

Edgar Filing: Independent Bank Group, Inc. - Form 10-Q

Independent Bank Group, Inc.
Form 10-Q
April 26, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the quarterly period ended March 31, 2018.

or
 Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the transition period from _____ to _____
Commission file number 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

75069-3257

McKinney, Texas

(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 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 No

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards pursuant to Section 13(a) of the Exchange Act.

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Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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, Par Value \$0.01 Per Share – 28,372,135 shares as of April 24, 2018.

INDEPENDENT BANK GROUP, INC. AND SUBSIDIARIES
Form 10-Q
March 31, 2018

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Signatures

Independent Bank Group, Inc. and Subsidiaries

Consolidated Balance Sheets

March 31, 2018 (unaudited) and December 31, 2017

(Dollars in thousands, except share information)

	March 31,	December 31,
	2018	2017
Assets		
Cash and due from banks	\$275,652	\$187,574
Interest-bearing deposits in other banks	122,450	243,528
Cash and cash equivalents	398,102	431,102
Certificates of deposit held in other banks	9,800	12,985
Securities available for sale, at fair value	762,662	763,002
Loans held for sale	28,017	39,202
Loans, net	6,607,620	6,432,273
Premises and equipment, net	147,367	147,835
Other real estate owned	5,463	7,126
Federal Home Loan Bank (FHLB) of Dallas stock and other restricted stock	29,324	29,184
Bank-owned life insurance (BOLI)	113,909	113,170
Deferred tax asset	11,280	9,763
Goodwill	621,458	621,458
Core deposit intangible, net	41,913	43,244
Other assets	34,099	34,119
Total assets	\$8,811,014	\$8,684,463
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	\$1,836,929	\$1,907,770
Interest-bearing	4,957,731	4,725,052
Total deposits	6,794,660	6,632,822
FHLB advances	480,646	530,667
Other borrowings	136,990	136,911
Junior subordinated debentures	27,704	27,654
Other liabilities	16,315	20,391
Total liabilities	7,456,315	7,348,445
Commitments and contingencies		
Stockholders' equity:		
Preferred stock (0 and 0 shares outstanding, respectively)	—	—
Common stock (28,362,973 and 28,254,893 shares outstanding, respectively)	284	283
Additional paid-in capital	1,153,553	1,151,990
Retained earnings	210,028	184,232
Accumulated other comprehensive loss	(9,166)	(487)
Total stockholders' equity	1,354,699	1,336,018
Total liabilities and stockholders' equity	\$8,811,014	\$8,684,463
See Notes to Consolidated Financial Statements		

Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Income

Three Months Ended March 31, 2018 and 2017 (unaudited)

(Dollars in thousands, except per share information)

	Three Months Ended March 31,	
	2018	2017
Interest income:		
Interest and fees on loans	\$83,275	\$53,744
Interest on taxable securities	2,903	764
Interest on nontaxable securities	1,193	541
Interest on interest-bearing deposits and other	743	890
Total interest income	88,114	55,939
Interest expense:		
Interest on deposits	9,799	5,029
Interest on FHLB advances	1,886	1,171
Interest on other borrowings	2,102	1,705
Interest on junior subordinated debentures	360	167
Total interest expense	14,147	8,072
Net interest income	73,967	47,867
Provision for loan losses	2,695	2,023
Net interest income after provision for loan losses	71,272	45,844
Noninterest income:		
Service charges on deposit accounts	3,485	1,927
Mortgage banking revenue	3,414	1,267
Gain on sale of other real estate	60	—
Loss on sale of securities available for sale	(224)	—
(Loss) gain on sale of premises and equipment	(8)	5
Increase in cash surrender value of BOLI	739	399
Other	1,989	985
Total noninterest income	9,455	4,583
Noninterest expense:		
Salaries and employee benefits	25,168	16,837
Occupancy	5,664	3,872
Data processing	2,405	1,288
FDIC assessment	741	878
Advertising and public relations	385	297
Communications	941	475
Other real estate owned expenses, net	90	37
Impairment of other real estate	85	—
Core deposit intangible amortization	1,331	492
Professional fees	1,119	773
Acquisition expense, including legal	545	146
Other	6,484	2,933
Total noninterest expense	44,958	28,028
Income before taxes	35,769	22,399
Income tax expense	6,805	6,728
Net income	\$28,964	\$15,671

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Basic earnings per share	\$1.02	\$0.83
Diluted earnings per share	\$1.02	\$0.82

See Notes to Consolidated Financial Statements

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Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income
 Three Months Ended March 31, 2018 and 2017 (unaudited)
 (Dollars in thousands)

	Three Months Ended March 31,	
	2018	2017
Net income	\$28,964	\$15,671
Other comprehensive income (loss) before tax:		
Change in net unrealized gains (losses) on available for sale securities during the year	(10,915)	2,000
Reclassification adjustment for loss on sale of securities available for sale included in net income	224	—
Other comprehensive income (loss) before tax	(10,691)	2,000
Income tax expense (benefit)	(2,245)	700
Other comprehensive income (loss), net of tax	(8,446)	1,300
Comprehensive income	\$20,518	\$16,971

See Notes to Consolidated Financial Statements

Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity
 Three Months Ended March 31, 2018 and 2017 (unaudited)
 (Dollars in thousands, except for par value, share and per share information)

	Preferred Stock \$.01 Par Value 10 million shares authorized	Common Stock \$.01 Par Value 100 million shares authorized	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance, December 31, 2017	\$ —	28,254,893	\$ 283	\$ 1,151,990	\$ 184,232	\$ (487) \$ 1,336,018
Cumulative effect of change in accounting principle	—	—	—	—	233	(233) —
Net income	—	—	—	—	28,964	— 28,964
Other comprehensive loss, net of tax	—	—	—	—	—	(8,446) (8,446)
Restricted stock forfeited	—	(606)	—	—	—	—
Restricted stock granted	—	99,812	1	(1)	—	—
Stock based compensation expense	—	—	—	1,412	—	— 1,412
Exercise of warrants	—	8,874	—	152	—	— 152
Cash dividends (\$0.12 per share)	—	—	—	—	(3,401)	— (3,401)
Balance, March 31, 2018	\$ —	28,362,973	\$ 284	\$ 1,153,553	\$ 210,028	\$ (9,166) \$ 1,354,699
Balance, December 31, 2016	\$ —	18,870,312	\$ 189	\$ 555,325	\$ 117,951	\$ (1,100) \$ 672,365
Net income	—	—	—	—	15,671	— 15,671
Other comprehensive income, net of tax	—	—	—	—	—	1,300 1,300
Restricted stock granted	—	51,667	—	—	—	—
Stock based compensation expense	—	—	—	970	—	— 970
Exercise of warrants	—	3,203	—	55	—	— 55
Cash dividends (\$0.10 per share)	—	—	—	—	(1,892)	— (1,892)
Balance, March 31, 2017	\$ —	18,925,182	\$ 189	\$ 556,350	\$ 131,730	\$ 200 \$ 688,469

See Notes to Consolidated Financial Statements

Independent Bank Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Three Months Ended March 31, 2018 and 2017 (unaudited)

(Dollars in thousands)

	Three Months Ended March 31, 2018	2017
Cash flows from operating activities:		
Net income	\$ 28,964	\$ 15,671
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	2,050	1,763
Accretion of income recognized on acquired loans	(3,503)	(480)
Amortization of core deposit intangibles	1,331	492
Amortization of premium on securities, net	1,175	721
Amortization of discount and origination costs on borrowings	158	89
Stock based compensation expense	1,412	970
Excess tax benefit on restricted stock vested	(349)	(724)
FHLB stock dividends	(140)	(88)
Loss on sale of securities available for sale	224	—
Loss (gain) on sale of premises and equipment	8	(5)
Gain on sale of other real estate owned	(60)	—
Impairment of other real estate	85	—
Deferred tax expense	729	981
	2,695	2,023

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Provision for loan losses				
Increase in cash surrender value of BOLI	(739)	(399)
Originations of loans held for sale	(97,009)	(51,631)
Proceeds from sale of loans held for sale	108,194		56,345	
Net change in other assets	19		(2,008)
Net change in other liabilities	(3,756)	3,201	
Net cash provided by operating activities	41,488		26,921	
Cash flows from investing activities:				
Proceeds from maturities, calls and pay downs of securities available for sale	32,333		17,241	
Proceeds from sale of securities available for sale	14,801		—	
Purchases of securities available for sale	(58,884)	(43,868)
Purchases of certificates of deposits held in other banks	—		(3,185)
Proceeds from maturities of certificates of deposits held in other banks	3,185		—	
Net purchases of FHLB stock	—		(48)
Net loans originated held for investment	(214,533)	(129,883)
Net proceeds from pay-offs of mortgage warehouse purchase loans	39,994		—	
Additions to premises and equipment	(1,594)	(155)
Proceeds from sale of premises and equipment	4		9	
	1,638		—	

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Proceeds from sale of other real estate owned			
Capitalized additions to other real estate	—		(174)
Net cash used in investing activities	(183,056)		(160,063)
Cash flows from financing activities:			
Net increase in demand deposits, money market and savings accounts	191,218		141,116
Net increase (decrease) in time deposits	(29,380)		3,978
Proceeds from FHLB advances	275,000		—
Repayments of FHLB advances	(325,021)		(19)
Proceeds from exercise of common stock warrants	152		55
Dividends paid	(3,401)		(1,892)
Net cash provided by financing activities	108,568		143,238
Net change in cash and cash equivalents	(33,000)		10,096
Cash and cash equivalents at beginning of year	431,102		505,027
Cash and cash equivalents at end of period	\$ 398,102		\$ 515,123

See Notes to Consolidated Financial Statements

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, Central and Southeast, Texas areas and along the Colorado Front Range, 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, IBG Adriatica Holdings, Inc. (Adriatica) and Carlile Capital, LLC and the Bank's wholly-owned subsidiaries, IBG Real Estate Holdings, Inc., IBG Real Estate Holdings II, Inc., IBG Aircraft Company III, Preston Grand, Inc., CFRH II, LLC, McKinney Avenue Holdings, Inc. and its wholly owned subsidiary, McKinney Avenue Holdings SPE 1, Inc. Adriatica, CFRH II, LLC, McKinney Avenue Holdings, Inc. and its subsidiary are currently not active entities.

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), Community Group Statutory Trust I (CGI Trust I), Northstar Statutory Trust II (Northstar Trust II) and Northstar Statutory Trust III (Northstar Trust III). 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 Annual Report of Form 10-K for the year ended December 31, 2017. The consolidated statement of condition at December 31, 2017 had 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.

Recently Adopted Accounting Pronouncements: ASU 2016-01, Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities was effective for the Company on January 1, 2018. The amendments in this update address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial

liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. Previously, the Company valued their financial instruments that are not measured at fair value in the financial statements using an entry price notion. This ASU emphasized that these instruments be measured using the exit price notion and clarified that entities should not make use of the practicability exception in determining the fair value of loans. Accordingly, the Company refined the calculation used to determine the disclosed fair value of loans as part of adopting this standard. The impact of this change was not significant to the Company's disclosures. See Note 7 -Fair Value Measurement. The adoption of the remaining provisions had no impact on the Company's consolidated financial statements.

Independent Bank Group, Inc. and Subsidiaries

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

ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The Company elected to early adopt and apply the guidance at the beginning of the period, effective January 1, 2018. The amendments in this update allow reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (TCJA) which was signed into law on December 22, 2017. The impact of adopting the amendment resulted in a cumulative effect adjustment to the consolidated balance sheet as of January 1, 2018 to reclassify approximately \$233 of tax expense from accumulated other comprehensive loss to retained earnings as reflected in the accompanying Consolidated Statements of Changes in Stockholders' Equity.

ASU 2014-09, Revenue from Contracts with Customers (Topic 606) was effective for the Company on January 1, 2018. ASU 2014-09 amends existing guidance related to revenue from contracts with customers. The amendments state that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 affects entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards. The Company's revenue consists of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and noninterest income. The Company has applied ASU 2014-09 using the modified retrospective approach to all existing contracts with customers covered under the scope of the standard. The adoption of this ASU was not significant to the Company and had no material effect on how the Company recognizes revenue nor did it result in a cumulative effect adjustment or any presentation changes to the consolidated financial statements. See below for additional information related to revenue generated from contracts with customers.

Revenue Recognition: ASC Topic 606, Revenue from Contracts with Customers, establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.

The majority of the Company's revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as loans, letters of credit, and investment securities, as well as revenue related to mortgage banking activities, and BOLI, as these activities are subject to other accounting guidance. Descriptions of revenue-generating activities that are within the scope of ASC 606, and are presented in the accompanying Consolidated Statements of Income as components of noninterest income, are as follows:

Service charges on deposit accounts - these represent general service fees for monthly account maintenance and activity- or-transaction-based fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when the performance obligation is completed which is generally monthly for account maintenance services or when a transaction has been completed (such as a wire transfer). Payment for such performance obligations are generally received at the time the performance obligations are satisfied.

Gains/losses on the sale of other real estate owned - generally recognized when the performance obligation is complete which is typically at delivery of control over the property to the buyer at time of each real estate closing.

Other noninterest income - includes the Company's correspondent bank earnings credit, mortgage warehouse purchase program fees, acquired loan recoveries, wealth management referral income, other deposit fees, and merchant interchange income. The majority of these fees in other noninterest income are not subject to the requirements of ASC 606. The wealth management referral fees, other deposit fees and merchant interchange income are in the scope of ASC 606, and payment for such performance obligations are generally received at the time the performance obligations are satisfied.

The Company has made no significant judgments in applying the revenue guidance prescribed in ASC 606 that affect the determination of the amount and timing of revenue from the above-described contracts with customers.

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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)

Subsequent events: Companies are required to evaluate events and transactions that occur after the balance sheet date but before the date the financial statements are issued. They must recognize in the financial statements the effect of all events or transactions that provide additional evidence of conditions that existed at the balance sheet date, including the estimates inherent in the financial statement preparation process. Entities shall not recognize the impact of events or transactions that provide evidence about conditions that did not exist at the balance sheet date but arose after that date. The Company has evaluated subsequent events through the date of filing these financial statements with the Securities and Exchange Commission (SEC) and noted no subsequent events requiring financial statement recognition or disclosure, except as disclosed in Note 10.

Earnings per share: Basic earnings per common share are net income available to common shareholders 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 participating nonvested common stock was not included in dilutive shares as it was anti-dilutive for the three months ended March 31, 2018 and 2017. Proceeds from the assumed exercise of dilutive stock warrants are assumed to be used to repurchase common stock at the average market price.

The following table presents a reconciliation of net income available to common shareholders and the number of shares used in the calculation of basic and diluted earnings per common share.

	Three Months Ended March 31,	
	2018	2017
Basic earnings per share:		
Net income	\$28,964	\$ 15,671
Less:		
Undistributed earnings allocated to participating securities	245	176
Dividends paid on participating securities	33	24
Net income available to common shareholders	\$28,686	\$ 15,471
Weighted-average basic shares outstanding	28,049,011	18,667,274
Basic earnings per share	\$1.02	\$ 0.83
Diluted earnings per share:		
Net income available to common shareholders	\$28,686	\$ 15,471
Total weighted-average basic shares outstanding	28,049,011	18,667,274
Add dilutive stock warrants	105,353	107,132
Total weighted-average diluted shares outstanding	28,154,364	18,774,406
Diluted earnings per share	\$1.02	\$ 0.82
Anti-dilutive participating securities	118,900	126,847

Independent Bank Group, Inc. and Subsidiaries

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

Note 2. Statement of Cash Flows

As allowed by the accounting standards, 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:

	Three Months Ended March 31,	
	2018	2017
Cash transactions:		
Interest expense paid	\$15,330	\$9,694
Income taxes paid	\$—	\$—
Noncash transactions:		
Transfers of loans to other real estate owned	\$—	\$750
Securities purchased, not yet settled	\$—	\$6,068

Independent Bank Group, Inc. and Subsidiaries

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

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 March 31, 2018 and December 31, 2017, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
March 31, 2018				
U.S. treasuries	\$ 35,449	\$ —	\$(553)	\$34,896
Government agency securities	207,292	28	(3,602)	203,718
Obligations of state and municipal subdivisions	218,239	863	(4,020)	215,082
Residential pass-through securities guaranteed by FNMA, GNMA, FHLMC, FHS, FHR and GNR	314,035	504	(5,573)	308,966
	\$ 775,015	\$ 1,395	\$(13,748)	\$762,662
December 31, 2017				
U.S. treasuries	\$ 37,480	\$ —	\$(326)	\$37,154
Government agency securities	213,649	83	(2,223)	211,509
Obligations of state and municipal subdivisions	228,782	2,118	(1,287)	229,613
Residential pass-through securities guaranteed by FNMA, GNMA, FHLMC, FHR and GNR	274,356	1,229	(1,208)	274,377
Other securities	10,397	—	(48)	10,349
	\$ 764,664	\$ 3,430	\$(5,092)	\$763,002

Securities with a carrying amount of approximately \$270,878 and \$238,344 at March 31, 2018 and December 31, 2017, respectively, were pledged to secure public fund deposits and repurchase agreements.

Independent Bank Group, Inc. and Subsidiaries

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

Proceeds from sale of securities available for sale and gross gains and gross losses for the three months ended March 31, 2018 and 2017 were as follows:

	Three Months Ended March 31,	
	2018	2017
Proceeds from sale	\$14,801	\$ —
Gross gains	\$15	\$ —
Gross losses	\$239	\$ —

The amortized cost and estimated fair value of securities available for sale at March 31, 2018, 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.

	March 31, 2018 Securities Available for Sale	
	Amortized Cost	Fair Value
Due in one year or less	\$101,216	\$100,888
Due from one year to five years	176,765	173,894
Due from five to ten years	85,936	83,478
Thereafter	97,063	95,436
	460,980	453,696
Residential pass-through securities guaranteed by FNMA, GNMA, FHLMC, FHS, FHR and GNR	314,035	308,966
	\$775,015	\$762,662

Independent Bank Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

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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 March 31, 2018 and December 31, 2017, are summarized as follows:

Description of Securities	Less Than 12 Months			Greater Than 12 Months			Total	
	Number of Securities	Estimated Fair Value	Unrealized Losses	Number of Securities	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Securities Available for Sale								
March 31, 2018								
U.S. treasuries	4	\$16,854	\$(450)	3	\$18,042	\$(103)	\$34,896	\$(553)
Government agency securities	42	120,230	(2,162)	34	79,155	(1,440)	199,385	(3,602)
Obligations of state and municipal subdivisions	313	137,154	(2,627)	66	30,245	(1,393)	167,399	(4,020)
Residential pass-through securities guaranteed by FNMA, GNMA, FHLMC, FHS, FHR and GNR	129	256,057	(4,632)	13	28,995	(941)	285,052	(5,573)
	488	\$530,295	\$(9,871)	116	\$156,437	\$(3,877)	\$686,732	\$(13,748)
December 31, 2017								
U.S. treasuries	7	\$34,053	\$(267)	1	\$3,101	\$(59)	\$37,154	\$(326)
Government agency securities	51	142,991	(1,155)	27	60,030	(1,068)	203,021	(2,223)
Obligations of state and municipal subdivisions	202	87,625	(564)	54	26,883	(723)	114,508	(1,287)
Residential pass-through securities guaranteed by FNMA, GNMA, FHLMC, FHR and GNR	55	125,970	(834)	10	25,398	(374)	151,368	(1,208)
Other securities	1	10,349	(48)	—	—	—	10,349	(48)
	316	\$400,988	\$(2,868)	92	\$115,412	\$(2,224)	\$516,400	\$(5,092)

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 March 31, 2018 and December 31, 2017, consisted of the following:

	March 31, 2018	December 31, 2017
Commercial	\$1,035,985	\$1,059,984
Real estate:		
Commercial	3,498,483	3,369,892
Commercial construction, land and land development	806,415	744,868
Residential	916,355	892,293
Single family interim construction	284,490	289,680
Agricultural	78,782	82,583
Consumer	31,633	34,639
Other	238	304
	6,652,381	6,474,243
Deferred loan fees	(2,801)	(2,568)
Allowance for loan losses	(41,960)	(39,402)
	\$6,607,620	\$6,432,273

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. At March 31, 2018 and December 31, 2017, there were approximately \$99,738 and \$90,323 of exploration and production (E&P) energy loans outstanding, respectively. Additionally, with the acquisition of Carlile in second quarter of 2017, the Company acquired a mortgage warehouse purchase program, which provides a mortgage warehouse lending vehicle to third party mortgage bankers across a broad geographic scale. The mortgage loans are underwritten, in part, on approved investor takeout commitments. These loans have a very short duration ranging between 10 days and 15 days. In some cases, loans to larger mortgage originators may be financed for up to 60 days. These loans are reported as commercial loans since the loans are secured by notes receivable, not real estate. As of March 31, 2018 and December 31, 2017, mortgage warehouse purchase loans outstanding totaled \$124,700 and \$164,694, respectively.

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. At March 31, 2018, the portfolio consisted of approximately 34% of owner occupied property.

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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 agricultural-related assets. 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 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 1% 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, central and southeast Texas regions. With the acquisition of Carlile, the Company expanded into the State of Colorado, specifically along the Front Range area. As of March 31, 2018, loans in the Colorado region represented about 6% of the total portfolio. A large percentage of the Company's portfolio consists of commercial and residential real estate loans. As of March 31, 2018 and December 31, 2017, 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, 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; change in value of underlying collateral; 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.

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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 identify potential internally classified loans that supplements the annual independent external loan review. The external review generally covers all loans greater than \$4,125 annually. 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 and Colorado economies, specifically the Company's lending area of north, central and southeast Texas and the Colorado Front Range area, continued to be strong in the first quarter of 2018. The Texas economy is the second largest in the nation, out-pacing the U.S. economy in job creation and employment growth. Overall, the forecast is strong with continued growth in the manufacturing and service sectors and rising activity in the energy sector. While the current economic outlook remains optimistic, future and long-term concerns continue to include the tightening labor markets, decreased housing affordability, energy price volatility and trade uncertainty. The risk of loss associated with all segments of the portfolio could increase due to these factors.

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. The following is a summary of the activity in the allowance for loan losses by loan class for the three months ended March 31, 2018 and 2017:

	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Unallocated	Total
Three Months Ended March 31, 2018									
Balance at the beginning of period	\$ 10,599	\$ 23,301	\$ 3,447	\$ 1,583	\$ 250	\$ 205	\$(32)	\$ 49	\$ 39,402
Provision for loan losses	1,740	926	143	53	(2)	(10)	71	(226)	2,695
Charge-offs	(82)	(11)	(3)	—	—	(16)	(48)	—	(160)
Recoveries	4	3	2	—	—	1	13	—	23
Balance at end of period	\$ 12,261	\$ 24,219	\$ 3,589	\$ 1,636	\$ 248	\$ 180	\$ 4	\$(177)	\$ 41,960

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Three months ended March 31, 2017

Balance at the beginning of period	\$ 8,593	\$ 18,399	\$ 2,760	\$ 1,301	\$ 207	\$ 242	\$ 29	\$ 60	\$ 31,591
Provision for loan losses	(590)	2,048	67	235	(6)	64	23	182	2,023
Charge-offs	—	—	—	(134)	—	(56)	(22)	—	(212)
Recoveries	2	20	1	—	—	2	4	—	29
Balance at end of period	\$ 8,005	\$ 20,467	\$ 2,828	\$ 1,402	\$ 201	\$ 252	\$ 34	\$ 242	\$ 33,431

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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 March 31, 2018 and December 31, 2017:

	Commercial	Commercial Real Estate, Land and Development	Residential Real Estate	Single-Family Interim Construction	Agricultural	Consumer	Other	Unallocated	Total
March 31, 2018									
Allowance for losses:									
Individually evaluated for impairment	\$3,961	\$300	\$—	\$—	\$—	\$1	\$—	\$—	\$4,262
Collectively evaluated for impairment	8,300	23,919	3,589	1,636	248	179	4	(177)	37,698
Loans acquired with deteriorated credit quality	—	—	—	—	—	—	—	—	—
Ending balance	\$12,261	\$24,219	\$3,589	\$1,636	\$248	\$180	\$4	\$(177)	\$41,960
Loans:									
Individually evaluated for impairment	\$9,314	\$3,335	\$2,124	\$—	\$—	\$54	\$—	\$—	\$14,827
Collectively evaluated for impairment	1,017,373	4,231,756	911,345	284,490	75,657	31,560	238	—	6,552,419
Acquired with deteriorated credit quality	9,298	69,807	2,886	—	3,125	19	—	—	85,135
Ending balance	\$1,035,985	\$4,304,898	\$916,355	\$284,490	\$78,782	\$31,633	\$238	\$—	\$6,652,381
December 31, 2017									
Allowance for losses:									
Individually evaluated for impairment	\$3,500	\$311	\$—	\$—	\$—	\$2	\$—	\$—	\$3,813
Collectively evaluated for impairment	7,099	22,990	3,447	1,583	250	203	(32)	49	35,589
Loans acquired with deteriorated credit quality	—	—	—	—	—	—	—	—	—
Ending balance	\$10,599	\$23,301	\$3,447	\$1,583	\$250	\$205	\$(32)	\$49	\$39,402
Loans:									
Individually evaluated for impairment	\$10,297	\$3,054	\$1,727	\$—	\$—	\$74	\$—	\$—	\$15,152
Collectively evaluated for impairment	1,037,401	4,039,332	887,292	289,680	78,646	34,544	304	—	6,367,199

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Acquired with deteriorated credit quality	12,286	72,374	3,274	—	3,937	21	—	—	91,892
Ending balance	\$ 1,059,984	\$ 4,114,760	\$ 892,293	\$ 289,680	\$ 82,583	\$ 34,639	\$ 304	\$ —	\$ 6,474,243

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Nonperforming loans by loan class (excluding loans acquired with deteriorated credit quality) at March 31, 2018 and December 31, 2017, are summarized as follows:

	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agriculture	Consumer	Other	Total
March 31, 2018								
Nonaccrual loans	\$ 9,314	\$ 2,892	\$ 1,950	\$ —	\$ —	\$ 35	\$ —	\$ —14,191
Loans past due 90 days and still accruing	—	—	68	—	—	27	—	95
Troubled debt restructurings (not included in nonaccrual or loans past due and still accruing)	—	443	174	—	—	19	—	636
	\$ 9,314	\$ 3,335	\$ 2,192	\$ —	\$ —	\$ 81	\$ —	\$ —14,922
December 31, 2017								
Nonaccrual loans	\$ 10,304	\$ 2,716	\$ 998	\$ —	\$ —	\$ 55	\$ —	\$ —14,073
Loans past due 90 days and still accruing	8	120	8	—	—	—	—	136
Troubled debt restructurings (not included in nonaccrual or loans past due and still accruing)	—	455	730	—	—	20	—	1,205
	\$ 10,312	\$ 3,291	\$ 1,736	\$ —	\$ —	\$ 75	\$ —	\$ —15,414

The accrual of interest is discontinued on a loan when management believes after considering collection efforts and other factors that the borrower's financial condition is such that collection of interest is doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status or charged-off is reversed against interest income. Cash collections on nonaccrual loans are generally credited to the loan receivable balance, and no interest income is recognized on those loans until the principal balance has been collected. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. 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 loan's 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 the other methods to determine the level of impairment of a loan if such loan is not collateral dependent.

All commercial, real estate, agricultural loans and troubled debt restructurings are considered for individual impairment analysis. Smaller balance consumer loans are collectively evaluated for impairment.

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Impaired loans by loan class (excluding loans acquired with deteriorated credit quality) at March 31, 2018 and December 31, 2017, are summarized as follows:

	Commercial	Commercial Real Estate, Land and Land Development	Residential Real Estate	Single-Family Interim Construction	Agriculture	Consumer	Other	Total
March 31, 2018								
Recorded investment in impaired loans:								
Impaired loans with an allowance for loan losses	\$ 7,606	\$ 1,602	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Impaired loans with no allowance for loan losses	1,708	1,733	2,124	—	—	53	—	5,618
Total	\$ 9,314	\$ 3,335	\$ 2,124	\$ —	\$ —	\$ —	\$ —	\$ —
Unpaid principal balance of impaired loans	\$ 12,477	\$ 3,434	\$ 2,223	\$ —	\$ —	\$ —	\$ —	\$ —
Allowance for loan losses on impaired loans	\$ 3,961	\$ 300	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
December 31, 2017								
Recorded investment in impaired loans:								
Impaired loans with an allowance for loan losses	\$ 9,255	\$ 1,793	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Impaired loans with no allowance for loan losses	1,042	1,261	1,727	—	—	72	—	4,102
Total	\$ 10,297	\$ 3,054	\$ 1,727	\$ —	\$ —	\$ —	\$ —	\$ —
Unpaid principal balance of impaired loans	\$ 13,456	\$ 3,124	\$ 1,818	\$ —	\$ —	\$ —	\$ —	\$ —
Allowance for loan losses on impaired loans	\$ 3,500	\$ 311	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
For the three months ended March 31, 2018								
Average recorded investment in impaired loans	\$ 9,806	\$ 3,195	\$ 1,926	\$ —	\$ —	\$ —	\$ —	\$ —
Interest income recognized on impaired loans	\$ 3	\$ 6	\$ 7	\$ —	\$ —	\$ —	\$ —	\$ —
For the three months ended March 31, 2017								
Average recorded investment in impaired loans	\$ 7,958	\$ 4,966	\$ 1,964	\$ 442	\$ —	\$ —	\$ —	\$ —
Interest income recognized on impaired loans	\$ 2	\$ 397	\$ 12	\$ —	\$ —	\$ —	\$ —	\$ —

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.

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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. 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 losses. The recorded investment in troubled debt restructurings, including those on nonaccrual, was \$2,388 and \$3,028 as of March 31, 2018 and December 31, 2017, respectively. There were no loans modified under troubled debt restructurings during the three months ended March 31, 2018 and 2017.

At March 31, 2018 and 2017, there were no loans modified under troubled debt restructurings during the previous twelve month period that subsequently defaulted during the three months ended March 31, 2018 and 2017, respectively. At March 31, 2018 and 2017, the Company had no commitments to lend additional funds to any borrowers with loans whose terms have been modified under troubled debt restructurings.

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 March 31, 2018 and December 31, 2017:

	Loans 30-89 Days Past Due	Loans 90 or More Past Due	Total Past Due Loans	Current Loans	Total Loans
March 31, 2018					
Commercial	\$2,354	\$8,132	\$10,486	\$1,016,201	\$1,026,687
Commercial real estate, land and land development	2,378	1,602	3,980	4,231,111	4,235,091
Residential real estate	2,358	794	3,152	910,317	913,469
Single-family interim construction	349	—	349	284,141	284,490
Agricultural	22	—	22	75,635	75,657
Consumer	186	54	240	31,374	31,614
Other	—	—	—	238	238
	7,647	10,582	18,229	6,549,017	6,567,246
Acquired with deteriorated credit quality	2,506	3,048	5,554	79,581	85,135
	\$10,153	\$13,630	\$23,783	\$6,628,598	\$6,652,381
December 31, 2017					
Commercial	\$730	\$10,300	\$11,030	\$1,036,668	\$1,047,698
Commercial real estate, land and land development	4,083	1,944	6,027	4,036,359	4,042,386
Residential real estate	6,269	138	6,407	882,612	889,019
Single-family interim construction	1,436	—	1,436	288,244	289,680
Agricultural	—	—	—	78,646	78,646
Consumer	373	47	420	34,198	34,618
Other	—	—	—	304	304
	12,891	12,429	25,320	6,357,031	6,382,351
Acquired with deteriorated credit quality	2,748	4,013	6,761	85,131	91,892
	\$15,639	\$16,442	\$32,081	\$6,442,162	\$6,474,243

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The Company's internal classified report is segregated into the following categories: 1) Pass/Watch, 2) Special Mention, 3) Substandard and 4) Doubtful. The loans placed in the Pass/Watch category reflect the Company's opinion that the loans reflect potential weakness that requires monitoring on a more frequent basis. The loans in the Special Mention 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 by officers and senior management 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 March 31, 2018 and December 31, 2017, is as follows:

	Pass	Pass/ Watch	Special Mention	Substandard	Doubtful	Total
March 31, 2018						
Commercial	\$970,717	\$18,946	\$17,047	\$29,275	\$	—\$1,035,985
Commercial real estate, construction, land and land development	4,228,173	54,938	4,226	17,561	—	4,304,898
Residential real estate	907,273	3,049	448	5,585	—	916,355
Single-family interim construction	282,832	1,658	—	—	—	284,490
Agricultural	56,519	6,222	13,288	2,753	—	78,782
Consumer	31,456	23	52	102	—	31,633
Other	238	—	—	—	—	238
	\$6,477,208	\$84,836	\$35,061	\$55,276	\$	—\$6,652,381
December 31, 2017						
Commercial	\$989,953	\$35,105	\$3,737	\$31,189	\$	—\$1,059,984
Commercial real estate, construction, land and land development	4,040,385	46,288	11,915	16,172	—	4,114,760
Residential real estate	883,653	2,722	462	5,456	—	892,293
Single-family interim construction	288,020	1,660	—	—	—	289,680
Agricultural	59,392	5,762	13,802	3,627	—	82,583
Consumer	34,510	25	4	100	—	34,639
Other	304	—	—	—	—	304
	\$6,296,217	\$91,562	\$29,920	\$56,544	\$	—\$6,474,243

The Company has acquired certain loans which experienced credit deterioration since origination (purchased credit impaired (PCI) loans).

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The Company has included PCI loans in the above grading tables. The following provides additional detail on the grades applied to those loans at March 31, 2018 and December 31, 2017:

	Pass	Pass/ Watch	Special Mention	Substandard	Doubtful	Total
March 31, 2018	\$35,670	\$30,284	\$ 1,663	\$ 17,518	\$	—\$85,135
December 31, 2017	36,928	32,674	2,662	19,628	—	91,892

PCI loans may remain on accrual status to the extent the company can reasonably estimate the amount and timing of expected future cash flows. At March 31, 2018 and December 31, 2017, non-accrual PCI loans were \$6,788 and \$7,889, respectively.

Accretion on PCI loans is based on estimated future cash flows, regardless of contractual maturity. The following table summarizes the outstanding balance and related carrying amount of purchased credit impaired loans as of the acquisition date for the acquisition occurring in 2017:

	Acquisition Date April 1, 2017 Carlife Bancshares, Inc.
Outstanding balance	\$ 101,153
Nonaccretable difference	(14,700)
Accretable yield	(685)
Carrying amount	\$ 85,768

The carrying amount of all acquired PCI loans included in the consolidated balance sheet and the related outstanding balance at March 31, 2018 and December 31, 2017 were as follows:

	March 31, 2018	December 31, 2017
Outstanding balance	\$97,612	\$ 105,685
Carrying amount	85,135	91,892

There was no allocation established in the allowance for loan losses relating to PCI loans at March 31, 2018 or December 31, 2017.

The changes in accretable yield during the three months ended March 31, 2018 and 2017 in regard to loans transferred at acquisition for which it was probable that all contractually required payments would not be collected are presented in the table below.

	For the Three Months Ended March 31, 2018 2017	
Balance at January 1,	\$1,546	\$1,526
Additions	—	—

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Accretion	(604)	(225)
Transfers from nonaccretable	1,286	270
Balance at March 31,	\$2,228	\$1,571

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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 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 March 31, 2018 and December 31, 2017, the approximate amounts of these financial instruments were as follows:

	March 31, 2018	December 31, 2017
Commitments to extend credit	\$1,377,327	\$1,286,704
Standby letters of credit	11,549	10,532
	\$1,388,876	\$1,297,236

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 March 31, 2018 and December 31, 2017, 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. A legal proceeding that the Company believes could become material is described below.

Independent Bank is a party to a legal proceeding inherited by Independent Bank in connection with its acquisition of BOH Holdings, Inc. and its subsidiary, Bank of Houston (BOH). The plaintiffs in the case are alleging that Independent Bank aided and abetted or participated in a fraudulent scheme. Independent Bank is pursuing insurance coverage for these claims, including reimbursement for defense costs. The Company believes the claims made in this lawsuit are without merit and is vigorously defending the lawsuit. The Company is unable to predict when the matter

will be resolved, the ultimate outcome or potential costs or damages to be incurred. Please see Part II, Item 1. for more details on this lawsuit.

Lease Commitments

The Company leases certain branch facilities and other facilities. Rent expense related to these leases amounted to \$731 and \$520 for the three months ended March 31, 2018 and March 31, 2017, respectively.

Independent Bank Group, Inc. and Subsidiaries

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

Note 6. Income Taxes

Income tax expense for the three months ended March 31, 2018 and 2017 was as follows:

	Three Months		Ended March 31,	
	2018	2017		
Income tax expense for the period	\$6,805	\$6,728		
Effective tax rate	19.0	% 30.0	%	%

Effective January 1, 2018, the corporate U.S. statutory federal income tax rate was reduced from 35% to 21% under TCJA. The Company completed its accounting under ASC 740 in December 2017 for all material deferred tax assets and liabilities with provisional amounts recorded for immaterial items. No adjustments were made to provisional amounts during the period ended March 31, 2018 and none are anticipated during the one year SEC Staff Accounting Bulletin 118 measurement period.

The effective tax rates differ from the statutory federal tax rate for 2018 and 2017 of 21% and 35%, respectively, largely due to tax exempt interest income earned on certain investment securities and loans, the nontaxable earnings on bank owned life insurance, and excess tax benefits on restricted stock vestings.

Note 7. 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.

Independent Bank Group, Inc. and Subsidiaries

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

The following table represents assets reported on the consolidated balance sheets at their fair value on a recurring basis as of March 31, 2018 and December 31, 2017 by level within the ASC Topic 820 fair value measurement hierarchy:

	Fair Value Measurements at Reporting Date Using Quoted Prices		
Assets/ Liabilities Measured at Fair Value	in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2018			
Measured on a recurring basis:			
Assets:			
Investment securities available for sale:			
U.S. treasuries	\$ 34,896	\$ -34,896	\$ —
Government agency securities	203,718	—203,718	—
Obligations of state and municipal subdivisions	215,082	—215,082	—
Residential pass-through securities guaranteed by FNMA, GNMA, FHLMC, FHS, FHR and GNR	308,966	—308,966	—
December 31, 2017			
Measured on a recurring basis:			
Assets:			
Investment securities available for sale:			
U.S. treasuries	\$ 37,154	\$ -37,154	\$ —
Government agency securities	211,509	—211,509	—
Obligations of state and municipal subdivisions	229,613	—229,613	—
Residential pass-through securities guaranteed by FNMA, GNMA, FHLMC, FHR and GNR	274,377	—274,377	—
Other securities	10,349	10,349	—

There were no transfers between level categorizations and no changes in valuation methodologies 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 1 and Level 2 inputs. Securities are classified within Level 1 when quoted market prices are available in an active market. Inputs include securities that have quoted prices in active markets for identical assets. For securities utilizing Level 2 inputs, 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.

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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)

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 March 31, 2018 and December 31, 2017, for which a nonrecurring change in fair value has been recorded:

Assets Measured at Fair Value	Fair Value Measurements at Reporting Date Using			Period Ended Total Losses
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
March 31, 2018				
Measured on a nonrecurring basis:				
Assets:				
Impaired loans	\$ 143	\$ —	—\$ 143	\$ 562
Other real estate	400	—	400	51
December 31, 2017				
Measured on a nonrecurring basis:				
Assets:				
Impaired loans	\$ 7,237	\$ —	—\$ 7,237	\$ 3,719
Other real estate	1,726	—	1,726	375

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.

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.

In addition, mortgage loans held for sale are required to be measured at the lower of cost or fair value. The fair value of mortgage loans held for sale is based upon binding quotes or bids from third party investors. As of March 31, 2018 and December 31, 2017, all mortgage loans held for sale were recorded at cost.

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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, as amended by ASU 2016-01 requiring public entities to use the exit price notion effective January 1, 2018, 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 fair value of certificates of deposit held in other banks is based upon current rates in the market.

Loans held for sale: The fair value of loans held for sale is determined based upon commitments on hand from investors.

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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)

Loans: Loans are valued on an individual basis, with consideration given to the loans' underlying characteristics, including account types, remaining terms, annual interest rates or coupons, interest types, past delinquencies, timing of principal and interest payments, current market rates, loan to value ratios, loss exposures, and remaining balances. A discounted cash flow model is used to estimate the fair value of the loans using assumptions for the coupon rates, remaining maturities, prepayment speeds, projected default probabilities, losses given defaults, and estimates of prevailing discount rates. The discounted cash flow approach models the credit losses directly in the projected cash flows, applying various assumptions regarding credit, interest, and prepayment risks for the loans based on loan types, payment types and fixed or variable classifications. For variable rate loans, forward interest rate curves are integrated into the projection of cash flows. The forward curves are index specific and obtained from Bloomberg. Future coupon payments are determined based upon the applicable forward curve, spread, next repricing date, and repricing frequency.

As of December 31, 2017, loans were valued as follows: 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.

Repurchase agreements and other borrowings: The carrying value of repurchase agreements approximates fair value due to the short term nature. The fair value of private subordinated debentures are based upon prevailing rates on similar debt in the market place. The subordinated debentures that are publicly traded are valued based on indicative bid prices based upon market pricing observations in the current market.

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.

Off-balance sheet instruments: Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments is not material.

Independent Bank Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

(Dollars in thousands, except for share and per share information)

The carrying amount, estimated fair value and the level of the fair value hierarchy of the Company's financial instruments were as follows at March 31, 2018 and December 31, 2017:

	Carrying Amount	Estimated Fair Value	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2018					
Financial assets:					
Cash and cash equivalents	\$ 398,102	\$ 398,102	\$ 398,102	\$ —	—
Certificates of deposit held in other banks	9,800	9,826	—	9,826	—
Securities available for sale	762,662	762,662	—	762,662	—
Loans held for sale	28,017	28,921	—	28,921	—
Loans, net	6,607,620	6,594,503	—	6,589,556	4,947
FHLB of Dallas stock and other restricted stock	29,324	29,324	—	29,324	—
Accrued interest receivable	18,768	18,768	—	18,768	—
Financial liabilities:					
Deposits	6,794,660	6,799,409	—	6,799,409	—
Accrued interest payable	3,471	3,471	—	3,471	—
FHLB advances	480,646	477,411	—	477,411	—
Other borrowings	136,990	140,950	—	140,950	—
Junior subordinated debentures	27,704	19,308	—	19,308	—
Off-balance sheet assets (liabilities):					
Commitments to extend credit	—	—	—	—	—
Standby letters of credit	—	—	—	—	—
December 31, 2017					
Financial assets:					
Cash and cash equivalents	\$ 431,102	\$ 431,102	\$ 431,102	\$ —	—
Certificates of deposit held in other banks	12,985	13,049	—	13,049	—
Securities available for sale	763,002	763,002	10,349	752,653	—
Loans held for sale	39,202	40,436	—	40,436	—
Loans, net	6,432,273	6,350,416	—	6,343,179	7,237
FHLB of Dallas stock and other restricted stock	29,184	29,184	—	29,184	—
Accrued interest receivable	20,835	20,835	—	20,835	—
Financial liabilities:					
Deposits	6,632,822	6,637,813	—	6,637,813	—
Accrued interest payable	4,654	4,654	—	4,654	—
FHLB advances	530,667	526,514	—	526,514	—
Other borrowings	136,911	141,650	—	141,650	—

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Junior subordinated debentures	27,654	20,008	—	20,008	—
Off-balance sheet assets (liabilities):					
Commitments to extend credit	—	—	—	—	—
Standby letters of credit	—	—	—	—	—

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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 8. Stock Awards and Stock Warrants

In connection with the Company's initial public offering in April 2013, the Board of Directors adopted the 2013 Equity Incentive Plan. Under this plan, the Compensation Committee may grant awards to certain employees of the Company in the form of restricted stock, restricted stock rights, restricted stock units, qualified and nonqualified stock options, performance-based share awards and other equity-based awards. The Plan reserved 800,000 shares of common stock to be awarded by the Company's compensation committee. The shares currently issued under the 2013 Plan are restricted stock awards and will vest evenly over the required employment period, generally ranging from three to five years.

The following table summarizes the activity in nonvested shares for the three months ended March 31, 2018 and 2017:

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested shares, December 31, 2017	242,056	\$ 49.17
Granted during the period	99,812	71.74
Vested during the period	(49,881)	39.15
Forfeited during the period	(606)	71.75
Nonvested shares, March 31, 2018	291,381	\$ 58.57
Nonvested shares, December 31, 2016	280,524	\$ 36.88
Granted during the period	40,627	62.37
Vested during the period	(65,668)	31.23
Nonvested shares, March 31, 2017	255,483	\$ 42.38

Compensation expense related to these awards is recorded based on the fair value of the award at the date of grant and totaled \$1,412 and \$970 for the three months ended March 31, 2018 and March 31, 2017, respectively. Compensation expense is recorded in salaries and employee benefits in the accompanying consolidated statements of income. At March 31, 2018, future compensation expense is estimated to be \$13,842 and will be recognized over a remaining weighted average period of 3.29 years.

The fair value of common stock awards that vested during the three months ended March 31, 2018 and 2017 was \$3,617 and \$4,119, respectively. The Company recorded \$349 and \$724 in excess tax benefits on vested restricted stock to income tax expense for the three months ended March 31, 2018 and 2017, respectively.

At March 31, 2018, the future vesting schedule of the nonvested shares is as follows:

First year	119,807
Second year	82,518
Third year	42,125
Fourth year	25,387
Fifth year	21,544
Total nonvested shares	291,381

The Company has warrants outstanding representing the right to purchase 138,467 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 were recorded as equity awards at fair value and were amortized over the term of the debt. The subordinated debt was paid off by the Company in 2013. The warrants expire in December 2018. During the three months ended March 31, 2018, warrants to purchase 8,874 shares of common stock were exercised and have been issued by the Company.

Independent Bank Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)
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Note 9. 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.

The Company is subject to the Basel III regulatory capital framework (the "Basel III Capital Rules"). Starting in January 2016, the implementation of the capital conservation buffer was effective for the Company starting at the 0.625% level and increasing 0.625% each year thereafter, until it reaches 2.5% on January 1, 2019. The capital conservation buffer is designed to absorb losses during periods of economic stress and requires increased capital levels for the purpose of capital distributions and other payments. Failure to meet the full amount of the buffer will result in restrictions on the Company's ability to make capital distributions, including dividend payments and stock repurchases and to pay discretionary bonuses to executive officers.

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company and Bank to maintain (i) a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 4.5%, plus the 2.5% capital conservation buffer (7.0% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer (8.5% upon full implementation), (iii) a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer (10.5% upon full implementation) and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average quarterly assets.

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, CET1 and Tier 1 capital (as defined in the regulations) to risk weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of March 31, 2018 and December 31, 2017, the Company and the Bank meet all capital adequacy requirements to which they are subject, including the capital buffer requirement.

As of March 31, 2018 and December 31, 2017, 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, CET1, Tier 1 risk based and Tier 1 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.

Independent Bank Group, Inc. and Subsidiaries

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

The actual capital amounts and ratios of the Company and Bank as of March 31, 2018 and December 31, 2017, 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
March 31, 2018						
Total capital to risk weighted assets:						
Consolidated	\$917,825	12.48%	\$588,484	8.00%	N/A	N/A
Bank	892,325	12.14	587,829	8.00	\$734,787	10.00%
Tier 1 capital to risk weighted assets:						
Consolidated	735,865	10.00	441,363	6.00	N/A	N/A
Bank	850,365	11.57	440,872	6.00	587,829	8.00
Common equity tier 1 to risk weighted assets						
Consolidated	705,265	9.59	331,022	4.50	N/A	N/A
Bank	850,365	11.57	330,654	4.50	477,611	6.50
Tier 1 capital to average assets:						
Consolidated	735,865	9.18	320,680	4.00	N/A	N/A
Bank	850,365	10.62	320,377	4.00	400,472	5.00
December 31, 2017						
Total capital to risk weighted assets:						
Consolidated	\$897,760	12.56%	\$572,025	8.00%	N/A	N/A
Bank	867,082	12.15	571,142	8.00	\$713,928	10.00%
Tier 1 capital to risk weighted assets:						
Consolidated	718,358	10.05	429,019	6.00	N/A	N/A
Bank	827,680	11.59	428,357	6.00	571,142	8.00
Common equity tier 1 to risk weighted assets						
Consolidated	687,006	9.61	321,764	4.50	N/A	N/A
Bank	827,680	11.59	321,268	4.50	464,053	6.50
Tier 1 capital to average assets:						
Consolidated	718,358	8.92	322,124	4.00	N/A	N/A
Bank	827,680	10.30	321,384	4.00	401,730	5.00

Note 10. Subsequent Events

Declaration of Dividends

On April 25, 2018, the Company declared a quarterly cash dividend in the amount of \$0.14 per share of common stock to the stockholders of record on May 7, 2018. The dividend will be paid on May 17, 2018.

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 and the integration thereof, 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," "is expected," "is intended," "objective," "plan," "projected," "projection," "will affect," "will continue," "will decrease," "will grow," "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:

- our ability to sustain our current internal growth rate and total growth rate;
- changes in geopolitical, business and economic events, occurrences and conditions, including changes in rates of inflation or deflation, nationally, regionally and in our target markets, particularly in Texas and Colorado;
- worsening business and economic conditions nationally, regionally and in our target markets, particularly in Texas and Colorado, and the geographic areas in those states 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 and Colorado;
- changes in asset quality, including increases in default rates and loans and higher levels of nonperforming loans and loan charge-offs;
- concentration of the loan portfolio of Independent Bank, before and after the completion of acquisitions of financial institutions, in commercial and residential real estate loans and changes in the prices, values and sales volumes of commercial and residential real estate, values and sales volumes of commercial and residential real estate;
- the ability of Independent Bank to make loans with acceptable net interest margins and levels of risk of repayment and to otherwise invest in assets at acceptable yields and presenting acceptable investment risks;
- inaccuracy of the assumptions and estimates that the managements of our Company and the financial institutions that we acquire make in establishing reserves for probable loan losses and other estimates;
- lack of liquidity, including as a result of a reduction in the amount of sources of liquidity we currently have;
- material increases or decreases in the amount of deposits held by Independent Bank or other financial institutions that we acquire and the cost of those deposits;
- our access to the debt and equity markets and the overall cost of funding our operations;
- regulatory requirements to maintain minimum capital levels or maintenance of capital at levels sufficient to support our anticipated growth;

changes in market interest rates that affect the pricing of the loans and deposits of each of Independent Bank and the financial institutions that we acquire and the net interest income of each of Independent Bank and the financial institutions that we acquire;

fluctuations in the market value and liquidity of the securities we hold for sale, including as a result of changes in market interest rates;

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 and value of the assets of Independent Bank and of financial institutions that we acquire;

the institution and outcome of, and costs associated with, litigation and other legal proceedings against one of more of us, Independent Bank and financial institutions that we acquire or to which any of such entities is subject;

the occurrence of market conditions adversely 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, specifically the Dodd-Frank Act stress testing requirements as we approach \$10 billion in total assets, and changes in federal government policies;

changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the SEC and the Public Company Accounting Oversight Board, as the case may be;

governmental monetary and fiscal policies;

changes in the scope and cost of FDIC insurance and other coverage;

the effects of war or other conflicts, acts of terrorism (including cyber attacks) or other catastrophic events, including storms, droughts, tornadoes, hurricanes and flooding, that may affect general economic conditions;

our actual cost savings resulting from previous or future acquisitions are less than expected, we are unable to realize those cost savings as soon as expected, or we incur additional or unexpected costs;

our revenues after previous or future acquisitions are less than expected;

the liquidity of, and changes in the amounts and sources of liquidity available to, us, before and after the acquisition of any financial institutions that we acquire;

deposit attrition, operating costs, customer loss and business disruption before and after our completed acquisitions, including, without limitation, difficulties in maintaining relationships with employees, may be greater than we expected;

the effects of the combination of the operations of financial institutions that we have acquired in the recent past or may acquire in the future with our operations and the operations of Independent Bank, the effects of the integration of such operations being unsuccessful, and the effects of such integration being more difficult, time-consuming or costly than expected or not yielding the cost savings that we expect;

the impact of investments that we or Independent Bank may have made or may make and the changes in the value of those investments;

the quality of the assets of financial institutions and companies that we have acquired in the recent past or may acquire in the future being different than we determined or determine in our due diligence investigation in connection with the acquisition of such financial institutions and any inadequacy of loan loss reserves relating to, and exposure to unrecoverable losses on, loans acquired;

our ability to continue to identify acquisition targets and successfully acquire desirable financial institutions to sustain our growth, to expand our presence in our markets and to enter new markets;

general business and economic conditions in our markets change or are less favorable than expected;

changes occur in business conditions and inflation;

an increase in the rate of personal or commercial customers' bankruptcies;

technology-related changes are harder to make or are more expensive than expected;

attacks on the security of, and breaches of, our Independent Bank's digital information systems, the costs we or Independent Bank incur to provide security against such attacks and any costs and liability we or Independent Bank incurs in connection with any breach of those systems;

the potential impact of technology and "FinTech" entities on the banking industry generally; and

the other factors that are described or referenced in Part I, Item 1A. of this Annual Report on Form 10-K 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 that we may make. As a result of these and other matters, including changes in facts and assumptions not being realized, the actual results relating to the subject matter of any forward-looking statement may differ 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, except as required by law.

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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 included in the Annual Report on Form 10-K for the year ended December 31, 2017.

The Company was organized as a bank holding company in 2002. On January 1, 2009, the Company was merged with Independent Bank Group Central Texas, Inc., and, since that time, has 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, or IPO, of its common stock which is traded on the Nasdaq Global Select Market.

As of March 31, 2018, the Company operated 70 full service banking locations in north, central and southeast Texas regions, and along the Colorado Front Range 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.ibtx.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. 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

Acquisition. The Company completed the acquisition of Carlile Bancshares, Inc., a Texas corporation (Carlile) and its subsidiary, Northstar Bank (Northstar), Denton, Texas, a Texas state chartered bank on April 1, 2017. The Company acquired 42 new locations as part of the transaction, representing an expansion in the Dallas/North Texas and Central Texas areas as well as its entry into the Fort Worth, Texas and Colorado Front Range markets. This acquisition increased total assets by \$2.4 billion, gross loans by \$1.4 billion and deposits by \$1.8 billion.

The comparability of the Company's results of operations for the three months ended March 31, 2018 and 2017 are affected by this acquisition.

Discussion and Analysis of Results of Operations for the Three Months Ended March 31, 2018 and 2017

The following discussion and analysis of our results of operations compares the operations for the three months ended March 31, 2018 with the three months ended March 31, 2017. The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results of operations that may be expected for all of the year ending December 31, 2018.

Results of Operations

For the three months ended March 31, 2018, net income was \$29.0 million (\$1.02 per common share on a diluted basis) compared with net income of \$15.7 million (\$0.82 per common share on a diluted basis) for the three months ended March 31, 2017. The Company posted annualized returns on average equity of 8.72% and 9.33%, returns on average assets of 1.35% and 1.08% and efficiency ratios of 52.30% and 52.50% for the three months ended March 31, 2018 and 2017, respectively. The efficiency ratio is calculated by dividing total noninterest expense (which excludes the provision for loan losses and the amortization of core deposits intangibles) by net interest income plus noninterest income.

Net Interest Income

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

Net interest income was \$74.0 million for the three months ended March 31, 2018, an increase of \$26.1 million, or 54.5%, from \$47.9 million for the three months ended March 31, 2017. This increase is due primarily to a \$2.2 billion increase, or 41.6%, in average interest earning assets to \$7.5 billion for the three months ended March 31, 2018 compared to \$5.3 billion for the three months ended March 31, 2017. The increases in interest-earning assets and interest-bearing deposits is primarily due to the acquisition of Carlile Bancshares in April 2017 as well as organic growth. The average yield on interest earning assets increased 49 basis points from 4.28% for the three months ended March 31, 2017 to 4.77% for the three months ended March 31, 2018 primarily due to loans and taxable securities acquired in the Carlile transaction, which had higher effective interest rates as well as higher interest rates on loans and interest-bearing deposits tied to the Fed Funds rate. The average cost of interest-bearing liabilities increased 25 basis points to 1.05% for the three months ended March 31, 2018 compared to 0.80% for the three months ended March 31, 2017. The increase is primarily due to higher rates offered on our deposits, primarily commercial money market accounts, resulting from the increase in rates and since the December 2017 Fed rate increase, in addition to the increased interest rates on deposit products tied to Fed Funds rates and short-term FHLB advances. The aforementioned changes resulted in a 33 basis point increase in the net interest margin for the three months ended March 31, 2018 at 4.00% compared to 3.67% for the three months ended March 31, 2017.

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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 months ended March 31, 2018 and 2017. The average balances are principally daily averages and, for loans, include both performing and nonperforming balances.

	Three Months Ended March 31,					
	2018			2017		
	Average Outstanding Balance	Interest	Yield/ Rate ⁽³⁾	Average Outstanding Balance	Interest	Yield/ Rate ⁽³⁾
(dollars in thousands)						
Interest-earning assets:						
Loans ⁽¹⁾	\$6,549,083	\$83,275	5.16 %	\$4,631,918	\$53,744	4.71 %
Taxable securities	588,447	2,903	2.00	242,822	764	1.28
Nontaxable securities	189,429	1,193	2.55	81,773	541	2.68
Interest-bearing deposits and other	170,086	743	1.77	338,034	890	1.07
Total interest-earning assets	7,497,045	\$88,114	4.77	5,294,547	\$55,939	4.28
Noninterest-earning assets	1,178,551			585,926		
Total assets	\$8,675,596			\$5,880,473		
Interest-bearing liabilities:						
Checking accounts	\$2,940,180	\$4,958	0.68	\$1,938,628	\$2,166	0.45
Savings accounts	280,301	115	0.17	168,328	66	0.16
Money market accounts	737,493	2,621	1.44	566,833	1,056	0.76
Certificates of deposit	875,052	2,105	0.98	846,610	1,741	0.83
Total deposits	4,833,026	9,799	0.82	3,520,399	5,029	0.58
FHLB advances	483,709	1,886	1.58	460,733	1,171	1.03
Other borrowings	137,798	2,102	6.19	107,356	1,705	6.44
Junior subordinated debentures	27,686	360	5.27	18,147	167	3.73
Total interest-bearing liabilities	5,482,219	14,147	1.05	4,106,635	8,072	0.80
Noninterest-bearing checking accounts	1,829,955			1,073,703		
Noninterest-bearing liabilities	16,021			18,701		
Stockholders' equity	1,347,401			681,434		
Total liabilities and equity	\$8,675,596			\$5,880,473		
Net interest income		\$73,967			\$47,867	
Interest rate spread			3.72 %			3.48 %
Net interest margin ⁽²⁾			4.00			3.67
Net interest income and margin (tax equivalent basis) ⁽⁴⁾		\$74,421	4.03		\$48,270	3.70
Average interest earning assets to interest bearing liabilities			136.75			128.93

(1) Average loan balances include nonaccrual loans.

Net interest margins for the periods presented represent: (i) the difference between interest income on

(2) interest-earning assets and the interest expense on interest-bearing liabilities, divided by (ii) average interest-earning assets for the period.

(3) Yield and rates for the three month periods are annualized.

(4) A tax-equivalent adjustment has been computed using a federal income tax rate of 21% and 35% for the three months ended March 31, 2018 and 2017, respectively.

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 income 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, concentrations, 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 recorded a \$2.7 million provision for loan losses for the three months ended March 31, 2018 compared to \$2.0 million for the comparable period in 2017. Provision expense is primarily reflective of organic loan growth as well as charge-offs or specific reserves taken during the respective period. Net charge-offs were \$137 thousand and \$183 thousand for the three months ended March 31, 2018 and 2017, respectively.

Noninterest Income

The following table sets forth the components of noninterest income for the three months ended March 31, 2018 and 2017 and the period-over-period variations in such categories of noninterest income:

	Three Months		Variance	
	Ended March 31, 2018	2017	2018 v. 2017	
(dollars in thousands)				
Noninterest Income				
Service charges on deposit accounts	\$3,485	\$1,927	\$1,558	80.9 %
Mortgage banking revenue	3,414	1,267	2,147	169.5
Gain on sale of loans	—	—	—	—
Gain (loss) on sale of branches	—	—	—	—
Gain on sale of other real estate	60	—	60	100.0
Loss on sale of securities available for sale	(224)	—	(224)	(100.0)
(Loss) gain on sale of premises and equipment	(8)	5	(13)	(260.0)
Increase in cash surrender value of BOLI	739	399	340	85.2
Other	1,989	985	1,004	101.9
Total noninterest income	\$9,455	\$4,583	\$4,872	106.3 %

Total noninterest income increased \$4.9 million, or 106.3% for the three months ended March 31, 2018 over same period in 2017. Significant changes in the components of noninterest income are discussed below.

Service charges on deposit accounts. Service charges on deposit accounts increased \$1.6 million, or 80.9% for the three months ended March 31, 2018, as compared to the same period in 2017. The increase in service charge income reflects an increase in deposit accounts due to organic growth and the acquisition of Carlile in April 2017.

Mortgage banking revenue. Mortgage banking revenue for the three months ended March 31, 2018 increased \$2.1 million, or 169.5% compared to the same period in 2017. The increase is primarily reflective of the retail mortgage line of business acquired with the acquisition of Carlile.

Loss on sale of securities available for sale. The Company recognized a loss of \$224 thousand on the sale of securities available for sale for the three months ended March 31, 2018. The majority of the loss is due to the sale of a CRA equity fund.

Increase in cash surrender value of BOLI. The increase in cash surrender value of BOLI increased \$340 thousand, or 85.2% for the three months ended March 31, 2018, as compared to the same period in 2017. The increase is a result of \$53.2 million in policies acquired in the Carlile transaction.

Other. Other noninterest income increased \$1.0 million, or 101.9% for the three months ended March 31, 2018 as compared to the same period in 2017. The increase from prior year is primarily related to fee income on the mortgage warehouse purchase program acquired with the acquisition of Carlile, as well as an increase in acquired loan recoveries, merchant card income and increased earnings credits on correspondent accounts.

Noninterest Expense

Noninterest expense increased \$16.9 million, or 60.4% for the three months ended March 31, 2018 as compared to the same period in 2017. The following table sets forth the components of the Company's noninterest expense for the three months ended March 31, 2018 and 2017 and the period-over-period variations in such categories of noninterest expense:

(dollars in thousands)	Three Months Ended March 31,		Variance	
	2018	2017	2018 v. 2017	
Noninterest Expense				
Salaries and employee benefits	\$25,168	\$16,837	\$8,331	49.5 %
Occupancy	5,664	3,872	1,792	46.3
Data processing	2,405	1,288	1,117	86.7
FDIC assessment	741	878	(137)	(15.6)
Advertising and public relations	385	297	88	29.6
Communications	941	475	466	98.1
Other real estate owned expenses, net	90	37	53	143.2
Impairment of other real estate	85	—	85	100.0
Core deposit intangible amortization	1,331	492	839	170.5
Professional fees	1,119	773	346	44.8
Acquisition expense, including legal	545	146	399	273.3
Other	6,484	2,933	3,551	121.1
Total noninterest expense	\$44,958	\$28,028	\$16,930	60.4 %

Salaries and employee benefits. Salary and employee benefits increased \$8.3 million, or 49.5% for the three months ended March 31, 2018 compared to the same period in 2017. Salary and employee benefit expenses increased due to an increase in the number of the Company's full-time equivalent employees from 531 as of March 31, 2017 to 907 as of March 31, 2018, resulting from both the acquisition of Carlile and organic growth within the Company.

Occupancy. Occupancy expense increased by \$1.8 million, or 46.3% for the three months ended March 31, 2018 compared to the same period in 2017. The increase is reflective of additional branches acquired in the Carlile transaction.

Data processing. Data processing expense increased \$1.1 million, or 86.7% for the three months ended March 31, 2018 compared to the same period in 2017. The increase is reflective of increased costs related directly to the Carlile transaction due to the additional accounts, employees and locations added, but also due to organic growth over the same period prior year.

Core deposit intangible amortization. Core deposit intangible amortization increased \$839 thousand, or 170.5% for the three months ended March 31, 2018 compared to the same period in 2017. The increase reflects the \$36.7 million increase in core deposit intangibles recorded with the Carlile transaction.

Other noninterest expense. Other noninterest expense increased \$3.6 million, or 121.1% for the three months ended March 31, 2018 compared to the same period in 2017. The majority of the increase in 2018 over the prior period relates to general increases in operations due to additional accounts, employees and locations as a result of organic growth within the Company as well as the acquisition activity occurring in April 2017.

Income Tax Expense

Income tax expense was \$6.8 million for the three months ended March 31, 2018 and \$6.7 million for the same period in 2017. The effective tax rates were 19.0% for the three months ended March 31, 2018 compared to 30.0% for the same period in 2017. The lower tax rate in first quarter 2018 is due to the reduction of the corporate U.S. statutory federal income tax rate from 35% to 21% as a result the Tax Cuts and Jobs Act.

Discussion and Analysis of Financial Condition

The following discussion and analysis of the Company's financial condition discusses and analyzes the financial condition of the Company as of March 31, 2018 and December 31, 2017.

Assets

The Company's total assets increased by \$126.6 million, or 1.5%, to \$8.8 billion as of March 31, 2018 from \$8.7 billion at December 31, 2017. The increase is primarily due to organic growth for the period.

Loan Portfolio

The following table presents the balance and associated percentage of each major category in our loan portfolio as of March 31, 2018 and December 31, 2017:

(dollars in thousands)	March 31, 2018		December 31, 2017	
Commercial ⁽¹⁾	\$1,035,985	15.5 %	\$1,059,984	16.3 %
Real estate:				
Commercial	3,498,483	52.4	3,369,892	51.7
Commercial construction, land and land development	806,415	12.1	744,868	11.5
Residential ⁽²⁾	944,372	14.1	931,495	14.3
Single family interim construction	284,490	4.2	289,680	4.4
Agricultural	78,782	1.2	82,583	1.3
Consumer	31,633	0.5	34,639	0.5
Other	238	—	304	—
	6,680,398	100.0%	6,513,445	100.0%
Deferred loan fees	(2,801)		(2,568)	
Allowance for loan losses	(41,960)		(39,402)	
Total loans, net	\$6,635,637		\$6,471,475	

⁽¹⁾ Includes mortgage warehouse purchase loans of \$124.7 million and \$164.7 million at March 31, 2018 and December 31, 2017, respectively.

⁽²⁾ Includes mortgage loans held for sale as of March 31, 2018 and December 31, 2017 of \$28.0 million and \$39.2 million, respectively.

Our loan portfolio is the largest category of our earning assets. As of March 31, 2018 and December 31, 2017, total loans, net of allowance for loan losses and deferred fees, totaled \$6.6 billion and \$6.5 billion, respectively, which is an increase of 2.5% between the two dates. The increase is primarily due to organic loan growth during 2018.

Asset Quality

Nonperforming Assets. The Company has established procedures to assist the Company in maintaining the overall quality of the Company's loan portfolio. In addition, the Company has adopted underwriting guidelines to be followed by the Company's lending officers and require significant senior management review of proposed extensions of credit exceeding certain thresholds. When delinquencies exist, the Company rigorously monitors the levels of such delinquencies for any negative or adverse trends. The Company's loan review procedures include approval of lending policies and underwriting guidelines by Independent Bank's board of directors, an annual independent loan review, approval of large credit relationships by Independent Bank's Executive Loan Committee and loan quality documentation procedures. The Company, like other financial institutions, is subject to the risk that its loan portfolio will be subject to increasing pressures from deteriorating borrower credit due to general economic conditions. The Company discontinues accruing interest on a loan when management of the Company believes, after considering the Company's collection efforts and other factors, that the borrower's financial condition is such that collection of interest of that loan is doubtful. Loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans, including troubled debt restructurings, that are placed on nonaccrual status or charged off is reversed against interest income. Cash collections on nonaccrual loans are generally credited to the loan receivable balance, and no interest income is recognized on

those loans until the principal balance has been collected. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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Real estate the Company has acquired as a result of foreclosure or by deed-in-lieu-of foreclosure is classified as other real estate owned until sold. The Company's policy is to initially record other real estate owned at fair value less estimated costs to sell at the date of foreclosure. After foreclosure, other real estate is carried at the lower of the initial carrying amount (fair value less estimated costs to sell or lease), or at the value determined by subsequent appraisals or internal valuations of the other real estate.

The Company periodically modifies loans to extend the term or make other concessions to help a borrower with a deteriorating financial condition stay current on their loan and to avoid foreclosure. The Company generally does not forgive principal or interest on loans or modify the interest rates on loans to rates that are below market rates. Under applicable accounting standards, such loan modifications are generally classified as troubled debt restructurings.

The following table sets forth the allocation of the Company's nonperforming assets among the Company's different asset categories as of the dates indicated. The Company classifies nonperforming loans (excluding loans acquired with deteriorated credit quality) as nonaccrual loans, loans past due 90 days or more and still accruing interest or loans modified under restructurings as a result of the borrower experiencing financial difficulties. The balances of nonperforming loans reflect the net investment in these assets, including deductions for purchase discounts.

(dollars in thousands)	March 31, 2018	December 31, 2017		
Nonaccrual loans				
Commercial	\$9,314	\$ 10,304		
Real estate:				
Commercial real estate, construction, land and land development	2,892	2,716		
Residential real estate	1,950	998		
Consumer	35	55		
Total nonaccrual loans ⁽¹⁾	14,191	14,073		
Loans delinquent 90 days or more and still accruing				
Commercial	—	8		
Real estate:				
Commercial real estate, construction, land and land development	—	120		
Residential real estate	68	8		
Consumer	27	—		
Total loans delinquent 90 days or more and still accruing	95	136		
Troubled debt restructurings, not included in nonaccrual loans				
Real estate:				
Commercial real estate, construction, land and land development	443	455		
Residential real estate	174	730		
Consumer	19	20		
Total troubled debt restructurings, not included in nonaccrual loans	636	1,205		
Total nonperforming loans	14,922	15,414		
Other real estate owned and other repossessed assets:				
Commercial real estate, construction, land and land development	4,700	5,400		
Residential real estate	764	764		
Single family interim construction	—	963		
Consumer	129	114		
Total other real estate owned and other repossessed assets	5,593	7,241		
Total nonperforming assets	\$20,515	\$ 22,655		
Ratio of nonperforming loans to total loans held for investment ⁽²⁾	0.23	%	0.24	%
Ratio of nonperforming assets to total assets	0.23		0.26	

⁽¹⁾ Nonaccrual loans include troubled debt restructurings of \$1.0 million at both March 31, 2018 and December 31, 2017, and excludes loans acquired with deteriorated credit quality of \$6.8 million and \$7.9 million as of March 31,

2018 and December 31, 2017, respectively.

- (2) Excluding mortgage warehouse purchase loans of \$124.7 million and \$164.7 million as of March 31, 2018 and December 31, 2017, respectively.

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Nonaccrual loans increased slightly to \$14.2 million at March 31, 2018 from \$14.1 million as of December 31, 2017. Troubled debt restructurings that were not on nonaccrual status totaled \$636 thousand at March 31, 2018 decreasing from \$1.2 million at December 31, 2017. The increase in nonaccrual loans was primarily due to six loans placed on nonaccrual status totaling \$1.9 million during the three months ended March 31, 2018 offset by the payoff of one commercial loan totaling \$2.1 million. The net decrease in other real estate owned and repossessed assets is primarily due to \$1.6 million of other real estate dispositions.

As of March 31, 2018, the Company had a total of 94 substandard loans with an aggregate principal balance of \$36.1 million that were not currently impaired loans, nonaccrual loans, 90 days past due loans or troubled debt restructurings, but where the Company had information about possible credit problems of the borrowers that caused the Company's management to have serious concerns as to the ability of the borrowers to comply with present loan repayment terms and that could result in those loans becoming nonaccrual loans, 90 days past due loans or troubled debt restructurings in the future.

The Company generally continues to use the classification of acquired loans classified nonaccrual or 90 days and accruing as of the acquisition date. The Company does not classify acquired loans as troubled debt restructurings, or TDRs, unless the Company modifies an acquired loan subsequent to acquisition that meets the TDR criteria. Reported delinquency of the Company's purchased loan portfolio is based upon the contractual terms of the loans.

Allowance for Loan Losses. The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. The Company's allowance for loan losses represents the Company's estimate of probable and reasonably estimable loan losses inherent in loans held for investment as of the respective balance sheet date. The Company's methodology for assessing the adequacy of the allowance for loan losses includes a general allowance for performing loans, which are grouped based on similar characteristics, and an allocated allowance for individual impaired loans. Actual credit losses or recoveries are charged or credited directly to the allowance. As of March 31, 2018, the allowance for loan losses amounted to \$42.0 million, or 0.64% of total loans, compared with \$39.4 million, or 0.62% of total loans as of December 31, 2017. The increase in the allowance is primarily due to additional general reserves for organic loan growth.

The allowance for loan losses to nonperforming loans has increased from 255.62% at December 31, 2017 to 281.20% at March 31, 2018, due to an increase in the recorded allowance balance as well as a reduction in total nonperforming loans. Nonperforming loans have decreased to \$14.9 million at March 31, 2018 compared to \$15.4 million at December 31, 2017.

Securities Available for Sale

The Company's investment strategy aims to maximize earnings while maintaining liquidity in securities with minimal credit, interest rate and duration risk. The types and maturities of securities purchased are primarily based on the Company's current and projected liquidity and interest rate sensitivity positions.

The Company recognized a net loss of \$224 thousand on the sale of securities for the three months ended March 31, 2018 and there were no sales of securities for the three months ended March 31, 2017. Securities represented 8.7% and 8.8% of the Company's total assets at March 31, 2018 and December 31, 2017, respectively.

Management evaluates securities for other-than-temporary impairment (OTTI) on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation. Management does not intend to sell any debt securities it holds and believes the Company more likely than not will not be required to sell any debt securities it holds before their anticipated recovery, at which time the Company will receive full value for the securities.

Management has the ability and intent to hold the securities classified as available for sale that were in a loss position as of March 31, 2018 for a period of time sufficient for an entire recovery of the cost basis of the securities. For those securities that are impaired, the unrealized losses are largely due to interest rate changes. The fair value is expected to recover as the securities approach their maturity date. Management believes any impairment in the Company's securities at March 31, 2018, is temporary and no other-than-temporary impairment has been realized in the Company's consolidated financial statements.

Capital Resources and Regulatory Capital Requirements

Total stockholder's equity was \$1,355 million at March 31, 2018 compared with \$1,336 million at December 31, 2017, an increase of approximately \$19 million. The increase was primarily due to net income of \$29.0 million earned by the Company during the three months ended March 31, 2018, as well as stock based compensation of \$1.4 million, offset by an increase of \$8.4 million in unrealized loss on available for sale securities and dividends paid of \$3.4 million.

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As of March 31, 2018, the Company exceeded all capital ratio requirements under prompt corrective action and other regulatory requirements, as detailed in the table below:

	As of March 31, 2018			Required to be considered well capitalized (Bank only) Ratio
	Actual Consolidated Ratio	Actual Bank Ratio	Required to be considered adequately capitalized Ratio	
Tier 1 capital to average assets ratio	9.18	% 10.62	% 4.00-5.00	≥5.00%
Common equity tier 1 capital to risk-weighted assets ratio	9.59	11.57	4.50-6.50	≥6.50
Tier 1 capital to risk-weighted assets ratio	10.00	11.57	6.00-8.00	≥8.00
Total capital to risk-weighted assets ratio	12.48	12.14	8.00-10.00	≥10.00

Liquidity Management

The Company continuously monitors the Company's liquidity position to ensure that assets and liabilities are managed in a manner that will meet all of the Company's short-term and long-term cash requirements. The Company manages the Company's liquidity position to meet the daily cash flow needs of customers, while maintaining an appropriate balance between assets and liabilities to meet the return on investment objectives of the Company's shareholders. The Company also monitors its liquidity requirements in light of interest rate trends, changes in the economy and the scheduled maturity and interest rate sensitivity of the investment and loan portfolios and deposits.

Liquidity risk management is an important element in the Company's asset/liability management process. The Company's short-term and long-term liquidity requirements are primarily to fund on-going operations, including payment of interest on deposits and debt, extensions of credit to borrowers, capital expenditures and shareholder dividends. These liquidity requirements are met primarily through cash flow from operations, redeployment of pre-paid and maturing balances in the Company's loan and investment portfolios, debt financing and increases in customer deposits. The Company's liquidity position is supported by management of liquid assets and liabilities and access to alternative sources of funds. Liquid assets include cash, interest-bearing deposits in banks, federal funds sold, securities available for sale and maturing or prepaying balances in the Company's investment and loan portfolios. Liquid liabilities include core deposits, brokered deposits, federal funds purchased, securities sold under repurchase agreements and other borrowings. Other sources of liquidity include the sale of loans, the ability to acquire additional national market non core deposits, the issuance of additional collateralized borrowings such as FHLB advances, the issuance of debt securities, borrowings through the Federal Reserve's discount window and the issuance of equity securities. For additional information regarding the Company's operating, investing and financing cash flows, see the Consolidated Statements of Cash Flows provided in the Company's consolidated financial statements.

In addition to the liquidity provided by the sources described above, the Company maintains correspondent relationships with other banks in order to sell loans or purchase overnight funds should additional liquidity be needed. As of March 31, 2018, the Company had established federal funds lines of credit with nine unaffiliated banks totaling \$225.0 million with no amounts advanced against those lines at that time. The Company also participates in an exchange that provides direct overnight borrowings with other financial institutions with a borrowing capacity of \$114.0 million and none outstanding as of March 31, 2018. The Company has an unsecured line of credit totaling \$50.0 million with an unrelated commercial bank. Based on the values of stock, securities, and loans pledged as collateral, as of March 31, 2018, the Company had additional borrowing capacity with the FHLB of \$1.9 billion. In addition, the Company maintains a secured line of credit with the Federal Reserve Bank with an availability to borrow \$600.8 million.

Contractual Obligations

In the ordinary course of the Company's operations, the Company enters into certain contractual obligations, such as obligations for operating leases and other arrangements with respect to deposit liabilities, FHLB advances and other borrowed funds. The Company believes that it will be able to meet its contractual obligations as they come due through the maintenance of adequate cash levels. The Company expects to maintain adequate cash levels through

profitability, loan and securities repayment and maturity activity and continued deposit gathering activities. The Company has in place various borrowing mechanisms for both short-term and long-term liquidity needs. On January 18, 2018, the Company entered into an agreement with an independent contractor for the oversight and construction of the Company's new corporate headquarters office building in McKinney, Texas. The 165,000 square foot building is estimated to cost approximately \$50 million and expected to be completed in early 2019.

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Other than normal changes in the ordinary course of business and the item mentioned above, there have been no significant changes in the types of contractual obligations or amounts due since December 31, 2017.

Off-Balance Sheet Arrangements

In the normal course of business, the Company enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in the Company's consolidated balance sheets. However, the Company has only limited off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on the Company's financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources. Independent Bank enters into these transactions to meet the financing needs of the Company's customers. These transactions include commitments to extend credit and issue standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

Commitments to Extend Credit. Independent Bank enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of Independent Bank's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. Independent Bank minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

Standby Letters of Credit. Standby letters of credit are written conditional commitments that Independent Bank issues to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, Independent Bank would be required to fund the commitment. The maximum potential amount of future payments Independent Bank could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the customer is obligated to reimburse Independent Bank for the amount paid under this standby letter of credit.

Independent Bank's commitments to extend credit and outstanding standby letters of credit were \$1.4 billion and \$11.5 million, respectively, as of March 31, 2018. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements. The Company manages the Company's liquidity in light of the aggregate amounts of commitments to extend credit and outstanding standby letters of credit in effect from time to time to ensure that the Company will have adequate sources of liquidity to fund such commitments and honor drafts under such letters of credit.

Critical Accounting Policies and Estimates

The preparation of the Company's consolidated financial statements in accordance with U.S. generally accepted accounting principles, or GAAP, requires the Company to make estimates and judgments that affect the Company's reported amounts of assets, liabilities, income and expenses and related disclosure of contingent assets and liabilities. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under current circumstances, results of which form the basis for making judgments about the carrying value of certain assets and liabilities that are not readily available from other sources. The Company evaluates the Company's estimates on an ongoing basis. Actual results may differ from these estimates under different assumptions or conditions.

Accounting policies, as described in detail in the notes to the Company's consolidated financial statements, are an integral part of the Company's financial statements. A thorough understanding of these accounting policies is essential when reviewing the Company's reported results of operations and the Company's financial position. The Company believes that the critical accounting policies and estimates discussed below require the Company to make difficult, subjective or complex judgments about matters that are inherently uncertain. Changes in these estimates, that are likely to occur from period to period, or the use of different estimates that the Company could have reasonably used in the current period, would have a material impact on the Company's financial position, results of operations or liquidity.

Acquired Loans. The Company's accounting policies require that the Company evaluates all acquired loans for evidence of deterioration in credit quality since origination and to evaluate whether it is probable that the Company will collect all contractually required payments from the borrower.

Acquired loans from the transactions accounted for as a business combination include both loans with evidence of credit deterioration since their origination date and performing loans. The Company accounts for performing loans under ASC Paragraph 310-20, Nonrefundable Fees and Other Costs, with the related difference in the initial fair value and unpaid principal balance (the discount) recognized as interest income on a level yield basis over the life of the loan. The Company accounts for the nonperforming loans acquired in accordance with ASC Paragraph 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. At the date of the acquisition, acquired loans are recorded at their fair value.

The Company recognizes the difference between the undiscounted cash flows the Company expects (at the time the Company acquires the loan) to be collected and the investment in the loan, or the “accretable yield,” as interest income using the interest method over the life of the loan. The Company does not recognize contractually required payments for interest and principal that exceed undiscounted cash flows expected at acquisition, or the “nonaccretable difference,” as a yield adjustment, loss accrual or valuation allowance. Increases in the expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over the loan’s remaining life, while decreases in expected cash flows are recognized as impairment. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition.

Upon an acquisition, the Company generally continues to use the classification of acquired loans classified nonaccrual or 90 days and accruing. The Company does not classify acquired loans as TDRs unless the Company modifies an acquired loan subsequent to acquisition that meets the TDR criteria. Reported delinquency of the Company’s purchased loan portfolio is based upon the contractual terms of the loans.

Allowance for Loan Losses. The allowance for loan losses represents management’s estimate of probable and reasonably estimable credit losses inherent in the loan portfolio. In determining the allowance, the Company estimates losses on individual impaired loans, or groups of loans which are not impaired, where the probable loss can be identified and reasonably estimated. On a quarterly basis, the Company assesses the risk inherent in the Company’s loan portfolio based on qualitative and quantitative trends in the portfolio, including the internal risk classification of loans, historical loss rates, changes in the nature and volume of the loan portfolio, industry or borrower concentrations, delinquency trends, detailed reviews of significant loans with identified weaknesses and the impacts of local, regional and national economic factors on the quality of the loan portfolio. Based on this analysis, the Company records a provision for loan losses in order to maintain the allowance at appropriate levels.

Determining the amount of the allowance is considered a critical accounting estimate, as it requires significant judgment and the use of subjective measurements, including management’s assessment of overall portfolio quality. The Company maintains the allowance at an amount the Company believes is sufficient to provide for estimated losses inherent in the Company’s loan portfolio at each balance sheet date, and fluctuations in the provision for loan losses may result from management’s assessment of the adequacy of the allowance. Changes in these estimates and assumptions are possible and may have a material impact on the Company’s allowance, and therefore the Company’s financial position, liquidity or results of operations.

Goodwill and Core Deposit Intangible. The excess purchase price over the fair value of net assets from acquisitions, or goodwill, is evaluated for impairment at least annually and on an interim basis if an event or circumstance indicates that it is likely an impairment has occurred. The Company first assesses qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, the Company determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing a two step impairment test is unnecessary. If the Company concludes otherwise, then it is required to perform the first step of the two step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. The Company performs its impairment test annually as of December 31. There have been no circumstances since December 31, 2017 that would indicate any impairment has occurred, therefore, management does not believe goodwill is impaired as of March 31, 2018.

Core deposit intangibles are acquired customer relationships that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. Core deposit intangibles are being

amortized on a straight-line basis over their estimated useful lives of ten years. Core deposit intangibles are tested for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The principal objective of the Company's asset and liability management function is to evaluate the interest rate risk within the balance sheet and pursue a controlled assumption of interest rate risk while maximizing net income and preserving adequate levels of liquidity and capital. The Investment Committee of the Bank's Board of Directors has oversight of Independent Bank's asset and liability management function, which is managed by the Company's Treasurer. The Treasurer meets with our Chief Financial Officer and senior executive management team regularly to review, among other things, the sensitivity of the Company's assets and liabilities to market interest rate changes, local and national market conditions and market interest rates. That group also reviews the liquidity, capital, deposit mix, loan mix and investment positions of the Company.

The Company's management and the Board of Directors are responsible for managing interest rate risk and employing risk management policies that monitor and limit the Company's exposure to interest rate risk. Interest rate risk is measured using net interest income simulations and market value of portfolio equity analyses. These analyses use various assumptions, including the nature and timing of interest rate changes, yield curve shape, prepayments on loans, securities and deposits, deposit decay rates, pricing decisions on loans and deposits, reinvestment and replacement of asset and liability cash flows.

Instantaneous parallel rate shift scenarios are modeled and utilized to evaluate risk and establish exposure limits for acceptable changes in net interest margin. These scenarios, known as rate shocks, simulate an instantaneous change in interest rates and use various assumptions, including, but not limited to, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment and replacement of asset and liability cash flows. The Company also analyzes the economic value of equity as a secondary measure of interest rate risk. This is a complementary measure to net interest income where the calculated value is the result of the market value of assets less the market value of liabilities. The economic value of equity is a longer term view of interest rate risk because it measures the present value of the future cash flows. The impact of changes in interest rates on this calculation is analyzed for the risk to the Company's future earnings and is used in conjunction with the analyses on net interest income.

The Company conducts periodic analyses of its sensitivity to interest rate risks through the use of a third-party proprietary interest-rate sensitivity model. That model has been customized to the Company's specifications. The analyses conducted by use of that model are based on current information regarding the Company's actual interest-earnings assets, interest-bearing liabilities, capital and other financial information that it supplies. The third party uses that information in the model to estimate the Company's sensitivity to interest rate risk.

The Company's interest rate risk model indicated that it was in a balanced rate sensitive position in terms of interest rate sensitivity as of March 31, 2018. The table below illustrates the impact of an immediate and sustained 200 and 100 basis point increase and a 100 basis point decrease in interest rates on net interest income based on the interest rate risk model as of March 31, 2018:

Hypothetical Shift in Interest Rates (in bps)	% Change in Projected Net Interest Income
200	(1.98)%
100	(0.89)
(100)	1.84

These are good faith estimates and assume that the composition of the Company's interest sensitive assets and liabilities existing at each period-end and is based on future maturities and market pricing over the relevant twelve month measurement period and that changes in market interest rates are instantaneous and sustained across the yield curve regardless of duration of pricing characteristics of specific assets or liabilities. Also, this analysis does not contemplate any actions that the Company might undertake in response to changes in market interest rates. The Company believes these estimates are not necessarily indicative of what actually could occur in the event of immediate interest rate increases or decreases of this magnitude. As interest-bearing assets and liabilities re-price in different time frames and proportions to market interest rate movements, various assumptions must be made based on

historical relationships of these variables in reaching any conclusion. Since these correlations are based on competitive and market conditions, the Company anticipates that our future results will likely be different from the foregoing estimates, and such differences could be material.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q was performed under the supervision and with the participation of management, including its Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure and are effective to provide reasonable assurance that such information is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Changes in internal control over financial reporting. There were no changes in the Company's internal control over financial reporting during the three months ended March 31, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

Item 1. LEGAL PROCEEDINGS

In the normal course of business, the Company and Independent Bank are named as defendants in various lawsuits. Management of the Company and Independent Bank, following consultation with legal counsel, do not expect the ultimate disposition of any, or a combination, of these matters to have a material adverse effect on the business of the Company or Independent Bank. A legal proceeding that the Company believes could become material is described below.

Independent Bank is a party to a legal proceeding inherited by Independent Bank in connection with the Company's acquisition of BOH Holdings, Inc. and its subsidiary, Bank of Houston, or BOH, that was completed on April 15, 2014. Several entities related to R. A. Stanford, or the Stanford Entities, including Stanford International Bank, Ltd., or SIBL, had deposit accounts at BOH. Certain individuals who had purchased certificates of deposit from SIBL filed a class action lawsuit against several banks, including BOH, on November 11, 2009 in the U.S. District Court Northern District of Texas, Dallas Division, in a case styled Peggy Roif Rotstain, et al. on behalf of themselves and all others similarly situated, v. Trustmark National Bank, et al., Civil Action No. 3:09-CV-02384-N-BG. The suit alleges, among other things, that the plaintiffs were victims of fraud by SIBL and other Stanford Entities and seeks to recover damages and alleged fraudulent transfers by the defendant banks.

On May 1, 2015, the plaintiffs filed a motion requesting permission to file a Second Amended Class Action Complaint in this case, which motion was subsequently granted. The Second Amended Class Action Complaint asserted previously unasserted claims, including aiding and abetting or participation in a fraudulent scheme based upon the large amount of deposits that the Stanford Entities held at BOH and the alleged knowledge of certain BOH officers. The plaintiffs seek recovery from Independent Bank and other defendants for their losses. The case was inactive due to a court-ordered discovery stay issued March 2, 2015 pending the Court's ruling on plaintiff's motion for class certification and designation of class representatives and counsel. On November 7, 2017, the Court issued an order denying the plaintiff's motion. In addition, the Court lifted the previously ordered discovery stay. On January 11, 2018, the Court entered a scheduling order providing that the case be ready for trial on January 27, 2020. The Company anticipates an increase in legal fees associated with the defense of this claim as the case proceeds to trial.

Independent Bank notified its insurance carriers of the claims made in the Second Amended Class Action Complaint. The insurance carriers have initially indicated that a "loss" has not yet occurred or that the claims are not covered by the policies. However, Independent Bank is continuing to pursue insurance coverage for these claims, as well as for the reimbursement of defense costs, through the initiation of litigation and other means.

Independent Bank believes that the claims made in this lawsuit are without merit and is vigorously defending this lawsuit. This is complex litigation involving a number of procedural matters and issues. As such, Independent Bank is unable to predict when this matter may be resolved and, given the uncertainty of litigation, the ultimate outcome of, or potential costs or damages arising from, this case.

Item 1A. RISK FACTORS

In evaluating an investment in our securities, investors should consider carefully, among other things, the risk factors previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017, in the information contained in this Quarterly Report on Form 10-Q and our other reports and registrations statements.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

Item 3. DEFAULTS UPON SENIOR SECURITIES

None

Item 4. MINE SAFETY DISCLOSURES

Not applicable

Item 5. OTHER INFORMATION

None

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Item 6. EXHIBITS

The following documents are filed as exhibits to this Quarterly Report on Form 10-Q:

- Exhibit 3.1 Amended and Restated Certificate of Formation of Independent Bank Group, Inc., which is incorporated herein by reference to Exhibit 3.1 to Registration Statement on Form S-1 of Independent Bank Group, Inc. filed with the SEC on February 27, 2013 (the "S-1 Registration Statement")
- Exhibit 3.2 Certificate of Amendment to Amended and Restated Certificate of Formation of Independent Bank Group, Inc., which is incorporated herein by reference to Exhibit 3.3 to Amendment No. 2 to the S-1 Registration Statement filed with the SEC on April 1, 2013
- Exhibit 3.3 Third Amended and Restated Bylaws of Independent Bank Group, Inc., which are incorporated herein by reference to Exhibit 3.2 to Amendment No. 1 to the S-1 Registration Statement filed with the SEC on March 18, 2013
- Exhibit 3.4 Statement of Designations of Senior Non-Cumulative Perpetual Preferred Stock, Series A of Independent Bank Group, Inc., as filed with the Office of the Secretary of State of the State of Texas on April 15, 2014, which is incorporated herein by reference to Exhibit 3.1 to the Current Report on Form 8-K of Independent Bank Group, Inc. filed with the SEC on April 17, 2014
- Exhibit 3.5 Certificate of Merger, dated January 2, 2014, of Live Oak Financial Corp. with and into Independent Bank Group, Inc., which is incorporated herein by reference to Exhibit 3.5 to Amendment No. 1 to the Registrant's Registration Statement on Form S-3 (Registration No. 333-196627) filed with the SEC on June 25, 2014 (the "S-3 Registration Statement")
- Exhibit 3.6 Certificate of Merger, dated April 15, 2014, of BOH Holdings, Inc. with and into Independent Bank Group, Inc., which is incorporated herein by reference to Exhibit 3.6 to Amendment No. 1 to the S-3 Registration Statement filed with the SEC on June 25, 2014
- Exhibit 3.7 Certificate of Merger, dated September 30, 2014, of Houston City Bancshares, Inc. with and into Independent Bank Group, Inc., which is incorporated by reference to Exhibit 3.7 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2015
- Exhibit 3.8 Certificate of Merger, dated March 31, 2017, of Carlile Bancshares, Inc. with and into Independent Bank Group, Inc. which is incorporated by reference to Exhibit 3.8 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2017
- Exhibit 4.1 Form of certificate representing shares of the Registrant's common stock, which is incorporated herein by reference to Exhibit 4.1 to Amendment No. 1 to the Form S-1 Registration Statement filed with the SEC on March 18, 2013

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- Exhibit 4.2 Form of Common Stock Purchase Warrant, with schedules of differences, which is incorporated herein by reference to Exhibit 4.2 to the Form S-1 Registration Statement
- Exhibit 4.3 Subordinated Debt Indenture, dated as of June 25, 2014, between Independent Bank Group, Inc. and Wells Fargo Bank, National Association, in its capacity as Indenture Trustee, which is incorporated herein by reference to Exhibit 4.6 to the Registrant's Amendment No. 1 to the S-3 Registration Statement filed with the SEC on June 25, 2014
- Exhibit 4.4 First Supplemental Indenture, dated as of July 17, 2014, between Independent Bank Group, Inc. and Wells Fargo Bank Shareowner Services, in its capacity as Indenture Trustee, which is incorporated herein by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K, dated July 17, 2014
- Exhibit 4.5 Form of Global Note to represent the 5.875% Subordinated Notes due August 1, 2024, of the Registrant, which is incorporated herein by reference to Exhibit 4.5 in the Registrant's Quarterly Report on Form 10-Q, for the quarter ended September 30, 2017
- Exhibit 4.6 Form of Global Note to represent the 5.875% Subordinated Notes due August 1, 2024, of the Registrant, which is incorporated herein by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K, dated June 22, 2016

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Exhibit 4.7 Second Supplemental Indenture, dated as of December 19, 2017, between the Company and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8 K, dated December 19, 2017)

The other instruments defining the rights of holders of the long-term debt securities of the Registrant and its subsidiaries are omitted pursuant to section (b)(4)(iii)(A) of Item 601 of Regulation S-K. The Registrant hereby agrees to furnish copies of these instruments to the SEC upon request.

Exhibit 4.8 Independent Bank 401(k) Profit Sharing Plan, including related Adoption Agreement, which is incorporated herein by reference to Exhibit 4.9 to the Registrant's Registration Statement on Form S-8 filed with the SEC on August 29, 2014

Exhibit 10.1 Development Management Agreement, dated January 18, 2018, by and between IBG Real Estate Holdings II, Inc. and KDC McKinney Development One LLC and guaranteed by Independent Bank Group, Inc. and KDC Holdings LLC, which is incorporated herein by reference to Exhibit 10.18 in the Registrant's Annual Report on Form 10 K for the year ended December 31, 2017

Exhibit 31.1* Chief Executive Officer Section 302 Certification

Exhibit 31.2* Chief Financial Officer Section 302 Certification

Exhibit 32.1** Chief Executive Officer Section 906 Certification

Exhibit 32.2** Chief Financial Officer Section 906 Certification

Exhibit 101.INS * XBRL Instance Document

Exhibit 101.SCH * XBRL Taxonomy Extension Schema Document

Exhibit 101.CAL * XBRL Taxonomy Extension Calculation Linkbase Document

Exhibit 101.DEF * XBRL Taxonomy Extension Definition Linkbase Document

Exhibit 101.LAB * XBRL Taxonomy Extension Label Linkbase Document

Exhibit 101.PRE * XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith as an Exhibit.

**Furnished herewith as an Exhibit.

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Signatures

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

Independent Bank Group, Inc.

Date: April 26, 2018 By: /s/ David R. Brooks

David R. Brooks
Chairman, Chief Executive Officer and President

Date: April 26, 2018 By: /s/ Michelle S. Hickox

Michelle S. Hickox
Executive Vice President
Chief Financial Officer