

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

Independent Bank Group, Inc.  
Form 10-Q  
October 25, 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 September 30, 2018.

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 001-35854

Independent Bank Group, Inc.

(Exact name of registrant as specified in its charter)

Texas

(State or other jurisdiction of incorporation or organization)

13-4219346

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

1600 Redbud Boulevard, Suite 400

McKinney, Texas

(Address of principal executive offices)

(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)

75069-3257

(Zip Code)

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.

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

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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 – 30,477,648 shares as of October 23, 2018.

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INDEPENDENT BANK GROUP, INC. AND SUBSIDIARIES  
Form 10-Q  
September 30, 2018

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Signatures

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## Independent Bank Group, Inc. and Subsidiaries

## Consolidated Balance Sheets

September 30, 2018 (unaudited) and December 31, 2017

(Dollars in thousands, except share information)

|   | September<br>30,<br>2018 | December<br>31,<br>2017 |
|---|--------------------------|-------------------------|
| <b>Assets</b>   |                          |                         |
| Cash and due from banks   | \$149,641                | \$187,574               |
| Interest-bearing deposits in other banks  | 140,529                  | 243,528                 |
| Cash and cash equivalents   | 290,170                  | 431,102                 |
| Certificates of deposit held in other banks   | 1,225                    | 12,985                  |
| Securities available for sale, at fair value  | 760,995                  | 763,002                 |
| Loans held for sale (includes \$15,964 carried at fair value at September 30, 2018) | 27,730                   | 39,202                  |
| Loans, net  | 7,658,989                | 6,432,273               |
| Premises and equipment, net   | 156,320                  | 147,835                 |
| Other real estate owned   | 4,610                    | 7,126                   |
| Federal Home Loan Bank (FHLB) of Dallas stock and other restricted stock            | 26,617                   | 29,184                  |
| Bank-owned life insurance (BOLI)  | 128,679                  | 113,170                 |
| Deferred tax asset  | 14,565                   | 9,763                   |
| Goodwill  | 721,784                  | 621,458                 |
| Core deposit intangible, net  | 46,533                   | 43,244                  |
| Other assets  | 53,247                   | 34,119                  |
| <b>Total assets</b>   | <b>\$9,891,464</b>       | <b>\$8,684,463</b>      |
| <b>Liabilities and Stockholders' Equity</b>   |                          |                         |
| <b>Deposits:</b>  |                          |                         |
| Noninterest-bearing   | \$2,235,377              | \$1,907,770             |
| Interest-bearing  | 5,547,475                | 4,725,052               |
| <b>Total deposits</b>   | <b>7,782,852</b>         | <b>6,632,822</b>        |
| FHLB advances   | 345,000                  | 530,667                 |
| Other borrowings  | 137,207                  | 136,911                 |
| Junior subordinated debentures  | 27,803                   | 27,654                  |
| Other liabilities   | 31,418                   | 20,391                  |
| <b>Total liabilities</b>  | <b>8,324,280</b>         | <b>7,348,445</b>        |
| <b>Commitments and contingencies</b>  |                          |                         |
| <b>Stockholders' equity:</b>  |                          |                         |
| Preferred stock (0 and 0 shares outstanding, respectively)                          | —                        | —                       |
| Common stock (30,477,648 and 28,254,893 shares outstanding, respectively)           | 305                      | 283                     |
| Additional paid-in capital  | 1,313,981                | 1,151,990               |
| Retained earnings   | 267,118                  | 184,232                 |
| Accumulated other comprehensive loss  | (14,220 )                | (487 )                  |
| <b>Total stockholders' equity</b>   | <b>1,567,184</b>         | <b>1,336,018</b>        |
| <b>Total liabilities and stockholders' equity</b>                                   | <b>\$9,891,464</b>       | <b>\$8,684,463</b>      |
| See Notes to Consolidated Financial Statements                                      |                          |                         |



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## Independent Bank Group, Inc. and Subsidiaries

## Consolidated Statements of Income

Three and Nine Months Ended September 30, 2018 and 2017 (unaudited)

(Dollars in thousands, except per share information)

|  | Three Months Ended |          | Nine Months Ended |           |
|--|--------------------|----------|-------------------|-----------|
|  | September 30,      |          | September 30,     |           |
|  | 2018               | 2017     | 2018              | 2017      |
| Interest income:                                       |                    |          |                   |           |
| Interest and fees on loans                             | \$103,104          | \$79,325 | \$277,993         | \$208,263 |
| Interest on taxable securities                         | 3,840              | 2,539    | 10,244            | 5,606     |
| Interest on nontaxable securities                      | 1,103              | 1,124    | 3,475             | 2,657     |
| Interest on interest-bearing deposits and other        | 1,242              | 1,684    | 2,773             | 3,968     |
| Total interest income                                  | 109,289            | 84,672   | 294,485           | 220,494   |
| Interest expense:                                      |                    |          |                   |           |
| Interest on deposits                                   | 17,380             | 8,033    | 40,006            | 20,043    |
| Interest on FHLB advances                              | 3,121              | 1,749    | 7,854             | 4,271     |
| Interest on repurchase agreements and other borrowings | 2,100              | 1,716    | 6,299             | 5,137     |
| Interest on junior subordinated debentures             | 420                | 317      | 1,182             | 819       |
| Total interest expense                                 | 23,021             | 11,815   | 55,341            | 30,270    |
| Net interest income                                    | 86,268             | 72,857   | 239,144           | 190,224   |
| Provision for loan losses                              | 1,525              | 1,873    | 6,950             | 6,368     |
| Net interest income after provision for loan losses    | 84,743             | 70,984   | 232,194           | 183,856   |
| Noninterest income:                                    |                    |          |                   |           |
| Service charges on deposit accounts                    | 3,589              | 3,677    | 10,607            | 9,364     |
| Mortgage banking revenue                               | 5,111              | 4,569    | 12,134            | 10,855    |
| Gain on sale of loans                                  | —                  | 351      | —                 | 351       |
| Loss on sale of branch                                 | —                  | (127)    | —                 | (127)     |
| Gain (loss) on sale of other real estate               | 95                 | —        | 213               | (36)      |
| (Loss) gain on sale of securities available for sale   | (115)              | —        | (349)             | 52        |
| Gain (loss) on sale of premises and equipment          | 220                | (21)     | 123               | (15)      |
| Increase in cash surrender value of BOLI               | 831                | 778      | 2,328             | 1,959     |
| Other  | 3,018              | 2,903    | 7,281             | 5,305     |
| Total noninterest income                               | 12,749             | 12,130   | 32,337            | 27,708    |
| Noninterest expense:                                   |                    |          |                   |           |
| Salaries and employee benefits                         | 30,114             | 25,684   | 82,072            | 69,610    |
| Occupancy  | 6,613              | 6,380    | 18,295            | 16,399    |
| Data processing  | 2,989              | 2,546    | 7,861             | 6,449     |
| FDIC assessment  | 760                | 1,077    | 2,213             | 3,156     |
| Advertising and public relations                       | 583                | 380      | 1,300             | 994       |
| Communications   | 810                | 771      | 2,544             | 2,098     |
| Other real estate owned expenses, net                  | 62                 | 61       | 271               | 223       |
| Impairment of other real estate                        | —                  | 917      | 85                | 1,037     |
| Core deposit intangible amortization                   | 1,519              | 1,409    | 4,243             | 3,311     |
| Professional fees                                      | 1,175              | 1,273    | 3,427             | 3,212     |
| Acquisition expense, including legal                   | 1,682              | 2,428    | 5,671             | 8,247     |
| Other  | 6,348              | 4,978    | 18,789            | 12,524    |
| Total noninterest expense                              | 52,655             | 47,904   | 146,771           | 127,260   |

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|                            |          |          |          |          |
|----------------------------|----------|----------|----------|----------|
| Income before taxes        | 44,837   | 35,210   | 117,760  | 84,304   |
| Income tax expense         | 9,141    | 11,696   | 23,465   | 26,985   |
| Net income                 | \$35,696 | \$23,514 | \$94,295 | \$57,319 |
| Basic earnings per share   | \$1.17   | \$0.85   | \$3.22   | \$2.31   |
| Diluted earnings per share | \$1.17   | \$0.84   | \$3.21   | \$2.30   |

See Notes to Consolidated Financial Statements

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Independent Bank Group, Inc. and Subsidiaries  
 Consolidated Statements of Comprehensive Income  
 Three and Nine Months Ended September 30, 2018 and 2017 (unaudited)  
 (Dollars in thousands)

|  | Three Months<br>Ended September<br>30,<br>2018 |          | Nine Months<br>Ended September<br>30,<br>2017 |          |
|--|--|----------|---|----------|
| Net income   | \$35,696                                       | \$23,514 | \$94,295                                      | \$57,319 |
| Other comprehensive income (loss) before tax:  |  |          |   |          |
| Change in net unrealized gains (losses) on available for sale securities during the year                   | (5,259 )                                       | (219 )   | (17,438 )                                     | 7,095    |
| Reclassification for amount realized through sales of securities available for sale included in net income | 115  | —        | 349   | (52 )    |
| Other comprehensive income (loss) before tax   | (5,144 )                                       | (219 )   | (17,089 )                                     | 7,043    |
| Income tax expense (benefit)   | (1,081 )                                       | (77 )    | (3,589 )                                      | 2,465    |
| Other comprehensive income (loss), net of tax  | (4,063 )                                       | (142 )   | (13,500 )                                     | 4,578    |
| Comprehensive income   | \$31,633                                       | \$23,372 | \$80,795                                      | \$61,897 |
| See Notes to Consolidated Financial Statements   |  |          |   |          |



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Independent Bank Group, Inc. and Subsidiaries  
Consolidated Statements of Changes in Stockholders' Equity  
Nine Months Ended September 30, 2018 and 2017 (unaudited)  
(Dollars in thousands, except for par value, share and per share information)

|  | Preferred<br>Stock<br>\$.01<br>Par<br>Value<br>10<br>million<br>shares<br>authorized | Common Stock<br>\$.01 Par Value<br>100 million shares<br>authorized | Additional<br>Paid in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>(Loss)<br>Income | Total                     |
|--|--|---|----------------------------------|----------------------|---|---------------------------|
| Balance, December 31, 2017   | \$ —   | 28,254,893  | \$ 283                           | \$ 1,151,990         | \$ 184,232  | \$ (487 ) \$ 1,336,018    |
| Cumulative effect of accounting change                               | —  | —   | —                                | —                    | 233   | (233 ) —                  |
| Net income   | —  | —   | —                                | —                    | 94,295  | — 94,295                  |
| Other comprehensive loss, net of tax                                 | —  | —   | —                                | —                    | —   | (13,500 ) (13,500 )       |
| Stock issued for acquisition of bank, net of offering costs of \$209 | —  | 2,071,981   | 21                               | 157,033              | —   | — 157,054                 |
| Restricted stock forfeited   | —  | (3,845 )  | —                                | —                    | —   | — —                       |
| Restricted stock granted   | —  | 127,712   | 1                                | (1 )                 | —   | — —                       |
| Stock based compensation expense                                     | —  | —   | —                                | 4,496                | —   | — 4,496                   |
| Exercise of warrants   | —  | 26,907  | —                                | 463                  | —   | — 463                     |
| Cash dividends (\$0.40 per share)                                    | —  | —   | —                                | —                    | (11,642 )   | — (11,642 )               |
| Balance, September 30, 2018  | \$ —   | 30,477,648  | \$ 305                           | \$ 1,313,981         | \$ 267,118  | \$ (14,220 ) \$ 1,567,184 |
| Balance, December 31, 2016   | \$ —   | 18,870,312  | \$ 189                           | \$ 555,325           | \$ 117,951  | \$ (1,100 ) \$ 672,365    |
| Net income   | —  | —   | —                                | —                    | 57,319  | — 57,319                  |
| Other comprehensive income, net of tax                               | —  | —   | —                                | —                    | —   | 4,578 4,578               |
| Stock issued for acquisition of bank, net of offering costs of \$942 | —  | 8,804,699   | 88                               | 565,112              | —   | — 565,200                 |
| Restricted stock forfeited   | —  | (67 )   | —                                | —                    | —   | — —                       |
| Restricted stock granted   | —  | 126,730   | 1                                | (1 )                 | —   | — —                       |
| Stock based compensation expense                                     | —  | —   | —                                | 3,442                | —   | — 3,442                   |
| Exercise of warrants   | —  | 3,203   | —                                | 55                   | —   | — 55                      |
| Cash dividends (\$0.30 per share)                                    | —  | —   | —                                | —                    | (7,450 )  | — (7,450 )                |
| Balance, September 30, 2017  | \$ —   | 27,804,877  | \$ 278                           | \$ 1,123,933         | \$ 167,820  | \$ 3,478 \$ 1,295,509     |

See Notes to Consolidated Financial Statements

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Independent Bank Group, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
Nine Months Ended September 30, 2018 and 2017 (unaudited)  
(Dollars in thousands)

|   | Nine Months Ended<br>September 30, |             |
|---|------------------------------------|-------------|
|   | 2018                               | 2017        |
| Cash flows from operating activities:   |                                    |             |
| Net income  | \$94,295                           | \$ 57,319   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |             |
| Depreciation expense  | 6,324                              | 6,203       |
| Accretion of income recognized on acquired loans                                  | (9,386 )                           | (4,293 )    |
| Amortization of core deposit intangibles  | 4,243                              | 3,311       |
| Amortization of premium on securities, net  | 2,768                              | 2,633       |
| Amortization of discount and origination costs on borrowings                      | 475                                | 366         |
| Stock based compensation expense  | 4,496                              | 3,442       |
| Excess tax benefit on restricted stock vested                                     | (632 )                             | (1,272 )    |
| FHLB stock dividends  | (538 )                             | (308 )      |
| Loss (gain) on sale of securities available for sale                              | 349                                | (52 )       |
| (Gain) loss on sale of premises and equipment                                     | (123 )                             | 15          |
| Gain on sale of loans   | —                                  | (351 )      |
| Loss on sale of branch  | —                                  | 127         |
| (Gain) loss on sale of other real estate owned                                    | (213 )                             | 36          |
| Impairment of other real estate   | 85                                 | 1,037       |
| Deferred tax expense  | 2,130                              | 3,329       |
| Provision for loan losses   | 6,950                              | 6,368       |
| Increase in cash surrender value of BOLI  | (2,328 )                           | (1,959 )    |
| Originations of loans held for sale   | (293,756)                          | (291,330 )  |
| Proceeds from sale of loans held for sale   | 305,228                            | 288,053     |
| Net change in other assets  | (15,883 )                          | (2,537 )    |
| Net change in other liabilities   | 1,121                              | 103         |
| Net cash provided by operating activities   | 105,605                            | 70,240      |
| Cash flows from investing activities:   |                                    |             |
| Proceeds from maturities, calls and pay downs of securities available for sale    | 2,213,168                          | 1,390,770   |
| Proceeds from sale of securities available for sale                               | 42,727                             | 17,227      |
| Purchases of securities available for sale  | (2,249,373)                        | (1,497,707) |
| Purchases of certificates of deposits held in other banks                         | —                                  | (1,960 )    |
| Proceeds from maturities of certificates of deposit held in other banks           | 11,760                             | —           |
| Proceeds from sale of loans   | —                                  | 3,867       |
| Purchase of bank owned life insurance contracts                                   | (5,000 )                           | —           |
| Purchases of FHLB stock and other restricted stock                                | (6,144 )                           | (48 )       |
| Proceeds from redemptions of FHLB stock and other restricted stock                | 12,606                             | 8,956       |
| Net loans originated held for investment  | (587,348)                          | (386,896 )  |
| Originations of mortgage warehouse purchase loans                                 | (3,869,234)                        | (2,365,799) |
| Proceeds from pay-offs of mortgage warehouse purchase loans                       | 3,883,661                          | 2,327,560   |
| Additions to premises and equipment   | (24,497 )                          | (11,626 )   |

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|   |           |            |
|---|-----------|------------|
| Proceeds from sale of premises and equipment      | 14,479    | 15         |
| Proceeds from sale of other real estate owned     | 3,054     | 5,648      |
| Capitalized additions to other real estate        | —         | (1,032 )   |
| Cash received from acquired bank                  | 44,723    | 148,444    |
| Cash paid in connection with acquisition          | (31,016 ) | (17,773 )  |
| Selling costs paid in connection with branch sale | —         | (62 )      |
| Net cash transferred in branch sale               | —         | (11,765 )  |
| Net cash used in investing activities             | (546,434) | (392,181 ) |

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Independent Bank Group, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows (Continued)  
Nine Months Ended September 30, 2018 and 2017 (unaudited)  
(Dollars in thousands)

|  | Nine Months Ended September 30,<br>2018 | 2017       |
|--|---|------------|
| Cash flows from financing activities:                              |   |            |
| Net increase in demand deposits, money market and savings accounts | 375,045                                 | 635,877    |
| Net increase (decrease) in time deposits                           | 181,907                                 | (144,785 ) |
| Proceeds from FHLB advances  | 1,110,000                               | 100,000    |
| Repayments of FHLB advances  | (1,355,667 )                            | (59 )      |
| Net change in repurchase agreements                                | —                                       | (2,765 )   |
| Proceeds from exercise of common stock warrants                    | 463                                     | 55         |
| Offering costs paid in connection with acquired bank               | (209 )                                  | (942 )     |
| Dividends paid   | (11,642 )                               | (7,450 )   |
| Net cash provided by financing activities                          | 299,897                                 | 579,931    |
| Net change in cash and cash equivalents                            | (140,932 )                              | 257,990    |
| Cash and cash equivalents at beginning of year                     | 431,102                                 | 505,027    |
| Cash and cash equivalents at end of period                         | \$ 290,170                              | \$ 763,017 |

See Notes to Consolidated Financial Statements



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Independent Bank Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

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

Note 1. Summary of Significant Accounting Policies

Nature of Operations: Independent Bank Group, Inc. (IBG) through its subsidiary, Independent Bank, a Texas state banking corporation (Bank) (collectively known as the Company), provides a full range of banking services to individual and corporate customers in the North, 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. On June 1, 2018, the Company acquired Integrity Bancshares, Inc. (Integrity) and its wholly owned subsidiary, Integrity Bank, SSB, Houston, Texas. Integrity has been merged into the Company and dissolved and Integrity Bank has been merged with the Bank as of acquisition date. See Note 11, Business Combinations for more details of the Integrity acquisition.

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 on Form 10-K for the year ended December 31, 2017. The consolidated balance sheet at December 31, 2017 has been derived from the audited financial statements as of that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

Segment Reporting: The Company has one reportable segment. The Company's chief operating decision-maker uses consolidated results to make operating and strategic decisions.

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 12.

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 and nine months ended September 30, 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.

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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)

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<br>Ended September<br>30, |            | Nine Months Ended<br>September 30, |            |
|--|--|------------|------------------------------------|------------|
|  | 2018                                   | 2017       | 2018                               | 2017       |
| Basic earnings per share:                                    |  |            |                                    |            |
| Net income   | \$35,696                               | \$ 23,514  | \$94,295                           | \$ 57,319  |
| Less:  |  |            |                                    |            |
| Undistributed earnings allocated to participating securities | 262                                    | 181        | 729                                | 555        |
| Dividends paid on participating securities                   | 36                                     | 24         | 104                                | 83         |
| Net income available to common shareholders                  | \$35,398                               | \$ 23,309  | \$93,462                           | \$ 56,681  |
| Weighted-average basic shares outstanding                    | 30,219,567                             | 27,555,978 | 29,035,724                         | 24,585,473 |
| Basic earnings per share                                     | \$1.17                                 | \$ 0.85    | \$3.22                             | \$ 2.31    |
| Diluted earnings per share:                                  |  |            |                                    |            |
| Net income available to common shareholders                  | \$35,398                               | \$ 23,309  | \$93,462                           | \$ 56,681  |
| Total weighted-average basic shares outstanding              | 30,219,567                             | 27,555,978 | 29,035,724                         | 24,585,473 |
| Add dilutive stock warrants                                  | 90,114                                 | 103,800    | 91,292                             | 105,317    |
| Total weighted-average diluted shares outstanding            | 30,309,681                             | 27,659,778 | 29,127,016                         | 24,690,790 |
| Diluted earnings per share                                   | \$1.17                                 | \$ 0.84    | \$3.21                             | \$ 2.30    |
| Anti-dilutive participating securities                       | 62,588                                 | 77,498     | 112,797                            | 145,925    |



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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 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:

|  | Nine Months<br>Ended September<br>30, |      |
|--|---------------------------------------|------|
|  | 2018                                  | 2017 |

## Cash transactions:

|                       |          |          |
|-----------------------|----------|----------|
| Interest expense paid | \$55,084 | \$31,113 |
|-----------------------|----------|----------|

|                   |          |          |
|-------------------|----------|----------|
| Income taxes paid | \$17,159 | \$21,911 |
|-------------------|----------|----------|

## Noncash transactions:

|   |       |       |
|---|-------|-------|
| Transfers of loans to other real estate owned | \$410 | \$750 |
|---|-------|-------|

|  |     |         |
|--|-----|---------|
| Transfer of bank premises to other real estate | \$— | \$2,716 |
|--|-----|---------|

Supplemental schedule of noncash investing activities from branch sales is as follows:

|  | Nine<br>Months<br>Ended<br>September<br>30,<br>2017 |  |
|--|---|--|
|--|---|--|

## Noncash assets transferred:

|                                   |     |         |
|-----------------------------------|-----|---------|
| Loans, including accrued interest | \$— | \$5,439 |
|-----------------------------------|-----|---------|

|              |     |         |
|--------------|-----|---------|
| Total assets | \$— | \$5,439 |
|--------------|-----|---------|

## Noncash liabilities transferred:

|                                      |     |          |
|--------------------------------------|-----|----------|
| Deposits, including accrued interest | \$— | \$17,509 |
|--------------------------------------|-----|----------|

|                   |   |    |
|-------------------|---|----|
| Other liabilities | — | 28 |
|-------------------|---|----|

|                   |     |          |
|-------------------|-----|----------|
| Total liabilities | \$— | \$17,537 |
|-------------------|-----|----------|

|  |     |       |
|--|-----|-------|
| Cash and cash equivalents transferred in branch sale | \$— | \$101 |
|--|-----|-------|

|                          |     |       |
|--------------------------|-----|-------|
| Deposit premium received | \$— | \$333 |
|--------------------------|-----|-------|

|  |     |          |
|--|-----|----------|
| Cash paid to buyer, net of deposit premium | \$— | \$11,664 |
|--|-----|----------|

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Supplemental schedule of noncash investing activities from acquisitions is as follows:

|  | Nine Months Ended<br>September 30, |             |
|--|------------------------------------|-------------|
|  | 2018                               | 2017        |
| Noncash assets acquired  |                                    |             |
| Certificates of deposit held in other banks                        | \$—                                | \$11,025    |
| Securities available for sale                                      | 24,721                             | 336,540     |
| Restricted stock   | 3,357                              | 11,110      |
| Loans  | 651,769                            | 1,384,210   |
| Premises and equipment   | 4,863                              | 63,166      |
| Other real estate owned  | —                                  | 11,124      |
| Goodwill   | 100,326                            | 362,431     |
| Core deposit intangibles   | 7,532                              | 36,717      |
| Bank owned life insurance  | 8,181                              | 53,213      |
| Other assets   | 6,393                              | 25,197      |
| Total assets   | \$807,142                          | \$2,294,733 |
| Noncash liabilities assumed:                                       |                                    |             |
| Deposits   | \$593,078                          | \$1,825,181 |
| Repurchase agreements  | —                                  | 18,003      |
| FHLB advances  | 60,000                             | —           |
| Junior subordinated debt   | —                                  | 9,359       |
| Other liabilities  | 10,508                             | 6,719       |
| Total liabilities  | \$663,586                          | \$1,859,262 |
| Cash and cash equivalents acquired from acquisitions               | \$44,723                           | \$148,444   |
| Cash paid to shareholders of acquired banks                        | \$31,016                           | \$17,773    |
| Fair value of common stock issued to shareholders of acquired bank | \$157,263                          | \$566,142   |

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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 3. Securities Available for Sale

Securities available for sale have been classified in the consolidated balance sheets according to management's intent. The amortized cost of securities and their approximate fair values at September 30, 2018 and December 31, 2017, are as follows:

|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|---------------|
| Securities Available for Sale  |                   |                              |                               |               |
| September 30, 2018   |                   |                              |                               |               |
| U.S. treasuries  | \$ 30,112         | \$ —                         | \$(740)                       | \$29,372      |
| Government agency securities   | 199,305           | —                            | (4,703)                       | 194,602       |
| Obligations of state and municipal subdivisions                                  | 200,956           | 560                          | (5,036)                       | 196,480       |
| Residential pass-through securities guaranteed by FNMA, GNMA, and FHLMC          | 349,373           | 190                          | (9,022)                       | 340,541       |
|  | \$ 779,746        | \$ 750                       | \$(19,501)                    | \$760,995     |
| 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 \$246,972 and \$238,344 at September 30, 2018 and December 31, 2017, respectively, were pledged to secure public fund deposits and repurchase agreements.

Proceeds from sale of securities available for sale and gross gains and gross losses for the three and nine months ended September 30, 2018 and 2017 were as follows:

|                    | Three Months<br>Ended<br>September 30,<br>2018 |       | Nine Months<br>Ended September<br>30,<br>2017 |          |
|--------------------|--|-------|---|----------|
| Proceeds from sale | \$15,254                                       | \$417 | \$42,727                                      | \$17,227 |
| Gross gains        | \$38   | \$—   | \$141   | \$104    |
| Gross losses       | \$153  | \$—   | \$490   | \$52     |

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The amortized cost and estimated fair value of securities available for sale at September 30, 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.

|   | September 30, 2018<br>Securities Available<br>for Sale |               |
|---|--|---------------|
|   | Amortized<br>Cost                                      | Fair<br>Value |
| Due in one year or less   | \$67,636   | \$67,345      |
| Due from one year to five years   | 172,196  | 168,195       |
| Due from five to ten years  | 97,962   | 95,001        |
| Thereafter  | 92,579   | 89,913        |
|   | 430,373  | 420,454       |
| Residential pass-through securities guaranteed by FNMA, GNMA, and FHLMC | 349,373  | 340,541       |
|   | \$779,746  | \$760,995     |

The number of securities, unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of September 30, 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  |                      |                      |                   |                        |                      |                   |                      |                   |
| September 30, 2018   |                      |                      |                   |                        |                      |                   |                      |                   |
| U.S. treasuries  | 1                    | \$9,661              | \$(64)            | 5                      | \$19,711             | \$(676)           | \$29,372             | \$(740)           |
| Government agency securities   | 17                   | 43,445               | (577)             | 53                     | 151,157              | (4,126)           | 194,602              | (4,703)           |
| Obligations of state and municipal subdivisions                        | 229                  | 102,542              | (2,017)           | 137                    | 64,684               | (3,019)           | 167,226              | (5,036)           |
| Residential pass-through securities guaranteed by FNMA, GNMA and FHLMC | 145                  | 267,915              | (6,611)           | 34                     | 64,628               | (2,411)           | 332,543              | (9,022)           |
|  | 392                  | \$423,563            | \$(9,269)         | 229                    | \$300,180            | \$(10,232)        | \$723,743            | \$(19,501)        |
| 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,                | 55                   | 125,970              | (834)             | 10                     | 25,398               | (374)             | 151,368              | (1,208)           |

GNMA, FHLMC, FHR  
and GNR

|                  |     |           |           |   |    |           |           |        |           |           |   |
|------------------|-----|-----------|-----------|---|----|-----------|-----------|--------|-----------|-----------|---|
| 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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## Independent Bank Group, Inc. and Subsidiaries

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

## Note 4. Loans, Net and Allowance for Loan Losses

Loans, net, at September 30, 2018 and December 31, 2017, consisted of the following:

|  | September<br>30,<br>2018 | December<br>31,<br>2017 |
|--|--------------------------|-------------------------|
| Commercial   | \$1,313,170              | \$1,059,984             |
| Real estate:                                       |                          |                         |
| Commercial   | 3,996,384                | 3,369,892               |
| Commercial construction, land and land development | 920,823                  | 744,868                 |
| Residential  | 1,010,749                | 892,293                 |
| Single family interim construction                 | 357,604                  | 289,680                 |
| Agricultural                                       | 70,738                   | 82,583                  |
| Consumer   | 34,648                   | 34,639                  |
| Other  | 275                      | 304                     |
|  | 7,704,391                | 6,474,243               |
| Deferred loan fees                                 | (3,236 )                 | (2,568 )                |
| Allowance for loan losses                          | (42,166 )                | (39,402 )               |
|  | \$7,658,989              | \$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 September 30, 2018 and December 31, 2017, there were approximately \$140,357 and \$106,060 of energy related loans outstanding, respectively. 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 September 30, 2018 and December 31, 2017, mortgage warehouse purchase loans outstanding totaled \$150,267 and \$164,694, respectively.



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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 September 30, 2018, the portfolio consisted of approximately 34% of owner occupied property. Land and commercial land development loans are underwritten using feasibility studies, independent appraisal reviews and financial analysis of the developers or property owners. Generally, borrowers must have a proven track record of success. Commercial construction loans are generally based upon estimates of cost and value of the completed project. These estimates may not be accurate. Commercial construction loans often involve the disbursement of substantial funds with the repayment dependent on the success of the ultimate project. Sources of repayment for these loans may be pre-committed permanent financing or sale of the developed property. The loans in this portfolio are geographically diverse and due to the increased risk are monitored closely by management and the board of directors on a quarterly basis.

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

Agricultural loans are collateralized by real estate and/or 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 September 30, 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 September 30, 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.





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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. 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 third 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.

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The economy and other risk factors are minimized by the Company's underwriting standards, which include the following principles: 1) financial strength of the borrower including strong earnings, high net worth, significant liquidity and acceptable debt to worth ratio, 2) managerial business competence, 3) ability to repay, 4) loan to value, 5) projected cash flow and 6) guarantor financial statements as applicable. The following is a summary of the activity in the allowance for loan losses by loan class for the three and nine months ended September 30, 2018 and 2017:

|                                       | Commercial | Commercial<br>Real Estate,<br>Construction<br>Land and<br>Land<br>Development | Residential<br>Real<br>Estate | Single-Family<br>Interim<br>Construction | Agricultural | Consumer | Other   | Unallocated | Total     |
|---------------------------------------|------------|---|-------------------------------|--|--------------|----------|---------|-------------|-----------|
| Three Months Ended September 30, 2018 |            |   |                               |  |              |          |         |             |           |
| Balance at the beginning of period    | \$ 11,805  | \$ 26,192   | \$ 3,319                      | \$ 1,643                                 | \$ 224       | \$ 187   | \$ 3    | \$ (65)     | \$ 43,308 |
| Provision for loan losses             | 1,887      | 149   | (233)                         | (151)                                    | 43           | (2)      | 50      | (218)       | 1,525     |
| Charge-offs                           | (2,538)    | (82)  | (1)                           | —  | —            | (8)      | (56)    | —           | (2,685)   |
| Recoveries                            | 1          | 5   | 1                             | —  | —            | 1        | 10      | —           | 18        |
| Balance at end of period              | \$ 11,155  | \$ 26,264   | \$ 3,086                      | \$ 1,492                                 | \$ 267       | \$ 178   | \$ 7    | \$ (283)    | \$ 42,166 |
| Nine Months Ended September 30, 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             | 4,183      | 3,385   | (358)                         | (91)                                     | 17           | (4)      | 150     | (332)       | 6,950     |
| Charge-offs                           | (3,633)    | (435)   | (6)                           | —  | —            | (27)     | (151)   | —           | (4,252)   |
| Recoveries                            | 6          | 13  | 3                             | —  | —            | 4        | 40      | —           | 66        |
| Balance at end of period              | \$ 11,155  | \$ 26,264   | \$ 3,086                      | \$ 1,492                                 | \$ 267       | \$ 178   | \$ 7    | \$ (283)    | \$ 42,166 |
| Three months ended September 30, 2017 |            |   |                               |  |              |          |         |             |           |
| Balance at the beginning of period    | \$ 8,700   | \$ 21,497   | \$ 3,292                      | \$ 1,387                                 | \$ 272       | \$ 288   | \$ 12   | \$ 433      | \$ 35,881 |
| Provision for loan losses             | 533        | 949   | 33                            | 258                                      | 8            | (37)     | 22      | 107         | 1,873     |
| Charge-offs                           | —          | —   | —                             | —  | —            | (1)      | (38)    | —           | (39)      |
| Recoveries                            | 3          | 3   | 1                             | —  | —            | 29       | 19      | —           | 55        |
| Balance at end of period              | \$ 9,236   | \$ 22,449   | \$ 3,326                      | \$ 1,645                                 | \$ 280       | \$ 279   | \$ 15   | \$ 540      | \$ 37,770 |
| Nine months ended September 30, 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             | 618        | 4,026   | 563                           | 478                                      | 73           | 62       | 68      | 480         | 6,368     |
| Charge-offs                           | —          | —   | —                             | (134)                                    | —            | (68)     | (115)   | —           | (317)     |

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|                          |          |           |          |          |        |        |       |        |           |
|--------------------------|----------|-----------|----------|----------|--------|--------|-------|--------|-----------|
| Recoveries               | 25       | 24        | 3        | —        | —      | 43     | 33    | —      | 128       |
| Balance at end of period | \$ 9,236 | \$ 22,449 | \$ 3,326 | \$ 1,645 | \$ 280 | \$ 279 | \$ 15 | \$ 540 | \$ 37,770 |

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The following table details the amount of the allowance for loan losses and recorded investment in loans by class as of September 30, 2018 and December 31, 2017:

|   | Commercial  | Commercial<br>Real Estate,<br>Construction<br>Land and<br>Land<br>Development | Residential<br>Real Estate | Single-Family<br>Interim<br>Construction | Agriculture | Consumer | Other | Unallocated | Total       |
|---|-------------|---|----------------------------|--|-------------|----------|-------|-------------|-------------|
| September 30, 2018                                    |             |   |                            |  |             |          |       |             |             |
| Allowance for losses:                                 |             |   |                            |  |             |          |       |             |             |
| Individually<br>evaluated for<br>impairment           | \$2,711     | \$61  | \$47                       | \$—                                      | \$—         | \$3      | \$—   | \$—         | \$2,822     |
| Collectively<br>evaluated for<br>impairment           | 8,444       | 26,203  | 3,039                      | 1,492                                    | 267         | 175      | 7     | (283)       | 39,344      |
| Loans acquired with<br>deteriorated credit<br>quality | —           | —   | —                          | —  | —           | —        | —     | —           | —           |
| Ending balance  | \$11,155    | \$26,264  | \$3,086                    | \$1,492                                  | \$267       | \$178    | \$7   | \$(283)     | \$42,166    |
| Loans:  |             |   |                            |  |             |          |       |             |             |
| Individually<br>evaluated for<br>impairment           | \$7,978     | \$2,520   | \$2,086                    | \$—                                      | \$—         | \$31     | \$—   | \$—         | \$12,615    |
| Collectively<br>evaluated for<br>impairment           | 1,281,830   | 4,820,213   | 1,005,085                  | 357,604                                  | 67,830      | 34,588   | 275   | —           | 7,567,425   |
| Acquired with<br>deteriorated credit<br>quality       | 23,362      | 94,474  | 3,578                      | —  | 2,908       | 29       | —     | —           | 124,351     |
| Ending balance  | \$1,313,170 | \$4,917,207   | \$1,010,749                | \$357,604                                | \$70,738    | \$34,648 | \$275 | \$—         | \$7,704,391 |
| December 31, 2017                                     |             |   |                            |  |             |          |       |             |             |
| Allowance for losses:                                 |             |   |                            |  |             |          |       |             |             |
| Individually<br>evaluated for<br>impairment           | \$3,500     | \$311   | \$—                        | \$—                                      | \$—         | \$2      | \$—   | \$—         | \$3,813     |
| Collectively<br>evaluated for<br>impairment           | 7,099       | 22,990  | 3,447                      | 1,583                                    | 250         | 203      | (32)  | 49          | 35,589      |
| Loans acquired with<br>deteriorated credit<br>quality | —           | —   | —                          | —  | —           | —        | —     | —           | —           |

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|   |              |              |            |            |           |           |         |       |              |
|---|--------------|--------------|------------|------------|-----------|-----------|---------|-------|--------------|
| 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    |
| 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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## Independent Bank Group, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (unaudited)

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

Nonperforming loans by loan class (excluding loans acquired with deteriorated credit quality) at September 30, 2018 and December 31, 2017, are summarized as follows:

|  | Commercial<br>Real<br>Estate,<br>Commercial<br>Land and<br>Land<br>Development | Construction<br>Real<br>Estate | Residential<br>Real<br>Estate | Single-Family<br>Interim<br>Construction | Agricultural | Consumer | Other | Total        |
|--|--|--------------------------------|-------------------------------|--|--------------|----------|-------|--------------|
| September 30, 2018   |  |                                |                               |  |              |          |       |              |
| Nonaccrual loans   | \$ 6,028   | \$ 2,112                       | \$ 1,916                      | \$ —                                     | —\$          | —\$ 31   | \$ —  | \$ —\$10,087 |
| Loans past due 90 days and still accruing  | —  | —                              | —                             | —  | —            | —        | —     | —            |
| Troubled debt restructurings (not included in nonaccrual or loans past due and still accruing) | —  | 408                            | 170                           | —  | —            | —        | —     | 578          |
|  | \$ 6,028   | \$ 2,520                       | \$ 2,086                      | \$ —                                     | —\$          | —\$ 31   | \$ —  | \$ —\$10,665 |
| 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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## Independent Bank Group, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (unaudited)

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

Impaired loans by loan class (excluding loans acquired with deteriorated credit quality) at September 30, 2018 and December 31, 2017, are summarized as follows:

|  | Commercial | Commercial<br>Real<br>Estate,<br>Construction<br>Land and<br>Land<br>Development | Residential<br>Real<br>Estate | Single-Family<br>Interim<br>Construction | Agricultural | Consumer | Other | Total        |
|--|------------|--|-------------------------------|--|--------------|----------|-------|--------------|
| September 30, 2018                               |            |  |                               |  |              |          |       |              |
| Recorded investment in impaired loans:           |            |  |                               |  |              |          |       |              |
| Impaired loans with an allowance for loan losses | \$ 6,639   | \$ 216   | \$ 47                         | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$6,905  |
| Impaired loans with no allowance for loan losses | 1,339      | 2,304  | 2,039                         | —  | —            | 28       | —     | 5,710        |
| Total  | \$ 7,978   | \$ 2,520   | \$ 2,086                      | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$12,615 |
| Unpaid principal balance of impaired loans       | \$ 8,007   | \$ 2,629   | \$ 2,184                      | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$12,858 |
| Allowance for loan losses on impaired loans      | \$ 2,711   | \$ 61  | \$ 47                         | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$2,822  |
| December 31, 2017                                |            |  |                               |  |              |          |       |              |
| Recorded investment in impaired loans:           |            |  |                               |  |              |          |       |              |
| Impaired loans with an allowance for loan losses | \$ 9,255   | \$ 1,793   | \$ —                          | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$11,050 |
| Impaired loans with no allowance for loan losses | 1,042      | 1,261  | 1,727                         | —  | —            | 72       | —     | 4,102        |
| Total  | \$ 10,297  | \$ 3,054   | \$ 1,727                      | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$15,152 |
| Unpaid principal balance of impaired loans       | \$ 13,456  | \$ 3,124   | \$ 1,818                      | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$18,595 |
| Allowance for loan losses on impaired loans      | \$ 3,500   | \$ 311   | \$ —                          | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$3,813  |
| For the three months ended September 30, 2018    |            |  |                               |  |              |          |       |              |
| Average recorded investment in impaired loans    | \$ 9,004   | \$ 2,850   | \$ 2,165                      | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$14,060 |
| Interest income recognized on impaired loans     | \$ 36      | \$ 19  | \$ 9                          | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$66     |
| For the nine months ended September 30, 2018     |            |  |                               |  |              |          |       |              |
| Average recorded investment in impaired loans    | \$ 9,327   | \$ 2,901   | \$ 2,056                      | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$14,333 |
| Interest income recognized on impaired loans     | \$ 56      | \$ 33  | \$ 53                         | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$144    |
| For the three months ended September 30, 2017    |            |  |                               |  |              |          |       |              |



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|   |          |          |          |        |      |            |              |
|---|----------|----------|----------|--------|------|------------|--------------|
| Average recorded investment in impaired loans | \$ 8,201 | \$ 2,769 | \$ 2,847 | \$ —   | \$ — | \$ —\$ 246 | \$ —\$14,063 |
| Interest income recognized on impaired loans  | \$ —     | \$ 15    | \$ 14    | \$ —   | \$ — | \$ —\$ —   | \$ —\$29     |
| For the nine months ended September 30, 2017  |          |          |          |        |      |            |              |
| Average recorded investment in impaired loans | \$ 8,081 | \$ 3,849 | \$ 2,608 | \$ 221 | \$ — | \$ —\$ 254 | \$ —\$15,013 |
| Interest income recognized on impaired loans  | \$ 4     | \$ 427   | \$ 38    | \$ —   | \$ — | \$ —\$ 5   | \$ —\$474    |

Certain impaired loans have adequate collateral and do not require a related allowance for loan loss.

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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)

The Company will charge-off that portion of any loan which management considers a loss. Commercial and real estate loans are generally considered for charge-off when exposure beyond collateral coverage is apparent and when no further collection of the loss portion is anticipated based on the borrower's financial condition.

The restructuring of a loan is considered a "troubled debt restructuring" if both 1) the borrower is experiencing financial difficulties and 2) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, extending amortization and other actions intended to minimize potential losses.

A "troubled debt restructured" loan is identified as impaired and measured for credit impairment as of each reporting period in accordance with the guidance in Accounting Standards Codification (ASC) 310-10-35. 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 \$1,851 and \$3,028 as of September 30, 2018 and December 31, 2017, respectively.

There were no loans modified under troubled debt restructurings during the three and nine months ended September 30, 2018.

Following is a summary of loans modified under troubled debt restructurings during the three and nine months ended September 30, 2017:

|   | Commercial<br>Real<br>Estate,<br>Construction<br>Land<br>and<br>Land<br>Development | Residential<br>Real<br>Estate | Single-Family<br>Interim<br>Construction | Agricultural | Consumer | Other | Total       |
|---|---|-------------------------------|--|--------------|----------|-------|-------------|
| Troubled debt restructurings during the three months ended September 30, 2017 |   |                               |  |              |          |       |             |
| Number of contracts   | 1   | —                             | —  | —            | —        | —     | 1           |
| Pre-restructuring outstanding recorded investment                             | \$ 873  | \$ —                          | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$873   |
| Post-restructuring outstanding recorded investment                            | \$ 873  | \$ —                          | \$ —                                     | \$ —         | \$ —     | \$ —  | \$ —\$873   |
| Troubled debt restructurings during the nine months ended September 30, 2017  |   |                               |  |              |          |       |             |
| Number of contracts   | 1   | —                             | 1  | —            | —        | 1     | — 3         |
| Pre-restructuring outstanding recorded investment                             | \$ 873  | \$ —                          | \$ 465                                   | \$ —         | \$ —     | \$ 22 | \$ —\$1,360 |
| Post-restructuring outstanding recorded investment                            | \$ 873  | \$ —                          | \$ 465                                   | \$ —         | \$ —     | \$ 22 | \$ —\$1,360 |

At September 30, 2018 and 2017, there were no loans modified under troubled debt restructurings during the previous twelve month period that subsequently defaulted during the three and nine months ended September 30, 2018 and 2017, respectively. At September 30, 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.



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## Independent Bank Group, Inc. and Subsidiaries

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

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. The following table presents information regarding the aging of past due loans by loan class as of September 30, 2018 and December 31, 2017:

|   | Loans<br>30-89<br>Days<br>Past<br>Due | Loans<br>90 or<br>More<br>Past<br>Due | Total<br>Past<br>Due<br>Loans | Current<br>Loans | Total<br>Loans |
|---|---------------------------------------|---------------------------------------|-------------------------------|------------------|----------------|
| September 30, 2018  |                                       |                                       |                               |                  |                |
| Commercial  | \$2,033                               | \$6,028                               | \$8,061                       | \$1,281,747      | \$1,289,808    |
| Commercial real estate, construction, land and land development | 2,279                                 | 813                                   | 3,092                         | 4,819,641        | 4,822,733      |
| Residential real estate   | 1,788                                 | 1,393                                 | 3,181                         | 1,003,990        | 1,007,171      |
| Single-family interim construction                              | 3,588                                 | —                                     | 3,588                         | 354,016          | 357,604        |
| Agricultural  | —                                     | —                                     | —                             | 67,830           | 67,830         |
| Consumer  | 168                                   | 29                                    | 197                           | 34,422           | 34,619         |
| Other   | —                                     | —                                     | —                             | 275              | 275            |
|   | 9,856                                 | 8,263                                 | 18,119                        | 7,561,921        | 7,580,040      |
| Acquired with deteriorated credit quality                       | 6,029                                 | 1,286                                 | 7,315                         | 117,036          | 124,351        |
|   | \$15,885                              | \$9,549                               | \$25,434                      | \$7,678,957      | \$7,704,391    |
| December 31, 2017   |                                       |                                       |                               |                  |                |
| Commercial  | \$730                                 | \$10,300                              | \$11,030                      | \$1,036,668      | \$1,047,698    |
| Commercial real estate, construction, 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    |

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 a 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.

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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)

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

A summary of loans by credit quality indicator by class as of September 30, 2018 and December 31, 2017, is as follows:

|   | Pass        | Pass/<br>Watch | Special<br>Mention | Substandard | Doubtful | Total        |
|---|-------------|----------------|--------------------|-------------|----------|--------------|
| September 30, 2018  |             |                |                    |             |          |              |
| Commercial  | \$1,211,771 | \$20,189       | \$42,580           | \$38,630    | \$—      | —\$1,313,170 |
| Commercial real estate, construction, land and land development | 4,780,287   | 66,107         | 40,950             | 29,863      | —        | 4,917,207    |
| Residential real estate   | 999,467     | 3,617          | 1,171              | 6,494       | —        | 1,010,749    |
| Single-family interim construction                              | 354,245     | —              | 3,359              | —           | —        | 357,604      |
| Agricultural  | 60,574      | 4,991          | 2,300              | 2,873       | —        | 70,738       |
| Consumer  | 34,449      | 42             | —                  | 157         | —        | 34,648       |
| Other   | 275         | —              | —                  | —           | —        | 275          |
|   | \$7,441,068 | \$94,946       | \$90,360           | \$78,017    | \$—      | —\$7,704,391 |
| 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).

The Company has included PCI loans in the above grading tables. The following provides additional detail on the grades applied to those loans at September 30, 2018 and December 31, 2017:

|                    | Pass     | Pass/<br>Watch | Special<br>Mention | Substandard | Doubtful | Total      |
|--------------------|----------|----------------|--------------------|-------------|----------|------------|
| September 30, 2018 | \$42,755 | \$35,318       | \$14,916           | \$31,362    | \$—      | —\$124,351 |
| 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 September 30, 2018 and December 31, 2017, nonaccrual PCI loans were \$9,720 and \$7,889, respectively.



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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 by acquired bank as of the acquisition date for the acquisitions occurring in 2018 and 2017:

|                          | Acquisition Date                 |                                 |
|--------------------------|----------------------------------|---------------------------------|
|                          | June 1,<br>2018                  | April 1,<br>2017                |
|                          | Integrity<br>Bancshares,<br>Inc. | Carlisle<br>Bancshares,<br>Inc. |
| Outstanding balance      | \$57,317                         | \$ 101,153                      |
| Nonaccretable difference | (9,969 )                         | (14,700 )                       |
| Accretable yield         | (128 )                           | (685 )                          |
| Carrying amount          | \$47,220                         | \$ 85,768                       |

The carrying amount of all acquired PCI loans included in the consolidated balance sheet and the related outstanding balance at September 30, 2018 and December 31, 2017 were as follows:

|                     | September<br>30, 2018 | December<br>31, 2017 |
|---------------------|-----------------------|----------------------|
| Outstanding balance | \$ 143,588            | \$ 105,685           |
| Carrying amount     | 124,351               | 91,892               |

There was no allocation established in the allowance for loan losses relating to PCI loans at September 30, 2018 or December 31, 2017.

The changes in accretable yield during the nine months ended September 30, 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 Nine<br>Months Ended<br>September 30, |         |
|------------------------------|---|---------|
|                              | 2018  | 2017    |
| Balance at January 1,        | \$1,546                                       | \$1,526 |
| Additions                    | 128   | 685     |
| Accretion                    | (1,503 )                                      | (355 )  |
| Transfers from nonaccretable | 1,319   | —       |
| Balance at September 30,     | \$1,490                                       | \$1,856 |



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## Independent Bank Group, Inc. and Subsidiaries

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(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 September 30, 2018 and December 31, 2017, the approximate amounts of these financial instruments were as follows:

|                              | September<br>30,<br>2018 | December<br>31,<br>2017 |
|------------------------------|--------------------------|-------------------------|
| Commitments to extend credit | \$1,720,245              | \$1,286,704             |
| Standby letters of credit    | 14,199                   | 10,532                  |
|                              | \$1,734,444              | \$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 September 30, 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.



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## Independent Bank Group, Inc. and Subsidiaries

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## Lease Commitments

The Company leases certain branch facilities and other facilities. Rent expense related to these leases amounted to \$984 and \$2,539 for the three and nine months ended September 30, 2018, respectively, and \$873 and \$2,292 for the three and nine months ended September 30, 2017, respectively.

## Note 6. Income Taxes

Income tax expense for the three and nine months ended September 30, 2018 and 2017 was as follows:

|                                   | Three Months Ended |          | Nine Months Ended |          |
|-----------------------------------|--------------------|----------|-------------------|----------|
|                                   | September 30,      |          | September 30,     |          |
|                                   | 2018               | 2017     | 2018              | 2017     |
| Income tax expense for the period | \$9,141            | \$11,696 | \$23,465          | \$26,985 |
| Effective tax rate                | 20.4 %             | 33.2 %   | 19.9 %            | 32.0 %   |

Effective January 1, 2018, the corporate U.S. statutory federal income tax rate was reduced from 35% to 21% under the Tax Cuts and Jobs Act. 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 material adjustments were made to provisional amounts during the period ended September 30, 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, excess tax benefits on restricted stock vestings, and nondeductible acquisition expenses.

## 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.



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The Company elected the fair value option for certain residential mortgage loans held for sale originated after July 1, 2018 in accordance with Accounting Standard Codification (ASC) 825, Financial Instruments. This election allows for a more effective offset of the changes in fair values of the loans and the derivative instruments used to economically hedge them without the burden of complying with the requirements for hedge accounting under ASC 815, Derivatives and Hedging. The Company has not elected the fair value option for other residential mortgage loans held for sale primarily because they are not economically hedged using derivative instruments. See below and Note 8, Derivative Financial Instruments for additional information.

## Assets and Liabilities Measured on a Recurring Basis

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value on a recurring basis as of September 30, 2018 and December 31, 2017 by level within the ASC Topic 820 fair value measurement hierarchy:

|   | Assets/<br>Liabilities<br>Measured<br>at<br>Fair<br>Value | in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|---|---|---|---|--|
| September 30, 2018  |   |   |   |  |
| Assets:   |   |   |   |  |
| Investment securities available for sale:                               |   |   |   |  |
| U.S. treasuries   | \$29,372  | \$—   | \$29,372  | \$ —   |
| Government agency securities  | 194,602   | —   | 194,602   | —  |
| Obligations of state and municipal subdivisions                         | 196,480   | —   | 196,480   | —  |
| Residential pass-through securities guaranteed by FNMA, GNMA, and FHLMC | 340,541   | —   | 340,541   | —  |
| Total investment securities available for sale                          | \$760,995   | \$—   | \$760,995   | \$ —   |
| Loans held for sale, fair value option elected <sup>(1)</sup>           | \$15,964  | \$—   | \$15,964  | \$ —   |
| Derivative financial instruments:                                       |   |   |   |  |
| Interest rate lock commitments  | 906   | —   | 906   | —  |
| Forward mortgage-backed securities trades                               | 110   | —   | 110   | —  |
| Loan customer counterparty  | 72  | —   | 72  | —  |
| Financial institution counterparty                                      | 443   | —   | 443   | —  |
| Liabilities:  |   |   |   |  |
| Derivative financial instruments:                                       |   |   |   |  |
| Loan customer counterparty  | 441   | —   | 441   | —  |
| Financial institution counterparty                                      | 86  | —   | 86  | —  |
| December 31, 2017   |   |   |   |  |

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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   | —         | —  | — |
| Total investment securities available for sale                                   | \$763,002 | \$10,349 | \$752,653 | \$ | — |

<sup>(1)</sup> At September 30, 2018, loans held for sale for which the fair value option was elected had an aggregate outstanding principal balance of \$15,417. There were no mortgage loans held for sale under the fair value option that were 90 days or greater past due or on non-accrual at September 30, 2018.

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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.

Certain mortgage loans held for sale are measured at fair value on a recurring basis due to the Company's election to adopt fair value accounting treatment for those loans originated after July 1, 2018 for which the Company has entered into certain derivative financial instruments as part of its mortgage banking and related risk management activities. These instruments include interest rate lock commitments and mandatory forward commitments to sell these loans to investors known as forward mortgage-backed securities trades. This election allows for a more effective offset of the changes in fair values of the assets and the mortgage related derivative instruments used to economically hedge them without the burden of complying with the requirements for hedge accounting under ASC 815, Derivatives and Hedging. Mortgage loans held for sale, for which the fair value option was elected, which are sold on a servicing released basis, are valued using a market approach by utilizing either: (i) the fair value of securities backed by similar mortgage loans, adjusted for certain factors to approximate the fair value of a whole mortgage loan, including the value attributable to mortgage servicing and credit risk, (ii) current commitments to purchase loans or (iii) recent observable market trades for similar loans, adjusted to credit risk and other individual loan characteristics. As these prices are derived from market observable inputs, the Company classifies these valuations as Level 2 in the fair value disclosures. For mortgage loans held for sale for which the fair value option was elected, the earned current contractual interest payment is recognized in interest income, loan origination costs and fees on fair value option loans are recognized in earnings as incurred and not deferred. The Company has no continuing involvement in any residential mortgage loans sold.

The estimated fair values of interest rate lock commitments utilize current secondary market prices for underlying loans and estimated servicing value with similar coupons, maturity and credit quality, subject to the anticipated loan funding probability (pull-through rate). The fair value of interest rate lock commitments is subject to change primarily due to changes in interest rates and the estimated pull-through rate. These commitments are classified as Level 2 in the fair value disclosures, as the valuations are based on observable market inputs.

Forward mortgage-backed securities trades are exchange-traded or traded within highly active dealer markets. In order to determine the fair value of these instruments, the Company utilized the exchange price or dealer market price for the particular derivative contract; therefore these contracts are classified as Level 2. The estimated fair values are subject to change primarily due to changes in interest rates.

The Company also enters into certain interest rate derivative positions that are not designated as hedging instruments. The estimated fair value of these commercial loan interest rate swaps are obtained from a pricing service that provides the swaps' unwind value (Level 2 inputs). See Note 8 - Derivative Financial Instruments for more information.





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## Assets and Liabilities Measured on a Nonrecurring Basis

In accordance with ASC Topic 820, certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets carried on the consolidated balance sheet by caption and by level in the fair value hierarchy at September 30, 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                |   |   |                           |
|-------------------------------|--|---|---|---------------------------|
|                               | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Period Ended Total Losses |
| September 30, 2018            |  |   |   |                           |
| Assets:                       |  |   |   |                           |
| Impaired loans                | \$ 4,083   | \$ —                                    | —\$ 4,083                                 | \$ 2,322                  |
| December 31, 2017             |  |   |   |                           |
| 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. Therefore, the Company has categorized its other real estate as Level 3.

In addition, mortgage loans held for sale not electing the fair value option are required to be measured at the lower of cost or fair value. The fair value of these loans is based upon binding quotes or bids from third party investors. As of December 31, 2017, all mortgage loans held for sale not electing the fair value option were recorded at cost.



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## Fair Value of Financial Instruments not Recorded at Fair Value

The carrying amount, estimated fair value and the level of the fair value hierarchy of the Company's financial instruments not recorded at fair value were as follows at September 30, 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) |
| September 30, 2018                              |                 |                      |  |   |   |
| Financial assets:                               |                 |                      |  |   |   |
| Cash and cash equivalents                       | \$290,170       | \$290,170            | \$290,170  | \$ —  | —   |
| Certificates of deposit held in other banks     | 1,225           | 1,235                | —  | 1,235   | —   |
| Loans held for sale, at cost                    | 11,766          | 12,056               | —  | 12,056  | —   |
| Loans, net                                      | 7,658,989       | 7,726,538            | —  | 7,722,455                                     | 4,083                                     |
| FHLB of Dallas stock and other restricted stock | 26,617          | 26,617               | —  | 26,617  | —   |
| Accrued interest receivable                     | 23,492          | 23,492               | —  | 23,492  | —   |
| Financial liabilities:                          |                 |                      |  |   |   |
| Deposits  | 7,782,852       | 7,795,883            | —  | 7,795,883                                     | —   |
| Accrued interest payable                        | 4,911           | 4,911                | —  | 4,911   | —   |
| FHLB advances                                   | 345,000         | 341,463              | —  | 341,463                                       | —   |
| Other borrowings                                | 137,207         | 143,850              | —  | 143,850                                       | —   |
| Junior subordinated debentures                  | 27,803          | 29,586               | —  | 29,586  | —   |
| 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  | —   |
| Loans held for sale, at cost                    | 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                                       | —   |
| 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

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

Loans: Pursuant to the adoption of ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, for loan values reported for the 2018 period, a discounted cash flow model is used to estimate the fair value of the loans. 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. Loans reported prior to 2018 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.

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.



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## Independent Bank Group, Inc. and Subsidiaries

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## Note 8. Derivative Financial Instruments

The Company enters into certain derivative financial instruments as part of its hedging strategy. These financial instruments are not designated as hedging instruments and are used for asset and liability management related to the Company's mortgage banking activities and commercial customers' financing needs. All derivatives are carried at fair value in either other assets or other liabilities.

Through the normal course of business, the Company enters into interest rate lock commitments with consumers to originate mortgage loans at a specified interest rate. These commitments, which contain fixed expiration dates, offer the borrower an interest rate guarantee provided the loan meets underwriting guidelines and closes within the timeframe established by the Company.

During July 2018, the Company began managing the changes in fair value associated with changes in interest rates related to interest rate lock commitments by using forward sold commitments known as forward mortgage-backed securities trades. These instruments are typically entered into at the time the interest rate lock commitment is made. The Company also offers certain derivatives products, primarily interest rate swaps, directly to qualified commercial banking customers to facilitate their risk management strategies. The interest rate swap derivative positions relate to transactions in which the Company enters into an interest rate swap with a customer, while at the same time entering into an offsetting interest rate swap with another financial institution. An interest rate swap transaction allows customers to effectively convert a variable rate loan to a fixed rate. In connection with each swap, the Company agrees to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a similar notional amount at a fixed interest rate. At the same time, the Company agrees to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. These products were not significant for disclosure in prior periods.

The following table provides the outstanding notional balances and fair values of outstanding derivative positions at September 30, 2018:

|   | September 30, 2018                 |                                   |                                       |
|---|------------------------------------|-----------------------------------|---------------------------------------|
|   | Outstanding<br>Notional<br>Balance | Asset<br>Derivative<br>Fair Value | Liability<br>Derivative<br>Fair Value |
| Interest rate lock commitments            | \$25,309                           | \$ 906                            | \$ —                                  |
| Forward mortgage-backed securities trades | 27,500                             | 110                               | —                                     |
| Commercial loan interest rate swaps:      |                                    |                                   |                                       |
| Loan customer counterparty                | 25,133                             | 72                                | 441                                   |
| Financial institution counterparty        | 25,133                             | 443                               | 86                                    |

The initial and subsequent changes in the fair value of interest rate lock commitments and the forward sales of mortgage-back securities are recorded in mortgage banking revenue. These gains and losses were not attributable to instrument-specific credit risk. For interest rate swaps, because the Company acts as an intermediary for our customer, changes in the fair value of the underlying derivative contracts substantially offset each other and do not have a material impact on the results of operations. The credit exposure related to interest rate swaps is limited to the net favorable value of all swaps by each counterparty, which was approximately \$515 at September 30, 2018.

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Income for the three and nine months ended September 30, 2018 and 2017 was as follows:

|   | Three<br>Months<br>Ended<br>September<br>30,<br>2018 | Nine<br>Months<br>Ended<br>September<br>30,<br>2018 |
|---|--|---|
| Derivatives not designated as hedging instruments |  |   |
| Interest rate lock commitments                    | \$ 906   | \$ 906  |
| Forward mortgage-backed securities trades         | 110  | 110   |

## Note 9. Stock Awards and Stock Warrants

The Company grants common stock awards to certain employees of the Company. The common stock issued prior to 2013 vests five years from the date the award is granted and the related compensation expense is recognized over the vesting period. In connection with the 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. In May 2018, the shareholders of the Company voted to amend the plan to increase the reserved shares of common stock to be awarded by the Company's compensation committee by 1,500,000 for a total of 2,300,000 reserved shares. 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. Shares granted under a previous plan prior to 2012 and those in and subsequent to 2013 under the 2013 Equity Incentive Plan were issued at the date of grant and receive dividends. Shares issued under a revised plan in 2012 are not outstanding shares of the Company until they vest and do not receive dividends. All stock awards issued under expired plans prior to 2013 are fully vested. During the nine months ended September 30, 2017, 24,160 shares that were issued under the 2012 Plan vested during the period.

The following table summarizes the activity in nonvested shares for the nine months ended September 30, 2018 and 2017:

|                                      | Number<br>of<br>Shares | Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value |
|--------------------------------------|------------------------|---|
| Nonvested shares, December 31, 2017  | 242,056                | \$ 49.17  |
| Granted during the period            | 127,712                | 72.09   |
| Vested during the period             | (111,520)              | 44.33   |
| Forfeited during the period          | (3,845 )               | 64.47   |
| Nonvested shares, September 30, 2018 | 254,403                | \$ 62.57  |
| Nonvested shares, December 31, 2016  | 280,524                | \$ 36.88  |
| Granted during the period            | 102,570                | 61.90   |
| Vested during the period             | (135,220)              | 34.10   |
| Forfeited during the period          | (67 )                  | 29.91   |



Nonvested shares, September 30, 2017 247,807 \$ 48.76

Compensation expense related to these awards is recorded based on the fair value of the award at the date of grant and totaled \$1,541 and \$4,496 for the three and nine months ended September 30, 2018, respectively, and \$1,276 and \$3,442 for the three and nine months ended September 30, 2017, respectively. Compensation expense is recorded in salaries and employee benefits in the accompanying consolidated statements of income. At September 30, 2018, future compensation expense is estimated to be \$12,603 and will be recognized over a remaining weighted average period of 3.25 years.

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## Independent Bank Group, Inc. and Subsidiaries

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The fair value of common stock awards that vested during the nine months ended September 30, 2018 and 2017 was \$7,960 and \$8,243, respectively. The Company recorded \$19 and \$632 in excess tax benefits on vested restricted stock to income tax expense for the three and nine months ended September 30, 2018, respectively, and \$28 and \$1,272 for the three and nine months ended September 30, 2017, respectively.

At September 30, 2018, the future vesting schedule of the nonvested shares is as follows:

|                        |         |
|------------------------|---------|
| First year             | 105,017 |
| Second year            | 60,910  |
| Third year             | 45,020  |
| Fourth year            | 26,076  |
| Fifth year             | 17,380  |
| Total nonvested shares | 254,403 |

The Company has warrants outstanding representing the right to purchase 120,434 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 nine months ended September 30, 2018, warrants to purchase 26,907 shares of common stock were exercised and have been issued by the Company.

## Note 10. Regulatory Matters

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

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

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.

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Notes to Consolidated Financial Statements (unaudited)

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

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 September 30, 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 September 30, 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 that management believes have changed the Bank's category. The actual capital amounts and ratios of the Company and Bank as of September 30, 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  |
| September 30, 2018                            |             |        |                                       |       |  |        |
| Total capital to risk weighted assets:        |             |        |                                       |       |  |        |
| Consolidated                                  | \$1,035,054 | 12.49% | \$662,873                             | 8.00% | N/A  | N/A    |
| Bank  | 1,018,223   | 12.30  | 662,166                               | 8.00  | \$827,708  | 10.00% |
| Tier 1 capital to risk weighted assets:       |             |        |                                       |       |  |        |
| Consolidated                                  | 852,888     | 10.29  | 497,155                               | 6.00  | N/A  | N/A    |
| Bank  | 976,057     | 11.79  | 496,625                               | 6.00  | 662,166  | 8.00   |
| Common equity tier 1 to risk weighted assets: |             |        |                                       |       |  |        |
| Consolidated                                  | 822,288     | 9.92   | 372,866                               | 4.50  | N/A  | N/A    |
| Bank  | 976,057     | 11.79  | 372,468                               | 4.50  | 538,010  | 6.50   |
| Tier 1 capital to average assets:             |             |        |                                       |       |  |        |
| Consolidated                                  | 852,888     | 9.20   | 370,764                               | 4.00  | N/A  | N/A    |
| Bank  | 976,057     | 10.54  | 370,469                               | 4.00  | 463,086  | 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   |



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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 11. Business Combinations

Guaranty Bancorp

On May 22, 2018, the Company announced that it entered into a definitive agreement with Guaranty Bancorp (GBNK) and its subsidiary, Guaranty Bank and Trust Company (Guaranty Bank), which operates its main office in Denver, Colorado and has 32 branches located in the Denver and Colorado Front Range areas. Pursuant to the agreement, GBNK will merge with and into the Company in an all-stock transaction. Upon completion of the merger, Guaranty Bank will be merged with and into the Bank. Under the terms of the merger agreement, shareholders of GBNK will receive 0.45 shares of the Company's common stock for each share of GBNK common stock. The merger has been approved by the Boards of Directors and shareholders of both companies and is expected to close at the end of 2018, although delays may occur. The transaction is subject to customary regulatory approvals.

Integrity Bancshares, Inc.

On June 1, 2018, the Company acquired 100% of the outstanding stock of Integrity Bancshares, Inc. and its subsidiary, Integrity Bank, SSB, Houston, Texas (Integrity) with four branches located in Houston, TX. The Company issued 2,071,981 shares of Company stock and paid \$31,016 in cash for the outstanding shares and options of Integrity common stock.

The Company recognized total goodwill of \$100,326, which is calculated as the excess of both the consideration exchanged and liabilities assumed compared to the fair market value of identifiable assets acquired. The fair value of consideration exchanged related to the Company's stock was calculated based upon the closing market price of the Company's stock as of June 1, 2018. The goodwill in this acquisition resulted from a combination of expected synergies and expansion in the Houston market. None of the goodwill recognized is expected to be deductible for income tax purposes.

The Company has incurred expenses related to the acquisition of approximately \$1,100 and \$2,396 for the three and nine months ended September 30, 2018, respectively, which are included in acquisition expense in the consolidated statements of income. The Company incurred expenses of \$360 during the year ended December 31, 2017. In addition, for the nine months ended September 30, 2018, the Company paid offering costs totaling \$209 which were recorded as a reduction to stock issuance proceeds through additional paid in capital.

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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)

Fair values of the assets acquired and liabilities assumed as of the closing date and subsequent measurement period adjustments are as follows:

|  | Initially<br>Recorded at<br>Acquisition<br>Date | Measurement<br>Period<br>Adjustments | Adjusted<br>Values |
|--|---|--------------------------------------|--------------------|
| Assets of acquired bank:                 |   |                                      |                    |
| Cash and cash equivalents                | \$ 44,723                                       | \$ —                                 | \$44,723           |
| Securities available for sale            | 24,726  | (5 )                                 | 24,721             |
| Restricted stock                         | 3,357   | —                                    | 3,357              |
| Loans                                    | 651,722   | 47                                   | 651,769            |
| Premises and equipment                   | 4,800   | 63                                   | 4,863              |
| Goodwill                                 | 100,120   | 206                                  | 100,326            |
| Core deposit intangible                  | 7,532   | —                                    | 7,532              |
| Bank owned life insurance                | 8,181   | —                                    | 8,181              |
| Other assets                             | 6,416   | (23 )                                | 6,393              |
| Total assets acquired                    | \$ 851,577                                      | \$ 288                               | \$851,865          |
| Liabilities of acquired bank:            |   |                                      |                    |
| Deposits                                 | \$ 593,078                                      | \$ —                                 | \$593,078          |
| FHLB advances                            | 60,000  | —                                    | 60,000             |
| Other liabilities                        | 10,220  | 288                                  | 10,508             |
| Total liabilities assumed                | \$ 663,298                                      | \$ 288                               | \$663,586          |
| Common stock issued at \$75.90 per share | \$ 157,263                                      | \$ —                                 | \$157,263          |
| Cash paid                                | \$ 31,016                                       | \$ —                                 | \$31,016           |

The nature of the measurement period adjustments noted in the table above was a result of information obtained subsequent to our initial reporting of provisional fair values but prior to finalizing our fair values as of September 30, 2018. Such information was determined to be a condition in existence as of acquisition date. The income effects resulting from the recorded measurement period adjustments during the period ending September 30, 2018 are immaterial for separate disclosure.

Non-credit impaired loans had a fair value of \$604,549 at acquisition date and contractual balance of \$609,675. As of acquisition date, the Company expects that an insignificant amount of the contractual balance of these loans will be uncollectible. The difference of \$5,126 will be recognized into interest income as an adjustment to yield over the life of the loans.

The acquisition is not considered significant to the Company's financial statements and therefore, pro-forma financial data is not included.

## Note 12. Subsequent Events

## Line of Credit Amendment

On October 20, 2018, the Company's unsecured line of credit with one unrelated commercial bank was amended to extend the termination date. The line bears interest at LIBOR plus 2.5% and matures on January 29, 2019. As of September 30, 2018, there were no advances outstanding on this line.





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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)

Declaration of Dividends

On October 24, 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 November 5, 2018. The dividend will be paid on November 15, 2018.

Share Repurchase Program

On October 24, 2018, the Company announced the reestablishment of its share repurchase program. The program authorizes the repurchase by the Company of up to \$75,000 of its common stock. The repurchase program is authorized to continue through October 1, 2019. No shares have been repurchased by the Company under this program through the date of this report.

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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 and other related federal securities laws. 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,” “projection,” “will affect,” “will be,” “will continue,” “will decrease,” “will grow,” “will impact,” “will increase,” “will incur,” “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;
- 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;

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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 or 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, 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;

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

the other factors that are described or referenced in Part I, Item 1A. of our Annual Report on Form 10-K or our Quarterly Reports on Form 10-Q, in each case 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 September 30, 2018, the Company operated 73 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](http://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 banking 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

**Acquisitions.** The Company completed the acquisition of Integrity Bancshares, Inc., a Texas corporation and its subsidiary, Integrity Bank, SSB, Houston, Texas (Integrity), a Texas state savings bank on June 1, 2018. The Company acquired four new locations as part of the transaction, representing an expansion in the Houston metropolitan area. This acquisition increased total assets by \$851.9 million, gross loans by \$651.8 million and deposits by \$593.1 million.

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 and nine months ended September 30, 2018 and 2017 are affected by these acquisitions.

### Pending Acquisition

**Guaranty Bancorp.** On May 22, 2018, the Company announced that it entered into a definitive agreement with Guaranty Bancorp (GBNK) and its subsidiary, Guaranty Bank and Trust Company (Guaranty Bank), which operates its main office in Denver, Colorado and has 32 branches located in the Denver and Colorado Front Range areas. Pursuant to the agreement, GBNK will merge with and into the Company in an all-stock transaction. Upon completion

of the merger, Guaranty Bank will be merged with and into the Bank. Under the terms of the merger agreement, shareholders of GBNK will receive 0.45 shares of the Company's common stock for each share of GBNK common stock. The merger has been approved by the Boards of Directors and shareholders of both companies and is expected to close at the end of 2018, although delays may occur. The transaction is subject to customary regulatory approvals.

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Discussion and Analysis of Results of Operations for the Three and Nine Months Ended September 30, 2018 and 2017

The following discussion and analysis of our results of operations compares the operations for the three and nine months ended September 30, 2018 with the three and nine months ended September 30, 2017. The results of operations for the three and nine months ended September 30, 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 September 30, 2018, net income was \$35.7 million (\$1.17 per common share on a diluted basis) compared with net income of \$23.5 million (\$0.84 per common share on a diluted basis) for the three months ended September 30, 2017. The Company posted annualized returns on average equity of 9.11% and 7.33%, returns on average assets of 1.41% and 1.07% and efficiency ratios of 51.64% and 54.71% for the three months ended September 30, 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.

For the nine months ended September 30, 2018, net income was \$94.3 million (\$3.21 per common share on a diluted basis) compared with \$57.3 million (\$2.30 per common share on a diluted basis) for the nine months ended September 30, 2017. The Company posted annualized returns on average common equity of 8.75% and 7.16%, returns on average assets of 1.36% and 0.99% and efficiency ratios of 52.50% and 56.88% for the nine months ended September 30, 2018 and 2017, respectively.

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 \$86.3 million for the three months ended September 30, 2018, an increase of \$13.4 million, or 18.4%, from \$72.9 million for the three months ended September 30, 2017. This increase is due primarily to a \$1.2 billion increase, or 15.6%, in average interest earning assets to \$8.7 billion for the three months ended September 30, 2018 compared to \$7.5 billion for the three months ended September 30, 2017. The increase in interest-earning assets is attributable to organic growth as well as the earning assets acquired in the Integrity transaction. The average yield on interest earning assets increased 52 basis points from 4.47% for the three months ended September 30, 2017 to 4.99% for the three months ended September 30, 2018. The increase from the prior year is due primarily to higher rates on interest-earning assets due to continued increases in the Fed Funds rate for the year over year period as well as loans and taxable securities acquired in the Integrity transaction, which had higher effective interest rates. The average cost of interest-bearing liabilities increased 63 basis points to 1.47% for the three months ended September 30, 2018 compared to 0.84% for the three months ended September 30, 2017. The increase is primarily due to higher rates offered on our deposits, primarily commercial money market accounts and certificates of deposit, resulting from both market competition and the increased interest rates on deposit products tied to Fed Funds rates. In addition, rate increases on short-term FHLB advances and junior subordinated debt impacted net interest income. The aforementioned changes resulted in a nine basis point increase in the net interest margin for the three months ended September 30, 2018 at 3.94% compared to 3.85% for the three months ended September 30, 2017.

Net interest income was \$239.1 million for the nine months ended September 30, 2018, an increase of \$48.9 million, or 25.7%, from \$190.2 million for the nine months ended September 30, 2017. This increase is due primarily to a \$1.3 billion increase, or 19.9%, in average interest earning assets to \$8.1 billion for the nine months ended September 30, 2018 compared to \$6.7 billion for nine months ended September 30, 2017. The increases in average interest-earning



assets is due to organic growth and the result of the Carlile acquisition in April 2017 and the Integrity acquisition completed in June 2018. The net interest margin for the nine months ended September 30, 2018 increased 18 basis points to 3.97% compared to 3.79% for the nine months ended September 30, 2017. The increase from prior year is primarily due to an increase in loan yields of 37 basis points which is reflective of higher effective interest rates on organic and acquired loans, as well as higher loan accretion income on acquired loans for the year over year period. The increase is also a result of a shift in the earning asset mix from interest-bearing deposits to higher yielding loans in addition to higher interest rates on securities and interest-bearing deposits. The average yield on interest earning assets increased 50 basis points from 4.39% for the nine months ended September 30, 2017 to 4.89% for the nine months ended September 30, 2018 while the average rate paid on interest bearing liabilities increased 47 basis points from 0.80% to 1.27% over the same period.

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Average Balance Sheet Amounts, Interest Earned and Yield Analysis. The following table presents average balance sheet information, interest income, interest expense and the corresponding average yields earned and rates paid for the three and nine months ended September 30, 2018 and 2017. The average balances are principally daily averages and, for loans, include both performing and nonperforming balances.

|  | Three Months Ended September 30, |           |                           |                             |          |                           |
|--|----------------------------------|-----------|---------------------------|-----------------------------|----------|---------------------------|
|  | 2018                             |           |                           | 2017                        |          |                           |
|  | Average Outstanding Balance      | Interest  | Yield/Rate <sup>(3)</sup> | Average Outstanding Balance | Interest | Yield/Rate <sup>(3)</sup> |
| (dollars in thousands)   |                                  |           |                           |                             |          |                           |
| Interest-earning assets:   |                                  |           |                           |                             |          |                           |
| Loans <sup>(1)</sup>   | \$7,667,237                      | \$103,104 | 5.34 %                    | \$6,286,990                 | \$79,325 | 5.01 %                    |
| Taxable securities   | 628,873                          | 3,840     | 2.42                      | 576,770                     | 2,539    | 1.75                      |
| Nontaxable securities  | 172,556                          | 1,103     | 2.54                      | 188,053                     | 1,124    | 2.37                      |
| Interest-bearing deposits and other                                  | 218,104                          | 1,242     | 2.26                      | 461,092                     | 1,684    | 1.45                      |
| Total interest-earning assets  | 8,686,770                        | \$109,289 | 4.99                      | 7,512,905                   | \$84,672 | 4.47                      |
| Noninterest-earning assets   | 1,341,454                        |           |                           | 1,213,942                   |          |                           |
| Total assets   | \$10,028,224                     |           |                           | \$8,726,847                 |          |                           |
| Interest-bearing liabilities:  |                                  |           |                           |                             |          |                           |
| Checking accounts  | \$2,986,694                      | \$7,380   | 0.98                      | \$2,864,775                 | \$4,102  | 0.57                      |
| Savings accounts   | 296,941                          | 212       | 0.28                      | 306,380                     | 104      | 0.13                      |
| Money market accounts  | 1,069,013                        | 5,226     | 1.94                      | 619,051                     | 1,459    | 0.94                      |
| Certificates of deposit  | 1,128,540                        | 4,562     | 1.60                      | 1,074,883                   | 2,368    | 0.87                      |
| Total deposits   | 5,481,188                        | 17,380    | 1.26                      | 4,865,089                   | 8,033    | 0.66                      |
| FHLB advances  | 587,537                          | 3,121     | 2.11                      | 541,129                     | 1,749    | 1.28                      |
| Repurchase agreements and other borrowings                           | 137,286                          | 2,100     | 6.07                      | 123,285                     | 1,716    | 5.52                      |
| Junior subordinated debentures                                       | 27,786                           | 420       | 6.00                      | 27,587                      | 317      | 4.56                      |
| Total interest-bearing liabilities                                   | 6,233,797                        | 23,021    | 1.47                      | 5,557,090                   | 11,815   | 0.84                      |
| Noninterest-bearing checking accounts                                | 2,206,612                        |           |                           | 1,863,971                   |          |                           |
| Noninterest-bearing liabilities                                      | 33,313                           |           |                           | 33,836                      |          |                           |
| Stockholders' equity   | 1,554,502                        |           |                           | 1,271,950                   |          |                           |
| Total liabilities and equity   | \$10,028,224                     |           |                           | \$8,726,847                 |          |                           |
| Net interest income  |                                  | \$86,268  |                           |                             | \$72,857 |                           |
| Interest rate spread   |                                  |           | 3.53 %                    |                             |          | 3.63 %                    |
| Net interest margin <sup>(2)</sup>                                   |                                  |           | 3.94                      |                             |          | 3.85                      |
| Net interest income and margin (tax equivalent basis) <sup>(4)</sup> |                                  | \$86,732  | 3.96                      |                             | \$73,148 | 3.86                      |
| Average interest earning assets to interest bearing liabilities      |                                  |           | 139.35                    |                             |          | 135.19                    |

(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 September 30, 2018 and 2017, respectively.



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|  | Nine Months Ended September 30, |           |                     |   |             |           |                     |   |
|--|---------------------------------|-----------|---------------------|---|-------------|-----------|---------------------|---|
|  | 2018                            |           |                     |   | 2017        |           |                     |   |
|  | Average                         |           | Yield/              |   | Average     |           | Yield/              |   |
|  | Outstanding                     | Interest  | Rate <sup>(3)</sup> |   | Outstanding | Interest  | Rate <sup>(3)</sup> |   |
|  | Balance                         |           |                     |   | Balance     |           |                     |   |
| (dollars in thousands)   |                                 |           |                     |   |             |           |                     |   |
| Interest-earning assets:   |                                 |           |                     |   |             |           |                     |   |
| Loans <sup>(1)</sup>   | \$7,083,329                     | \$277,993 | 5.25                | % | \$5,701,324 | \$208,263 | 4.88                | % |
| Taxable securities   | 607,591                         | 10,244    | 2.25                |   | 452,317     | 5,606     | 1.66                |   |
| Nontaxable securities  | 181,614                         | 3,475     | 2.56                |   | 144,132     | 2,657     | 2.46                |   |
| Interest-bearing deposits and other                                  | 181,234                         | 2,773     | 2.05                |   | 420,330     | 3,968     | 1.26                |   |
| Total interest-earning assets  | 8,053,768                       | \$294,485 | 4.89                |   | 6,718,103   | \$220,494 | 4.39                |   |
| Noninterest-earning assets   | 1,240,761                       |           |                     |   | 990,811     |           |                     |   |
| Total assets   | \$9,294,529                     |           |                     |   | \$7,708,914 |           |                     |   |
| Interest-bearing liabilities:  |                                 |           |                     |   |             |           |                     |   |
| Checking accounts  | \$2,962,162                     | \$18,555  | 0.84                |   | \$2,510,550 | \$8,828   | 0.47                |   |
| Savings accounts   | 287,176                         | 462       | 0.22                |   | 255,602     | 267       | 0.14                |   |
| Money market accounts  | 898,260                         | 11,737    | 1.75                |   | 610,819     | 4,451     | 0.97                |   |
| Certificates of deposit  | 966,769                         | 9,252     | 1.28                |   | 1,025,997   | 6,497     | 0.85                |   |
| Total deposits   | 5,114,367                       | 40,006    | 1.05                |   | 4,402,968   | 20,043    | 0.61                |   |
| FHLB advances  | 545,420                         | 7,854     | 1.93                |   | 487,820     | 4,271     | 1.17                |   |
| Repurchase agreements and other borrowings                           | 137,641                         | 6,299     | 6.12                |   | 118,331     | 5,137     | 5.80                |   |
| Junior subordinated debentures                                       | 27,736                          | 1,182     | 5.70                |   | 24,448      | 819       | 4.48                |   |
| Total interest-bearing liabilities                                   | 5,825,164                       | 55,341    | 1.27                |   | 5,033,567   | 30,270    | 0.80                |   |
| Noninterest-bearing checking accounts                                | 2,004,763                       |           |                     |   | 1,578,061   |           |                     |   |
| Noninterest-bearing liabilities                                      | 23,694                          |           |                     |   | 26,234      |           |                     |   |
| Stockholders' equity   | 1,440,908                       |           |                     |   | 1,071,052   |           |                     |   |
| Total liabilities and equity   | \$9,294,529                     |           |                     |   | \$7,708,914 |           |                     |   |
| Net interest income  |                                 | \$239,144 |                     |   |             | \$190,224 |                     |   |
| Interest rate spread   |                                 |           | 3.62                | % |             |           | 3.59                | % |
| Net interest margin <sup>(2)</sup>                                   |                                 |           | 3.97                |   |             |           | 3.79                |   |
| Net interest income and margin (tax equivalent basis) <sup>(4)</sup> |                                 | \$240,477 | 3.99                |   |             | \$192,136 | 3.82                |   |
| Average interest earning assets to interest bearing liabilities      |                                 |           | 138.26              |   |             |           | 133.47              |   |

(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 nine month periods are annualized.

(4) A tax-equivalent adjustment has been computed using a federal income tax rate of 21% and 35% for the nine months ended September 30, 2018 and 2017, respectively.



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## 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 \$1.5 million provision for loan losses for the three months ended September 30, 2018 compared to \$1.9 million for the comparable period in 2017. Provision expense for the nine months ended September 30, 2018 was \$7.0 million compared to \$6.4 million for the same 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 (recoveries) were \$2.7 million and \$(16) thousand for the three months ended September 30, 2018 and 2017, respectively, and \$4.2 million and \$189 thousand for the nine months ended September 30, 2018 and 2017, respectively. The increase in net charge-offs for the nine months ended September 30, 2018 was primarily related to a third quarter 2018 partial charge-off of an energy loan relationship totaling \$2.5 million in addition to second quarter 2018 partial charge-offs totaling \$1.3 million related to a commercial real estate loan and two commercial loans.

## Noninterest Income

The following table sets forth the components of noninterest income for the three and nine months ended September 30, 2018 and 2017 and the period-over-period variations in such categories of noninterest income:

|  | Three Months             |          |                       | Nine Months              |          |                       |
|--|--------------------------|----------|-----------------------|--------------------------|----------|-----------------------|
|  | Ended September 30, 2018 | 2017     | Variance 2018 v. 2017 | Ended September 30, 2018 | 2017     | Variance 2018 v. 2017 |
| (dollars in thousands)                               | 2018                     | 2017     | 2018 v. 2017          | 2018                     | 2017     | 2018 v. 2017          |
| Noninterest Income                                   |                          |          |                       |                          |          |                       |
| Service charges on deposit accounts                  | \$3,589                  | \$3,677  | \$(88) (2.4)%         | \$10,607                 | \$9,364  | \$1,243 13.3%         |
| Mortgage banking revenue                             | 5,111                    | 4,569    | 542 11.9              | 12,134                   | 10,855   | 1,279 11.8            |
| Gain on sale of loans                                | —                        | 351      | (351) (100.0)         | —                        | 351      | (351) (100.0)         |
| Loss on sale of branch                               | —                        | (127)    | 127 N/M               | —                        | (127)    | 127 N/M               |
| Gain (loss) on sale of other real estate             | 95                       | —        | 95 N/M                | 213                      | (36)     | 249 N/M               |
| (Loss) gain on sale of securities available for sale | (115)                    | —        | (115) N/M             | (349)                    | 52       | (401) N/M             |
| Gain (loss) on sale of premises and equipment        | 220                      | (21)     | 241 N/M               | 123                      | (15)     | 138 N/M               |
| Increase in cash surrender value of BOLI             | 831                      | 778      | 53 6.8                | 2,328                    | 1,959    | 369 18.8              |
| Other  | 3,018                    | 2,903    | 115 4.0               | 7,281                    | 5,305    | 1,976 37.2            |
| Total noninterest income                             | \$12,749                 | \$12,130 | \$619 5.1%            | \$32,337                 | \$27,708 | \$4,629 16.7%         |

N/M - not meaningful

Total noninterest income increased \$619 thousand, or 5.1% and increased \$4.6 million, or 16.7% for the three and nine months ended September 30, 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 decreased \$88 thousand, or 2.4% and increased \$1.2 million, or 13.3% for the three and nine months ended September 30, 2018, respectively, as compared to the same period in 2017. The increase in service charge income for the nine months ended September 30, 2018 compared to the same period in 2017 reflects an increase in deposit accounts due to organic growth, the acquisition of

Integrity in June 2018, as well as three quarters of income in 2018 from the Carlile accounts compared to two quarters in 2017.

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Mortgage banking revenue. Mortgage banking revenue for the three and nine months ended September 30, 2018 increased \$542 thousand, or 11.9% and increased \$1.3 million, or 11.8%, respectively, compared to the same period in 2017. The increase in the comparable three and nine month periods is reflective of the mortgage hedging strategy initiated in July 2018 which generated \$1.6 million of income during third quarter 2018. This increase was offset by a decrease in mortgage sales volume for the respective periods resulting from a decrease in market demand related to rising interest rates over the same period.

Gain on sale of loans. The Company recognized a net gain of \$351 thousand on the sale of loans for the three and nine months ended September 30, 2017 primarily due to the sale of an acquired loan that resulted in a \$312 thousand gain.

Loss on sale of securities available for sale. The Company recognized a loss of \$349 thousand on the sale of securities available for sale for the nine months ended September 30, 2018. The majority of the loss is due to the sale of a CRA equity fund in first quarter 2018 in addition to normal sales activity.

Increase in cash surrender value of BOLI. The increase in cash surrender value of BOLI increased \$369 thousand, or 18.8% for the nine months ended September 30, 2018, as compared to the same period in 2017. The increase is primarily a result of three quarters of income in 2018 from the \$53.2 million in policies acquired in the April 2017 Carlile transaction compared to two quarters of income in 2017.

Other. Other noninterest income increased \$115 thousand, or 4.0% and \$2.0 million, or 37.2% for the three and nine months ended September 30, 2018, respectively, as compared to the same period in 2017. The increase from prior year is primarily related to increased earnings credits on correspondent accounts as well as an increase in fee income on the mortgage warehouse purchase program acquired with the acquisition of Carlile.

Noninterest Expense

Noninterest expense increased \$4.8 million, or 9.9% and increased \$19.5 million, or 15.3% for the three and nine months ended September 30, 2018, respectively, as compared to the same period in 2017. The following table sets forth the components of the Company's noninterest expense for the three and nine months ended September 30, 2018 and 2017 and the period-over-period variations in such categories of noninterest expense:

|                                       | Three Months  |          |              |         | Nine Months     |           |              |        |
|---------------------------------------|---------------|----------|--------------|---------|-----------------|-----------|--------------|--------|
|                                       | Ended         |          | Variance     |         | Ended September |           | Variance     |        |
| (dollars in thousands)                | September 30, |          | 2018 v. 2017 |         | 30,             |           | 2018 v. 2017 |        |
|                                       | 2018          | 2017     | 2018         | 2017    | 2018            | 2017      | 2018         | 2017   |
| Noninterest Expense                   |               |          |              |         |                 |           |              |        |
| Salaries and employee benefits        | \$30,114      | \$25,684 | \$4,430      | 17.2 %  | \$82,072        | \$69,610  | \$12,462     | 17.9 % |
| Occupancy                             | 6,613         | 6,380    | 233          | 3.7     | 18,295          | 16,399    | 1,896        | 11.6   |
| Data processing                       | 2,989         | 2,546    | 443          | 17.4    | 7,861           | 6,449     | 1,412        | 21.9   |
| FDIC assessment                       | 760           | 1,077    | (317)        | (29.4)  | 2,213           | 3,156     | (943)        | (29.9) |
| Advertising and public relations      | 583           | 380      | 203          | 53.4    | 1,300           | 994       | 306          | 30.8   |
| Communications                        | 810           | 771      | 39           | 5.1     | 2,544           | 2,098     | 446          | 21.3   |
| Other real estate owned expenses, net | 62            | 61       | 1            | 1.6     | 271             | 223       | 48           | 21.5   |
| Impairment of other real estate       | —             | 917      | (917)        | (100.0) | 85              | 1,037     | (952)        | (91.8) |
| Core deposit intangible amortization  | 1,519         | 1,409    | 110          | 7.8     | 4,243           | 3,311     | 932          | 28.1   |
| Professional fees                     | 1,175         | 1,273    | (98)         | (7.7)   | 3,427           | 3,212     | 215          | 6.7    |
| Acquisition expense, including legal  | 1,682         | 2,428    | (746)        | (30.7)  | 5,671           | 8,247     | (2,576)      | (31.2) |
| Other                                 | 6,348         | 4,978    | 1,370        | 27.5    | 18,789          | 12,524    | 6,265        | 50.0   |
| Total noninterest expense             | \$52,655      | \$47,904 | \$4,751      | 9.9 %   | \$146,771       | \$127,260 | \$19,511     | 15.3 % |

Salaries and employee benefits. Salary and employee benefits increased \$4.4 million, or 17.2% and increased \$12.5 million, or 17.9% for the three and nine months ended September 30, 2018, respectively, compared to the same period in 2017. Salary and employee benefit expenses increased for the comparative three months due to additional headcount related to both the Integrity acquisition as well as organic growth during the year. The increase in the comparative nine month periods is primarily due to an increase in the number of the Company's full-time equivalent



employees due to the Carlile acquisition for three quarters in 2018 as compared to two quarters in 2017, in addition to increased employees related to organic growth within the Company and the Integrity acquisition from the year over year period.

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Occupancy. Occupancy expense increased \$1.9 million, or 11.6% for the nine months ended September 30, 2018 compared to the same period in 2017. The increase is primarily reflective of three quarters of expenses in 2018 related to the additional branches acquired in the Carlile transaction in April 2017 compared to two quarters of expenses in 2017, as well as the additional branches added with the Integrity transaction in June 2018.

Data processing. Data processing expense increased \$443 thousand, or 17.4% and increased \$1.4 million, or 21.9% for the three and nine months ended September 30, 2018 compared to the same period in 2017. Data processing increased for the comparative three months primarily due to additional branches and accounts acquired with the Integrity acquisition. The increase in the comparative nine months is reflective of increased costs for three quarters in 2018 related directly to the Carlile transaction due to the additional accounts, employees and locations added compared to two quarters in 2017, as well as increased costs for the Integrity acquisition.

FDIC assessment. FDIC assessment expense decreased \$317 thousand, or 29.4% and \$943 thousand, or 29.9% for the three and nine months ended September 30, 2018, respectively, compared to the same period in 2017. The decreases in FDIC assessment expense is related to the improvement of certain Bank capital ratios used in the assessment calculation over the same period prior year.

Communications. Communications expense increased \$446 thousand, or 21.3%, for the nine months ended September 30, 2018 compared to the same period in 2017. The increase is reflective of increased costs for three quarters in 2018 related directly to the Carlile transaction due to the added data lines and telecommunications for additional branches and employees compared to two quarters in 2017 as well as additional expenses related to the Integrity acquisition.

Impairment of other real estate. Impairment of other real estate decreased \$952 thousand, or 91.8%, for the nine months ended September 30, 2018 compared to the same period in 2017. The expense was elevated in 2017 due to a \$916 thousand writedown on the Houston branch location that closed during third quarter 2017 and was transferred from bank premises to other real estate owned.

Core deposit intangible amortization. Core deposit intangible amortization increased \$932 thousand, or 28.1% for the nine months ended September 30, 2018 compared to the same period in 2017. The increase reflects three quarters of amortization in 2018 related to the \$36.7 million increase in core deposit intangibles recorded with the Carlile transaction compared to two quarters of expense in 2017 as well the \$7.5 million in core deposit intangibles recorded with the Integrity transaction in June 2018.

Acquisition expenses. Acquisition expenses decreased \$746 thousand, or 30.7%, and \$2.6 million, or 31.2% for the three and nine months ended September 30, 2018, respectively, compared to the same period in 2017. Acquisition expenses were elevated in 2017 due to professional fees and termination and conversion related expenses incurred related to the acquisition of Carlile.

Other noninterest expense. Other noninterest expense increased \$1.4 million, or 27.5% and \$6.3 million, or 50.0% for the three and nine months ended September 30, 2018, respectively, compared to the same period in 2017. The majority of the increase in 2018 over the prior period relates to three quarters of general increases in operations due to additional accounts, employees and locations compared to two quarters of expense as a result of the Carlile transaction in 2017 as well as organic growth within the Company over the prior year period and the Integrity transaction that closed in second quarter 2018.

Income Tax Expense

Income tax expense was \$9.1 million and \$23.5 million for the three and nine months ended September 30, 2018, respectively, and \$11.7 million and \$27.0 million for the same period in 2017. The effective tax rates were 20.4% and 19.9% for the three and nine months ended September 30, 2018, respectively, compared to 33.2% and 32.0% for the same period in 2017. The lower tax rate in 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.



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## Discussion and Analysis of Financial Condition

The following is a discussion and analysis of the Company's financial condition as of September 30, 2018 and December 31, 2017.

## Assets

The Company's total assets increased by \$1.2 billion, or 13.9%, to \$9.9 billion as of September 30, 2018 from \$8.7 billion at December 31, 2017. The increase is primarily due to \$851.9 million in assets acquired with Integrity in addition 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 September 30, 2018 and December 31, 2017:

| (dollars in thousands)                             | September 30, 2018 |         | December 31, 2017 |         |
|--|--------------------|---------|-------------------|---------|
| Commercial <sup>(1)</sup>                          | \$1,313,170        | 17.1 %  | \$1,059,984       | 16.3 %  |
| Real estate:                                       |                    |         |                   |         |
| Commercial   | 3,996,384          | 51.7    | 3,369,892         | 51.7    |
| Commercial construction, land and land development | 920,823            | 11.9    | 744,868           | 11.5    |
| Residential <sup>(2)</sup>                         | 1,038,479          | 13.4    | 931,495           | 14.3    |
| Single family interim construction                 | 357,604            | 4.6     | 289,680           | 4.4     |
| Agricultural                                       | 70,738             | 0.9     | 82,583            | 1.3     |
| Consumer   | 34,648             | 0.4     | 34,639            | 0.5     |
| Other  | 275                | —       | 304               | —       |
|  | 7,732,121          | 100.0 % | 6,513,445         | 100.0 % |
| Deferred loan fees                                 | (3,236 )           |         | (2,568 )          |         |
| Allowance for loan losses                          | (42,166 )          |         | (39,402 )         |         |
| Total loans, net                                   | \$7,686,719        |         | \$6,471,475       |         |

<sup>(1)</sup> Includes mortgage warehouse purchase loans of \$150.3 million and \$164.7 million at September 30, 2018 and December 31, 2017, respectively.

<sup>(2)</sup> Includes mortgage loans held for sale as of September 30, 2018 and December 31, 2017 of \$27.7 million and \$39.2 million, respectively.

Our loan portfolio is the largest category of our earning assets. As of September 30, 2018 and December 31, 2017, total loans, net of allowance for loan losses and deferred fees, totaled \$7.7 billion and \$6.5 billion, respectively, which is an increase of 18.8% between the two dates. The increase is primarily due to \$651.8 million in loans acquired in the Integrity transaction but also 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.



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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.

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.

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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)   | September 30, December 31, |           |
|--|----------------------------|-----------|
|  | 2018                       | 2017      |
| Nonaccrual loans   |                            |           |
| Commercial   | \$ 6,028                   | \$ 10,304 |
| Real estate:   |                            |           |
| Commercial real estate, construction, land and land development                | 2,112                      | 2,716     |
| Residential real estate  | 1,916                      | 998       |
| Agricultural   | —                          | —         |
| Consumer   | 31                         | 55        |
| Total nonaccrual loans <sup>(1)</sup>  | 10,087                     | 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  | —                          | 8         |
| Consumer   | —                          | —         |
| Total loans delinquent 90 days or more and still accruing                      | —                          | 136       |
| Troubled debt restructurings, not included in nonaccrual loans                 |                            |           |
| Real estate:   |                            |           |
| Commercial real estate, construction, land and land development                | 408                        | 455       |
| Residential real estate  | 170                        | 730       |
| Consumer   | —                          | 20        |
| Total troubled debt restructurings, not included in nonaccrual loans           | 578                        | 1,205     |
| Total nonperforming loans  | 10,665                     | 15,414    |
| Other real estate owned and other repossessed assets:                          |                            |           |
| Commercial real estate, construction, land and land development                | 4,610                      | 5,400     |
| Residential real estate  | —                          | 764       |
| Single family interim construction   | —                          | 963       |
| Consumer   | 114                        | 114       |
| Total other real estate owned and other repossessed assets                     | 4,724                      | 7,241     |
| Total nonperforming assets   | \$ 15,389                  | \$ 22,655 |
| Ratio of nonperforming loans to total loans held for investment <sup>(2)</sup> | 0.14                       | % 0.24    |
| Ratio of nonperforming assets to total assets                                  | 0.16                       | 0.26      |

<sup>(1)</sup> Nonaccrual loans include troubled debt restructurings of \$529 thousand and \$1.0 million at September 30, 2018 and December 31, 2017, respectively and excludes loans acquired with deteriorated credit quality of \$9.7 million and \$7.9 million as of September 30, 2018 and December 31, 2017, respectively.

<sup>(2)</sup> Excluding mortgage warehouse purchase loans of \$150.3 million and \$164.7 million as of September 30, 2018 and December 31, 2017, respectively.

Nonaccrual loans decreased to \$10.1 million at September 30, 2018 from \$14.1 million as of December 31, 2017.

Troubled debt restructurings that were not on nonaccrual status totaled \$578 thousand at September 30, 2018 decreasing from \$1.2 million at December 31, 2017. The decrease in nonaccrual loans was primarily due to the disposition of three commercial loans totaling \$3.5 million, one commercial real estate loan totaling \$1.6 million and a

partial charge-off of an energy nonaccrual loan totaling \$2.5 million offset by nine loans placed on nonaccrual status totaling \$3.6 million during the nine months ended September 30, 2018. The net decrease in other real estate owned and repossessed assets is primarily due to \$2.9 million of other real estate dispositions.

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As of September 30, 2018, the Company had a total of 126 substandard and doubtful loans with an aggregate principal balance of \$61.7 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 September 30, 2018, the allowance for loan losses amounted to \$42.2 million, or 0.56% of total loans, compared with \$39.4 million, or 0.62% of total loans as of December 31, 2017. The dollar increase from year end is primarily due to additional general reserves for organic loan growth. The decrease in the allowance for loan losses as a percentage of loans reflects that loans acquired in the Integrity transaction were recorded at fair value without an allowance at acquisition date. As of September 30, 2018, the discount on acquired loans totaled \$29.6 million.

The allowance for loan losses to nonperforming loans has increased from 255.62% at December 31, 2017 to 395.37% at September 30, 2018, due to an increase in the recorded allowance balance as well as a reduction in total nonperforming loans as noted above. Nonperforming loans have decreased to \$10.7 million at September 30, 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 \$115 thousand and \$349 thousand on the sale of securities for the three and nine months ended September 30, 2018, respectively, and a net gain of \$52 thousand on the sale of securities for the nine months ended September 30, 2017. Securities represented 7.7% and 8.8% of the Company's total assets at September 30, 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 September 30, 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 September 30, 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 \$1.6 billion at September 30, 2018 compared with \$1.3 billion at December 31, 2017, an increase of approximately \$231.2 million. The increase was primarily due to stock issued in the Integrity acquisition for a total, net of offering costs, of \$157.1 million as well as net income of \$94.3 million earned by the

Company during the nine months ended September 30, 2018, and stock based compensation of \$4.5 million, offset by an increase of \$13.5 million in unrealized loss on available for sale securities and dividends paid of \$11.6 million.

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As of September 30, 2018, the Company exceeded all capital ratio requirements under prompt corrective action and other regulatory requirements, as detailed in the table below:

|  | As of September 30, 2018        |                         |  |  |
|--|---------------------------------|-------------------------|--|--|
|  | Actual<br>Consolidated<br>Ratio | Actual<br>Bank<br>Ratio | Required to be considered<br>adequately capitalized<br>Ratio | Required to be considered well<br>capitalized (Bank only)<br>Ratio |
| Tier 1 capital to average assets ratio                     | 9.20                            | % 10.54%                | 4.00-5.00%   | ≥5.00%   |
| Common equity tier 1 capital to risk-weighted assets ratio | 9.92                            | 11.79                   | 4.50-6.50  | ≥6.50  |
| Tier 1 capital to risk-weighted assets ratio               | 10.29                           | 11.79                   | 6.00-8.00  | ≥8.00  |
| Total capital to risk-weighted assets ratio                | 12.49                           | 12.30                   | 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 September 30, 2018, the Company had established federal funds lines of credit with 10 unaffiliated banks totaling \$365.0 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 \$164.0 million and none outstanding as of September 30, 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 September 30, 2018, the Company had additional borrowing capacity with the FHLB of \$1.8 billion. In addition, the Company maintains a secured line of credit with the Federal Reserve Bank with an availability to borrow \$692.5 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.

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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 \$50.0 million and expected to be completed in early 2019.

During the nine months ended September 30, 2018, the Company acquired deposit accounts, FHLB advances and assumed the operating lease commitments for three branch locations acquired in the Integrity transaction. In addition, the Company entered into several lease commitments in the normal course of business during the period.

Other than normal changes in the ordinary course of business and the items 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 \$1.7 billion and \$14.2 million, respectively, as of September 30, 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.

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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 September 30, 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 September 30, 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 September 30, 2018:

| Hypothetical Shift in Interest Rates (in bps) | % Change in Projected Net Interest Income |
|---|---|
| 200   | (0.33)%                                   |
| 100   | (0.04)                                    |
| (100)   | 1.09                                      |

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.

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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 September 30, 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.

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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, and 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 filed with the SEC on July 31, 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 filed with the SEC on April 27, 2017
- Exhibit 3.9 Certificate of Merger, dated October 23, 2017, of Washington Investment Company with and into Independent Bank Group, Inc., which is incorporated by reference to Exhibit 3.9 to the Registrant's Current Report on Form 10-Q filed with the SEC on July 26, 2018
- Exhibit 3.10 Certificate of Merger, dated May 31, 2018, of Integrity Bancshares, Inc. with and into Independent Bank Group, Inc., which is incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 10-Q filed with the SEC on July 26, 2018

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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

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 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

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|-------------|---|
| Exhibit 4.4 | <u>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</u> |
| Exhibit 4.5 | <u>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</u>   |
| Exhibit 4.6 | <u>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</u>   |
| Exhibit 4.7 | <u>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 Registrant's Current Report on Form 8 K, dated December 19, 2017)</u>  |

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       | <u>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</u> |
| Exhibit 31.1*     | <u>Chief Executive Officer Section 302 Certification</u>  |
| Exhibit 31.2*     | <u>Chief Financial Officer Section 302 Certification</u>  |
| Exhibit 32.1**    | <u>Chief Executive Officer Section 906 Certification</u>  |
| Exhibit 32.2**    | <u>Chief Financial Officer Section 906 Certification</u>  |
| 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: October 25, 2018 By: /s/ David R. Brooks

David R. Brooks  
Chairman, Chief Executive Officer and President

Date: October 25, 2018 By: /s/ Michelle S. Hickox

Michelle S. Hickox  
Executive Vice President  
Chief Financial Officer