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

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

5

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

6

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.

10

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.

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

13

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

14

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.

17

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				