Independent Bank Group, Inc.
Form 10-Q
November 05, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the quarterly period ended September 30, 2013.
or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the transition period from to .
Commission file number 001-35854
Independent Bank Group, Inc.
(Exact name of registrant as specified in its charter)

Texas	13-4219346
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1600 Redbud Boulevard, Suite 400 McKinney, Texas	75069-3257
(Address of principal executive offices)	(Zip Code)

(972) 562-9004
(Registrant’s telephone number, including area code)
Not applicable
(Former name, former address and former fiscal year, if changed since last report)
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 such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. Check One:

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	ý	Smaller reporting company	¨

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý
Applicable Only to Corporate Issuers
Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practical date.
Common Stock, $0.01 Par Value – 12,076,927 shares as of November 5, 2013.

INDEPENDENT BANK GROUP, INC. AND SUBSIDIARIES
Form 10-Q
Quarter Ended September 30, 2013

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Independent Bank Group, Inc. and Subsidiaries

Consolidated Balance Sheets
September 30, 2013 and December 31, 2012 (unaudited)
(Dollars in thousands, except share information)

Assets	September 30, 2013	December 31, 2012
Cash and due from banks	$29,281	$30,920
Federal Reserve Excess Balance Account (EBA)	91,000	71,370
Cash and cash equivalents	120,281	102,290
Certificates of deposit held in other banks	348	7,720
Securities available for sale (amortized cost of $132,757 and $110,777, respectively)	130,987	113,355
Loans held for sale	4,254	9,162
Loans, net of allowance for loan losses of $13,145 and $11,478, respectively	1,542,453	1,358,036
Premises and equipment, net	73,513	70,581
Other real estate owned	8,376	6,819
Adriatica real estate	9,678	9,727
Goodwill	28,742	28,742
Core deposit intangible, net	2,724	3,251
Federal Home Loan Bank (FHLB) of Dallas stock and other restricted stock	8,324	8,165
Bank-owned life insurance (BOLI)	11,164	10,924
Deferred tax asset	2,939	—
Other assets	10,971	11,288
Total assets	$1,954,754	$1,740,060
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	$281,452	$259,664
Interest-bearing	1,259,296	1,131,076
Total deposits	1,540,748	1,390,740
FHLB advances	161,507	164,601
Notes payable	—	15,729
Other borrowings	4,460	12,252
Other borrowings, related parties	3,270	8,536
Junior subordinated debentures	18,147	18,147
Other liabilities	8,111	5,545
Total liabilities	1,736,243	1,615,550
Commitments and contingencies		
Stockholders' equity:		
Common stock (12,076,927 and 8,278,354 shares outstanding, respectively)	121	83
Additional paid-in capital	209,840	88,791
Retained earnings	9,108	33,290
Treasury stock, at cost (0 and 8,647 shares, respectively)	—	(232)
Accumulated other comprehensive income (loss)	(558)	2,578
Total stockholders' equity	218,511	124,510

Total liabilities and stockholders’ equity	$1,954,754	$1,740,060

See Notes to Consolidated Financial Statements

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Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Income
Three and nine months ended September 30, 2013 and 2012 (unaudited)
(Dollars in thousands, except per share information)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Interest income:				
Interest and fees on loans	$21,140	$17,892	$62,347	$49,898
Interest on taxable securities	358	288	999	948
Interest on nontaxable securities	258	205	765	604
Interest on federal funds sold and other	85	69	256	226
Total interest income	21,841	18,454	64,367	51,676
Interest expense:				
Interest on deposits	1,717	2,070	5,178	6,371
Interest on FHLB advances	819	609	2,475	1,696
Interest on notes payable and other borrowings	253	492	1,326	1,466
Interest on junior subordinated debentures	137	128	408	381
Total interest expense	2,926	3,299	9,387	9,914
Net interest income	18,915	15,155	54,980	41,762
Provision for loan losses	830	1,013	2,939	2,255
Net interest income after provision for loan losses	18,085	14,142	52,041	39,507
Noninterest income:				
Service charges on deposit accounts	1,248	826	3,597	2,473
Mortgage fee income	957	1,108	3,120	2,965
Gain (loss) on sale of other real estate	—	(31)	173	(75)
Gain on sale of branch	—	51	—	51
Loss on sale of securities available for sale	—	—	—	(3)
Gain (loss) on sale of premises and equipment	5	(1)	4	(346)
Increase in cash surrender value of BOLI	80	82	240	245
Other	161	52	475	302
Total noninterest income	2,451	2,087	7,609	5,612
Noninterest expense:				
Salaries and employee benefits	7,976	6,653	23,688	18,910
Occupancy	2,117	1,821	6,562	5,315
Data processing	357	292	969	851
FDIC assessment	253	211	241	624
Advertising and public relations	216	183	620	522
Communications	412	342	1,090	985
Net other real estate owned expenses (including taxes)	111	64	368	205
Operations of IBG Adriatica, net	228	213	600	741
Other real estate impairment	12	—	475	56
Core deposit intangible amortization	175	169	527	480
Professional fees	353	304	918	752
Acquisition expense, including legal	474	206	602	811
Other	1,966	1,278	5,297	3,579
Total noninterest expense	14,650	11,736	41,957	33,831

Income before taxes	5,886	4,493	17,693	11,288
Income tax expense	1,927	—	2,172	—
Net income	$3,959	$4,493	$15,521	$11,288
Basic earnings per share	$0.33	$0.57	$1.44	$1.47
Diluted earnings per share	$0.33	$0.57	$1.43	$1.47
Pro Forma:				
Income tax expense	n/a	1,447	5,798	3,635
Net income	n/a	$3,046	$11,895	$7,653
Basic earnings per share	n/a	$0.39	$1.10	$1.00
Diluted earnings per share	n/a	$0.39	$1.10	$1.00

See Notes to Consolidated Financial Statements

Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income
Three and nine months ended September 30, 2013 and 2012 (unaudited)
(Dollars in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net income	$3,959	$4,493	$15,521	$11,288
Other comprehensive income (loss) before tax:				
Net change in unrealized gains on available for sale securities	1,002	664	(4,348)	685
Reclassification adjustment for loss on sale of securities available for sale	—	—	—	3
Other comprehensive income (loss) before tax:	1,002	664	(4,348)	688
Income tax expense (benefit)	351	—	(1,212)	—
Other comprehensive income (loss), net of tax	651	664	(3,136)	688
Comprehensive income	$4,610	$5,157	$12,385	$11,976

See Notes to Consolidated Financial Statements

Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity
Nine months ended September 30, 2013 and 2012 (unaudited)
(Dollars in thousands, except for par value and share information)

	Common Stock $.01 Par Value 100 million shares authorized		Additional Paid in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount					
Balance, December 31, 2012	8,278,354	$83	$88,791	$33,290	$ (232)	$ 2,578	$124,510
Net income	—	—	—	15,521	—	—	15,521
Other comprehensive income (loss), net of tax	—	—	—	—	—	(3,136)	(3,136)
Treasury stock retired	(8,647)	—	(232)	—	232	—	—
Common stock issued, net of offering costs	3,680,000	37	86,600	—	—	—	86,637
Reclassification adjustment for change in taxable status	—	—	33,624	(33,624)	—	—	—
Restricted stock granted	127,220	1	(1)	—	—	—	—
Restricted stock vested	—	—	9	—	—	—	9
Stock awards amortized	—	—	1,049	—	—	—	1,049
Dividends ($0.71 per share)	—	—	—	(6,079)	—	—	(6,079)
Balance, September 30, 2013	12,076,927	$121	$209,840	$9,108	$ —	$ (558)	$218,511
Balance, December 31, 2011	6,852,309	$69	$59,196	$24,594	$ (24)	$ 2,162	$85,997
Net income	—	—	—	11,288	—	—	11,288
Other comprehensive income	—	—	—	—	—	688	688
Stock issued	1,238,156	12	25,138	—	—	—	25,150
Stock awards amortized	—	—	446	—	—	—	446
Treasury stock purchased	—	—	—	—	(208)	—	(208)
Dividends ($0.74 per share)	—	—	—	(5,629)	—	—	(5,629)
Balance, September 30, 2012	8,090,465	$81	$84,780	$30,253	$ (232)	$ 2,850	$117,732

See Notes to Consolidated Financial Statements

Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
Nine months ended September 30, 2013 and 2012 (unaudited)
(Dollars in thousands)

	Nine months ended September 30,	
	2013	2012
Cash flows from operating activities:		
Net income	$15,521	$11,288
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	3,171	2,571
Amortization of core deposit intangibles	527	480
Amortization (accretion) of premium (discount) on securities, net	51	(12)
Stock grants amortized	1,049	446
FHLB stock dividends	(20)	(13)
Loss on sale of securities available for sale	—	3
Net (gain) loss on sale of premises and equipment	(4)	346
Gain on sale of branch	—	(51)
(Gain) loss recognized on other real estate transactions	(173)	75
Impairment of other real estate	475	56
Deferred tax benefit	(1,727)	—
Provision for loan losses	2,939	2,255
Increase in cash surrender value of life insurance	(240)	(245)
Loans originated for sale	(132,897)	(127,931)
Proceeds from sale of loans	137,805	126,230
Net change in other assets	317	(188)
Net change in other liabilities	1,575	732
Net cash provided by operating activities	28,369	16,042
Cash flows from investing activities:		
Proceeds from maturities and pay downs of securities available for sale	142,887	43,308
Proceeds from sale of securities available for sale	—	2,078
Purchases of securities available for sale	(163,918)	(49,125)
Proceeds from maturities of certificates held in other banks	7,372	6,667
Net purchases of FHLB stock	(139)	(402)
Net loans originated	(190,128)	(124,072)
Additions to premises and equipment	(6,165)	(10,643)
Proceeds from sale of premises and equipment	66	3,244
Proceeds from sale of other real estate owned	1,047	2,053
Capitalized additions to other real estate	(85)	(476)
Cash received from acquired bank	—	19,993
Cash paid in connection with acquisition	—	(37,000)
Net cash transferred in branch sale	—	(18,550)
Net cash used in investing activities	(209,063)	(162,925)
Cash flows from financing activities:		
Net increase in demand deposits, NOW and savings accounts	109,341	101,624
Net increase (decrease) in time deposits	40,667	(22,306)
Net change in FHLB advances	(3,094)	25,858
Repayments of notes payable and other borrowings	(28,787)	(3,143)

Proceeds from other borrowings	—	11,680
Proceeds from sale of common stock	86,637	25,150
Treasury stock purchased	—	(208)
Dividends paid	(6,079)	(5,629)
Net cash provided by financing activities	198,685	133,026
Net change in cash and cash equivalents	17,991	(13,857)
Cash and cash equivalents at beginning of period	102,290	56,654
Cash and cash equivalents at end of period	$120,281	$42,797

See Notes to Consolidated Financial Statements

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Independent Bank Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)
(Dollars in thousands, except for share and per share information)

Note 1. Summary of Significant Accounting Policies
Nature of Operations: Independent Bank Group, Inc. (IBG) through its subsidiary, Independent Bank, a Texas state banking corporation (Bank) (collectively known as the Company), provides a full range of banking services to individual and corporate customers in the North and Central Texas areas through its various branch locations in those areas. The Company is engaged in traditional community banking activities, which include commercial and retail lending, deposit gathering, investment and liquidity management activities. The Company's primary deposit products are demand deposits, money market accounts and certificates of deposit, and its primary lending products are commercial business and real estate, real estate mortgage and consumer loans.
Basis of Presentation: The accompanying consolidated financial statements include the accounts of IBG, its wholly-owned subsidiaries, the Bank and IBG Adriatica Holdings, Inc. (Adriatica) and the Bank's wholly-owned subsidiaries, IBG Real Estate Holdings, Inc., and IBG Aircraft Acquisition, Inc. Adriatica was formed in 2011 to acquire a mixed use residential and retail real estate development in McKinney, Texas. All material intercompany transactions and balances have been eliminated in consolidation. In addition, the Company wholly-owns IB Trust I (Trust I), IB Trust II (Trust II), IB Trust III (Trust III), IB Centex Trust I (Centex Trust I) and Community Group Statutory Trust I (CGI Trust I). The Trusts were formed to issue trust preferred securities and do not meet the criteria for consolidation.
The consolidated interim financial statements are unaudited, but include all adjustments, which, in the opinion of management are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. These financial statements should be read in conjunction with the financial statements and the notes thereto in the Company's registration statement on Form S-1. The consolidated statement of condition at December 31, 2012 has been derived from the audited financial statements as of that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.
Segment Reporting: The Company has one reportable segment. The Company's chief operating decision-maker uses consolidated results to make operating and strategic decisions.
Initial Public Offering (IPO): IBG qualifies as an “emerging growth company” as defined by the Jumpstart Our Business Startups Act (JOBS Act). In October 2012, the Board of Directors of the Company approved a resolution for IBG to sell shares of common stock to the public in an initial public offering. On December 28, 2012, the Company submitted a confidential draft Registration Statement on Form S-1 with the SEC with respect to the shares to be registered and sold. On February 27, 2013, the Company filed a Registration Statement on Form S-1 with the SEC. That Registration Statement was declared effective by the SEC on April 2, 2013. The Company sold and issued 3,680,000 shares of common stock at $26 per share in reliance on that Registration Statement. Total proceeds received by the Company, net of offering costs were approximately $87 million.
In connection with the initial public offering, on February 22, 2013, the Company amended its certificate of incorporation to affect a 3.2 for one stock split of its common stock and change the par value of common stock from $1 to $.01. All previously reported share amounts have been retrospectively restated to give effect to the stock split and the common stock account has been reallocated to additional paid in capital to reflect the new par value. The Company also terminated its S-Corporation status and became a taxable corporate entity (C Corporation) on April 1, 2013. The consolidated statement of stockholders' equity presents a constructive distribution to the owners followed by a contribution to the capital of the corporate entity. The transfer did not affect total stockholders' equity.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities (excluding deferred tax assets and liabilities related to business combinations or components of other comprehensive income). Deferred tax assets and liabilities are the expected future tax amounts

for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the expected amount most likely to be realized. Realization of deferred tax assets is dependent upon the level of historical income and estimates of future taxable income. Although realization is not assured, management believes it is more likely than not that all of the deferred tax assets will be realized.

The Company evaluates uncertain tax positions at the end of each reporting period. The Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position.

The tax benefit recognized in the financial statements from any such a position is measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. Any interest and/or penalties related to income taxes are reported as a component of income tax expense.
The Company files a consolidated income tax return in U.S. federal jurisdiction and Texas.
Pro forma statements: Because the Company was not a taxable entity prior to April 1, 2013, pro forma amounts for income tax expense and basic and diluted earnings per share have been presented assuming the Company's effective tax rate of 32.8% for the nine months ended September 30, 2013 and 32.2% for the three and nine months ended September 30, 2012, as if it had been a C Corporation during those periods. The difference in the statutory rate of 35% and the Company's effective rate is primarily due to nontaxable income earned on municipal securities and bank owned life insurance. In addition, the pro forma results for the nine months ended September 30, 2013 excludes the initial deferred tax credit as discussed in Note 7.
Earnings per share: Basic earnings per common share are net income divided by the weighted average number of common shares outstanding during the period. The unvested share-based payment awards that contain rights to non forfeitable dividends are considered participating securities for this calculation. Diluted earnings per common share include the dilutive effect of additional potential common shares issuable under stock warrants. The dilutive effect of participating non vested common stock was not included as it was anti-dilutive. Proceeds from the assumed exercise of dilutive stock warrants are assumed to be used to repurchase common stock at the average market price.

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Basic earnings per share:				
Net income	$3,959	$4,493	$15,521	$11,288
Less:				
Undistributed earnings allocated to participating securities	68	41	184	112
Dividends paid on participating securities	15	44	119	111
Net income available to common shareholders	$3,876	$4,408	$15,218	$11,065
Weighted-average basic shares outstanding	11,823,655	7,718,276	10,588,554	7,502,758
Basic earnings per share	$0.33	$0.57	$1.44	$1.47
Diluted earnings per share:				
Net income available to common shareholders	$3,876	$4,408	$15,218	$11,065
Total weighted-average basic shares outstanding	11,823,655	7,718,276	10,588,554	7,502,758
Add dilutive stock warrants	74,229	23,126	58,874	23,126
Total weighted-average diluted shares outstanding	11,897,884	7,741,402	10,647,428	7,525,884
Diluted earnings per share	$0.33	$0.57	$1.43	$1.47
Pro forma earnings per share:				
Pro forma net income	n/a	$3,046	$11,895	$7,653
Less undistributed earnings allocated to participating securities	n/a	14	113	40
Less dividends paid on participating securities	n/a	44	119	111
Pro forma net income available to common shareholders after tax	n/a	$2,988	$11,663	$7,502
Pro forma basic earnings per share	n/a	$0.39	$1.10	$1.00
Pro forma diluted earnings per share	n/a	$0.39	$1.10	$1.00
Anti-dilutive participating securities	151,674	106,941	139,416	102,086

Subsequent events: The Company has evaluated subsequent events through the date of filing these financial statements with the SEC and noted no subsequent events requiring financial statement recognition or disclosure.

Reclassifications: Certain prior period accounts have been reclassified to conform with current year presentation.

Note 2. Statement of Cash Flows

The Company has chosen to report on a net basis its cash receipts and cash payments for time deposits accepted and repayments of those deposits, and loans made to customers and principal collections on those loans. The Company uses the indirect method to present cash flows from operating activities. Other supplemental cash flow information is presented below:

	Nine months ended September 30,	
	2013	2012
Cash transactions:		
Interest expense paid	$9,270	$9,899
Income taxes paid	$3,100	$—
Noncash transactions:		
Transfers of loans to other real estate owned	$2,885	$340
Loans to facilitate the sale of other real estate owned	$113	$20
Writeoff of debt origination costs related to warrants	$223	$—
Security purchased, not yet settled	$1,000	$—
Restricted stock vested	$9	$—

Note 3. Securities Available for Sale

Securities available for sale have been classified in the consolidated balance sheets according to management's intent. The amortized cost of securities and their approximate fair values at September 30, 2013 and December 31, 2012, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
September 30, 2013:				
U.S. treasuries	$3,497	$24	$—	$3,521
Government agency securities	88,854	197	(644)	88,407
Obligations of state and municipal subdivisions	37,873	477	(1,810)	36,540
Corporate bonds	2,085	—	(41)	2,044
Residential mortgage-backed securities guaranteed by FNMA, GNMA, FHLMC and SBA	448	27	—	475
	$132,757	$725	$(2,495)	$130,987
December 31, 2012:				
U.S. treasuries	$3,493	$54	$—	$3,547
Government agency securities	69,636	575	—	70,211
Obligations of state and municipal subdivisions	34,908	2,123	(217)	36,814
Corporate bonds	2,105	23	(25)	2,103
Residential mortgage-backed securities guaranteed by FNMA, GNMA, FHLMC and SBA	635	45	—	680
	$110,777	$2,820	$(242)	$113,355

Securities with a carrying amount of approximately $96,374 and $84,117 at September 30, 2013 and December 31, 2012, respectively, were pledged to secure public fund deposits.

Proceeds from sale of securities available for sale and gross gains and losses for the three and nine months ended September 30, 2013 and 2012 were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Proceeds from sale	$—	$—	$—	$2,078
Gross gains	$—	$—	$—	$—
Gross losses	$—	$—	$—	$3

The amortized cost and estimated fair value of securities available for sale at September 30, 2013, by contractual maturity, are shown below. Maturities of pass-through certificates will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2013 Securities Available for Sale	
	Amortized Cost	Fair Value
Due in one year or less	$6,093	$6,133
Due from one year to five years	58,361	57,966
Due from five to ten years	35,108	35,081
Thereafter	32,747	31,332
	132,309	130,512
Residential mortgage-backed securities guaranteed by FNMA, GNMA, FHLMC and SBA	448	475
	$132,757	$130,987

The number of securities, unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of September 30, 2013 and December 31, 2012, are summarized as follows:

		Value Impaired					
		Less Than 12 Months		Greater Than 12 Months		Total	
Description of Securities	Number of Securities	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Securities Available for Sale							
September 30, 2013							
Government agency securities	29	$45,643	$(644)	$—	$—	$45,643	$(644)
Obligations of state and municipal subdivisions	27	15,460	(1,810)	—	—	15,460	(1,810)
Corporate bonds	2	2,044	(41)	—	—	2,044	(41)
		$63,147	$(2,495)	$—	$—	$63,147	$(2,495)
December 31, 2012							
Obligations of state and municipal subdivisions	9	$6,551	$(217)	$—	$—	$6,551	$(217)
Corporate bonds	1	990	(25)	—	—	990	(25)
		$7,541	$(242)	$—	$—	$7,541	$(242)

Unrealized losses are generally due to changes in interest rates. The Company has the intent to hold these securities until maturity or a forecasted recovery and it is more likely than not that the Company will not have to sell the securities before the recovery of their cost basis. As such, the losses are deemed to be temporary.

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Note 4. Loans, Net and Allowance for Loan Losses
Loans, net at September 30, 2013 and December 31, 2012, consisted of the following:

	September 30, 2013	December 31, 2012
Commercial	$209,453	$169,882
Real estate:		
Commercial	768,427	648,494
Commercial construction, land and land development	95,661	97,329
Residential	331,312	306,187
Single family interim construction	77,493	67,920
Agricultural	31,445	40,127
Consumer	41,747	39,502
Other	60	73
	1,555,598	1,369,514
Allowance for loan losses	(13,145)	(11,478)
	$1,542,453	$1,358,036

The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans.
Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. The Company's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. These cash flows, however, may not be as expected and the value of collateral securing the loans may fluctuate. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short term loans may be made on an unsecured basis. Additionally, our commercial loan portfolio includes loans made to customers in the energy industry, which is a complex, technical and cyclical industry. Experienced bankers with specialized energy lending experience originate our energy loans. Companies in this industry produce, extract, develop, exploit and explore for oil and natural gas. Loans are primarily collateralized with proven producing oil and gas reserves based on a technical evaluation of these reserves.
Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. Management monitors the diversification of the portfolio on a quarterly basis by type and geographic location. Management also tracks the level of owner occupied property versus non owner occupied property.
Land and commercial land development loans are underwritten using feasibility studies, independent appraisal reviews and financial analysis of the developers or property owners. Generally, borrowers must have a proven track record of success. Commercial construction loans are generally based upon estimates of cost and value of the completed project. These estimates may not be accurate. Commercial construction loans often involve the disbursement of substantial funds with the repayment dependent on the success of the ultimate project. Sources of repayment for these loans may be pre-committed permanent financing or sale of the developed property. The loans in this portfolio are geographically diverse and due to the increased risk are monitored closely by management and the

board of directors on a quarterly basis.
Residential real estate and single family interim construction loans are underwritten primarily based on borrowers' credit scores, documented income and minimum collateral values. Relatively small loan amounts are spread across many individual borrowers which minimizes risk in the residential portfolio. In addition, management evaluates trends in past dues and current economic factors on a regular basis.

Agricultural loans are collateralized by real estate and/or non-real estate. Agricultural real estate loans are primarily comprised of loans for the purchase of farmland. Loan-to-value ratios on loans secured by farmland generally do not exceed 80% and have amortization periods limited to twenty years. Agricultural non-real estate loans are generally comprised of term loans to fund the purchase of equipment, livestock and seasonal operating lines to cash grain farmers to plant and harvest corn and soybeans. Specific underwriting standards have been established for agricultural-related loans including the establishment of projections for each operating year based on industry developed estimates of farm input costs and expected commodity yields and prices. Operating lines are typically written for one year and secured by the crop and other farm assets as considered necessary.

Agricultural loans carry significant credit risks as they involve larger balances concentrated with single borrowers or groups of related borrowers. In addition, repayment of such loans depends on the successful operation or management of the farm property securing the loan or for which an operating loan is utilized. Farming operations may be affected by adverse weather conditions such as drought, hail or floods that can severely limit crop yields.

Consumer loans represent less than 3% of the outstanding total loan portfolio. Collateral consists primarily of automobiles and other personal assets. Credit score analysis is used to supplement the underwriting process.

Most of the Company’s lending activity occurs within the State of Texas, primarily in the north and central Texas regions. The majority of the Company’s portfolio consists of commercial and residential real estate loans. As of September 30, 2013 and December 31, 2012, there were no concentrations of loans related to a single industry in excess of 10% of total loans.

The allowance for loan losses is an amount that management believes will be adequate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. The allowance is derived from the following two components: 1) allowances established on individual impaired loans, which are based on a review of the individual characteristics of each loan, including the customer’s ability to repay the loan, the underlying collateral values, and the industry the customer operates in, and 2) allowances based on actual historical loss experience for the last three years for similar types of loans in the Company’s loan portfolio adjusted for primarily changes in the lending policies and procedures; collection, charge-off and recovery practices; nature and volume of the loan portfolio; volume and severity of nonperforming loans; existence and effect of any concentrations of credit and the level of such concentrations and current, national and local economic and business conditions. This second component also includes an unallocated allowance to cover uncertainties that could affect management’s estimate of probable losses. The unallocated allowance reflects the imprecision inherent in the underlying assumptions used in the methodologies for estimating this component.

The Company’s management continually evaluates the allowance for loan losses determined from the allowances established on individual loans and the amounts determined from historical loss percentages adjusted for the qualitative factors above. Should any of the factors considered by management change, the Company’s estimate of loan losses could also change and would affect the level of future provision expense. While the calculation of the allowance for loan losses utilizes management’s best judgment and all the information available, the adequacy of the allowance for loan losses is dependent on a variety of factors beyond the Company’s control, including, among other things, the performance of the entire loan portfolio, the economy, changes in interest rates and the view of regulatory authorities towards loan classifications.

In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank’s allowance for loan losses, and may require the Bank to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

Loans requiring an allocated loan loss provision are generally identified at the servicing officer level based on review of weekly past due reports and/or the loan officer’s communication with borrowers. In addition, past due loans are discussed at weekly officer loan committee meetings to determine if classification is warranted. The Company’s credit department has implemented an internal risk based loan review process to identity potential internally classified loans that supplements the annual independent external loan review. The external review generally covers all loans greater than one million dollars. These reviews include analysis of borrower’s financial condition, payment histories and collateral values to determine if a loan should be internally classified. Generally, once classified, an impaired loan analysis is completed by the credit department to determine if the loan is impaired and the amount of allocated

allowance required.
The Texas economy, specifically the Company’s lending area of north and central Texas, has generally performed better and appears to be recovering faster than certain other parts of the country. However, Texas is not completely immune to the problems associated with the U.S. economy. The risk of loss associated with all segments of the loan portfolio continues to be impacted by the prolonged economic recovery.

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The economy and other risk factors are minimized by the Company's underwriting standards which include the following principles: 1) financial strength of the borrower including strong earnings, high net worth, significant liquidity and acceptable debt to worth ratio, 2) managerial business competence, 3) ability to repay, 4) loan to value, 5) projected cash flow and 6) guarantor financial statements as applicable. Following is a summary of the activity in the allowance for loan losses by loan class for the three and nine months ended September 30, 2013 and 2012:

	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Unallocated	Total
Three months ended September 30, 2013									
Balance at the beginning of period	$ 1,970	$ 7,044	$ 2,567	$ 540	$ 210	$ 350	$—	$ 81	$ 12,762
Provision for loan losses	264	401	(67)	46	(17)	(3)	—	206	830
Charge-offs	(350)	(78)	(21)	—	—	(26)	—	—	(475)
Recoveries	5	13	2	—	—	8	—	—	28
Balance at end of period	$ 1,889	$ 7,380	$ 2,481	$ 586	$ 193	$ 329	$—	$ 287	$ 13,145
Nine months ended September 30, 2013									
Balance at the beginning of period	$ 2,377	$ 4,924	$ 2,965	$ 523	$ 159	$ 278	$—	$ 252	$ 11,478
Provision for loan losses	79	3,068	(405)	63	34	65	—	35	2,939
Charge-offs	(581)	(634)	(87)	—	—	(50)	—	—	(1,352)
Recoveries	14	22	8	—	—	36	—	—	80
Balance at end of period	$ 1,889	$ 7,380	$ 2,481	$ 586	$ 193	$ 329	$—	$ 287	$ 13,145
Three months ended September 30, 2012									
Balance at the beginning of period	$ 1,201	$ 5,772	$ 1,884	$ 677	$ 231	$ 344	$—	$ (215)	$ 9,894
Provision for loan losses	105	308	(14)	76	(23)	59	—	502	1,013
Charge-offs	(3)	—	(8)	—	—	(23)	—	—	(34)
Recoveries	—	14	1	—	—	13	—	—	28
Balance at end of period	$ 1,303	$ 6,094	$ 1,863	$ 753	$ 208	$ 393	$—	$ 287	$ 10,901
Nine months ended September 30, 2012									
Balance at the beginning of period	$ 1,259	$ 5,051	$ 1,964	$ 317	$ 209	$ 235	$—	$ 25	$ 9,060
Provision for loan losses	125	1,182	77	436	(1)	174	—	262	2,255

Charge-offs	(81)	(203)	(179)	—	—	(61)	—	—	(524)
Recoveries	—	64	1	—	—	45	—	—	110
Balance at end of period	$ 1,303	$ 6,094	$ 1,863	$ 753	$ 208	$ 393	$—	$ 287	$ 10,901

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The following table details the amount of the allowance for loan losses and recorded investment in loans by class as of September 30, 2013 and December 31, 2012:

	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Unallocated	Total
At September 30, 2013									
Allowance for losses:									
Individually evaluated for impairment	$ 124	$ 489	$ 72	$ —	$ —	$ 23	$ —	$ —	$ 708
Collectively evaluated for impairment	1,765	6,891	2,409	586	193	306	—	287	12,437
Loans acquired with deteriorated credit quality	—	—	—	—	—	—	—	—	—
Ending balance	$ 1,889	$ 7,380	$ 2,481	$ 586	$ 193	$ 329	$ —	$ 287	$ 13,145
Loans:									
Individually evaluated for impairment	$ 627	$ 8,241	$ 3,309	$ —	$ —	$ 71	$ —	$ —	$ 12,248
Collectively evaluated for impairment	207,083	855,305	327,421	77,493	31,445	41,676	60	—	1,540,483
Acquired with deteriorated credit quality	1,743	542	582	—	—	—	—	—	2,867
Ending balance	$ 209,453	$ 864,088	$ 331,312	$ 77,493	$ 31,445	$ 41,747	$ 60	$ —	$ 1,555,598
At December 31, 2012									
Allowance for losses:									
Individually evaluated for impairment	$ 165	$ 644	$ 164	$ —	$ —	$ 16	$ —	$ —	$ 989
Collectively evaluated for impairment	2,212	4,280	2,801	523	159	262	—	252	10,489
Loans acquired with deteriorated credit quality	—	—	—	—	—	—	—	—	—
Ending balance	$ 2,377	$ 4,924	$ 2,965	$ 523	$ 159	$ 278	$ —	$ 252	$ 11,478

Loans:									
Individually evaluated for impairment	$ 724	$ 10,601	$ 3,376	$ —	$ —	$ 105	$—	$ —	$ 14,806
Collectively evaluated for impairment	166,965	732,581	301,259	67,361	40,127	39,397	73	—	1,347,763
Acquired with deteriorated credit quality	2,193	2,641	1,552	559	—	—	—	—	6,945
Ending balance	$ 169,882	$ 745,823	$ 306,187	$ 67,920	$ 40,127	$ 39,502	$ 73	$ —	$ 1,369,514

Nonperforming loans by loan class at September 30, 2013 and December 31, 2012, are summarized as follows:

	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Total
September 30, 2013:								
Nonaccrual loans	$ 189	$ 827	$ 1,816	$ —	$ —	$ 43	$—	$ 2,875
Loans past due 90 days and still accruing	—	—	—	—	—	—	—	—
Troubled debt restructurings (not included in nonaccrual or loans past due and still accruing)	114	3,102	571	—	—	1	—	3,788
	$ 303	$ 3,929	$ 2,387	$ —	$ —	$ 44	$—	$ 6,663
December 31, 2012:								
Nonaccrual loans	$ 218	$ 4,857	$ 894	$ 560	$ —	$ 70	$—	$ 6,599
Loans past due 90 days and still accruing	—	—	—	—	—	2	—	2
Troubled debt restructurings (not included in nonaccrual or loans past due and still accruing)	481	1,778	2,165	—	—	9	—	4,433
	$ 699	$ 6,635	$ 3,059	$ 560	$ —	$ 81	$—	$ 11,034

Impaired loans are those loans where it is probable that all amounts due according to contractual terms of the loan agreement will not be collected. The Company has identified these loans through its normal loan review procedures. Impaired loans are measured based on 1) the present value of expected future cash flows discounted at the loans effective interest rate; 2) the loans observable market price; or 3) the fair value of collateral if the loan is collateral dependent. Substantially all of the Company’s impaired loans are measured at the fair value of the collateral. In limited cases, the Company may use other methods to determine the level of impairment of a loan if such loan is not collateral dependent.

Impaired loans by loan class at September 30, 2013 and December 31, 2012, are summarized as follows:

	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Total
At September 30, 2013:								
Recorded investment in impaired loans:								
Impaired loans with an allowance for loan losses	$ 478	$ 3,245	$ 1,324	$ —	$ —	$ 45	$—	$5,092
Impaired loans with no allowance for loan losses	149	4,996	1,985	—	—	26	—	7,156
Total	$ 627	$ 8,241	$ 3,309	$ —	$ —	$ 71	$—	$12,248
Unpaid principal balance of impaired loans	$ 627	$ 8,630	$ 3,337	$ —	$ —	$ 71	$—	$12,665
Allowance for loan losses on impaired loans	$ 124	$ 489	$ 72	$ —	$ —	$ 23	$—	$708
At December 31, 2012:								
Recorded investment in impaired loans:								
Impaired loans with an allowance for loan losses	$ 644	$ 5,532	$ 1,301	$ —	$ —	$ 73	$—	$7,550
Impaired loans with no allowance for loan losses	80	5,069	2,075	—	—	32	—	7,256
Total	$ 724	$ 10,601	$ 3,376	$ —	$ —	$ 105	$—	$14,806
Unpaid principal balance of impaired loans	$ 741	$ 11,140	$ 3,475	$ —	$ —	$ 122	$—	$15,478
Allowance for loan losses on impaired loans	$ 165	$ 644	$ 164	$ —	$ —	$ 16	$—	$989
For the three months ended September 30, 2013:								
Average recorded investment in impaired loans	$ 599	$ 8,095	$ 3,394	$ —	$ —	$ 73	$—	$12,161
Interest income recognized on impaired loans	$ 4	$ 112	$ 34	$ —	$ —	$ 1	$—	$151
For the nine months ended September 30, 2013:								
Average recorded investment in impaired loans	$ 687	$ 8,833	$ 3,435	$ —	$ —	$ 83	$—	$13,038
Interest income recognized on impaired loans	$ 26	$ 347	$ 120	$ —	$ —	$ 4	$—	$497
For the three months ended September 30, 2012:								
Average recorded investment in impaired loans	$ 736	$ 13,396	$ 3,939	$ 41	$ —	$ 141	$—	$18,253
Interest income recognized on impaired loans	$ 15	$ 277	$ 108	$ 4	$ —	$ 3	$—	$407

For the nine months ended September 30, 2012:								
Average recorded investment in impaired loans	$ 784	$ 13,331	$ 4,205	$ 43	$ —	$ 134	$—	$ 18,497
Interest income recognized on impaired loans	$ 39	$ 520	$ 181	$ 4	$ —	$ 7	$—	$ 751

Certain impaired loans have adequate collateral and do not require a related allowance for loan loss.
The Company will charge off that portion of any loan which management considers a loss. Commercial and real estate loans are generally considered for charge-off when exposure beyond collateral coverage is apparent and when no further collection of the loss portion is anticipated based on the borrower’s financial condition.
The restructuring of a loan is considered a “troubled debt restructuring” if both 1) the borrower is experiencing financial difficulties and 2) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, extending amortization and other actions intended to minimize potential losses.

A "troubled debt restructured" loan is identified as impaired and measured for credit impairment as of each reporting period in accordance with the guidance in Accounting Standards Codification (ASC) 310-10-35. The recorded investment in troubled debt restructurings, including those on nonaccrual, was $5,258 and $7,544 as of September 30, 2013 and December 31, 2012.

Following is a summary of loans modified under troubled debt restructurings during the three and nine months ended September 30, 2013 and 2012:

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	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Total
Troubled debt restructurings during the three months ended September 30, 2013:								
Number of contracts	—	1	—	—	—	—	—	1
Pre-restructuring outstanding recorded investment	$—	$ 640	$—	$ —	$—	$—	$—	$ 640
Post-restructuring outstanding recorded investment	$—	$ 640	$—	$ —	$—	$—	$—	$ 640
Troubled debt restructurings during the nine months ended September 30, 2013:								
Number of contracts	—	2	—	—	—	—	—	2
Pre-restructuring outstanding recorded investment	$—	$ 1,460	$—	$ —	$—	$—	$—	$ 1,460
Post-restructuring outstanding recorded investment	$—	$ 1,460	$—	$ —	$—	$—	$—	$ 1,460
Troubled debt restructurings during the three months ended September 30, 2012:								
Number of contracts	—	—	2	—	—	—	—	2
Pre-restructuring outstanding recorded investment	$—	$—	$ 1,825	$ —	$—	$—	$—	$ 1,825
Post-restructuring outstanding recorded investment	$—	$—	$ 1,825	$ —	$—	$—	$—	$ 1,825

Troubled debt restructurings during the nine months ended September 30, 2012:								
Number of contracts	2	1	3	—	—	1	—	7
Pre-restructuring outstanding recorded investment	$ 351	$ 101	$ 1,920	$ —	$—	$ 26	$—	$ 2,398
Post-restructuring outstanding recorded investment	$ 351	$ 101	$ 1,920	$ —	$—	$ 26	$—	$ 2,398

At September 30, 2013, there were no loans modified under troubled debt restructurings during the previous twelve month period that subsequently defaulted during the three and nine months ended September 30, 2013. At September 30, 2012, there was one consumer loan totaling $26 that was originated during the previous twelve month period that defaulted during the three and nine months ended September 30, 2012.

Modifications primarily relate to extending the amortization periods of the loans and interest rate concessions. The majority of these loans were identified as impaired prior to restructuring; therefore the modifications did not materially impact the Company's determination of the allowance for loan loss.

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Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. The following table presents information regarding the aging of past due loans by loan class as of September 30, 2013 and December 31, 2012:

	Loans 30-89 Days Past Due	Loans 90 or More Past Due	Total Past Due Loans	Current Loans	Total Loans
September 30, 2013					
Commercial	$1,202	$184	$1,386	$208,067	$209,453
Commercial real estate, land and land development	2,087	631	2,718	861,370	864,088
Residential real estate	348	1,523	1,871	329,441	331,312
Single-family interim construction	173	—	173	77,320	77,493
Agricultural	8	—	8	31,437	31,445
Consumer	41	26	67	41,680	41,747
Other	—		—	60	60
	$3,859	$2,364	$6,223	$1,549,375	$1,555,598
December 31, 2012					
Commercial	$845	$—	$845	$169,037	$169,882
Commercial real estate, land and land development	3,091	62	3,153	742,670	745,823
Residential real estate	1,305	360	1,665	304,522	306,187
Single-family interim construction	—	559	559	67,361	67,920
Agricultural	23	—	23	40,104	40,127
Consumer	110	32	142	39,360	39,502
Other	—	—	—	73	73
	$5,374	$1,013	$6,387	$1,363,127	$1,369,514

The Company’s internal classified report is segregated into the following categories: 1) Pass/Watch, 2) Other Assets Especially Mentioned (OAEM), 3) Substandard and 4) Doubtful. The loans placed in the Pass/Watch category reflect the Company’s opinion that the loans reflect potential weakness which requires monitoring on a more frequent basis. The loans in the OAEM category reflect the Company’s opinion that the credit contains weaknesses which represent a greater degree of risk and warrant extra attention. These loans are reviewed monthly in the officers and directors loan committee meetings to determine if a change in category is warranted. The loans placed in the Substandard category are considered to be potentially inadequately protected by the current debt service capacity of the borrower and/or the pledged collateral. These credits, even if apparently protected by collateral value, have shown weakness related to adverse financial, managerial, economic, market or political conditions which may jeopardize repayment of principal and interest. There is possibility that some future loss could be sustained by the Company if such weakness is not corrected. The Doubtful category includes loans that are in default or principal exposure is probable. Substandard and Doubtful loans are individually evaluated to determine if they should be classified as impaired and an allowance is allocated if deemed necessary under ASC 310-10.

The loans that are not impaired are included with the remaining “pass” credits in determining the portion of the allowance for loan loss based on historical loss experience and other qualitative factors. The portfolio is segmented into categories including: commercial loans, consumer loans, commercial real estate loans, residential real estate loans and agricultural loans. The adjusted historical loss percentage is applied to each category. Each category is then added together to determine the allowance allocated under ASC 450-20.

A summary of loans by credit quality indicator by class as of September 30, 2013 and December 31, 2012, is as follows:

	Pass (Rating 1-4)	Pass/ Watch	OAEM	Substandard	Doubtful	Total
September 30, 2013						
Commercial	$199,777	$2,148	$5,734	$1,794	$—	$209,453
Commercial real estate, construction, land and land development	841,665	10,169	4,173	8,081	—	864,088
Residential real estate	321,518	5,623	443	3,728	—	331,312
Single-family interim construction	77,128	365	—	—	—	77,493
Agricultural	31,199	214	—	32	—	31,445
Consumer	41,664	1	15	67	—	41,747
Other	60	—	—	—	—	60
	$1,513,011	$18,520	$10,365	$13,702	$—	$1,555,598
December 31, 2012						
Commercial	$165,842	$2,824	$203	$1,013	$—	$169,882
Commercial real estate, construction, land and land development	716,243	11,502	8,804	9,274	—	745,823
Residential real estate	295,870	4,303	867	5,039	108	306,187
Single-family interim construction	67,360	—	—	560	—	67,920
Agricultural	39,936	147	—	44	—	40,127
Consumer	39,315	60	13	114	—	39,502
Other	73	—	—	—	—	73
	$1,324,639	$18,836	$9,887	$16,044	$108	$1,369,514

The Company acquired certain loans which experienced credit deterioration since origination (purchased credit impaired (PCI) loans). Accretion on PCI loans is based on estimated future cash flows, regardless of contractual maturity.
The outstanding balance and related carrying amount of purchased credit impaired loans at September 30, 2013, December 31, 2012, and acquisition date are as follows:

	September 30, 2013	December 31, 2012	Acquisition Date
Outstanding balance	$3,632	$9,178	$10,839
Nonaccretable difference	(765)	(2,232)	(2,590)
Accretable yield	—	(1)	(27)
Carrying amount	$2,867	$6,945	$8,222

At September 30, 2013 and December 31, 2012, there was no allocation established in the allowance for loan losses related to purchased credit impaired loans.

Note 5. Commitments and Contingencies

Financial Instruments with Off-Balance Sheet Risk
The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. The commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.
The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of this instrument. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.
At September 30, 2013 and December 31, 2012, the approximate amounts of these financial instruments were as follows:

	September 30, 2013	December 31, 2012
Commitments to extend credit	$286,616	$153,932
Standby letters of credit	2,229	2,704
	$288,845	$156,636

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, farm crops, property, plant and equipment and income-producing commercial properties.
Letters of credit are written conditional commitments used by the Company to guarantee the performance of a customer to a third party. The Company's policies generally require that letter of credit arrangements contain security and debt covenants similar to those contained in loan arrangements. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount shown in the table above. If the commitment is funded, the Company would be entitled to seek recovery from the customer. As of September 30, 2013 and December 31, 2012, no amounts have been recorded as liabilities for the Company's potential obligations under these guarantees.

Litigation
The Company is involved in certain legal actions arising from normal business activities. Management believes that the outcome of such proceedings will not materially affect the financial position, results of operations or cash flows of the Company.

Lease Commitments
The Company leases certain branch facilities and other facilities. Rent expense related to these leases amounted to $168 and $538 for the three and nine months ended September 30, 2013, respectively, and $103 and $267 for the three and nine months ended September 30, 2012, respectively.

Note 6. Notes Payable and Other Borrowings

Notes payable totaled $0 and $15,729 at September 30, 2013 and December 31, 2012, respectively. During April 2013, the Company repaid all of its outstanding notes payable, including two notes payable from Adriatica to an

unaffiliated commercial bank and two senior notes payable to another unaffiliated commercial bank. Other borrowings, including those borrowings due to related parties totaled $7,730 and $20,788 at September 30, 2013 and December 31, 2012, respectively. In April 2013, $2,812 subordinated debt issuance from a commercial bank and $1,223 subordinated debt issued to individuals were repaid. In addition, the Company repaid $4,155 and $4,680 of subordinated debt issued to individuals in August and September, 2013, respectively.

Note 7. Income Taxes

Income tax expense was as follows:

	For the Three Months Ended September 30, 2013	For the Nine Months Ended September 30, 2013
Income tax expense for the period	$1,927	$3,932
Initial recording of deferred tax asset	—	(1,760)
Income tax expense, as reported	$1,927	$2,172
Effective tax rate	32.7 %	12.3 %

In connection with the initial public offering as discussed in Note 1, the Company terminated its S-Corporation status and became a taxable entity (C Corporation) on April 1, 2013. As such, any periods prior to April 1, 2013 will not reflect income tax expense. The reported income tax expense for the nine months ended September 30, 2013 reflects the initial recording of the deferred tax net asset of $1,760, which is the result of timing differences in the recognition of income/deductions for generally accepted accounting principles (GAAP) and tax purposes. The consolidated statements of income present pro forma results of operations for the current year to date period and for prior year quarter and year to date periods. Without the initial recording of the deferred tax benefit, the effective tax rate would have been 32.8% for the nine months ended September 30, 2013. The difference in the statutory rate of 35% and the Company's effective tax rate is primarily due to nontaxable income earned on municipal securities and bank owned life insurance.

Components of deferred tax assets and liabilities are as follows:

	September 30, 2013
Deferred tax assets:	
Allowance for loan losses	$4,601
NOL carryforwards from acquisitions	993
Net unrealized loss on available for sale securities	620
Acquired loan fair market value adjustments	748
Restricted stock	918
Bonus accrual	306
Other real estate owned	397
Unearned rent income	59
Nonaccrual loans	67
Other	48
	8,757
Deferred tax liabilities:	
Premises and equipment	(4,703)
Core deposit intangibles	(953)
Securities	(98)
FHLB stock	(64)
	(5,818)
Net deferred tax asset	$2,939

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Note 8. Fair Value Measurements

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820, Fair Value Measurements and Disclosures, establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

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

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

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

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value on a recurring basis as of September 30, 2013 and December 31, 2012 by level within the ASC Topic 820 fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using		
	Assets/ Liabilities Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2013				
Measured on a recurring basis:				
Assets:				
Investment securities available for sale:				
U.S. treasuries	$3,521	$—	$3,521	$—
Government agency securities	88,407	—	88,407	—
Obligations of state and municipal subdivisions	36,540	—	36,540	—
Corporate bonds	2,044	—	2,044	—
Residential mortgage backed securities guaranteed by FNMA, GNMA, FHLMC and SBA	475	—	475	—
Liabilities:				
Contingent consideration	—	—	—	—
December 31, 2012				
Measured on a recurring basis:				
Assets:				
Investment securities available for sale:				
U.S. treasuries	$3,547	$—	$3,547	$—
Government agency securities	70,211	—	70,211	—
Obligations of state and municipal subdivisions	36,814	—	36,814	—
Corporate bonds	2,103	—	2,103	—

Residential mortgage backed securities guaranteed by FNMA, GNMA, FHLMC and SBA	680	—	680	—
Liabilities:				
Contingent consideration	290	—	—	290

There were no transfers between Level 1 and Level 2 categorizations for the periods presented.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.
Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury and other yield curves, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security's terms and conditions, among other things.
Contingent consideration, related to the acquisition of Town Center Bank in 2010, is reported at fair value using Level 3 inputs. The contingent consideration is remeasured on a recurring basis based on the expected present value of cash flows to be paid to the shareholders of the acquired institution using a market discount rate. In August 2013, the Company paid the final contingent payment of $287.
The following table presents the activity in the contingent consideration for the nine months ended September 30, 2013 and 2012:

	Nine months ended September 30,	
	2013	2012
Balance, beginning of period	$290	$821
Settlements	(287)	(393)
Change in estimated payments to be made	(3)	(2)
Balance, end of period	$—	$426

In accordance with ASC Topic 820, certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets carried on the consolidated balance sheet by caption and by level in the fair value hierarchy at September 30, 2013 and December 31, 2012, for which a nonrecurring change in fair value has been recorded:

		Fair Value Measurements at Reporting Date Using			
	Assets/ Liabilities Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Period Ended Total Losses
September 30, 2013					
Measured on a nonrecurring basis:					
Assets:					
Impaired loans	$1,111	$—	$—	$1,111	$282
Other real estate	2,768	—	—	2,768	475
December 31, 2012					
Measured on a nonrecurring basis:					
Assets:					
Impaired loans	$5,146	$—	$—	$5,146	$187
Other real estate	748	—	—	748	94

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Impaired loans (loans which are not expected to repay all principal and interest amounts due in accordance with the original contractual terms) are measured at an observable market price (if available) or at the fair value of the loan's collateral (if collateral dependent). Fair value of the loan's collateral is determined by appraisals or independent valuation which is then adjusted for the estimated costs related to liquidation of the collateral. Management's ongoing review of appraisal information may result in additional discounts or adjustments to valuation based upon more recent market sales activity or more current appraisal information derived from properties of similar type and/or locale. Therefore, the Company has categorized its impaired loans as Level 3.

The Company has no nonfinancial assets or nonfinancial liabilities measured at fair value on a recurring basis. Other real estate is measured at fair value on a nonrecurring basis (upon initial recognition or subsequent impairment). Other real estate is classified within Level 3 of the valuation hierarchy. When transferred from the loan portfolio, other real estate is adjusted to fair value less estimated selling costs and is subsequently carried at the lower of carrying value or fair value less estimated selling costs. The fair value is determined using an external appraisal process, discounted based on internal criteria.

There were no transfers into or out of Level 3 categorization for the periods presented.

For Level 3 financial and nonfinancial assets and liabilities measured at fair value at September 30, 2013, the significant unobservable inputs used in the fair value measurements are as follows:

Assets/Liabilities	Fair Value	Valuation Technique	Unobservable Input(s)	Weighted Average
Impaired loans	$1,111	Collateral method	Adjustments for selling costs	8%
Other real estate	2,768	Collateral method	Adjustments for selling costs	8%

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The methods and assumptions used by the Company in estimating fair values of financial instruments as disclosed herein in accordance with ASC Topic 825, Financial Instruments, other than for those measured at fair value on a recurring and nonrecurring basis discussed above, are as follows:
Cash and cash equivalents: The carrying amounts of cash and cash equivalents approximate their fair value.
Certificates of deposit held in other banks: The carrying amount of certificates of deposit in other banks, which mature within one year, approximates fair value.
Securities available for sale: Fair values for securities are based on quoted market prices or other observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment spreads, credit information and the bond’s terms and conditions, among other things.
Loans and loans held for sale: For variable-rate loans that reprice frequently and have no significant changes in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (for example, one-to-four family residential), commercial real estate and commercial loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.
Federal Home Loan Bank of Dallas and other restricted stock: The carrying value of restricted securities such as stock in the Federal Home Loan Bank of Dallas and Independent Bankers Financial Corporation approximates fair value.
Deposits: The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is their carrying amounts). The carrying amounts of variable-rate certificates of deposit (CDs) approximate their fair values at the reporting date. Fair values for fixed-rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.
Federal Home Loan Bank advances, line of credit and federal funds purchased: The fair value of advances maturing within 90 days approximates carrying value. Fair value of other advances is based on the Company’s current borrowing rate for similar arrangements.
Notes payable and other borrowings: The fair values are based upon prevailing rates on similar debt in the market place.
Junior subordinated debentures: The fair value of junior subordinated debentures is estimated using discounted cash flow analyses based on the Company’s current incremental borrowing rates for similar types of borrowing arrangements.
Accrued interest: The carrying amounts of accrued interest approximate their fair values.
Contingent Consideration: The contingent consideration liability related to an acquisition is based on the expected present value of cash flows to be paid to the shareholders of the acquired institution using a market discount rate.
Off-balance sheet instruments: Commitments to extend credit and standby letters of credit have short maturities and therefore have no significant fair value.

The carrying amount, estimated fair value and the level of the fair value hierarchy of the Company's financial instruments were as follows at September 30, 2013 and December 31, 2012:

			Fair Value Measurements at Reporting Date Using		
	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2013					
Financial assets:					
Cash and cash equivalents	$120,281	$120,281	$120,281	$—	$—
Certificates of deposit held in other banks	348	348	—	348	—
Securities available for sale	130,987	130,987	—	130,987	—
Loans held for sale	4,254	4,254	—	4,254	—
Loans, net	1,542,453	1,559,313	—	1,554,929	4,384
FHLB of Dallas stock and other restricted stock	8,324	8,324	—	8,324	—
Accrued interest receivable	4,595	4,595	—	4,595	—
Financial liabilities:					
Deposits	1,540,748	1,542,753	—	1,542,753	—
Accrued interest payable	879	879	—	879	—
FHLB advances	161,507	163,768	—	163,768	—
Other borrowings	7,730	7,983	—	7,983	—
Junior subordinated debentures	18,147	18,111	—	18,111	—
Off-balance sheet assets (liabilities):					
Commitments to extend credit	—	—	—	—	—
Standby letters of credit	—	—	—	—	—
December 31, 2012					
Financial assets:					
Cash and cash equivalents	$102,290	$102,290	$102,290	$—	$—
Certificates of deposit held in other banks	7,720	7,720	—	7,720	—
Securities available for sale	113,355	113,355	—	113,355	—
Loans held for sale	9,162	9,162	—	9,162	—
Loans, net	1,358,036	1,399,938	—	1,393,377	6,561
FHLB of Dallas stock and other restricted stock	8,165	8,165	—	8,165	—
Accrued interest receivable	4,647	4,647	—	4,647	—
Financial liabilities:					
Deposits	1,390,740	1,399,373	—	1,399,373	—
Accrued interest payable	985	985	—	985	—
FHLB advances	164,601	170,239	—	170,239	—
Notes payable	15,729	15,729	—	15,729	—
Other borrowings	20,788	20,970	—	20,970	—
Junior subordinated debentures	18,147	18,114	—	18,114	—
Contingent consideration	290	290	—	—	290
Off-balance sheet assets (liabilities):					

Commitments to extend credit	—	—	—	—	—
Standby letters of credit	—	—	—	—	—

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Note 9. Stock Awards and Stock Warrants

The Company grants common stock awards to certain employees of the Company. The common stock issued prior to 2013 vests five years from the date the award is granted and the related compensation expense is recognized over the vesting period. In connection with the initial public offering in April 2013, the Board of Directors adopted a new 2013 Equity Incentive Plan. The Plan reserved 800,000 shares of common stock to be awarded by the Company's compensation committee. The shares issued under the 2013 Plan are restricted and will vest evenly over a five year employment period. Shares granted prior to 2012 and those in 2013 were issued at the date of grant and receive dividends. Shares issued under a revised plan in 2012 are not outstanding shares of the Company until they vest and do not receive dividends.

The following table summarizes the activity in nonvested shares for the nine months ended September 30, 2013 and 2012:

	Number of Shares	Weighted Average Grant Date Price
Nonvested shares, December 31, 2012	208,608	$17.07
Granted during the period	119,540	28.68
Vested during the period	(22,716)	14.30
Nonvested shares, September 30, 2013	305,432	$22.16
Nonvested shares, December 31, 2011	180,025	$15.64
Granted during the period	36,960	20.31
Vested during the period	(29,977)	14.76
Nonvested shares, September 30, 2012	187,008	$16.70

Compensation expense related to these awards was $455 and $1,049 for the three and nine months ended September 30, 2013, respectively and $156 and $446 for the three and nine months ended September 30, 2012, respectively. Compensation expense is recorded in salaries and employee benefits in the accompanying consolidated statements of income. At September 30, 2013, future compensation expense is estimated to be $4,147 and will be recognized over a remaining weighted average period of 2.64 years.

The fair value of common stock awards that vested during the nine months ended September 30, 2013 and 2012 was $641 and $609, respectively.

The Company has issued warrants representing the right to purchase 150,544 shares of Company stock at $17.19 per share to certain Company directors and shareholders. The warrants were issued in return for the shareholders agreement to repurchase the subordinated debt outstanding to an unaffiliated bank in the event of Company default. The warrants expire in December 2018 and were recorded at a fair value of $475 as of the date of the warrants issuance. The Company recorded this amount as debt origination costs and was amortizing it over the term of the debt. In April 2013, the Company paid off the subordinated debt and wrote off the remaining balance of $223 of the debt origination costs to interest expense.

Note 10. Regulatory Matters

Under banking law, there are legal restrictions limiting the amount of dividends the Bank can declare. Approval of the regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of the Bank to fall below specified minimum levels. For state banks, subject to regulatory capital requirements, payment of dividends is generally allowed to the extent of net profits.

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory

framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of September 30, 2013 and December 31, 2012, the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of September 30, 2013 and December 31, 2012, the Bank's capital ratios exceeded those levels necessary to be categorized as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized", the Bank must maintain minimum total risk based, Tier I risk based and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category.

The actual capital amounts and ratios of the Company and Bank as of September 30, 2013 and December 31, 2012, are presented in the following table:

	Actual			Minimum for Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
September 30, 2013									
Total capital to risk weighted assets:									
Consolidated	$225,078	15.05	%	$119,627	8.00	%	N/A	N/A	
Bank	185,911	12.53		118,684	8.00		$148,355	10.00	%
Tier I capital to risk weighted assets:									
Consolidated	205,203	13.72		59,814	4.00		N/A	N/A	
Bank	172,766	11.65		59,342	4.00		89,013	6.00	%
Tier I capital to average assets:									
Consolidated	205,203	10.74		76,456	4.00		N/A	N/A	
Bank	172,766	9.10		75,963	4.00		94,954	5.00	%
December 31, 2012									
Total capital to risk weighted assets:									
Consolidated	$137,553	10.51	%	$104,693	8.00	%	N/A	N/A	
Bank	143,646	11.07		103,790	8.00		$129,738	10.00	%
Tier I capital to risk weighted assets:									
Consolidated	107,539	8.22		52,346	4.00		N/A	N/A	
Bank	132,168	10.19		51,895	4.00		77,843	6.00	%
Tier I capital to average assets:									
Consolidated	107,539	6.45		66,722	4.00		N/A	N/A	
Bank	132,168	7.99		66,162	4.00		82,702	5.00	%

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

Cautionary Note Regarding Forward Looking Statements

This Quarterly Report on Form 10-Q, our other filings with the SEC, and other press releases, documents, reports and announcements that we make, issue or publish may contain statements that we believe are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are statements or projections with respect to matters such as our future results of operations, including our future revenues, income, expenses, provision for taxes, effective tax rate, earnings per share and cash flows, our future capital expenditures and dividends, our future financial condition and changes therein, including changes in our loan portfolio and allowance for loan losses, our future capital structure or changes therein, the plan and objectives of management for future operations, our future or proposed acquisitions, the future or expected effect of acquisitions on our operations, results of operations and financial condition, our future economic performance and the statements of the assumptions underlying any such statement. Such statements are typically identified by the use in the statements of words or phrases such as “aim,” “anticipate,” “estimate,” “expect,” “goal,” “guidance,” “intend,” “is anticipated,” “is estimated expected,” “is intended,” “objective,” “plan,” “projected,” “projection,” “will affect,” “will be,” “will continue,” “will decrease “will impact,” “will increase,” “will incur,” “will reduce,” “will remain,” “will result,” “would be,” variations of such words or phrases (including where the word “could", “may” or “would” is used rather than the word “will” in a phrase) and similar words and phrases indicating that the statement addresses some future result, occurrence, plan or objective. The forward-looking statements that we make are based on the Company's current expectations and assumptions regarding its business, the economy, and other future conditions. Because forward-looking statements relate to future results and occurrences, they are subject to inherent uncertainties, risks, and changes in circumstances that are difficult to predict. The Company's actual results may differ materially from those contemplated by the forward-looking statements, which are neither statements of historical fact nor guarantees or assurances of future performance. Many possible events or factors could affect the future financial results and performance of the Company and could cause such results or performance to differ materially from those expressed in forward-looking statements. These factors include, but are not limited to, the following:

- worsening business and economic conditions nationally, regionally and in our target markets, particularly in Texas and the geographic areas in which we operate;
- our dependence on our management team and our ability to attract, motivate and retain qualified personnel;
- the concentration of our business within our geographic areas of operation in Texas;
- deteriorating asset quality and higher loan charge-offs;
- concentration of our loan portfolio in commercial and residential real estate loans and changes in the prices, values and sales volumes of commercial and residential real estate;
- inaccuracy of the assumptions and estimates we make in establishing reserves for probable loan losses and other estimates;
- the quality of the assets acquired from other organizations being lower than determined in our due diligence investigation and related exposure to unrecoverable losses on loans acquired;
- lack of liquidity, including as a result of a reduction in the amount of sources of liquidity we currently have;
- material decreases in the amount of deposits we hold;
- regulatory requirements to maintain minimum capital levels;
- changes in market interest rates that affect the pricing of our loans and deposits and our net interest income;
- fluctuations in the market value and liquidity of the securities we hold for sale;
- effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services;
- changes in economic and market conditions that affect the amount of assets we have under administration;
- the institution and outcome of litigation and other legal proceeding against us or to which we become subject;
- worsening market conditions affecting the financial industry generally;

- the impact of recent and future legislative and regulatory changes, including changes in banking, securities and tax laws and regulations and their application by our regulators, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and Public Company Accounting Oversight Board:
- governmental monetary and fiscal policies;
- changes in the scope and cost of Federal Deposit Insurance Corporation, or FDIC, insurance and other coverage;

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- the effects of war or other conflicts, acts of terrorism (including cyber attacks) or other catastrophic events, including storms, droughts, tornadoes and flooding, that may affect general economic conditions; and
- the other factors that are described in Part II, Item 1A. of this Quarterly Report on Form 10-Q under the caption "Risk Factors."

We urge you to consider all of these risks, uncertainties and other factors carefully in evaluating all such forward-looking statements we may make. As a result of these and other matters, including changes in facts, assumptions not being realized or other factors, the actual results relating to the subject matter of any forward-looking statement may different materially from the anticipated results expressed or implied in that forward-looking statement. Any forward-looking statement made by the Company in any report, filing, press release, document, report or announcement speaks only as of the date on which it is made. The Company undertakes no obligation to update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

A forward looking-statement may include a statement of the assumptions or bases underlying the forward-looking statement. The Company believes it has chosen these assumptions or bases in good faith and they are reasonable. However, the Company cautions you that assumptions or bases almost always vary from actual results, and the differences between assumptions or bases and actual results can be material. The Company undertakes no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

This Management's Discussion and Analysis of Financial Condition and Results of Operations analyzes the major elements of the Company's financial condition and results of operation as reflected in the interim consolidated financial statements and accompanying notes appearing in this Quarterly Report on Form 10-Q. This section should be read in conjunction with the Company's interim consolidated financial statements and accompanying notes included elsewhere in this report and with the consolidated financial statements for the year ended December 31, 2012 and accompanying notes and other detailed information appearing in the Company's registration statement on Form S-1 (File No. 333-186912) filed with the SEC.

The Company was organized as a bank holding company in 2002. On January 1, 2009, we merged with Independent Bank Group Central Texas, Inc., and, since that time, we have pursued a strategy to create long-term shareholder value through organic growth of our community banking franchise in our market areas and through selective acquisitions of complementary banking institutions with operations in our market areas. On April 8, 2013, the Company consummated the initial public offering of its common stock for trading on the NASDAQ Global Market. As of September 30, 2013, the Company operated 29 full service banking locations; with 21 located in the Dallas/North Texas region and 8 located in the Austin/Central Texas region. The Company's headquarters are located at 1600 Redbud, Suite 400, McKinney, Texas 75069 and its telephone number is (972) 562-9004. The Company's website address is www.independent-bank.com. Information contained on the Company's website is not incorporated by reference into this quarterly report on Form 10-Q and is not part of this or any other report.

Our principal business is lending to and accepting deposits from businesses, professionals and individuals. We conduct all of our banking operations through Independent Bank, which is a Texas state banking corporation and our principal subsidiary (the Bank). We derive our income principally from interest earned on loans and, to a lesser extent, income from securities available for sale. We also derive income from non-interest sources, such as fees received in connection with various deposit services and mortgage brokerage operations. From time to time, we also realize gains on the sale of assets and, in some instances, gains on acquisitions. Our principal expenses include interest expense on interest-bearing customer deposits, advances from the Federal Home Loan Bank of Dallas, or the FHLB, and other borrowings, operating expenses, such as salaries, employee benefits, occupancy costs, data processing and communication costs, expenses associated with other real estate owned, other administrative expenses, provisions for loan losses and our assessment for FDIC deposit insurance.

Certain Events Affect Year-over-Year Comparability

Acquisitions. The comparability of our consolidated results of operations for the periods ended September 30, 2013 and September 30, 2012 is affected by the two acquisitions we completed in 2012. We acquired I Bank Holding Company (IBank) and its bank subsidiary, on April 1, 2012, and its results of operations were first included in our consolidated financial statements in the second quarter of 2012. As a result, the comparability of our consolidated results of operations for the nine-month periods ended September 30, 2013 and 2012 are affected by that acquisition. We acquired The Community Group (CGI) and its bank subsidiary on October 1, 2012, and its results of operations were first included in our consolidated results of operations in the fourth quarter of 2012. As a result, the comparability of our consolidated results of operations for the three-month and the nine-month periods ended September 30, 2013 and 2012 are affected by that acquisition.

Our Initial Public Offering. We consummated the initial public offering of our common stock during the nine months ended September 30, 2013. The period-over-period comparability of certain aspects of our results of operations and the changes in our financial condition from December 31, 2012 to September 30, 2013 are affected by the issuance of 3,680,000 shares of our common stock issued in that offering and our receipt of the net proceeds of the sale of those shares of our common stock. In particular, the period-over-period comparability of our earnings per share is affected by such issuance of the shares in our initial public offering.

S Corporation Status. From our formation in 2002 through March 31, 2013, we elected to be taxed for federal income tax purposes as a “Subchapter S corporation” under the provisions of Section 1361 through 1379 of the Internal Revenue Code. As a result, our net income was not subject to, and we did not pay, U.S. federal income taxes and we were not required to make any provision or recognize any liability for federal income tax in our financial statements for the periods ending on or prior to March 31, 2013. We terminated our status as a “Subchapter S” corporation in connection with our initial public offering as of April 1, 2013. Starting April 1, 2013, we became subject to corporate federal income tax and our net income for each subsequent fiscal year and each subsequent interim period will reflect a provision for federal income taxes. As a result of that change in our status under the federal income tax laws, the net income and earnings per share data presented in our historical financial statements set forth elsewhere in this report, which do not include any provision for federal income taxes, are not comparable with our net income and earnings per share in periods in which we are taxed as a C corporation, which will be calculated by including a provision for federal income taxes. Although we were not subject to corporate federal income tax prior to April 1, 2013, we made periodic cash distributions to our shareholders in amounts estimated to be necessary for them to pay their estimated personal U.S. federal income tax liabilities related to the items of our income, gain, deductions and losses allocated to each of our shareholders. The aggregate amount of such cash distributions has equaled 35% of our taxable income for the related period. Our historical cash flows and financial condition have been affected by such cash distributions.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of the change in tax rates resulting from being a C corporation will be recognized in income in the quarter in which such change takes place. On April 1, 2013, the Company recorded an initial net deferred tax asset of $1.8 million to recognize the difference between the financial statement carrying amounts of assets and liabilities and their respective tax bases as of the date that the Company became a taxable corporate entity.

Discussion and Analysis of Results of Operations for the Three and Nine Months Ended September 30, 2013 and September 30, 2012

The following discussion and analysis of our results of operations compares our results of operations for the three months ended September 30, 2013 with the three months ended September 30, 2012 and our results of operations for the nine months ended September 30, 2013 with our results of operations for the nine months ended September 30, 2012. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results of operations that may be expected for all of the year ending December 31, 2013, in part because our results of operations for the three months ended March 31, 2013 that are included in our results of operations for the nine months ended September 30, 2013 do not include any provision for federal income taxes as do our results of operations for periods after March 31, 2013 and as will our results of operations for the remaining three months of the year ending December 31, 2013.

Results of Operations

Net income was $4.0 million ($0.33 per common share on a diluted basis) for the three months ended September 30, 2013 compared with $4.5 million ($0.57 per common share on a diluted basis) for the three months ended September 30 , 2012, in which three months we did not have any federal income tax expense. Pro forma after tax income for the three months ended September 30, 2012 was $3.0 million ($0.39 per common share on a diluted basis). The Company posted returns on average common equity of 7.30% and 15.96%, returns on average assets of 0.81% and 1.20% and efficiency ratios of 68.6% and 68.1% for the three-month periods ended September 30, 2013 and 2012, respectively.

The efficiency ratio is calculated by dividing total noninterest expense (which does not include the provision for loan losses) by net interest income plus noninterest income.

For the nine months ended September 30, 2013, net income was $15.5 million ($1.43 per common share on a diluted basis) compared with $11.3 million ($1.47 per common share on a diluted basis) for the nine months ended September 30, 2012. Pro forma after tax income for the nine months ended September 30, 2013 was $11.9 million ($1.10 per common share on a diluted basis) compared to $7.7 million ($1.00 per common share on a diluted basis) for the nine months ended September 30, 2012. The Company posted returns on average common equity of 10.85% and 14.62%, returns on average assets of 1.12% and 1.06% and efficiency ratios of 67.0% and 71.4% for the nine months ended September 30, 2013 and 2012, respectively.

Net Interest Income

Our net interest income is our interest income, net of interest expenses. Changes in the balances of our earning assets and our deposits, FHLB advances and other borrowings, as well as changes in the market interest rates, affect our net interest income. The difference between our average yield on earning assets and our average rate paid for interest-bearing liabilities is our net interest spread. Noninterest-bearing sources of funds, such as demand deposits and stockholders' equity, also support our earning assets. The impact of the noninterest-bearing sources of funds is reflected in our net interest margin, which is calculated as annualized net interest income divided by average earning assets.

We earned net interest income of $18.9 million for the three months ended September 30, 2013, an increase of $3.7 million, or 24.8%, from $15.2 million for the three months ended September 30, 2012. This increase is primarily attributable to the $444 million, or 33.0%, increase in average interest-earning assets from $1.3 billion for the three months ended September 30, 2012 to $1.8 billion for the three months ended September 30, 2013 and a 31 basis point decrease in interest expense on interest bearing liabilities from the comparable prior year period. This increase occurred even though yields on interest-earnings assets for the three months ended September 30, 2013 decreased 61 basis points from the comparable period in 2012, primarily as the result of a 43 basis point decline in loan yields. The increase in average interest-earning assets is due to acquisition growth in the last quarter of 2012 as well as organic growth sustained in the first nine months of 2013 primarily related to the addition of experienced lending teams. The decrease in both the loan yields and the cost of funds of deposits is due to continued low rates and competition in the market.

Our net interest margin for the three months ended September 30, 2013 was 4.20% compared to 4.49% for the three months ended September 30, 2012. Our interest rate spread was 4.05% for the three months ended September 30, 2013 compared to 4.35% for the three months ended September 30, 2012. The decrease in the interest rate spread and the net interest margin was due to a combination of factors, including the weighted-average rate on average interest-earning assets declining by 61 basis points from 5.46% for the three months ended September 30, 2012 to 4.85% for the three months ended September 30, 2013. This decrease is primarily due to a 43 basis point decrease in loan yields and an increased balance in the federal reserve interest bearing account due to IPO proceeds that were not yet deployed.

Net interest income was $55.0 million for the nine months ended September 30, 2013, an increase of $13.2 million, or 31.7%, from $41.8 million for the same period in 2012. This increase is due primarily to a $432 million increase, or 34.1%, in average interest earning assets to $1.7 billion for the nine months ended September 30, 2013 compared to $1.3 billion for the nine months ended September 30, 2012. In addition, discount accretion on acquired loans of $1.3 million and $98 thousand is included in net interest income for the nine months ended September 30 2013 and 2012, respectively. The significant increase in acquired loan accretion was primarily related to the unexpected payoff of four loans. The net interest margin for the nine months ended September 30, 2013 decreased 8 basis points to 4.33% compared to 4.41% for the comparable period in 2012. The average yield on interest earning assets decreased 38 basis points from 5.45% to 5.07%. The effect of this decrease was offset by a decrease in the average rate paid on interest bearing liabilities of 29 basis points from 1.18% to 0.89%. The average yield on interest earning assets would have been 4.96% for the nine months ended September 30, 2013 compared to 5.44% for the nine months ended September 30, 2012 without the effect of the discount accretion on acquired loans.

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Average Balance Sheet Amounts, Interest Earned and Yield Analysis. The following table presents average balance sheet information, interest income, interest expense and the corresponding average yields earned and rates paid for the three and nine months ended September 30, 2013 and 2012. The average balances are principally daily averages and, for loans, include both performing and nonperforming balances.

	For The Three Months Ended September 30,							
	2013				2012			
(dollars in thousands)	Average Outstanding Balance (2)	Interest	Yield/ Rate (1)		Average Outstanding Balance (2)	Interest	Yield/ Rate (1)	
Interest-earning assets:								
Loans	$1,535,460	$21,140	5.46	%	$1,208,578	$17,892	5.89	%
Taxable securities	91,075	358	1.56		74,339	288	1.54	
Nontaxable securities	29,926	258	3.42		23,490	205	3.47	
Federal funds sold and other	131,422	85	0.26		37,415	69	0.73	
Total interest-earning assets	1,787,883	$21,841	4.85		1,343,822	$18,454	5.46	
Noninterest-earning assets	154,981				143,603			
Total assets	$1,942,864				$1,487,425			
Interest-bearing liabilities:								
Checking accounts	$754,835	$952	0.50		$597,287	$1,143	0.76	
Savings accounts	113,321	94	0.33		111,719	172	0.61	
Money market accounts	56,161	39	0.28		34,527	32	0.37	
Certificates of deposit	332,405	632	0.75		277,489	723	1.04	
Total deposits	1,256,722	1,717	0.54		1,021,022	2,070	0.81	
FHLB advances	162,009	819	2.01		105,720	609	2.29	
Notes payable and other borrowings	13,819	253	7.26		42,523	492	4.60	
Junior subordinated debentures	18,147	137	3.00		14,538	128	3.50	
Total interest-bearing liabilities	1,450,697	2,926	0.80		1,183,803	3,299	1.11	
Noninterest-bearing checking accounts	266,334				185,038			
Noninterest-bearing liabilities	10,652				6,557			
Stockholders' equity	215,181				112,027			
Total liabilities and equity	$1,942,864				$1,487,425			
Net interest income		$18,915				$15,155		
Interest rate spread			4.05	%			4.35	%
Net interest margin (3)			4.20				4.49	
Average interest earning assets to interest bearing liabilities			123.24				113.52	

(1) Yields and rates for the three-month periods are annualized.

(2) Average loan balances include nonaccrual loans.

(3) Net interest margins for the periods presented represent: (i) the difference between interest income on interest-earning assets and the interest expense on interest-bearing liabilities, divided by (ii) average interest-earning assets for the period.

(dollars in thousands)	For The Nine Months Ended September 30, 2013 Average Outstanding Balance (2)	Interest	Yield/ Rate (1)	2012 Average Outstanding Balance (2)	Interest	Yield/ Rate (1)
Interest-earning assets:						
Loans	$1,467,960	$62,347	5.68 %	$1,118,586	$49,898	5.96 %
Taxable securities	84,975	999	1.57	70,655	948	1.79
Nontaxable securities	31,464	765	3.25	22,800	604	3.54
Federal funds sold and other	113,906	256	0.30	54,060	226	0.56
Total interest-earning assets	1,698,305	$64,367	5.07	1,266,101	$51,676	5.45
Noninterest-earning assets	154,770			151,207		
Total assets	$1,853,075			$1,417,308		
Interest-bearing liabilities:						
Checking accounts	$723,561	$2,861	0.53	$552,889	$3,423	0.83
Savings accounts	113,424	279	0.33	108,304	575	0.71
Money market accounts	50,125	103	0.27	32,600	95	0.39
Certificates of deposit	319,001	1,935	0.81	278,842	2,278	1.09
Total deposits	1,206,111	5,178	0.57	972,635	6,371	0.87
FHLB advances	163,702	2,475	2.02	96,688	1,696	2.34
Notes payable and other borrowings	20,826	1,326	8.51	40,824	1,466	4.80
Junior subordinated debentures	18,147	408	3.01	14,538	381	3.50
Total interest-bearing liabilities	1,408,786	9,387	0.89	1,124,685	9,914	1.18
Noninterest-bearing checking accounts	247,330			181,793		
Noninterest-bearing liabilities	5,634			7,720		
Stockholders' equity	191,325			103,110		
Total liabilities and equity	$1,853,075			$1,417,308		
Net interest income		$54,980			$41,762	
Interest rate spread			4.18 %			4.27 %
Net interest margin (3)			4.33			4.41
Average interest earning assets to interest bearing liabilities			120.55			112.57

(1) Yields and rates for the nine-month periods are annualized.

(2) Average loan balances include nonaccrual loans.

(3) Net interest margins for the periods presented represent: (i) the difference between interest income on interest-earning assets and the interest expense on interest-bearing liabilities, divided by (ii) average interest-earning assets for the period.

Provision for Loan Losses

Management actively monitors the Company's asset quality and provides specific loss provisions when necessary. Provisions for loan losses are charged to expense to bring the total allowance for loan losses to a level deemed appropriate by management based on such factors as historical loss experience, trends in classified loans and past dues, the volume and growth in the loan portfolio, current economic conditions and the value of collateral.

Loans are charged off against the allowance for loan losses when appropriate. Although management believes it uses the best information available to make determinations with respect to the provision for loan losses, future adjustments may be necessary if economic conditions differ from the assumptions used in making the determination.

The Company made a $830 thousand provision for loan losses for the three months ended September 30, 2013 and a $1.0 million provision for the three months ended September 30, 2012. The decrease reflects continued excellent asset quality and lower loan growth as compared to the same quarter in the prior year. Provision expense for the nine months ended September 30, 2013 was $2.9 million compared to $2.3 million for the comparable period in 2012. The increase for the current nine month period over the same period in the prior year was to properly reserve for the growth in our loan portfolio. Net charge-offs were $447 thousand for the three months ended September 30, 2013 compared to $6 thousand for the three months ended September 30, 2012. The increase is due primarily to the chargeoff of a $350 commercial loan during September 2013. Net charge-offs were $1,272 thousand for the nine months ended September 30, 2013 compared to $414 thousand for the nine months ended September 30, 2012. The increase in net charge-offs from the previous period was primarily related to the chargeoff in September discussed above and one large commercial real estate loan that was foreclosed during the period and charged down by $516 thousand prior to being transferred to other real estate.

Noninterest Income

The following table sets forth the major components of noninterest income for the three and nine months ended September 30, 2013 and 2012 and the period-over-period variations in such categories of noninterest income:

	For the Three Months Ended September 30,		Variance	For the Nine Months Ended September 30,		Variance
	2013	2012	2013 v. 2012	2013	2012	2013 v. 2012
(dollars in thousands)						
Noninterest Income						
Service charges on deposit accounts	$1,248	$826	$422	$3,597	$2,473	$1,124
Mortgage fee income	957	1,108	(151)	3,120	2,965	155
Gain (loss) on sale of other real estate	—	(31)	31	173	(75)	248
Gain on sale of branch	—	51	(51)	—	51	(51)
Loss on sale of securities available for sale	—	—	—	—	(3)	3
Gain (loss) on sale of premises and equipment	5	(1)	6	4	(346)	350
Increase in cash surrender value of bank owned life insurance	80	82	(2)	240	245	(5)
Other noninterest income	161	52	109	475	302	173
Total noninterest income	$2,451	$2,087	$364	$7,609	$5,612	$1,997

Total noninterest income increased $364 thousand, or 17.4% and $2.0 million, or 35.6% for the three and nine months ended September 30, 2013, respectively compared to the same periods in 2012. Changes in the components of noninterest income are discussed below:

Service charges. Service charges on deposit accounts for the three and nine months ended September 30, 2013 increased $422 thousand, or 51.1%, and $1.1 million, or 45.5%, compared to the comparable periods in 2012. The increase in each period primarily relates to ATM service fees which have previously been reported net of related expense and commencing in 2013 are being reported on a gross basis with offsetting expense being reported in noninterest expense, which expense is $258 and $856 thousand for the three and nine months ended September 30, 2013, respectively. In 2012, ATM fees were settled on a net basis.

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Mortgage fee income. Mortgage fee income for the three months ended September 30, 2013 decreased $151 thousand, or 13.6%, compared to the same period in 2012, while income for the nine-month period ended September 30, 2013 increased $155 thousand, or 5.2%, compared to the same nine-month period in 2012. The overall increase for the year to date periods is due to an increase in mortgage loan origination, although the activity in the third quarter of 2013 was lower than the same period in 2012 and the first six months of 2013 due to the increased interest rates during the quarter.
Gain (loss) on sale of other real estate. Other real estate gain of $173 thousand for the nine-month period ended September 30, 2013 is related to several sales of property including two sales of Adriatica property. In the comparable period in 2012, there was a loss of $75 thousand as a result of fewer transactions at the Bank and no sales of Adriatica property.
Loss on sale of premises and equipment. Loss on sale of premises and equipment decreased $350 thousand for the nine months ended September 30, 2013 from the comparable period in 2012 because the Company did not have any significant sales of premises and equipment in the current year period while it recognized a loss on the sale of the corporate aircraft in June 2012.
Other noninterest income. Other noninterest income increased $109 thousand, or 209.6% and $173 thousand, or 57.3%, for the three and nine months ended September 30, 2013, respectively, compared to the comparable periods in 2012. The increase is due to income received from increased non-bank usage of the Company airplane.

Noninterest Expense
The following table sets forth the major components of noninterest expense for the three and nine months ended September 30, 2013 and 2012 and the period-over-period variations in such categories of noninterest expense:

	For the Three Months Ended September 30,		Variance	For the Nine Months Ended September 30,		Variance
	2013	2012	2013 v. 2012	2013	2012	2013 v. 2012
(dollars in thousands)						