

Independent Bank Group, Inc.
Form 10-K
March 27, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)

ANNUAL REPORT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934

For The Fiscal Year Ended December 31, 2013.

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

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

Independent Bank Group, Inc.
(Exact name of registrant as specified in its charter)

Texas 13-4219346
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1600 Redbud Boulevard, Suite 400 75069-3257
McKinney, Texas
(Address of principal executive offices) (Zip Code)

(972) 562-9004
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on which Registered
Common Stock, par value \$0.01 per share	NASDAQ Stock Market, Inc., Global Select Market System

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained to the best of registrant's knowledge, in definitive proxy or

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information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the shares of common stock held by non-affiliates based on the closing price of the common stock on the NASDAQ Global Market on June 30, 2013 was approximately \$366,775,000 .

At March 25, 2014, the Company had outstanding 12,592,935 shares of common stock, par value \$.01 per share.

Documents Incorporated By Reference:

Portions of the Company’s Proxy Statement relating to the 2014 Annual Meeting of Shareholders, which will be filed within 120 days after December 31, 2013, are incorporated by reference into Part III, Items 10 - 14 of this Annual Report on Form 10-K.

INDEPENDENT BANK GROUP, INC. AND SUBSIDIARIES

Annual Report on Form 10-K

December 31, 2013

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PART I

ITEM 1. BUSINESS

Company. Independent Bank Group, a Texas corporation (the “Company”), is a Texas registered bank holding company headquartered in McKinney, Texas, which is located in the northern portion of the Dallas-Fort Worth metropolitan area. Through the Company’s wholly owned subsidiary, Independent Bank, a Texas state chartered bank, the Company provides a wide range of relationship-driven commercial banking products and services tailored to meet the needs of businesses, professionals and individuals. The Company operates 30 banking offices in 26 communities in two market regions centered in the Dallas-Fort Worth metropolitan area and in the greater Austin area. As of December 31, 2013, the Company had consolidated total assets of approximately \$2.2 billion, total loans of approximately \$1.7 billion, total deposits of approximately \$1.7 billion and total stockholders’ equity of approximately \$234 million.

History. While the origins of Independent Bank go back almost 100 years, the Company began its modern history in 1988 when an investor group led by David Brooks, the Company’s Chairman and Chief Executive Officer, and Vincent Viola, the Company’s largest shareholder, acquired a small bank in a community north of Dallas. The Company was organized as a Texas corporation on September 20, 2002. The Company acquired 100% of the stock of Independent Bank on December 31, 2002. From its first acquisition, the Company has expanded in the Dallas and Austin areas by growing organically and making strategic acquisitions. Effective January 1, 2009, the Company merged Independent Bank Group Central Texas (a separate, but affiliated bank holding company operating in Central Texas) into the Company, forming the foundation of the Company’s current franchise.

The Company’s primary function is and will be to own all of the stock of Independent Bank. Independent Bank is a locally managed community bank that seeks to provide personal attention and professional assistance to its customer base, which consists principally of small to medium sized businesses, professionals and individuals. Independent Bank’s philosophy includes offering direct access to its officers and personnel, providing friendly, informed and courteous service, local and timely decision making, flexible and reasonable operating procedures, and consistently applied credit policies.

Initial Public Offering. The Company consummated the underwritten initial public offering of its common stock in April 2013, where it sold an aggregate of 3,680,000 shares of its common stock and received approximately \$86.6 million net proceeds from the sale of the shares in the offering. The Company’s common stock was initially traded on the NASDAQ Global Market, but effective January 2, 2014, the Company’s stock began trading on the NASDAQ Global Select Market.

Strategy

The Company operates based upon the following core strategies, which the Company designed to enhance shareholder value by growing strategically while preserving asset quality, improving efficiency and increasing profitability:

Grow Organically. The Company focuses on continued organic growth through the Company’s existing footprint and business lines. The Dallas/North Texas and Austin/Central Texas market regions in which the Company currently operates provide abundant opportunities to grow the Company’s customer base and expand the Company’s current market share. The Company plans to follow the Company’s community-focused, relationship-driven customer strategy to increase loans and deposits through the Company’s existing locations. Additionally, the Company intends to add teams of experienced bankers to grow in the Company’s current markets and expand into new markets. Preserving the safety and soundness of the Company’s loan portfolio is a fundamental element of the Company’s organic growth strategy. The Company has a strong and conservative credit culture, which allows the Company to maintain the Company’s asset quality as the Company grows.

Grow Through Acquisitions. The Company plans to continue to take advantage of opportunities to acquire other banking franchises both within and outside the Company’s current footprint. Since mid-2010, the Company has completed six acquisitions that the Company believes have enhanced shareholder value and the Company’s market presence. The following table summarizes each of the six acquisitions completed since 2010:

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Acquired Institution/Market	Date of Acquisition	Fair Value of Total Assets Acquired (dollars in thousands)
Town Center Bank Dallas/North Texas	July 31, 2010	\$37,451
Farmersville Bancshares, Inc. Dallas/North Texas	September 30, 2010	\$99,420
I Bank Holding Company, Inc. Austin/Central Texas	April 1, 2012	\$172,587
The Community Group, Inc. Dallas/North Texas	October 1, 2012	\$110,967
Collin Bank Dallas/North Texas	November 30, 2013	\$167,795*
Live Oak Financial Corp. Dallas/North Texas	January 1, 2014	\$130,935*

*Estimated pending receipt of final third party valuations.

Recent Acquisitions

Collin Bank. On November 30, 2013, the Company completed the acquisition of Collin Bank, Plano, Texas, a Texas state chartered bank with total assets of \$168 million, total loans of \$73 million and total deposits of \$111 million as of the acquisition date. Collin Bank was a full service commercial bank with one office located on the Dallas North Tollway in Plano. Under the terms of the definitive agreement, the Company paid \$18.4 million in cash and issued 247,731 shares of the Company common stock, resulting in an aggregate transaction value of \$30.3 million.

Live Oak Financial. On August 22, 2013, the Company entered into a definitive agreement to acquire Live Oak Financial Corp. and its subsidiary, Live Oak State Bank, Dallas, Texas, a Texas state chartered bank. The Company completed this acquisition on January 1, 2014. Live Oak State Bank was a full service commercial bank with one office located in the Swiss Avenue/Lakewood area east of downtown Dallas, Texas. Live Oak had total assets of \$131 million, total loans of \$71 million and total deposits of \$105 million as of the effective date of the transaction. Under the terms of the agreement, the Company paid aggregate cash consideration of \$10 million and issued 235,594 registered shares of the Company common stock, resulting in an aggregate transaction value of approximately \$21.7 million.

Pending Acquisition of BOH Holdings, Inc.

On November 21, 2013, the Company entered into a definitive agreement to acquire BOH Holdings, Inc., (BOH Holdings), and its subsidiary, Bank of Houston, Houston, Texas, a Texas state chartered bank. Pursuant to an Agreement and Plan of Reorganization, or the reorganization agreement, dated as of November 21, 2013, by and between the Company and BOH Holdings, BOH Holdings would be merged with and into the Company, with the Company continuing as the surviving company, such merger being referred to as the "BOH Holdings acquisition." At the effective time of the BOH Holdings acquisition, BOH Holdings would cease to exist. Immediately following the BOH Holdings acquisition, Bank of Houston would be merged with and into Independent Bank, with Independent Bank being the surviving bank. After the bank merger occurs, Bank of Houston would cease to exist and the existing locations of Bank of Houston would become banking centers of Independent Bank. The Company expects to complete the BOH Holdings acquisition in the second quarter of 2014, although delays could occur. Under the terms of the BOH Holdings acquisition, the Company would acquire all of the outstanding shares of BOH Holdings common stock and outstanding securities convertible into BOH Holdings common in exchange for the Company's issuance of 3,616,060 shares of its common stock and \$34 million in cash, subject to downward adjustment, as set forth in the reorganization agreement.

Future Opportunities

The Company believes there will continue to be numerous small to mid-sized banking organizations available for acquisition in the Company's existing market regions and in attractive new markets in Texas, as a result of scale and operational challenges, regulatory pressure, management succession issues or shareholder liquidity needs. There are approximately 500 banks in Texas with total assets of less than \$1 billion, which affords the Company future opportunities to make acquisitions that the Company believes would strengthen the Company's business and increase franchise value over the long term. The Company plans to explore additional opportunities in the Houston (other than BOH Holdings) and San Antonio metropolitan areas, as well as in attractive sub-markets within the Company's current market regions, including opportunities in Tarrant County in the Dallas/North Texas region. Factors considered by the Company to evaluate expansion opportunities include a) similar management

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and operating philosophy, b) accretive to earnings and increase shareholder value, c) ability to improve efficiency, d) strategic expansion of Company footprint and e) enhance market presence in existing markets.

Improve Efficiency and Increase Profitability

The Company employs a systematic and calculated approach to increasing the Company's profitability and improving the Company's efficiencies. The Company has updated the Company's operating capabilities and created synergies within the Company in the areas of technology, data processing, finance, compliance and human resources. The Company believes that the Company's scalable infrastructure provides the Company with an efficient operating platform from which to grow in the near term without incurring significant incremental noninterest expenses, which will enhance the Company's returns.

Independent's Community Banking Services

The Independent Way. Nearly a century after the Company's beginning, the Company's dedication to serving the needs of individuals and businesses in the Company's communities remains stronger than ever. The Company strives to provide the Company's customers with innovative financial products and services, local decision making and a level of service and responsiveness that is second to none. The Company's innovative and independent spirit is balanced by adherence to fundamental banking principles that have enabled the Company to remain strong, sound and financially secure even during challenging economic times. The Company is also steeped in a tradition of civic pride as evidenced by the investment of the Company's time, energies and financial resources in many local organizations to improve and benefit the Company's communities.

Lending Strategy and Types of Loans. Through Independent Bank, the Company offers a broad range of commercial and retail lending products to businesses, professionals and individuals. Commercial lending products include owner-occupied commercial real estate loans, interim construction loans, commercial loans (such as SBA guaranteed loans, business term loans, equipment financing and lines of credit) to a diversified mix of small and midsized businesses, and loans to professionals, particularly medical practices. Retail lending products include residential first and second mortgage loans, and consumer installment loans such as loans to purchase cars, boats and other recreational vehicles.

The Company's strategy is to maintain a broadly diversified loan portfolio by type and location. The Company's loans are primarily real estate secured loans spread among a variety of types of borrowers, including owner occupied offices for small businesses, medical practices and offices, retail operations and multi-family properties. The Company's loans are diversified geographically throughout the Company's Dallas/North Texas region (approximately 59%) and the Company's Austin/Central Texas region (approximately 41%). The Company seeks to be the premier provider of lending products and services in the Company's market areas and to serve the credit needs of high quality businesses and individual borrowers in the communities the Company serves.

The Company markets its lending products and services to qualified lending customers through the Company's high touch personal service, and seek to attract new lending customers through competitive pricing and innovative structures. The Company targets its business development and marketing strategy primarily on businesses with between \$500,000 and \$25 million in annual revenue. The Company's lending officers actively solicit the business of companies entering the Company's market areas as well as long-standing businesses operating in the communities the Company serves. As a general practice, the Company originates substantially all of the Company's loans and the Company limits the amount of participations the Company purchases to loans originated by lead banks with which the Company has a close relationship and which share the Company's credit philosophies.

The following is a discussion of the Company's major types of lending:

Commercial Real Estate Loans. The Company is primarily a real estate secured lender. The Company originates real estate loans to finance commercial property that is owner-occupied as well as commercial property owned by real estate investors. The total amount of owner-occupied commercial real estate loans outstanding as of December 31, 2013, was \$359.4 million, or 20.8%, of the Company's loan portfolio. The total amount of commercial real estate loans outstanding as of December 31, 2013, excluding owner-occupied properties, was \$484.0 million, or 28.0%, of the Company's loan portfolio. The real estate securing the Company's existing commercial real estate loans includes a wide variety of property types, such as owner-occupied offices/warehouses/production facilities, office buildings, health care facilities, hotels, mixed-use residential/commercial, retail centers, multifamily properties, restaurants, churches

and assisted living facilities.

Commercial real estate loans are often larger and involve greater risks than other types of lending. Adverse developments affecting commercial real estate values in the Company's market area could increase the credit risk associated with these loans,

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impair the value of property pledged as collateral for these loans, and affect the Company's ability to sell the collateral upon foreclosure without a loss. Due to the larger average size of commercial real estate loans, the Company faces the risk that losses incurred on a small number of commercial real estate loans could have a material adverse impact on the Company's financial condition and results of operations. In addition, commercial real estate loans have the risk that repayment is subject to the ongoing business operations of the borrower.

Commercial Construction, Land and Land Development Loans. The Company's construction portfolio includes loans to small and mid-sized businesses to construct owner-user properties, and, to a much lesser extent, loans to developers of commercial real estate investment properties and residential developments. These loans are typically disbursed as construction progresses and carry interest rates that vary with the prime rate. As of December 31, 2013, the outstanding balance of the Company's construction loans was \$130.3 million, or 7.5%, of the Company's total loan portfolio.

Construction and development loans typically involve more risk than other types of lending products because repayment of these loans is dependent, in part, on the success of the ultimate project or, to a lesser extent, the ability of the borrower to refinance the loan or sell the property upon completion of the project, rather than the ability of the borrower or guarantor to repay principal and interest. Moreover, these loans are typically based on future estimates of value and economic circumstances, which may differ from actual results or be affected by unforeseen events. If the actual circumstances differ from the estimates made at the time of approval of these loans, the Company faces the risk of having inadequate security for the repayment of the loan. Further, if the Company forecloses on the loan, the Company may be required to fund additional amounts to complete the project and may have to hold the property for an unspecified period of time while the Company attempts to dispose of it.

Residential Real Estate Loans. The Company offers first and second mortgage loans to the Company's individual customers primarily for the purchase of primary and secondary residences. As of December 31, 2013, the outstanding balance of one-to-four family real estate secured loans, including home equity loans, represented \$342.0 million, or 19.8%, of the Company's total loan portfolio. Residential real estate loans held for sale of \$3.4 million as of December 31, 2013, are also included in this category.

Like the Company's commercial real estate loans, the Company's residential real estate loans are secured by real estate, the value of which may fluctuate significantly over a short period of time as a result of market conditions in the area in which the real estate is located. Adverse developments affecting real estate values in the Company's market areas could therefore increase the credit risk associated with these loans, impair the value of property pledged as collateral on loans and affect the Company's ability to sell the collateral upon foreclosure without a loss or additional losses.

Single-Family Interim Construction Loans. The Company makes single-family interim construction loans to home builders and individuals to fund the construction of single family residences with the understanding that such loans will be repaid from the proceeds of the sale of the homes by builders or, in the case of individuals building their own homes, with the proceeds of a permanent mortgage loan. Such loans are secured by the real property being built and are made based on the Company's assessment of the value of the property on an as-completed basis. As of December 31, 2013, the outstanding balance of the Company's single-family interim construction loans was \$83.1 million, or 4.8%, of the Company's total loan portfolio.

Like the Company's commercial and residential real estate loans, the Company's single-family interim construction loans are secured by real estate, the value of which may fluctuate significantly over a short period of time as a result of market conditions in the area in which the real estate is located. Adverse developments affecting real estate values in the Company's market areas could therefore increase the credit risk associated with these loans, impair the value of property pledged as collateral on loans, and affect the Company's ability to sell the collateral upon foreclosure without a loss or additional losses. Further, like the Company's commercial construction and land development loans, the repayment of single-family interim construction loans is dependent upon the ability of the borrower to obtain a permanent loan or to sell the property rather than on the borrower's ability to repay the loans.

Commercial Loans. The Company originates commercial loans to small businesses and professionals, in particular, medical practices, located in the Company's market areas. These loans are primarily term loans to purchase capital equipment and small loans for working capital and operational purposes. Because the Company is a community bank with long standing close ties to the businesses and professionals operating in the Company's market areas, the

Company is able to tailor the Company's commercial loan programs to meet the needs of the Company's customers. As of December 31, 2013, the Company had outstanding commercial loans of \$241.2 million, or 14.0%, of the Company's total loan portfolio.

Like the Company's commercial real estate loans, commercial loans have the risk that repayment is subject to the ongoing business operations of the borrower. Any interruption or discontinuance of operating cash flows from the business, which may

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be influenced by events not under the control of the borrower such as economic events and changes in governmental regulations, could materially affect the ability of the borrower to repay the loan.

Further, commercial loans are often secured by personal property, such as inventory, and intangible property, such as accounts receivable, which if the business is unsuccessful, typically have values insufficient to satisfy the loan without a loss.

To further diversify the Company's portfolio in October, 2012, the Company hired an experienced energy lending team, which operates as part of the Company's downtown Dallas location. Energy loans are primarily collateralized by proven reserves. As of December 31, 2013, the Company had outstanding energy loans of \$68.3 million.

Agricultural Loans. The Company's agricultural loan portfolio primarily includes loans secured by real property used for agricultural purposes. The Company provides loans for the acquisition of farm and ranch land, as well as the construction of buildings upon agricultural real estate. On a more limited basis, the Company offers agricultural equipment financing and crop production loans which are secured by crops, equipment, and crop insurance. The total amount of agricultural loans outstanding at December 31, 2013, was \$40.6 million, or 2.3%, of the Company's total loan portfolio.

Like the Company's other types of real estate loans, the Company's agricultural loans are secured primarily by real estate, the value of which may fluctuate significantly over a short period of time as a result of market conditions in the area in which the real estate is located. Adverse developments affecting real estate values in the Company's market areas could therefore increase the credit risk associated with these loans, impair the value of the property pledged as collateral, and affect the Company's ability to sell the collateral upon foreclosure without a loss. Further, agricultural loans carry additional risk because repayment of this type of loan is dependent, in part, on continuing successful agricultural operations, which can be adversely affected by weather, market conditions and governmental agricultural policies, all of which are beyond control of the borrower. If the agricultural operation is unsuccessful, agricultural loans secured by livestock, crops or equipment are at even greater risk because this type of collateral typically has values insufficient to satisfy the loan without a loss.

Consumer Loans. The Company offers a variety of consumer loans, such as installment loans to purchase cars, boats and other recreational vehicles. The Company's consumer loans typically are part of an overall customer relationship designed to support the individual consumer borrowing needs of the Company's commercial loan and deposit customers. As of December 31, 2013, the Company had outstanding \$45.8 million of consumer loans, or 2.7% of the Company's total loan portfolio. Consumer loans typically have shorter terms, lower balances, higher yields and higher risks of default than residential real estate mortgage loans. Consumer loan collections are dependent on the borrower's continuing financial stability and are therefore more likely to be affected by adverse personal circumstances.

Consumer loan collections are dependent on the borrower's financial stability and therefore involve greater risk of being affected by adverse individual circumstances, such as the loss of employment or unexpected medical costs.

Mortgage Brokerage Activities. The Company also engages in the origination of residential loans sold into the secondary market. The Company originates mortgages for specific institutional purchasers, such as investment banks and other financial institutions. The Company's mortgage originations were \$161.2 million during the fiscal year ended December 31, 2013, \$177.1 million during 2012 and \$113.5 million during 2011. The Company sells all of the originated mortgages to institutional purchasers shortly after closing. The Company only retains a portion of the revenue generated by the Company's mortgage brokerage division, with the remaining portion, less expenses and salaries, paid to the Company's mortgage brokers as part of their compensation arrangement.

Underwriting. Prudent underwriting is the foundation of the Company's strong credit culture. The Company seeks to maintain a broadly diversified loan portfolio in terms of type of customer, type of loan product, geographic area and industries in which the Company's business customers are engaged. The Company adheres to disciplined underwriting standards and offer creative loan solutions in a responsive and timely manner.

In considering a loan, the Company follows the conservative underwriting principles in the Company's loan policy which include the following:

- having a relationship with the Company's customers to ensure a complete understanding of their financial condition and ability to repay the loan;
- verifying that the primary and secondary sources of repayment are adequate in relation to the amount of the loan;

- observing appropriate loan to value guidelines for real estate secured loans;
- maintaining the Company's targeted levels of diversification for the loan portfolio, both as to type of borrower and geographic location of collateral; and
- ensuring that each loan is properly documented with perfected liens on collateral.

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The Company implements its underwriting policy through a tiered system of individual loan authority for the Company's loan officers and a loan committee approval structure. Lending officers are assigned various levels of authority based upon their respective levels of experience and expertise. Loans with relationships over the lending authority of the loan officer must be approved by the Company's Executive Loan Committee.

The Company employs appropriate limits on its overall loan portfolio and requirements with respect to certain types of lending. As a general practice, the Company operates with an internal guideline limiting loans to any single borrowing relationship to less than half of Independent Bank's legal lending limit.

The Company requires its nonowner occupied commercial real estate loans to be secured by well-managed income producing property with adequate margins, supported by a history of profitable operations and cash flows, and proven operating stability in the case of commercial loans. Except in very limited circumstances, the Company's commercial real estate loans and commercial loans are supported by personal guarantees from the principals of the borrower.

As part of the underwriting process, the Company seeks to minimize risk in a variety of ways, including the following:

- careful analysis of the borrower's financial condition, cash flow, liquidity, and leverage;
- assessment of the project's operating history, operating projections, location and condition;
- review of appraisals, title commitment and environmental reports;
- consideration of the management experience and financial strength of the principals of the borrower; and
- understanding economic trends and industry conditions.

The Company is a relationship-oriented, rather than transaction-oriented, lender. Accordingly, substantially all of the Company's loans are made to borrowers located or operating in the Company's primary market areas. The limited number of loans secured by properties located outside the Company's market areas are made to borrowers who are well-known to Independent Bank because they are headquartered or reside within one of the Company's primary market areas. For example, the Company has loans secured by second homes in other states owned by customers whose primary residence is located in the Company's market areas, and the Company has loans to a restaurant franchise headquartered in the Company's Austin market, but which has locations in other states.

Credit Risk Management

Managing credit risk is a company-wide process. The Company's strategy for credit risk management includes the conservative underwriting process described above, and ongoing risk monitoring and review processes for all credit exposures. The Company's Vice Chairman and Chief Risk Officer provides bank-wide credit oversight and periodically reviews the loan portfolio to ensure that the risk identification processes are functioning properly and that the Company's credit standards are followed. In addition, a third party annually performs a loan review to identify problem assets. The Company strives to identify potential problem loans early in an effort to aggressively seek resolution of these situations before the loans become a loss, record any necessary charge-offs promptly and maintain adequate allowance levels for probable loan losses inherent in the loan portfolio. Credit risk management involves a partnership between the Company's lenders and the Company's credit administration group. The manager of this group has significant prior experience working in credit administration. The members of the Company's credit administration group primarily focus their efforts on credit analysis, underwriting and monitoring new credits and providing management reporting to executive management and the board of directors. In addition, the group includes a special assets manager who is responsible for monitoring and working out problem loans, managing the collection and foreclosure process, and operating and disposing of other real estate owned.

In general, whenever a particular loan or overall borrower relationship is downgraded to special mention or substandard based on one or more standard loan grading factors, the Company's special assets manager will make a determination as to whether responsibility for the ongoing monitoring of the loan or relationship should be retained by the loan officer, or whether this responsibility should be transferred to the special assets group. Executive management regularly reviews the status of the watch list and classified assets portfolio as well as the larger credits in the portfolio.

Deposits

Deposits are the Company's principal source of funds for use in lending and other general banking purposes. The Company provides a full range of deposit products and services, including a variety of checking and savings accounts, debit cards, online banking, mobile banking, eStatements and bank-by-mail and direct deposit services. The Company also offers business accounts and management services, including analyzed business checking, business savings, and treasury management

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services. The Company solicits deposits through its relationship-driven team of dedicated and accessible bankers and through community focused marketing.

The Company's Market Areas

The Company is based in Texas which continues to have a rapidly growing population, a high level of job growth and an attractive business climate. The Texas economy is strong, diverse and growing, and it benefits from a number of expanding industries, in particular, the energy, technology and healthcare industries.

The Company operates in two market regions situated in the heart of Texas along the Interstate 35 corridor from Dallas to Austin. The communities the Company serves are a mix of affluent and growing suburban areas related to the Dallas-Fort Worth and Austin metropolitan areas, the "New Urbanism" areas of Dallas and Austin, the Waco metropolitan area, and smaller rural communities on the outskirts of the Dallas metropolitan area. The Company believes its presence in a diversified group of communities enables the Company to match the strengths of each area with needs in other areas, thereby enhancing the Company's overall operations. Within these regions, the Company's strategy is to selectively place the Company's banking offices in growing and affluent markets. For example, Collin County, the county in which the Company has the most locations, has projected population growth of 13% from 2012 through 2017, which is approximately double the projected population growth for the Dallas-Fort Worth MSA, and the county's 2012 median household income was \$79,858, which is 46% higher than the 2012 median household income for the Dallas-Fort Worth MSA. Further, the Austin-Round Rock MSA, where the Company has five Central Texas locations, is projected to have 4% annual job growth, ranking first on the Forbes list of "Best Cities for Future Job Growth." The Company is also proud that McKinney, Texas, home of the Company's corporate headquarters, ranked as the second best place to live in 2012 by CNN Money Magazine.

Dallas/North Texas Region. The Dallas-Fort Worth metropolitan area, the fourth largest metropolitan area in the nation based upon the 2012 estimate by the U.S. Census Bureau, serves as the corporate headquarters for numerous Fortune 500 companies, including Exxon Mobil, AT&T, Texas Instruments, Southwest Airlines, and JCPenney. The Dallas-Fort Worth area also contains several world class hospitals and medical research facilities, major universities, and professional sports franchises. The Company primarily operates in Collin, Dallas, Denton, and Grayson Counties, which are located in the northern growth corridor of the Dallas-Fort Worth metropolitan area.

The Company's locations in the Dallas/North Texas region are positioned among the fastest growing and most affluent counties within the region. The following table reflects the Company's position in the Dallas/North Texas region and highlights key demographics of the counties within this region:

County	Number of Branches ⁽¹⁾	Company Deposits in Market ⁽¹⁾⁽²⁾	Percent of Franchise Deposits	Total Population 2012	Projected Population Change 2012-2017	Median Household Income 2012
Collin	10	\$754,735	42.7%	822,906	12.71%	\$79,858
Grayson	6	323,727	18.3	122,690	2.82	44,841
Denton	3	152,218	8.6	695,694	13.00	68,075
Dallas	3	133,156	7.6	2,401,029	4.72	45,720
County Totals/ Weighted Avg. ⁽³⁾	22	\$1,363,836	77.2%	4,042,319	9.61%	\$66,898
State of Texas				25,906,038	7.70	47,622

(1) Gives effect to the Company's acquisition of Collin Bank completed on November 30, 2013 and the acquisition of Live Oak Financial Corp completed on January 1, 2014.

(2) Deposits as of June 30, 2013. In thousands.

(3) Demographics are weighted by the percentage of deposits in each county.

Source: SNL Financial

Austin/Central Texas Region. Austin is the capital of Texas, the home to The University of Texas, and is a major national cultural, arts, film, and media center. One of the fastest growing areas in the country, Austin ranked first nationally in percentage population growth from 2010 to 2012 as estimated by the U.S. Census Bureau. Several public high tech companies maintain their corporate headquarters in the Austin metropolitan area, including Dell, Freescale Semiconductor, and National Instruments Corp. In fact, Austin is often dubbed “Silicon Hills” because of the number technology companies that have operations in this area, including Apple, Google, Facebook, IBM and Advanced Micro Devices. The Company’s Central Texas

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region also includes the city of Waco, which is located equi-distant between Dallas and Austin and is home to Baylor University.

The following table reflects the Company's position in the Austin/Central Texas region and highlights key demographics of the counties within this region:

County	Number of Branches ⁽¹⁾	Company Deposits in Market ⁽¹⁾	Percent of Franchise Deposits	Total Population 2012	Projected Population Change 2012-2017	Median Household Income 2012
Travis	3	\$159,088	9.0%	1,068,253	12.46%	\$54,707
McLennan	3	124,364	7.0	239,640	5.33	\$39,415
Williamson	2	120,280	6.8	453,629	16.76	68,074
County Totals/ Weighted Avg. ⁽²⁾	8	\$363,111	22.8%	1,761,522	11.54%	\$53,979
State of Texas				25,906,038	7.70	47,622

(1) Deposits as of June 30, 2013. In thousands.

(2) Demographics are weighted by the percentage of deposits in each county.

Source: SNL Financial

Competition

The Company competes in the commercial banking industry solely through Independent Bank and firmly believe that Independent Bank's long-standing presence in the community and personal service philosophy enhances the Company's ability to attract and retain customers. This industry is highly competitive, and Independent Bank faces strong direct competition for deposits, loans, and other financial-related services. The Company competes with other commercial banks, thrifts and credit unions. Although some of these competitors are situated locally, others have statewide or nationwide presence. In addition, the Company competes with large banks in major financial centers and other financial intermediaries, such as consumer finance companies, brokerage firms, mortgage banking companies, insurance companies, securities firms, mutual funds and certain government agencies as well as major retailers, all actively engaged in providing various types of loans and other financial services. The Company believes that its banking professionals, the range and quality of products that the Company offers and its emphasis on building long-lasting relationships distinguishes Independent Bank from its competitors.

IBG Adriatica

Independent established IBG Adriatica, Inc., or IBG Adriatica, as a wholly owned subsidiary of Independent on June 20, 2011 to acquire distressed loans related to a mixed commercial/residential development in McKinney, Texas, from a third party. The distressed loans had an aggregate face value of approximately \$23 million at acquisition and were secured by approximately 27 acres of real property located in the Adriatica development in McKinney. The purchase price for the loans was \$16.3 million, of which IBG Adriatica borrowed \$12.2 million from the seller. Independent guaranteed this loan.

Following the acquisition of the distressed loans, IBG Adriatica acquired all of the real property securing the loans through a Deed in Lieu of Foreclosure. The real property consisted of a 29,000 square foot commercial office building, a 16,500 square foot retail center, 36 residential lots, a 625 space multistory parking garage, and approximately 18 acres of undeveloped real property. In connection with its acquisition of the real property, IBG Adriatica obtained a third party appraisal indicating that the combined value of the real property was approximately \$18.4 million. The property was recorded at \$17.0 million in recognition of expected selling costs.

IBG Adriatica never intended to act as the developer of the project. Rather, in 2011 it began divesting itself of the property, completing an initial sale of one piece of this property on December 31, 2011. IBG Adriatica also completed sales of a portion of the property on December 31, 2012, and completed a final sale of all of the remaining property on December 31, 2013. Adriatica currently owns no material assets and Independent plans to dissolve this subsidiary in

2014.

Please see “Certain Relationships and Related Transactions and Director Independence” incorporated by reference into Part III, Item 13 for certain information regarding transactions between IBG Adriatica and Himalayan Ventures, an investment partnership comprised of certain principals of the Company.

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Employees

As of December 31, 2013, the Company employed approximately 340 persons. The Company provides extensive training to the Company's employees in an effort to ensure that the Company's customers receive superior customer service. None of the Company's employees are represented by any collective bargaining unit or are parties to a collective bargaining agreement. The Company believes that the Company's relations with the Company's employees are good.

Available Information

The Company files reports, proxy statements and other information with the Securities and Exchange Commission, or SEC, under the Securities Exchange Act of 1934, as amended. You may read and copy this information at the SEC's Public Reference Room, 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements and other information about issuers, like the Company, who file electronically with the SEC. The address of that site is <http://www.sec.gov>.

Documents filed by the Company with the SEC are available from the Company without charge (except for exhibits to the documents). You may obtain documents filed by the Company with the SEC by requesting them in writing or by telephone from the Company at the following address:

Independent Bank Group, Inc.
1600 Redbud Boulevard, Suite 400
McKinney, Texas 75069-3257
Attention: Michelle S. Hickox
Executive Vice President and Chief Financial Officer
Telephone: (972) 562-9004

Documents filed by the Company with the SEC are also available on the Company's website, www.ibtx.com. Information furnished by the Company and information on, or accessible through, the SEC's or the Company's website is not part of this Annual Report on Form 10 K.

Supervision and Regulation

The U.S. banking industry is highly regulated under federal and state law. Consequently, the growth and earnings performance of the Company and its subsidiaries will be affected not only by management decisions and general and local economic conditions, but also by the statutes administered by, and the regulations and policies of, various governmental regulatory authorities. These authorities include the Board of Governors of the Federal Reserve System, or Federal Reserve, the Federal Deposit Insurance Corporation, or the FDIC, the Office of the Comptroller of the Currency, or the OCC, the Texas Department of Banking, or TDB, the Internal Revenue Service and state taxing authorities. The effect of these statutes, regulations and policies, and any changes to such statutes, regulations and policies, can be significant and cannot be predicted.

The primary goals of the bank regulatory scheme are to maintain a safe and sound banking system and to facilitate the conduct of sound monetary policy. The system of supervision and regulation applicable to the Company and its subsidiaries establishes a comprehensive framework for their respective operations and is intended primarily for the protection of the FDIC's deposit insurance fund, the banks' depositors and the public, rather than the Company's shareholders or creditors. The description below summarizes certain elements of the applicable bank regulatory framework. This description is not intended to describe all laws and regulations applicable to the Company and its subsidiaries, and the description is qualified in its entirety by reference to the full text of the statutes, regulations, policies, interpretive letters and other written guidance that are described herein.

Independent Bank Group as a Bank Holding Company

As a bank holding company, the Company is subject to regulation under the Bank Holding Company Act of 1956, or the BHC Act, and to supervision, examination and enforcement by the Federal Reserve. The BHC Act and other federal laws subject bank holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations. The Federal Reserve's jurisdiction also extends to any company that the Company

directly or indirectly controls, such as the Company's nonbank subsidiaries and other companies in which the Company owns a controlling investment.

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Regulatory Restrictions on Dividends; Source of Strength. The Company is regarded as a legal entity separate and distinct from Independent Bank. The principal source of the Company's revenues is dividends received from Independent Bank. As described in more detail below, Texas state law places limitations on the amount that state banks may pay in dividends, which Independent Bank must adhere to when paying dividends to the Company. The Federal Reserve has issued a policy statement that provides that a bank holding company should not pay dividends unless (a) its net income over the last four quarters (net of dividends paid) has been sufficient to fully fund the dividends, (b) the prospective rate of earnings retention appears to be consistent with the capital needs, asset quality and overall financial condition of the bank holding company and its subsidiaries and (c) the bank holding company will continue to meet minimum required capital adequacy ratios. Accordingly, the Company should not pay cash dividends that exceed its net income in any year or that can only be funded in ways that weaken its ability to serve as a source of financial strength for its banking subsidiaries, including by borrowing money to pay dividends.

Under Federal Reserve policy, bank holding companies have historically been required to act as a source of financial and managerial strength to each of its banking subsidiaries, and the Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement, the Company is expected to commit resources to support Independent Bank, including at times when the Company may not be in a financial position to provide such resources. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. As discussed below, a bank holding company, in certain circumstances, could be required to guarantee the capital restoration plan of an undercapitalized banking subsidiary. If the capital of Independent Bank were to become impaired, the Federal Reserve could assess the Company for the deficiency. If the Company failed to pay the assessment within three months, the Federal Reserve could order the sale of the Company's stock in Independent Bank to cover the deficiency.

In the event of a bank holding company's bankruptcy under Chapter 11 of the U.S. Bankruptcy Code, the trustee will be deemed to have assumed and will be required to cure immediately any deficit under any commitment by the debtor holding company to any of the federal banking agencies to maintain the capital of an insured depository institution, and any claim for breach of such obligation will generally have priority over most other unsecured claims.

Scope of Permissible Activities. Under the BHC Act, the Company is prohibited from acquiring a direct or indirect interest in or control of more than 5% of the voting shares of any company that is not a bank or financial holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks or furnishing services to or performing services for its subsidiary banks, except that the Company may engage in, directly or indirectly, and may own shares of companies engaged in certain activities found by the Federal Reserve to be so closely related to banking or managing and controlling banks as to be a proper incident thereto. These activities include, among others, operating a mortgage, finance, credit card or factoring company; performing certain data processing operations; providing investment and financial advice; acting as an insurance agent for certain types of credit-related insurance; leasing personal property on a full-payout, nonoperating basis; and providing certain stock brokerage and investment advisory services. In approving acquisitions or the addition of activities, the Federal Reserve considers, among other things, whether the acquisition or the additional activities can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh such possible adverse effects as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices.

Notwithstanding the foregoing, the Gramm-Leach-Bliley Act, also known as the Financial Services Modernization Act of 1999, effective March 11, 2000, or the GLB Act, amended the BHC Act and eliminated the barriers to affiliations among banks, securities firms, insurance companies and other financial service providers. The GLB Act permits bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. The GLB Act defines "financial in nature" to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve has determined to be closely related to banking. No regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve.

Safe and Sound Banking Practices. Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve's Regulation Y, for example, generally requires a bank holding company to provide the Federal Reserve with prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the bank holding company's consolidated net worth. The Federal Reserve may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. In certain circumstances, the Federal Reserve could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

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The Federal Reserve has broad authority to prohibit activities of bank holding companies and their nonbanking subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as one million dollars (\$1,000,000) for each day the activity continues.

Anti-Tying Restrictions. Bank holding companies and their affiliates are prohibited from tying the provision of certain services, such as extensions of credit, to other nonbanking services offered by a bank holding company or its affiliates.

Capital Adequacy Requirements. The Federal Reserve has historically utilized a system based upon risk-based capital guidelines under a two-tier capital framework to evaluate the capital adequacy of bank holding companies. Tier 1 capital generally consists of common stockholders' equity, retained earnings, a limited amount of qualifying perpetual preferred stock, qualifying trust preferred securities and noncontrolling interests in the equity accounts of consolidated subsidiaries, less goodwill and certain intangibles. Tier 2 capital generally consists of certain hybrid capital instruments and perpetual debt, mandatory convertible debt securities and a limited amount of subordinated debt, qualifying preferred stock, loan loss allowance, and unrealized holding gains on certain equity securities. The regulatory capital requirements are applicable to the Company because its total consolidated assets equal more than \$500 million, and Independent Bank is subject to the capital requirements of the FDIC.

Under the guidelines, specific categories of assets are assigned different risk weights, based generally on the perceived credit risk of the asset. These risk weights are multiplied by corresponding asset balances to determine a "risk-weighted" asset base. The guidelines require a minimum ratio of total capital to total risk-weighted assets of 8.0% (of which at least 4.0% is required to consist of Tier 1 capital elements). Total capital is the sum of Tier 1 and Tier 2 capital.

Risk-weighted assets exclude intangible assets such as goodwill and core deposit intangibles.

In addition to the risk-based capital guidelines, the Federal Reserve uses a leverage ratio as an additional tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company's Tier 1 capital divided by its average total consolidated assets. Certain highly rated bank holding companies may maintain a minimum leverage ratio of 3.0%, but other bank holding companies are required to maintain a leverage ratio of at least 4.0%.

The federal banking agencies' risk-based and leverage capital ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria. Banking organizations not meeting these criteria are expected to operate with capital positions well above the minimum ratios. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

On July 2, 2013, the Federal Reserve approved a final rule implementing the revised capital standards issued by the Basel Committee on Banking Supervision, commonly known as "Basel III," as well as additional capital reforms required by the Dodd-Frank Act. This final rule, once fully phased-in, requires bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity.

The new final capital framework, among other things, (i) introduces as a new capital measure "Common Equity Tier 1," or CET1, (ii) specifies that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, (iii) defines CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expands the scope of the adjustments as compared to existing regulations.

The new capital rule requires, when fully phased in, among other things, a new common equity Tier 1 risk-based ratio with a minimum required ratio of 4.5% of total assets and an increase in the minimum required amount of Tier 1 capital from the current level of 4% of total assets to 6% of total risk weighted assets and the continuation of the requirement to maintain total capital of 8% of total risk-weighted assets. Moreover, the new rule requires banks to hold additional capital equal to 2.5% of total assets as a "capital conservation buffer" in order to avoid restrictions on certain activities, including the payment of dividends and certain bonuses. The new rule also provides for a "countercyclical capital buffer," that would be added to the capital conservation buffer generally to be imposed when

national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk. The new rule will be implemented in stages beginning in January 2014 for large banking organizations (greater than \$10 billion in assets) and in January 2015 for other banking organizations.

Proposed Liquidity Requirements. Historically, regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III final framework will require banks

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and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward will be required by regulation. One test, referred to as the liquidity coverage ratio, or LCR, is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity's expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other, referred to as the net stable funding ratio, or NSFR, is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will incentivize banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source. The LCR will not be introduced as a requirement until January 1, 2015, and the NSFR will not be introduced as a requirement until January 1, 2018. These new standards are subject to further rulemaking and their terms could change before implementation.

Imposition of Liability for Undercapitalized Subsidiaries. Bank regulators are required to take prompt corrective action to resolve problems associated with insured depository institutions whose capital declines below certain levels. In the event an institution becomes undercapitalized, it must submit a capital restoration plan. The capital restoration plan will not be accepted by the regulators unless each company having control of the undercapitalized institution guarantees the subsidiary's compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institution's holding company is entitled to a priority of payment in bankruptcy.

The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5.0% of the institution's assets at the time it became undercapitalized or the amount necessary to cause the institution to be adequately capitalized. The bank regulators have greater power in situations where an institution becomes significantly or critically undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to obtain prior Federal Reserve approval of proposed dividends, or might be required to consent to a consolidation or to divest the troubled institution or other affiliates.

Acquisitions by Bank Holding Companies. The BHC Act requires every bank holding company to obtain the prior approval of the Federal Reserve before it acquires all or substantially all of the assets of any bank, or ownership or control of any voting shares of any bank if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. In approving bank acquisitions by bank holding companies, the Federal Reserve is required to consider, among other things, the effect of the acquisition on competition, the financial condition, managerial resources and future prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served (including the record of performance under the Community Reinvestment Act (CRA)), the effectiveness of the applicant in combating money laundering activities and the extent to which the proposed acquisition would result in greater or more concentrated risks to the stability of the U.S. banking or financial system. The Company's ability to make future acquisitions will depend on its ability to obtain approval for such acquisitions from the Federal Reserve. The Federal Reserve could deny the Company's application based on the above criteria or other considerations. For example, the Company could be required to sell banking centers as a condition to receiving regulatory approval, which condition may not be acceptable to the Company or, if acceptable, may reduce the benefit of a proposed acquisition.

Control Acquisitions. Federal and state laws, including the BHCA and the Change in Bank Control Act, or the CBCA, impose additional prior notice or approval requirements and ongoing regulatory requirements on any investor that seeks to acquire direct or indirect "control" of an FDIC-insured depository institution or bank holding company.

Whether an investor "controls" a depository institution is based on all of the facts and circumstances surrounding the investment. As a general matter, an investor is deemed to control a depository institution or other company if the investor owns or controls 25% or more of any class of voting securities. Subject to rebuttal, an investor is presumed to control a depository institution or other company if the investor owns or controls 10% or more of any class of voting securities and either the depository institution or company is a public company or no other person will hold a greater percentage of that class of voting securities after the acquisition. If an investor's ownership of the Company's voting securities were to exceed certain thresholds, the investor could be deemed to "control" the Company for regulatory purposes, which could subject such investor to regulatory filings or other regulatory consequences.

Regulation of Independent Bank

Independent Bank is a Texas-chartered banking association, the deposits of which are insured by the deposit insurance fund of the FDIC. Independent Bank is not a member of the Federal Reserve System; therefore, Independent Bank is subject to supervision and regulation by the FDIC and the TDB. Such supervision and regulation subject Independent Bank to special restrictions, requirements, potential enforcement actions and periodic examination by the FDIC and the TDB. Because the

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Federal Reserve regulates the Company, the Federal Reserve also has supervisory authority which directly affects Independent Bank.

Equivalence to National Bank Powers. The Texas Constitution, as amended in 1986, provides that a Texas-chartered bank has the same rights and privileges that are or may be granted to national banks domiciled in Texas. To the extent that the Texas laws and regulations may have allowed state-chartered banks to engage in a broader range of activities than national banks, the Federal Deposit Insurance Corporation Improvement Act of 1991, or the FDICIA, has operated to limit this authority. The FDICIA provides that no state bank or subsidiary thereof may engage as a principal in any activity not permitted for national banks, unless the institution complies with applicable capital requirements and the FDIC determines that the activity poses no significant risk to the deposit insurance fund of the FDIC. In general, statutory restrictions on the activities of banks are aimed at protecting the safety and soundness of depository institutions.

Financial Modernization. Under the GLB Act, a national bank may establish a financial subsidiary and engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting as principal, insurance company portfolio investment, real estate development, real estate investment, annuity issuance and merchant banking activities. To do so, a bank must be well capitalized, well managed and have a Community Reinvestment Act, or CRA, rating from the FDIC of satisfactory or better. Subsidiary banks of a financial holding company or national banks with financial subsidiaries must remain well capitalized and well managed in order to continue to engage in activities that are financial in nature without regulatory actions or restrictions. Such actions or restrictions could include divestiture of the “financial in nature” subsidiary or subsidiaries. In addition, a financial holding company or a bank may not acquire a company that is engaged in activities that are financial in nature unless each of the subsidiary banks of the financial holding company or the bank has a CRA rating of satisfactory or better. Although the powers of state chartered banks are not specifically addressed in the GLB Act, Texas-chartered banks such as Independent Bank will have the same if not greater powers as national banks through the parity provisions contained in the Texas Constitution and other Texas statutes.

Branching. Texas law provides that a Texas-chartered bank can establish a branch anywhere in Texas provided that the branch is approved in advance by the TDB. The branch must also be approved by the FDIC, which considers a number of factors, including financial history, capital adequacy, earnings prospects, character of management, needs of the community and consistency with corporate powers. The Dodd-Frank Act permits insured state banks to engage in de novo interstate branching if the laws of the state where the new branch is to be established would permit the establishment of the branch if it were chartered by such state.

Restrictions on Transactions with Affiliates and Insiders. Transactions between Independent Bank and its nonbanking subsidiaries and/or affiliates, including the Company, are subject to Section 23A of the Federal Reserve Act. In general, Section 23A of the Federal Reserve Act imposes limits on the amount of such transactions, and also requires certain levels of collateral for loans to affiliated parties. It also limits the amount of advances to third parties which are collateralized by the securities or obligations of the Company or its subsidiaries. Covered transactions with any single affiliate may not exceed 10% of the capital stock and surplus of Independent Bank, and covered transactions with all affiliates may not exceed, in the aggregate, 20% of Independent Bank’s capital and surplus. For a bank, capital stock and surplus refers to the bank’s tier 1 and tier 2 capital, as calculated under the risk-based capital guidelines, plus the balance of the allowance for credit losses excluded from tier 2 capital. Independent Bank’s transactions with all of its affiliates in the aggregate are limited to 20% of the foregoing capital. “Covered transactions” are defined by statute to include a loan or extension of credit to an affiliate, as well as a purchase of securities issued by an affiliate, a purchase of assets (unless otherwise exempted by the Federal Reserve) from the affiliate, the acceptance of securities issued by the affiliate as collateral for a loan, and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate. In addition, in connection with covered transactions that are extensions of credit, Independent Bank may be required to hold collateral to provide added security to Independent Bank, and the types of permissible collateral may be limited. The Dodd-Frank Act generally enhances the restrictions on transactions with affiliates, including an expansion of what types of transactions are covered transactions to include credit exposures related to derivatives, repurchase agreement and securities lending arrangements and an increase in the amount of time for which collateral requirements regarding covered transactions must be satisfied.

Affiliate transactions are also subject to Section 23B of the Federal Reserve Act which generally requires that certain transactions between Independent Bank and its affiliates be on terms substantially the same, or at least as favorable to Independent Bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated persons. The Federal Reserve has also issued Regulation W, which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretive guidance with respect to affiliate transactions.

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The restrictions on loans to directors, executive officers, principal shareholders and their related interests (collectively referred to herein as “insiders”) contained in the Federal Reserve Act and in Regulation O promulgated by the Federal Reserve apply to all insured institutions and their subsidiaries and bank holding companies. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to insiders and their related interests. Generally, these loans cannot exceed the institution’s total unimpaired capital and surplus, and the FDIC may determine that a lesser amount is appropriate. Loans to senior executive officers of a bank are even further restricted, generally limited to \$100,000 per senior executive officer. Insiders are subject to enforcement actions for knowingly accepting loans in violation of applicable restrictions.

Restrictions on Distribution of Subsidiary Bank Dividends and Assets. Dividends paid by Independent Bank have provided a substantial part of the Company’s operating funds, and for the foreseeable future, it is anticipated that dividends paid by Independent Bank to the Company will continue to be the Company’s principal source of operating funds. However, capital adequacy requirements serve to limit the amount of dividends that may be paid by Independent Bank. Under federal law, Independent Bank cannot pay a dividend if, after paying the dividend, the Surviving Bank would be undercapitalized. The FDIC may declare a dividend payment to be unsafe and unsound even though Independent Bank would continue to meet its capital requirements after payment of the dividend.

Because the Company is a legal entity separate and distinct from its subsidiaries, its right to participate in the distribution of assets of any subsidiary upon the subsidiary’s liquidation or reorganization will be subject to the prior claims of the subsidiary’s creditors. The Federal Deposit Insurance Act, or the FDI Act, provides that, in the event of a “liquidation or other resolution” of an insured depository institution, the claims of depositors of the institution (including the claims of the FDIC as subrogee of insured depositors) and certain claims for administrative expenses of the FDIC as a receiver will have priority over other general unsecured claims against the institution. If Independent Bank fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, nondeposit creditors, including the Company, with respect to any extensions of credit it has made to Independent Bank.

Examinations. The FDIC periodically examines and evaluates state nonmember banks. Based on such an evaluation, the FDIC may revalue the assets of the institution and require that it establish specific reserves to compensate for the difference between the FDIC determined value and the book value of such assets. The TDB also conducts examinations of state banks but may accept the results of a federal examination in lieu of conducting an independent examination. In addition, the FDIC and TDB may elect to conduct a joint examination.

Audit Reports. Insured institutions with total assets of \$500 million or more must submit annual audit reports prepared by independent auditors to federal and state regulators. In some instances, the audit report of the institution’s holding company can be used to satisfy this requirement. Auditors must receive examination reports, supervisory agreements and reports of enforcement actions. For institutions with total assets of \$1 billion or more, financial statements prepared in accordance with GAAP, management’s certifications signed by the Company’s and Independent Bank’s chief executive officer and chief accounting or financial officer concerning management’s responsibility for the financial statements, and an attestation by the auditors regarding Independent Bank’s internal controls must be submitted. For institutions with total assets of more than \$3 billion, independent auditors may be required to review quarterly financial statements. The FDICIA requires that Independent Bank have an independent audit committee, consisting of outside directors only, or that the Company has an audit committee that is entirely independent. The committees of such institutions must include members with experience in banking or financial management, must have access to outside counsel and must not include representatives of large customers.

Capital Adequacy Requirements. The FDIC has adopted regulations establishing minimum requirements for the capital adequacy of insured institutions and may establish higher minimum requirements if, for example, a bank has previously received special attention or has a high susceptibility to interest rate risk. The FDIC’s risk-based capital guidelines generally require state banks to have a minimum ratio of Tier 1 capital to total risk-weighted assets of 4.0% and a ratio of total capital to total risk-weighted assets of 8.0%. The capital categories have the same definitions for Independent Bank as for the Company. The FDIC’s leverage guidelines require state banks to maintain Tier 1 capital of no less than 4.0% of average total assets, except in the case of certain highly rated banks for which the requirement is 3.0% of average total assets. The TDB has issued a policy which generally requires state chartered banks to

maintain a leverage ratio (defined in accordance with federal capital guidelines) of 5.0%.

Corrective Measures for Capital Deficiencies. The federal banking regulators are required by the FDI Act to take “prompt corrective action” with respect to capital-deficient institutions that are FDIC-insured. Agency regulations define, for each capital category, the levels at which institutions are “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized.” A “well capitalized” bank has a total risk-based capital ratio of 10.0% or higher, a Tier 1 risk-based capital ratio of 6.0% or higher; a leverage ratio of 5.0% or higher and is not subject to

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any written agreement, order or directive requiring it to maintain a specific capital level for any capital measure. An “adequately capitalized” bank has a total risk-based capital ratio of 8.0% or higher, a Tier 1 risk-based capital ratio of 4.0% or higher, a leverage ratio of 4.0% or higher (3.0% or higher if the bank was rated a composite 1 in its most recent examination report and is not experiencing significant growth) and does not meet the criteria for a well-capitalized bank. A bank is “undercapitalized” if it fails to meet any one of the ratios required to be adequately capitalized.

In addition to requiring undercapitalized institutions to submit a capital restoration plan, agency regulations contain broad restrictions on certain activities of undercapitalized institutions including asset growth, acquisitions, branch establishment and expansion into new lines of business. With certain exceptions, an insured depository institution is prohibited from making capital distributions, including dividends, and is prohibited from paying management fees to control persons if the institution would be undercapitalized after any such distribution or payment.

As an institution’s capital decreases, the FDIC’s enforcement powers become more severe. A significantly undercapitalized institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management and other restrictions. The FDIC has only very limited discretion in dealing with a critically undercapitalized institution and is virtually required to appoint a receiver or conservator. Banks with risk-based capital and leverage ratios below the required minimums may also be subject to certain administrative actions, including the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing in the event the institution has no tangible capital.

Deposit Insurance Assessments. Substantially all of the deposits of Independent Bank are insured up to applicable limits by the deposit insurance fund of the FDIC, and Independent Bank must pay deposit insurance assessments to the FDIC for such deposit insurance protection. The FDIC maintains the deposit insurance fund by designating a required reserve ratio. If the reserve ratio falls below the designated level, the FDIC must adopt a restoration plan that provides that the deposit insurance fund will return to an acceptable level generally within five years.

On December 20, 2010, the FDIC raised the minimum designated reserve ratio of the deposit insurance fund to 2.00%, which exceeds the 1.35% reserve ratio that is required by the Dodd-Frank Act. The FDIC has the discretion to set the price for deposit insurance according to the risk for all insured institutions regardless of the level of the reserve ratio. Under the Dodd-Frank Act, the FDIC is required to offset the effect of the higher reserve ratio on small insured depository institutions, which are those with consolidated assets of less than \$10 billion.

The deposit insurance fund reserve ratio is maintained by assessing depository institutions and establishing an insurance premium based upon statutory factors. Under its current regulations, the FDIC imposes assessments for deposit insurance according to a depository institution’s ranking in one of four risk categories based upon supervisory and capital evaluations. The assessment rate for an individual institution is determined according to a formula based on a combination of weighted average CAMELS component ratings, financial ratios and, for institutions that have long-term debt ratings, the average ratings of its long-term debt. Well-capitalized institutions (generally those with CAMELS composite ratings of 1 or 2) are grouped in Risk Category I and the initial base assessment rate for deposit insurance is set at an annual rate of between 12 and 16 basis points. The initial base assessment rate for institutions in Risk Categories II, III and IV is set at annual rates of 22, 32 and 50 basis points, respectively. These initial base assessment rates are adjusted to determine an institution’s final assessment rate based on its brokered deposits, secured liabilities and unsecured debt. Total base assessment rates after adjustments range from 7 to 24 basis points for Risk Category I, 17 to 43 basis points for Risk Category II, 27 to 58 basis points for Risk Category III, and 40 to 77.5 basis points for Risk Category IV.

In November 2009, the FDIC adopted a rule that required all insured institutions, with limited exceptions, to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012. The assessment was calculated by taking the institution’s actual September 30, 2009 assessment base and adjusting it quarterly by an estimated 5% annual growth rate through the end of 2012. Each institution was required to record the entire amount of its prepaid assessment as a prepaid expense, i.e., an asset on its balance sheet, as of December 30, 2009. As of December 31, 2009, and each quarter thereafter, each institution is required to record an expense, or a charge to earnings, for its quarterly assessment invoiced on its quarterly statement and an offsetting credit to the prepaid assessment until the asset is exhausted.

On February 7, 2012, the FDIC approved a final rule that amends its existing deposit insurance funds restoration plan and implements certain provisions of the Dodd-Frank Act. Effective as of July 1, 2012, the assessment base is determined using average consolidated total assets minus average tangible equity rather than the current assessment base of adjusted domestic deposits. Since the change will result in a much larger assessment base, the final rule also lowers the assessment rates in order to keep the total amount collected from financial institutions relatively unchanged from the amounts currently being collected.

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The new assessment rates, calculated on the revised assessment base, generally range from 2.5 to 9 basis points for Risk Category I institutions, 9 to 24 basis points for Risk Category II institutions, 18 to 33 basis points for Risk Category III institutions, and 30 to 45 basis points for Risk Category IV institutions. For large institutions (generally those with total assets of \$10 billion or more), which does not include Independent Bank, the initial base assessment rate ranges from 5 to 35 basis points on an annualized basis. After the effect of potential base-rate adjustments, the total base assessment rate could range from 2.5 to 45 basis points on an annualized basis. Assessment rates for large institutions will be calculated using a scorecard that combines CAMELS ratings and certain forward-looking financial measures to assess the risk a large institution poses to the deposit insurance fund. The new assessment rates will be calculated for the quarter beginning July 1, 2012 and reflected in invoices for assessments due September 30, 2012.

Brokered Deposit Restrictions. Adequately capitalized institutions cannot accept, renew or roll over brokered deposits, without receiving a waiver from the FDIC, and are subject to restrictions on the interest rates that can be paid on any deposits. Undercapitalized institutions may not accept, renew, or roll over brokered deposits.

Concentrated Commercial Real Estate Lending Regulations. The federal banking agencies, including the FDIC, have promulgated guidance governing financial institutions with concentrations in commercial real estate lending. The guidance provides that a bank has a concentration in commercial real estate lending if (i) total reported loans for construction, land development, and other land represent 100% or more of total capital or (ii) total reported loans secured by multifamily and nonfarm residential properties and loans for construction, land development, and other land represent 300% or more of total capital and the bank's commercial real estate loan portfolio has increased 50% or more during the prior 36 months. Owner occupied loans are excluded from this second category. If a concentration is present, management must employ heightened risk management practices that address the following key elements: including board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending.

Cross-Guarantee Provisions. The Financial Institutions Reform, Recovery and Enforcement Act of 1989, or the FIRREA, contains a "cross-guarantee" provision which generally makes commonly controlled insured depository institutions liable to the FDIC for any losses incurred in connection with the failure of a commonly controlled depository institution.

Community Reinvestment Act. The CRA and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their entire service area, including low and moderate income neighborhoods, consistent with the safe and sound operations of such banks. These regulations also provide for regulatory assessment of a bank's record in meeting the needs of its service area when considering applications to establish branches, merger applications and applications to acquire the assets and assume the liabilities of another bank. The FIRREA requires federal banking agencies to make public a rating of a bank's performance under the CRA. In the case of a bank holding company, the CRA performance record of the banks involved in the transaction are reviewed in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or to merge with any other bank holding company. An unsatisfactory CRA record could substantially delay approval or result in denial of an application.

Consumer Laws and Regulations. In addition to the laws and regulations discussed herein, Independent Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, and the Fair Housing Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. Independent Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations.

The Dodd-Frank Act created a new independent Consumer Financial Protection Bureau, which will have broad authority to regulate and supervise retail financial services activities of banks, such as Independent Bank, and will have the authority to promulgate regulations, issue orders, guidance and policy statements, conduct examinations and bring enforcement actions with regard to consumer financial products and services. In general, however, banks with

assets of \$10 billion or less, such as Independent Bank, will continue to be examined for consumer compliance by their primary bank regulator.

Anti-Money Laundering and Anti-Terrorism Legislation. A major focus of governmental policy on financial institutions in recent years has been aimed at combating money laundering and terrorist financing. The USA PATRIOT Act of 2001, or the USA Patriot Act, substantially broadened the scope of U.S. anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The U.S. Treasury Department has issued and, in some cases, proposed a number of

regulations that apply various requirements of the USA Patriot Act to financial institutions. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers. Certain of those regulations impose specific due diligence requirements on financial institutions that maintain correspondent or private banking relationships with non-U.S. financial institutions or persons. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution.

Office of Foreign Assets Control Regulation. The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the “OFAC” rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control, or OFAC. The OFAC-administered sanctions targeting certain countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on “U.S. persons” engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to a U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

Privacy. In addition to expanding the activities in which banks and bank holding companies may engage, the GLB Act also imposed new requirements on financial institutions with respect to customer privacy. The GLB Act generally prohibits disclosure of customer information to nonaffiliated third parties unless the customer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to customers annually. Financial institutions, however, are required to comply with state law if it is more protective of customer privacy than the GLB Act.

The USA Patriot Act. The USA Patriot Act is intended to strengthen U.S. law enforcement’s and the intelligence community’s ability to work cohesively to combat terrorism on a variety of fronts. The potential impact of the USA Patriot Act on financial institutions of all kinds is significant and wide ranging. The USA Patriot Act requires financial institutions to prohibit correspondent accounts with foreign shell banks, establish an anti-money laundering program that includes employee training and an independent audit, follow minimum standards for identifying customers and maintaining records of the identification information and make regular comparisons of customers against agency lists of suspected terrorists, their organizations and money launderers.

Changes in Laws, Regulations or Policies

In light of current conditions and the market outlook for continuing weak economic conditions, regulators have increased their focus on the regulation of financial institutions. From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures. Such initiatives may change banking statutes and the operating environment of the Company and Independent Bank in substantial and unpredictable ways. The Company cannot determine the ultimate effect that any potential legislation, if enacted, or implementing regulations with respect thereto, would have, upon the financial condition or results of operations of the Company or Independent Bank. A change in statutes, regulations or regulatory policies applicable to the Company or Independent Bank could have a material effect on the financial condition, results of operations or business of the Company and Independent Bank.

Dodd-Frank Act. In July 2010, Congress enacted the Dodd-Frank Act regulatory reform legislation, which President Obama signed into law on July 21, 2010. This new law broadly affects the financial services industry by implementing changes to the financial regulatory landscape aimed at strengthening the sound operation of the financial services sector, including provisions that, among other things, has created a new agency, the Consumer Financial Protection Bureau (as discussed above), and will:

• apply the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies, which, among other things, will require the Company to deduct all trust preferred securities issued on or after May 19, 2010 from the Company’s Tier 1 capital (existing trust preferred securities issued prior to May 19,

2010 for all bank holding companies with less than \$15.0 billion in total consolidated assets as of December 31, 2009 are exempt from this requirement);

broaden the base for FDIC insurance assessments from the amount of insured deposits to average total consolidated assets less average tangible equity during the assessment period (subject to risk-based adjustments that would further reduce the assessment base for custodial banks) rather than domestic deposits;

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- permanently increase FDIC deposit insurance maximum to \$250,000;
- eliminate the upper limit for the reserve ratio designated by the FDIC each year, increase the minimum designated reserve ratio of the deposit insurance fund from 1.15% to 1.35% of the estimated amount of total insured deposits by September 30, 2020 and eliminate the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds;
- permit banks to engage in de novo interstate branching if the laws of the state where the new branch is to be established would permit the establishment of the branch if it were chartered by such state;
- repeal the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts;
- eliminate the ceiling and increase the floor on the size of the FDIC's deposit insurance fund;
- implement corporate governance revisions, including with regard to executive compensation and proxy access by shareholders, that apply to all public companies, not just financial institutions; and
- increase the authority of the Federal Reserve to examine the Company and any nonbank subsidiaries.

In addition, the Dodd-Frank Act addresses many investor protection, corporate governance and executive compensation matters that will affect publicly traded companies. However, under the JOBS Act there are certain exceptions to these requirements for so long as a publicly traded qualifies as an emerging growth company. The Company's management is actively reviewing the provisions of the Dodd-Frank Act and assessing its probable impact on its business, financial condition, and results of operations. Provisions in the Dodd-Frank Act that affect deposit insurance assessments and payment of interest on demand deposits could increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate. Provisions in the legislation that revoke the Tier 1 capital treatment of newly issued trust preferred securities could require the Company to seek other sources of capital in the future. Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company, its customers or the financial industry more generally.

Incentive Compensation. In June 2010, the Federal Reserve, the OCC and the FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. Also, on February 7, 2012, the FDIC proposed an interagency rule to implement certain incentive compensation requirements of the Dodd-Frank Act. Under the proposed rule, financial institutions must prohibit incentive-based compensation arrangements that encourage inappropriate risk taking that are deemed excessive or that may lead to material losses.

The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Enforcement Powers of Federal and State Banking Agencies

The federal banking agencies have broad enforcement powers, including the power to terminate deposit insurance, impose substantial fines and other civil and criminal penalties, and appoint a conservator or receiver. Failure to

comply with applicable laws, regulations and supervisory agreements could subject the Company or Independent Bank and their subsidiaries, as well as their respective officers, directors, and other institution- affiliated parties, to administrative sanctions and potentially substantial civil money penalties. In addition to the grounds discussed above under “Corrective Measures for Capital Deficiencies,” the appropriate federal banking agency may appoint the FDIC as conservator or receiver for a banking institution (or the FDIC may appoint itself, under certain circumstances) if any one or more of a number of circumstances exist, including, without limitation, the fact that the banking institution is undercapitalized and has no reasonable prospect of becoming adequately capitalized, fails to become adequately capitalized when required to do so, fails to submit a timely and acceptable capital

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restoration plan or materially fails to implement an accepted capital restoration plan. The TDB also has broad enforcement powers over Independent Bank, including the power to impose orders, remove officers and directors, impose fines and appoint supervisors and conservators.

Effect on Economic Environment

The policies of regulatory authorities, including the monetary policy of the Federal Reserve, have a significant effect on the operating results of bank holding companies and their subsidiaries. Among the means available to the Federal Reserve to affect the money supply are open market operations in U.S. government securities, changes in the discount rate on member bank borrowings, and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid for deposits.

Federal Reserve monetary policies have materially affected the operating results of commercial banks in the past and are expected to continue to do so in the future. The nature of future monetary policies and the effect of such policies on the business and earnings of the Company and its subsidiaries cannot be predicted.

Item 1A. RISK FACTORS

An investment in the Company common stock involves risks. The material risks and uncertainties connected with the decision to invest in the Company common stock and with the Company's business in general are described below. Holders of the Company common stock should carefully read and consider all of these risks and all other information contained in this Annual Report on Form 10-K in making their investment decisions. If any of the risks described in this Annual Report on Form 10-K occur, the value of the Company common stock that you currently hold could decline significantly, and the current holders of the Company common stock could lose all or part of their respective investments.

Risks Related to the Company's Business

The Company's success depends significantly on the Company's management team, and the loss of the Company's senior executive officers or other key employees and the Company's inability to recruit or retain suitable replacements could adversely affect the Company's business, results of operations and growth prospects.

The Company's success depends significantly on the continued service and skills of the Company's existing executive management team, particularly David Brooks, the Company's Chairman of the Board and Chief Executive Officer, Torry Berntsen, the Company's President and Chief Operating Officer, Daniel Brooks, the Company's Vice Chairman and Chief Risk Officer, Brian Hobart, the Company's Vice Chairman and Chief Lending Officer, Michelle Hickox, the Company's Executive Vice President and Chief Financial Officer, and Jan Webb, the Company's Executive Vice President and Secretary. The implementation of the Company's business and growth strategies also depends significantly on the Company's ability to retain employees with experience and business relationships within their respective market areas. The Company's officers may terminate their employment with the Company at any time, and the Company could have difficulty replacing such officers with persons who are experienced in the specialized aspects of the Company's business or who have ties to the communities within the Company's market areas. The loss of any of the Company's key personnel could therefore have an adverse impact on the Company's business and growth.

The Company's strategy of pursuing acquisitions exposes the Company to financial, execution and operational risks that could have a material adverse effect on the Company's business, financial condition, results of operations and growth prospects.

The Company has been pursuing a growth strategy that includes the acquisition of other financial institutions in target markets. The Company has completed six acquisitions since 2010, is in the process of consummating the acquisition of BOH Holdings and currently intends to continue its acquisition strategy. Such an acquisition strategy involves significant risks, including the following:

- finding suitable markets for expansion;
- finding suitable candidates for acquisition;

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