manager, sells our investment securities overnight to our customers under an agreement to repurchase them the next day at a price which reflects the market value of the use of funds by the Bank for the period concerned. These repurchase agreements are signed with customers who want to invest their excess deposits, above a pre-determined balance in a demand deposit account, in order to earn interest. As of September 30, 2018 and December 31, 2017, total customer repurchases were \$399.5 million and \$553.8 million, respectively, with a weighted average interest rate of 0.35% and 0.30%, respectively.

We had \$30.0 million in short-term borrowings at September 30, 2018, compared to zero at December 31, 2017.

At September 30, 2018, \$5.53 billion of loans and \$1.60 billion of investment securities, at carrying value, were pledged to secure public deposits, short and long-term borrowings, and for other purposes as required or permitted by law.



Operating leases represent the total minimum lease payments due under non-cancelable operating leases.

**Table of Contents****Off-Balance Sheet Arrangements**

The following table summarizes the off-balance sheet items at September 30, 2018.

|  | Total        | Maturity by Period       |                               |                                |                        |
|--|--------------|--------------------------|-------------------------------|--------------------------------|------------------------|
|  |              | Less Than<br>One<br>Year | One Year<br>to Three<br>Years | Four Years<br>to Five<br>Years | After<br>Five<br>Years |
| <i>(Dollars in thousands)</i>          |              |                          |                               |                                |                        |
| Commitment to extend credit:           |              |                          |                               |                                |                        |
| Commercial and industrial              | \$ 956,748   | \$ 664,476               | \$ 222,850                    | \$ 16,406                      | \$ 53,016              |
| SBA                                    | 1,047        | 12                       | 4                             | -                              | 1,031                  |
| Real estate:                           |              |                          |                               |                                |                        |
| Commercial real estate                 | 237,567      | 56,264                   | 83,670                        | 85,572                         | 12,061                 |
| Construction                           | 117,147      | 65,230                   | 46,593                        | -                              | 5,324                  |
| SFR Mortgage                           | 3,496        | 88                       | 1,782                         | -                              | 1,626                  |
| Dairy & livestock and agribusiness (1) | 170,736      | 147,384                  | 23,002                        | 350                            | -                      |
| Consumer and other loans               | 167,254      | 20,680                   | 10,068                        | 4,947                          | 131,559                |
| Total commitment to extend credit      | 1,653,995    | 954,134                  | 387,969                       | 107,275                        | 204,617                |
| Obligations under letters of credit    | 54,443       | 45,025                   | 8,834                         | 200                            | 384                    |
| Total                                  | \$ 1,708,438 | \$ 999,159               | \$ 396,803                    | \$ 107,475                     | \$ 205,001             |

(1) Total commitments to extend credit to agribusiness were \$13.5 million at September 30, 2018.

As of September 30, 2018, we had commitments to extend credit of approximately \$1.65 billion, and obligations under letters of credit of \$54.4 million. Commitments to extend credit are agreements to lend to customers, provided 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. Commitments are generally variable rate, and many of these commitments are expected to expire without being drawn upon. As such, the total commitment amounts do not necessarily represent future cash requirements. We use the same credit underwriting policies in granting or accepting such commitments or contingent obligations as we do for on-balance sheet instruments, which consist of evaluating customers' creditworthiness individually. The Company had a reserve for unfunded loan commitments of \$9.2 million as of September 30, 2018 and \$6.3 million as of December 31, 2017 included in other liabilities.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the financial performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing or purchase arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. When deemed necessary, we hold appropriate collateral supporting those commitments.

### *Capital Resources*

Our primary source of capital has been the retention of operating earnings and issuance of common stock in connection with periodic acquisitions. In order to ensure adequate levels of capital, we conduct an ongoing assessment of projected sources, needs and uses of capital in conjunction with projected increases in assets and the level of risk. As part of this ongoing assessment, the Board of Directors reviews the various components of capital.

The Company's total equity was \$1.82 billion at September 30, 2018. This represented an increase of \$749.3 million, or 70.08%, from total equity of \$1.07 billion at December 31, 2017. This increase was due to \$722.8 million for the issuance of common stock for the acquisition of CB, \$108.8 million in net earnings and \$2.8 million for various stock based compensation items. This was offset by \$50.5 million in cash dividends declared and a \$34.6 million decline in other comprehensive income resulting from the tax effected impact of the decline in market value of our investment securities portfolio.

During the third quarter of 2018, the Board of Directors of CVB declared quarterly cash dividends totaling \$0.14 per share. Dividends are payable at the discretion of the Board of Directors and there can be no assurance that the Board of Directors will continue to pay dividends at the same rate, or at all, in the future. CVB's ability to pay cash dividends to its shareholders is subject to restrictions under federal and California law, including restrictions imposed by the Federal Reserve, and covenants set forth in various agreements we are a party to including covenants set forth in our junior subordinated debentures.

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On August 11, 2016, our Board of Directors authorized an increase in the Company's common stock repurchase program originally announced in 2008 to 10,000,000 shares, or approximately 9.3% of the Company's outstanding shares at the time of authorization, and adopted a 10b5-1. There is no expiration date for this repurchase program. On March 30, 2018, the Company terminated its 10b5-1 plan in order to comply with Regulation M, due to the then-pending CB acquisition and contemplated issuance of shares of CVB. For the three months ended September 30, 2018, the Company did not repurchase any shares of common stock under this program. A new 10b5-1 plan was approved by the Board of Directors and became effective on November 1, 2018. As of September 30, 2018, we have 9,918,200 shares of our common stock remaining that are eligible for repurchase under the common stock repurchase program.

The Bank and the Company are required to meet risk-based capital standards under the revised capital framework referred to as Basel III set by their respective regulatory authorities. The risk-based capital standards require the achievement of a minimum total risk-based capital ratio of 8.0%, a Tier 1 risk-based capital ratio of 6.0% and a common equity Tier 1 ( CET1 ) capital ratio of 4.5%. In addition, the regulatory authorities require the highest rated institutions to maintain a minimum leverage ratio of 4.0%. To be considered well-capitalized for bank regulatory purposes, the Bank and the Company are required to have a CET1 capital ratio equal to or greater than 6.5%, a Tier 1 risk-based capital ratio equal to or greater than 8.0%, a total risk-based capital ratio equal to or greater than 10.0% and a Tier 1 leverage ratio equal to or greater than 5.0%. At September 30, 2018, the Bank and the Company exceeded the minimum risk-based capital ratios and leverage ratios required to be considered well-capitalized for regulatory purposes. For further information about capital requirements and our capital ratios, see Item 1. *Business Capital Adequacy Requirements* as described in our Annual Report on Form 10-K for the year ended December 31, 2017.

At September 30, 2018, the Bank and the Company exceeded the minimum risk-based capital ratios and leverage ratios, under the revised capital framework referred to as Basel III, required to be considered well-capitalized for regulatory purposes.

The table below presents the Company's and the Bank's risk-based and leverage capital ratios for the periods presented.

| Capital Ratios                     |                               |                         | September 30, 2018               |                        | December 31, 2017                |                        |
|------------------------------------|-------------------------------|-------------------------|----------------------------------|------------------------|----------------------------------|------------------------|
|                                    | Adequately Capitalized Ratios | Well Capitalized Ratios | CVB Financial Corp. Consolidated | Citizens Business Bank | CVB Financial Corp. Consolidated | Citizens Business Bank |
| Tier 1 leverage capital ratio      | 4.00%                         | 5.00%                   | 12.52%                           | 12.40%                 | 11.88%                           | 11.77%                 |
| Common equity Tier I capital ratio | 4.50%                         | 6.50%                   | 12.94%                           | 13.10%                 | 16.43%                           | 16.71%                 |
| Tier 1 risk-based capital ratio    | 6.00%                         | 8.00%                   | 13.22%                           | 13.10%                 | 16.87%                           | 16.71%                 |
| Total risk-based capital ratio     | 8.00%                         | 10.00%                  | 14.00%                           | 13.88%                 | 18.01%                           | 17.86%                 |

Basel III also introduces a new capital conservation buffer, composed entirely of CET1, on top of minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum requirement but below the capital conservation buffer will face constraints on dividends, equity repurchases and payment of discretionary bonuses based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at 0.625% and will be phased in over a four-year period (increasing by that amount on each



subsequent January 1, until it reaches 2.5% on January 1, 2019). Thus, when fully phased in on January 1, 2019, the Bank will be required to maintain this additional capital conservation buffer of 2.5% of CET1. When fully phased in on January 1, 2019, the Company and the Bank will be required to maintain minimum capital ratios as follows:

|   | <b>Equity<br/>Tier 1 Ratio</b> | <b>Tier 1<br/>Capital Ratio</b> | <b>Total<br/>Capital Ratio</b> | <b>Leverage<br/>Ratio</b> |
|---|--------------------------------|---------------------------------|--------------------------------|---------------------------|
| Regulatory minimum ratio                                  | 4.5%                           | 6.0%                            | 8.0%                           | 4.0%                      |
| Plus: Capital conservation buffer requirement             | 2.5%                           | 2.5%                            | 2.5%                           | -                         |
| Regulatory minimum ratio plus capital conservation buffer | 7.0%                           | 8.5%                            | 10.5%                          | 4.0%                      |

We anticipate that the Company and the Bank will meet these requirements well in advance of the ultimate full phase-in date. However, it is possible that further increases in regulatory capital may be required in response to the implementation of the Basel III final rule. The exact amount, however, will depend upon our prevailing risk profile under various stress scenarios.

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**ASSET/LIABILITY AND MARKET RISK MANAGEMENT**

***Liquidity and Cash Flow***

The objective of liquidity management is to ensure that funds are available in a timely manner to meet our financial obligations when they come due without incurring unnecessary cost or risk, or causing a disruption to our normal operating activities. This includes the ability to manage unplanned decreases or changes in funding sources, accommodating loan demand and growth, funding investments, repurchasing securities, paying creditors as necessary, and other operating or capital needs.

We regularly assess the amount and likelihood of projected funding requirements through a review of factors such as historical deposit volatility and funding patterns, present and forecasted market and economic conditions, individual customer funding needs, as well as current and planned business activities. Management has an Asset/Liability Committee that meets at least quarterly. This committee analyzes the cash flows from loans, investments, deposits and borrowings. In addition, the Company has a Balance Sheet Management Committee of the Board of Directors that meets monthly to review the Company's balance sheet and liquidity position. This committee provides oversight to the balance sheet and liquidity management process and recommends policy guidelines for the approval of our Board of Directors, and courses of action to address our actual and projected liquidity needs.

Our primary sources and uses of funds for the Company are deposits and loans. Our deposit levels and cost of deposits may fluctuate from period-to-period due to a variety of factors, including the stability of our deposit base, prevailing interest rates, and market conditions. Total deposits of \$9.11 billion at September 30, 2018 increased \$2.56 billion, or 39.15%, over total deposits of \$6.55 billion at December 31, 2017.

In general, our liquidity is managed daily by controlling the level of liquid assets as well as the use of funds provided by the cash flow from the investment portfolio, loan demand and deposit fluctuations. Our definition of liquid assets includes cash and cash equivalents in excess of minimum levels needed to fulfill normal business operations, short-term investment securities and other anticipated near term cash flows from investments. To meet unexpected demands, lines of credit are maintained with correspondent banks, the Federal Home Loan Bank and the Federal Reserve, although availability under these lines of credit are subject to certain conditions. The sale of securities can also serve as a contingent source of funds. We can obtain additional liquidity from deposit growth by offering competitive interest rates on deposits from both our local and national wholesale markets.

CVB is a company separate and apart from the Bank that must provide for its own liquidity and must service its own obligations. Substantially all of CVB's revenues are obtained from dividends declared and paid by the Bank to CVB. There are statutory and regulatory provisions that could limit the ability of the Bank to pay dividends to CVB. In addition, our regulators could limit the ability of the Bank or CVB to pay dividends or make other distributions. For the Bank, sources of funds include principal payments on loans and investments, growth in deposits, FHLB advances, and other borrowed funds. Uses of funds include withdrawal of deposits, interest paid on deposits, increased loan balances, purchases, and noninterest expenses.

Below is a summary of our average cash position and statement of cash flows for the nine months ended September 30, 2018 and 2017. For further details see our *Condensed Consolidated Statements of Cash Flows* (Unaudited) under Part I, Item 1 of this report.

*Consolidated Summary of Cash Flows*

|   | <b>For the Nine Months Ended</b> |             |
|---|----------------------------------|-------------|
|   | <b>2018</b>                      | <b>2017</b> |
|   | <i>(Dollars in thousands)</i>    |             |
| Average cash and cash equivalents         | \$ 237,817                       | \$ 188,848  |
| Percentage of total average assets        | 2.69%                            | 2.28%       |
| Net cash provided by operating activities | \$ 116,564                       | \$ 106,276  |
| Net cash provided by investing activities | 874,202                          | 157,307     |
| Net cash used in financing activities     | (940,668)                        | (241,426)   |
| Net increase in cash and cash equivalents | \$ 50,098                        | \$ 22,157   |

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Average cash and cash equivalents increased by \$49.0 million, or 25.93%, to \$237.8 million for the nine months ended September 30, 2018, compared to \$188.8 million for the same period of 2017.

At September 30, 2018, cash and cash equivalents totaled \$194.5 million. This represented a decrease of \$50.7 million, or 35.25%, from \$143.8 million at September 30, 2017.

***Interest Rate Sensitivity Management***

During periods of changing interest rates, the ability to re-price interest-earning assets and interest-bearing liabilities can influence net interest income, the net interest margin, and consequently, our earnings. Interest rate risk is managed by attempting to control the spread between rates earned on interest-earning assets and the rates paid on interest-bearing liabilities within the constraints imposed by market competition in our service area. The primary goal of interest rate risk management is to control exposure to interest rate risk, within policy limits approved by the Board of Directors. These limits and guidelines reflect our risk appetite for interest rate risk over both short-term and long-term horizons. We measure these risks and their impact by identifying and quantifying exposures through the use of sophisticated simulation and valuation models, which, as described in additional detail below, are employed by management to understand net interest income (NII) at risk and economic value of equity (EVE) at risk. Net interest income at risk sensitivity captures asset and liability re-pricing mismatches and is considered a shorter term measure, while EVE sensitivity captures mismatches within the period end balance sheets through the financial instruments respective maturities and is considered a longer term measure.

One of the primary methods that we use to quantify and manage interest rate risk is simulation analysis, which we use to model NII from the Company's balance sheet under various interest rate scenarios. We use simulation analysis to project rate sensitive income under many scenarios. The analyses may include rapid and gradual ramping of interest rates, rate shocks, basis risk analysis, and yield curve twists. Specific balance sheet management strategies are also analyzed to determine their impact on NII and EVE. Key assumptions in the simulation analysis relate to the behavior of interest rates and pricing spreads, the changes in product balances, and the behavior of loan and deposit clients in different rate environments. This analysis incorporates several assumptions, the most material of which relate to the re-pricing characteristics and balance fluctuations of deposits with indeterminate or non-contractual maturities, and prepayment of loans and securities.

Our interest rate risk policy measures the sensitivity of our net interest income over both a one year and two year cumulative time horizon.

The simulation model estimates the impact of changing interest rates on interest income from all interest-earning assets and interest expense paid on all interest-bearing liabilities reflected on our balance sheet. This sensitivity analysis is compared to policy limits, which specify a maximum tolerance level for net interest income exposure over a one-year horizon assuming no balance sheet growth, given a 200 basis point upward and a 100 basis point downward shift in interest rates. The simulation model uses a parallel yield curve shift that ramps rates up or down on a pro rata basis over the 12-month and 24-month time horizon.

The following depicts the Company's net interest income sensitivity analysis as of the periods presented below.

|   |
|---|
| <b>Estimated Net Interest Income Sensitivity (1)</b>                                  |
| <b>September 30, 2018</b> <span style="float: right;"><b>December 31, 2017</b></span> |

| Interest Rate Scenario | 24-month Period |              | 24-month Period |              |
|------------------------|-----------------|--------------|-----------------|--------------|
|                        | 12-month Period | (Cumulative) | 12-month Period | (Cumulative) |
| + 200 basis points     | 4.44%           | 8.37%        | 3.17%           | 6.35%        |
| - 100 basis points     | -3.60%          | -6.21%       | -2.70%          | -5.53%       |

(1) Percentage change from base.

Based on our current simulation models, we believe that the interest rate risk profile of the balance sheet is asset sensitive over both a one year and a two year horizon. The estimated sensitivity does not necessarily represent a forecast and the results may not be indicative of actual changes to our net interest income. These estimates are based upon a number of assumptions including: the nature and timing of interest rate levels including yield curve shape, re-pricing characteristics and balance fluctuations of deposits with indeterminate or non-contractual maturities, prepayments on loans and securities, pricing strategies on loans and deposits, and replacement of asset and liability cash flows. While the assumptions used are based on current economic and local market conditions, there is no assurance as to the predictive nature of these conditions including how customer preferences or competitor influences might change.

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We also perform valuation analysis, which incorporates all cash flows over the estimated remaining life of all balance sheet and derivative positions. The valuation of the balance sheet, at a point in time, is defined as the discounted present value of all asset cash flows and derivative cash flows minus the discounted present value of all liability cash flows, the net of which is referred to as EVE. The sensitivity of EVE to changes in the level of interest rates is a measure of the longer-term re-pricing risk and options risk embedded in the balance sheet. EVE uses instantaneous changes in rates, as shown in the table below. Assumptions about the timing and variability of balance sheet cash flows are critical in the EVE analysis. Particularly important are the assumptions driving prepayments and the expected duration and pricing of the indeterminate deposit portfolios. EVE sensitivity is reported in both upward and downward rate shocks. At September 30, 2018, the EVE profile indicates a decline in net balance sheet value due to instantaneous downward changes in rates, compared to an increase resulting from an increase in rates.

***Economic Value of Equity Sensitivity***

| <b>Instantaneous Rate Change</b>  | <b>September 30, 2018</b> |  | <b>December 31, 2017</b> |  |
|-----------------------------------|---------------------------|--|--------------------------|--|
| 100 bp decrease in interest rates | -8.8%                     |  | -9.8%                    |  |
| 100 bp increase in interest rates | 6.4%                      |  | 4.2%                     |  |
| 200 bp increase in interest rates | 10.9%                     |  | 7.1%                     |  |
| 300 bp increase in interest rates | 12.1%                     |  | 6.0%                     |  |
| 400 bp increase in interest rates | 12.7%                     |  | 4.2%                     |  |

As EVE measures the discounted present value of cash flows over the estimated lives of instruments, the change in EVE does not directly correlate to the degree that earnings would be impacted over a shorter time horizon (i.e., the current year). Further, EVE does not take into account factors such as future balance sheet growth, changes in asset and liability mix, changes in yield curve relationships, and changing product spreads that could mitigate the adverse impact of changes in interest rates.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For quantitative and qualitative disclosures about market risks in our portfolio, see *Asset/Liability Management and Interest Rate Sensitivity Management* included in Item 2 *Management's Discussion and Analysis of Financial Condition and Results of Operations* presented elsewhere in this report. This analysis should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017. Our analysis of market risk and market-sensitive financial information contain forward looking statements and is subject to the disclosure at the beginning of Part I regarding such forward-looking information.

**ITEM 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, we carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures under the supervision and with the participation of the Chief Executive Officer, the Chief Financial Officer and other senior management of the Company. Based on the foregoing, the Company's Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

During the fiscal quarter ended September 30, 2018, there have been no changes in our internal controls over financial reporting that have materially affected or are reasonably likely to materially affect our internal controls over financial reporting.

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**Table of Contents****PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

The Company and its subsidiaries are parties to various lawsuits and threatened lawsuits in the ordinary and non-ordinary course of business. From time to time, such lawsuits and threatened lawsuits may include, but are not limited to, actions involving securities litigation, employment matters, wage-hour and labor law claims, consumer, lender liability claims and negligence claims, some of which may be styled as class action or representative cases. Some of these lawsuits may be similar in nature to other lawsuits pending against the Company's competitors.

The Company is a defendant and cross-complainant in an action entitled *Edward A. Dunagan et al v. Citizens Business Bank*, as successor to American Security Bank (ASB), Case No. CVDS1408287, filed in the Superior Court for San Bernardino County. The complaint was initially filed in May, 2014 against ASB, which was acquired during the same month by CBB, and a Second Amended Complaint (SAC) was filed on September 9, 2015, naming CBB as the primary defendant. The case arises out of a number of defaulted commercial real estate loans originally made by ASB to the Dunagans and various entities owned by the Dunagans (Dunagan Parties), and the SAC includes claims by the Dunagans (1) contesting their liabilities under their personal guarantees for deficiencies on certain of the defaulted loans, (2) attacking the validity of ASB's foreclosures on certain properties owned by the Dunagan Parties, and (3) claiming emotional distress caused by ASB's allegedly wrongful actions in connection with such foreclosures. The Dunagans sought compensatory damages in excess of \$2 million plus punitive damages. ASB/CBB filed a cross-complaint against the Dunagans alleging breach of guaranty and demanding additional damages. A bench trial on the respective claims by the Dunagans and ASB/CBB took place in late July and early August, 2018.

On November 7, 2018, subsequent to the end of the third quarter of 2018, the Court issued a minute order finding in favor of the Dunagans and against ASB on all three claims made by the plaintiffs enumerated above, denying ASB's claims under the cross-complaint, and awarding damages and attorney's fees and costs to the Dunagans in an aggregate amount of approximately \$1.35 million. The Company intends to appeal this decision. The Company also believes that the bankers professional liability insurance policy previously obtained by ASB (which provides for a \$5 million per claim limit subject to a \$100,000 deductible) may cover all or a substantial portion of any final monetary award. In any event, the Company believes that this ruling and any monetary award ultimately payable by CBB are not expected to have a material adverse impact on the Company's results of operations, financial condition or cash flows.

For lawsuits where the Company has determined that a loss is both probable and reasonably estimable, a liability representing the best estimate of the Company's financial exposure based on known facts has been recorded in accordance with FASB guidance over loss contingencies (ASC 450). However, as a result of ambiguities and inconsistencies in the myriad laws applicable to the Company's business, and the unique, complex factual issues presented in any given lawsuit, the Company often cannot determine the probability of loss or estimate the amount of damages which a plaintiff might successfully prove if the Company were found to be liable. For lawsuits or threatened lawsuits where a claim has been asserted or the Company has determined that it is probable that a claim will be asserted, and there is a reasonable possibility that the outcome will be unfavorable, the Company will disclose the existence of the loss contingency, even if the Company is not able to make an estimate of the possible loss or range of possible loss with respect to the action or potential action in question, unless the Company believes that the nature, potential magnitude or potential timing (if known) of the loss contingency is not reasonably likely to be material to the Company's liquidity, consolidated financial position, and/or results of operations.

Our accruals and disclosures for loss contingencies are reviewed quarterly and adjusted as additional information becomes available. We disclose a loss contingency and/or the amount accrued if we believe it is reasonably likely to



be material or if we believe such disclosure is necessary for our financial statements to not be misleading. If we determine that an exposure to loss exists in excess of an amount previously accrued or disclosed, we assess whether there is at least a reasonable possibility that a loss, or additional loss, may have been incurred, and we adjust our accruals and disclosures accordingly.

We do not presently believe that the ultimate resolution of any lawsuits currently pending against the Company will have a material adverse effect on the Company's results of operations, financial condition, or cash flows. The outcome of litigation and other legal and regulatory matters is inherently uncertain, however, and it is possible that one or more of the legal matters currently pending or threatened against the Company could have a material adverse effect on our results of operations, financial condition or cash flows.

#### **ITEM 1A. RISK FACTORS**

There have been no material changes to the risk factors as previously disclosed in Item 1A. to Part I of our Annual Report on Form 10-K for the year ended December 31, 2017. The materiality of any risks and uncertainties identified in our Forward Looking Statements contained in this report together with those previously disclosed in the Form 10-K and any subsequent Form 10-Q or those that are presently unforeseen could result in significant adverse effects on our financial condition, results of operations and cash flows. See Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations* in this Quarterly Report on Form 10-Q.

**Table of Contents****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

On July 16, 2008, our Board of Directors approved a program to repurchase up to 10,000,000 shares of our common stock (such number will not be adjusted for stock splits, stock dividends, and the like) in the open market or in privately negotiated transactions, at times and at prices considered appropriate by us, depending upon prevailing market conditions and other corporate and legal considerations. As a result of various repurchases made under the 2008 repurchase program, on August 11, 2016, our Board of Directors authorized an increase in the Company's common stock repurchase program back to 10,000,000 shares, or approximately 9.3% of the Company's currently outstanding shares at the time of authorization, and adopted a 10b5-1 plan. There is no expiration date for this repurchase program. The Company terminated its 10b5-1 plan in January 2017 in order to comply with Regulation M. A new 10b5-1 plan was approved by the Board of Directors effective as of May 2, 2017. On March 30, 2018, the Company terminated its 10b5-1 plan in order to comply with Regulation M, due to the then-pending CB acquisition and contemplated issuance of shares of CVB. For the three months ended September 30, 2018, the Company did not repurchase any shares of common stock under this program. A new 10b5-1 plan was approved by the Board of Directors and became effective on November 1, 2018. As of September 30, 2018, we have 9,918,200 shares of our common stock remaining that are eligible for repurchase under the common stock repurchase program.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not Applicable

**ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

| <b>Exhibit No.</b> | <b>Description of Exhibits</b>  |
|--------------------|---|
| 10.1               | <u>Employment Agreement, dated as of September 12, 2018, by and between Christopher D. Myers, on the one hand, and CVB Financial Corp. and Citizens Business Bank, on the other hand. (1)</u> |
| 31.1               | <u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>   |
| 31.2               | <u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>   |
| 32.1               | <u>Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>   |
| 32.2               | <u>Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>   |
| 101.INS            | XBRL Instance Document  |
| 101.SCH            | XBRL Taxonomy Extension Schema Document   |

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|         |  |
|---------|--|
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document        |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

Indicates a management contract or compensation plan.

(1) Incorporated herein by reference to Exhibit 10.1 to our Form 8-K filed with the SEC on September 13, 2018.

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**SIGNATURES**

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

Date: November 9, 2018

CVB FINANCIAL CORP.  
(Registrant)

/s/ E. Allen Nicholson  
E. Allen Nicholson  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)