FIRST FINANCIAL BANKSHARES INC
Form 10-K
February 17, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2016

Commission file number 0-7674

First Financial Bankshares, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Texas	75-0944023
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

400 Pine Street, Abilene, Texas	**79601**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (325) 627-7155

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

Title of Class	**Name of Exchange on Which Registered**
Common Stock, par value $0.01 per share	**Nasdaq Global Select Market**

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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or 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.

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

As of June 30, 2016, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of the registrant s voting and non-voting common stock held by non-affiliates was $2.07 billion.

As of February 17, 2017, there were 66,125,622 shares of common stock outstanding.

Documents Incorporated by Reference

Certain information called for by Part III is incorporated by reference to the proxy statement for our 2017 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2016.

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CAUTIONARY STATEMENT REGARDING

FORWARD-LOOKING STATEMENTS

This Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used in this Form 10-K, words such as anticipate, believe, estimate, expect, intend, predict, project, and similar expressions, as they relate to us or management, identify forward-looking statements. These forward-looking statements are based on information currently available to our management. Actual results could differ materially from those contemplated by the forward-looking statements as a result of certain factors, including, but not limited to, those listed in Item 1A-Risk Factors and the following:

- general economic conditions, including our local, state and national real estate markets and employment trends;
- volatility and disruption in national and international financial and commodity markets;
- government intervention in the U.S. financial system, including the effects of recent legislative, tax, accounting and regulatory actions and reforms, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the Jumpstart Our Business Startups Act, the Consumer Financial Protection Bureau and the capital ratios of Basel III as adopted by the federal banking authorities;
- political instability;
- the ability of the Federal government to address the national economy;
- changes in our competitive environment from other financial institutions and financial service providers;
- the effects of and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System (the Federal Reserve Board);
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;

the effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which we and our subsidiaries must comply;

changes in the demand for loans;

fluctuations in the value of collateral securing our loan portfolio and in the level of the allowance for loan losses;

the accuracy of our estimates of future loan losses;

the accuracy of our estimates and assumptions regarding the performance of our securities portfolio;

soundness of other financial institutions with which we have transactions;

inflation, interest rate, market and monetary fluctuations;

changes in consumer spending, borrowing and savings habits;

changes in commodity prices (e.g., oil and gas, cattle, and wind energy);

- our ability to attract deposits and increase market share;
- changes in our liquidity position;
- changes in the reliability of our vendors, internal control system or information systems;
- cyber attacks on our technology information systems, including fraud from our customers and external third party vendors;
- our ability to attract and retain qualified employees;
- acquisitions and integration of acquired businesses;
- the possible impairment of goodwill associated with our acquisitions;
- consequences of continued bank mergers and acquisitions in our market area, resulting in fewer but much larger and stronger competitors;
- expansion of operations, including branch openings, new product offerings and expansion into new markets;
- changes in our compensation and benefit plans; and
- acts of God or of war or terrorism.

Such forward-looking statements reflect the current views of our management with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this paragraph. We undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events or otherwise (except as required by law).

PART I

ITEM 1. BUSINESS

General

First Financial Bankshares, Inc., a Texas corporation (the Company), is a financial holding company registered under the Bank Holding Company Act of 1956, as amended, or BHCA. As such, we are supervised by the Federal Reserve Board, as well as several other bank regulators. We were formed as a bank holding company in 1956 under the original name F & M Operating Company, but our banking operations date back to 1890, when Farmers and Merchants National Bank opened for business in Abilene, Texas. On July 31, 2015, we acquired FBC Bancshares, Inc., and its wholly owned subsidiary, First Bank, N.A., Conroe, Texas and merged these entities with and into the Company and our subsidiary bank, respectively. We also completed an asset purchase of 4Trust Mortgage, Inc. on June 1, 2015 that significantly increased our residential mortgages/loan originations that are sold in the secondary market. On January 1, 2015, our technology subsidiary, First Technology Services, Inc., was contributed to our bank subsidiary, First Financial Bank, National Association, Abilene, Texas, and therefore became an indirect subsidiary of the Company. As of December 31, 2016, our subsidiaries are:

First Financial Bank, National Association, Abilene, Texas;

First Technology Services, Inc., Abilene, Texas, a wholly owned subsidiary of First Financial Bank, National Association, Abilene, Texas;

First Financial Trust & Asset Management Company, National Association, Abilene, Texas;

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First Financial Insurance Agency, Inc., Abilene, Texas; and

First Financial Investments, Inc., Abilene, Texas.

Through our subsidiaries, we conduct a full-service commercial banking business. Our banking centers are located primarily in Central, North Central, Southeast and West Texas. As of December 31, 2016, we had 69 financial centers across Texas, with eleven locations in Abilene, three locations in San Angelo and Weatherford, two locations in Cleburne, Conroe, Stephenville, and Granbury, and one location each in Acton, Albany, Aledo, Alvarado, Beaumont, Boyd, Bridgeport, Brock, Burleson, Cisco, Clyde, Cut and Shoot, Decatur, Eastland, Fort Worth, Glen Rose, Grapevine, Hereford, Huntsville, Keller, Magnolia, Mauriceville, Merkel, Midlothian, Mineral Wells, Montgomery, Moran, New Waverly, Newton, Odessa, Orange, Port Arthur, Ranger, Rising Star, Roby, Southlake, Sweetwater, Tomball, Trent, Trophy Club, Vidor, Waxahachie, Willis and Willow Park, all in Texas.

Even though we operate in a growing number of Texas markets, we continue to believe that decisions are best made at the local level. Although we consolidated our bank charters into one charter, we continue to regionally manage our operations with local advisory boards of directors, local bank region presidents and local decision-making. We have consolidated many of the backroom operations, such as investment securities, accounting, check processing, technology and employee benefits, which improves our efficiency and frees management of our bank regions to concentrate on serving the banking needs of their local communities. On January 1, 2016, we combined our Huntsville and Conroe Regions and our Abilene, Sweetwater and Eastland Regions. Also, the Company established a Fort Worth Region that previously was a branch of our Weatherford Region.

In the past, we have chosen to keep our Company focused on the State of Texas, one of the nation s largest, fastest-growing and most economically diverse states. With approximately 27.7 million residents, Texas has more people than any other state except California. The population of Texas grew 21.1% from 2005-2015 according to the U.S. Census Bureau. Many of the communities in which we operate are also experiencing positive growth as shown below:

Population Growth 2005-2015*

Bridgeport and Wise County	20.1%
Fort Worth and Tarrant County	20.9%
Cleburne and Johnson County	14.6%
Granbury and Hood County	18.0%
Weatherford, Willow Park, Aledo and Parker County	31.8%
Stephenville and Erath County	16.3%
Conroe and Montgomery County	46.0%

* Source: U. S. Census Bureau

These economies include dynamic centers of higher education, agriculture, wind energy and natural resources, retail, military, healthcare, tourism, retirement living, manufacturing and distribution.

We believe our community approach to doing business works best for us in small and mid-size markets, where we can play a prominent role in the economic, civic and cultural life of the community. Our goal is to serve these communities well and to experience growth as these markets continue to expand. In many instances, banking competition is less intense in smaller markets, making it easier for us to operate rationally and attract and retain high-caliber employees who prefer not only our community-banker concept but the high quality of life in smaller cities.

Over the years, we have grown in three ways: by growing organically, by opening new branch locations and by acquiring other banks. Since 1997, we have completed twelve bank acquisitions and have increased our total assets from $1.57 billion to $6.81 billion as of December 31, 2016. We have also established a trust and asset management company and a technology services company. First Financial Trust and Asset Management Company, National Association operates as a subsidiary of First Financial Bankshares, Inc. and First Technology Services, Inc. operates as a subsidiary of First Financial Bank, National Association, Abilene, Texas. Looking ahead, we intend to continue to grow organically by better serving the needs of our customers and putting them first in all of our decisions. We continually look for new branch locations, so we can provide more convenient service to our customers, and we are actively pursuing acquisition opportunities by calling on banks that we are interested in possibly acquiring.

When targeting a bank for acquisition, the subject bank generally needs to be well managed and profitable, while being located in the type of community that fits our profile. We seek to enter growing communities with good amenities schools, infrastructure, commerce and lifestyle. We prefer non-metropolitan markets, either around

Dallas/Fort Worth, Houston, San Antonio or Austin or along the Interstate 35, 45, 10 and 20 corridors in Texas. We might also consider the acquisition of banks in East Texas, the Texas Hill Country area or in states contiguous to Texas. Banks between $300 million and $1.0 billion in asset size fit our sweet spot for acquisition, but we would consider banks that are larger or smaller, or that are in other areas of Texas if we believe they would be a good fit for our Company.

Information on our revenues, profits and losses and total assets appears in Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Item 7 hereof.

First Financial Bankshares, Inc.

We provide management, technical resources and policy direction to our subsidiaries, which enable them to improve or expand their services while continuing their local activity and identity. Each of our subsidiaries operates under the day-to-day management of its own board of directors and officers, including advisory boards of directors for our bank regions. We provide resources and policy direction in, among other things, the following areas:

- asset and liability management;
- investments;
- accounting;
- budgeting;
- training;
- marketing;
- planning;
- risk management;
- loan review;
- loan analysis;

- human resources;
- insurance;
- capitalization;
- regulatory compliance; and
- internal audit.

In particular, we assist our subsidiaries with, among other things, decisions concerning major capital expenditures, employee fringe benefits, including retirement plans and group medical coverage, dividend policies, and appointment of officers and directors, including advisory directors, and their compensation. We also perform, through corporate staff groups or by outsourcing to third parties, internal audits, compliance oversight and loan reviews of our subsidiaries. We provide advice and specialized services for our bank regions related to lending, investing, purchasing, advertising, public relations, and technology services.

We evaluate various potential financial institution acquisition opportunities and approve potential locations for new branch offices. We anticipate that funding for any acquisitions or expansions would be provided from our existing cash balances, available dividends from our subsidiaries, utilization of available lines of credit and future debt or equity offerings.

Services Offered by Our Subsidiaries

Our subsidiary bank, First Financial Bank, National Association, is a separate legal entity that operates under the day-to-day management of its board of directors and officers. Our multiple banking regions, which operate under our subsidiary bank, each have separate advisory boards that make recommendations and provide assistance to regional management of the bank regarding the operations of their respective region. Each of our bank regions provides general commercial banking services, which include accepting and holding checking, savings and time deposits, making loans, automated teller machines, drive-in and night deposit services, safe deposit facilities, remote deposit capture, internet banking, mobile banking, payroll cards, transmitting funds, and performing other customary commercial banking services. We also conduct full service trust activities through First Financial Trust & Asset Management Company, National Association, our trust company. Our trust company has eight locations which are located in Abilene, Fort Worth, Lubbock, Odessa, Beaumont, San Angelo, Stephenville and Sweetwater, all in Texas. Through our trust company, we offer personal trust services, which include wealth management, the administration of estates, testamentary trusts, revocable and irrevocable trusts and agency accounts. We also administer all types of retirement and employee benefit accounts, which include 401(k) profit sharing plans and IRAs. In addition, we provide securities brokerage services through arrangements with an unrelated third party in our Abilene, Cleburne, San Angelo, Southlake, Stephenville and Weatherford banking regions.

Competition

Commercial banking in Texas is highly competitive, and because we hold less than 1% of the state s deposits, we represent only a minor segment of the industry. To succeed in this industry, we believe that we must have the capability to compete effectively in the areas of (1) interest rates paid or charged; (2) scope of services offered; and (3) prices charged for such services. Our bank regions compete in their respective service areas against highly competitive banks, thrifts, savings and loan associations, small loan companies, credit unions, mortgage companies, insurance companies, and brokerage firms, all of which are engaged in providing financial products and services and some of which are larger than us in terms of capital, resources and personnel.

Our business does not depend on any single customer or any few customers, and the loss of any one would not have a materially adverse effect upon our business. Although we have a broad base of customers that are not related to us, our customers also occasionally include our officers and directors, as well as other entities with which we are affiliated. Through our bank regions we may make loans to our officers and directors, and entities with which we are affiliated, in the ordinary course of business. We make these loans on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons. Loans to our directors, officers and their affiliates are also subject to numerous restrictions under federal and state banking laws, which we describe in greater detail below, under the heading Supervision and Regulation Loans to Directors, Executive Officers and Principal Shareholders.

Employees

Including all of our subsidiaries, we employed approximately 1,300 full-time equivalent employees at December 31, 2016. Our management believes that our employee relations have been and will continue to be good.

Supervision and Regulation

Both federal and state laws extensively regulate bank holding companies, financial holding companies and banks. These laws (and the regulations promulgated thereunder) are primarily intended to protect depositors and the deposit insurance fund (the DIF) of the Federal Deposit Insurance Corporation, or the FDIC. The following information

describes particular laws and regulatory provisions relating to financial holding companies and banks. This discussion is qualified in its entirety by reference to the particular laws and regulatory provisions. A change in any of these laws or regulations may have a material effect on our business and the business of our subsidiaries. Recent political developments, including the change in administration of the United States federal government, have added additional uncertainty in the implementation, scope and timing of regulatory reforms.

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Bank Holding Companies and Financial Holding Companies

Historically, the activities of bank holding companies were limited to the business of banking and activities closely related or incidental to banking. Bank holding companies were generally prohibited from acquiring control of any company that was not a bank and from engaging in any business other than the business of banking or managing and controlling banks. The Gramm-Leach-Bliley Act, which took effect on March 12, 2000, dismantled many Depression-era restrictions against affiliations between banking, securities and insurance firms by permitting bank holding companies to engage in a broader range of financial activities, so long as certain safeguards are observed. Specifically, bank holding companies may elect to become financial holding companies that may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental to a financial activity. Thus, with the enactment of the Gramm-Leach-Bliley Act, banks, security firms and insurance companies find it easier to acquire or affiliate with each other and cross-sell financial products. The Gramm-Leach-Bliley Act permits a single financial services organization to offer a more complete array of financial products and services than historically was permitted.

A financial holding company is essentially a bank holding company with significantly expanded powers. Under the Gramm-Leach-Bliley Act, in addition to traditional lending activities, the following activities are among those that are deemed financial in nature for financial holding companies: securities underwriting, dealing in or making a market in securities, sponsoring mutual funds and investment companies, insurance underwriting and agency activities, activities which the Federal Reserve Board determines to be closely related to banking, and certain merchant banking activities.

We elected to become a financial holding company in September 2001. As a financial holding company, we have very broad discretion to affiliate with securities firms and insurance companies, provide merchant banking services, and engage in other activities that the Federal Reserve Board has deemed financial in nature. In order to continue as a financial holding company, we must continue to be well-capitalized, well-managed and maintain compliance with the Community Reinvestment Act. Depending on the types of financial activities that we may elect to engage in, under the Gramm-Leach-Bliley Act s functional regulation principles, we may become subject to supervision by additional government agencies. The election to be treated as a financial holding company increases our ability to offer financial products and services that historically we were either unable to provide or were only able to provide on a limited basis. As a result, we will face increased competition in the markets for any new financial products and services that we may offer. Likewise, an increased amount of consolidation among banks and securities firms or banks and insurance firms could result in a growing number of large financial institutions that could compete aggressively with us.

Mergers and Acquisitions

We generally must obtain approval from the banking regulators before we can acquire other financial institutions. We may not engage in certain acquisitions if we are undercapitalized. Furthermore, the BHCA provides that the Federal Reserve Board cannot approve any acquisition, merger or consolidation that may substantially lessen competition in the banking industry, create a monopoly in any section of the country, or be a restraint of trade. However, the Federal Reserve Board may approve such a transaction if the convenience and needs of the community clearly outweigh any anti-competitive effects. Specifically, the Federal Reserve Board would consider, among other factors, the expected benefits to the public (greater convenience, increased competition, greater efficiency, etc.) against the risks of possible adverse effects (undue concentration of resources, decreased or unfair competition, conflicts of interest, unsound banking practices, etc.).

Under the BHCA, the Company must obtain the prior approval of the Federal Reserve Board, or acting under delegated authority, the Federal Reserve Bank of Dallas before (1) acquiring direct or indirect ownership or control of

any class of voting securities of any bank or bank holding company if, after the acquisition, the Company would directly or indirectly own or control 5% or more of the class; (2) acquiring all or substantially all of the assets of another bank or bank holding company; or (3) merging or consolidating with another bank holding company.

The Change in Bank Control Act of 1978, as amended, or the CIBCA, and the related regulations of the Federal Reserve Board require any person or groups of persons acting in concert (except for companies required to make application under the BHCA), to file a written notice with the Federal Reserve Board before the person or group

acquires control of the Company. The CIBCA defines control as the direct or indirect power to vote 25% or more of any class of voting securities or to direct the management or policies of a bank holding company or an insured bank. A rebuttable presumption of control arises under the CIBCA where a person or group controls 10% or more, but less than 25%, of a class of the voting stock of a company or insured bank which is a reporting company under the Securities Exchange Act of 1934, as amended, such as the Company, or such ownership interest is greater than the ownership interest held by any other person or group.

Banks

Federal and state laws and regulations that govern banks have the effect of, among other things, regulating the scope of business, investments, cash reserves, the purpose and nature of loans, the maximum interest rate chargeable on loans, the amount of dividends declared, and required capitalization ratios.

National Banking Associations. Banks organized as national banking associations under the National Bank Act are subject to regulation and examination by the Office of the Comptroller of the Currency, or OCC. Effective December 30, 2012, we consolidated our then eleven bank charters into one, that being our Abilene charter. As a result, the OCC now supervises, regulates and regularly examines the following subsidiaries:

- First Financial Bank, National Association, Abilene, Texas;
- First Financial Trust & Asset Management Company, National Association; and
- First Technology Services, Inc. (a wholly owned subsidiary of First Financial Bank, National Association)

The OCC s supervision and regulation of banks is primarily intended to protect the interests of depositors. The National Bank Act:

- requires each national banking association to maintain reserves against deposits;
- restricts the nature and amount of loans that may be made and the interest that may be charged; and
- restricts investments and other activities.

Deposit Insurance Coverage and Assessments

Our subsidiary bank is a member of the FDIC. Through the DIF, the FDIC provides deposit insurance protection that covers all deposit accounts in FDIC-insured depository institutions up to applicable limits (currently, $250,000 per depositor).

Our subsidiary bank must pay assessments to the FDIC under a risk-based assessment system for this federal deposit insurance protection. FDIC-insured depository institutions that are members of the Bank Insurance Fund pay insurance premiums at rates based on their risk classification. Institutions assigned to higher risk classifications (i.e.,

institutions that pose a greater risk of loss to the DIF) pay assessments at higher rates than institutions assigned to lower risk classifications. An institution s risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to bank regulators. Through June 30, 2016, the assessment rate for our subsidiary bank was at the lowest risk-based premium available, which was 5.00% of the assessment base per annum. Effective for the third and fourth quarters of 2016, in connection with the DIF reaching the required percentage levels, our assessment rate per annum was reduced to 3.00%, the current lowest risk-based premium available.

In addition, the FDIC can impose special assessments to cover shortages in the DIF. The FDIC required insured depository institutions to prepay on December 30, 2009 their estimated quarterly assessments for 2010, 2011 and 2012, including a three basis point increase in premium rates for 2011 and 2012. (The three basis point increase was later cancelled under the Restoration Plan described below.) The Company s prepayment amount on December 31, 2009 totaled $11.60 million in the aggregate and was expensed based on quarterly assessment calculations. In June 2013, the unused portion of our prepaid assessment totaling $3.72 million was refunded by FDIC to our subsidiary bank.

In October 2010, the FDIC adopted a new Restoration Plan for the DIF to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. On April 26, 2016, the FDIC adopted a rule amending pricing for deposit insurance for institutions with less than $10 billion in assets effective the quarter after the fund reserve ratio reached 1.15%. As of June 30, 2016, the FDIC announced that the fund reserve ratio had reached 1.15%. As a result, the Company s assessment rate was decreased to the rate stated above. The Dodd-Frank Act also eliminated the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The Dodd-Frank Act requires the FDIC to offset the effect of increasing the reserve ratio on institutions with total consolidated assets of less than $10 billion, such as the Company.

As required by the Dodd-Frank Act, the FDIC also revised the deposit insurance assessment system, effective April 1, 2011, to base assessments on the average total consolidated assets of insured depository institutions during the assessment period, less the average tangible equity of the institution during the assessment period as opposed to solely bank deposits at an institution. This base assessment change necessitated that the FDIC adjust the assessment rates to ensure that the revenue collected under the new assessment system will approximately equal that under the existing assessment system.

Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, or FIRREA, an FDIC-insured depository institution can be held liable for any losses incurred by the FDIC in connection with (1) the default of one of its FDIC-insured subsidiaries or (2) any assistance provided by the FDIC to one of its FDIC-receivers, and in danger of default is defined generally as the existence of certain conditions indicating that a default is likely to occur in the absence of regulatory assistance.

The FDIC is also empowered to regulate interest rates paid by insured banks. Approval of the FDIC is also required before an insured bank retires any part of its common or preferred stock, or any capital notes or debentures.

Payment of Dividends

We are a legal entity separate and distinct from our banking and other subsidiaries. We receive most of our revenue from dividends paid to us by our bank and trust company subsidiaries. Described below are some of the laws and regulations that apply when either we or our subsidiaries pay or paid dividends.

The Federal Reserve Board, the OCC and the FDIC have issued policy statements that recommend that bank holding companies and insured banks should generally only pay dividends to the extent net income is sufficient to cover both cash dividends and a rate of earnings retention consistent with capital needs, asset quality and overall financial condition. Further, the Federal Reserve Board s policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company s ability to serve as a source of strength to its banking subsidiaries. In addition, the Federal Reserve Board has indicated that each bank holding company should carefully review its dividend policy, and has discouraged payment ratios that are at maximum allowable levels, which is the maximum dividend amount that may be issued and allow the company to still maintain its target Tier 1 capital ratio, unless both asset quality and capital are very strong.

To pay dividends, our subsidiaries must maintain adequate capital above regulatory guidelines. Under federal law, our subsidiary bank cannot pay a dividend if, after paying the dividend, the bank would be undercapitalized. In addition, if the FDIC believes that a bank under its jurisdiction is engaged in, or is about to engage in, an unsafe or unsound practice (which, depending on the financial condition of the bank, could include the payment of dividends), the FDIC may require, after notice and hearing, that such bank cease and desist from the unsafe practice. The FDIC and the OCC have each indicated paying dividends that deplete a bank s capital base to an inadequate level would be an unsafe and unsound banking practice.

National banks are required by federal law to obtain the prior approval of the OCC in order to declare and pay dividends if the total of all dividends declared in any calendar year would exceed the total of (1) such bank s net profits (as defined and interpreted by regulation) for that year plus (2) its retained net profits (as defined and interpreted by regulation) for the preceding two calendar years, less any required transfers to surplus. In addition, these banks may only pay dividends to the extent that retained net profits (including the portion transferred to surplus) exceed bad debts (as defined by regulation).

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Our subsidiaries paid aggregate dividends to us of $48.8 million in 2016 and $51.20 million in 2015. Under the dividend restrictions discussed above, as of December 31, 2016, our subsidiaries could have declared in the aggregate additional dividends of approximately $170.73 million from retained net profits, without obtaining regulatory approvals.

Affiliate Transactions

The Federal Reserve Act, the Federal Deposit Insurance Act (FDIA) and the rules adopted under these statutes restrict the extent to which we can borrow or otherwise obtain credit from, or engage in certain other transactions with, our subsidiaries. These laws regulate covered transactions between insured depository institutions and their subsidiaries, on the one hand, and their nondepository affiliates, on the other hand. The Dodd-Frank Act expanded the definition of affiliate to make any investment fund, including a mutual fund, for which a depository institution or its affiliates serve as investment advisor an affiliate of the depository institution. Covered transactions include a loan or extension of credit to a non-depository affiliate, a purchase of securities issued by such an affiliate, a purchase of assets from such an affiliate (unless otherwise exempted by the Federal Reserve Board), an acceptance of securities issued by such an affiliate as collateral for a loan, and an issuance of a guarantee, acceptance, or letter of credit for the benefit of such an affiliate. The Dodd-Frank Act extended the limitations to derivative transactions, repurchase agreements and securities lending and borrowing transactions that create credit exposure to an affiliate or an insider. The covered transactions that an insured depository institution and its subsidiaries are permitted to engage in with their non-depository affiliates are limited to the following amounts: (1) in the case of any one such affiliate, the aggregate amount of covered transactions cannot exceed ten percent of the capital stock and the surplus of the insured depository institution; and (2) in the case of all affiliates, the aggregate amount of covered transactions cannot exceed twenty percent of the capital stock and surplus of the insured depository institution. In addition, extensions of credit that constitute covered transactions must be collateralized in prescribed amounts. Further, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services. Finally, when we and our subsidiaries conduct transactions internally among us, we are required to do so at arm s length.

Loans to Directors, Executive Officers and Principal Shareholders

The authority of our subsidiary bank to extend credit to our directors, executive officers and principal shareholders, including their immediate family members, corporations and other entities that they control, is subject to substantial restrictions and requirements under Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O promulgated thereunder, as well as the Sarbanes-Oxley Act of 2002. These statutes and regulations impose specific limits on the amount of loans our subsidiary bank may make to directors and other insiders, and specified approval procedures must be followed in making loans that exceed certain amounts. In addition, all loans our subsidiary bank makes to directors and other insiders must satisfy the following requirements:

- the loans must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with persons not affiliated with us or our subsidiary bank;

- the subsidiary bank must follow credit underwriting procedures at least as stringent as those applicable to comparable transactions with persons who are not affiliated with us or our subsidiary bank; and

the loans must not involve a greater than normal risk of non-payment or include other features not favorable to our subsidiary bank.

Furthermore, our subsidiary bank must periodically report all loans made to directors and other insiders to the bank regulators, and these loans are closely scrutinized by the regulators for compliance with Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O. Each loan to directors or other insiders must be pre-approved by the bank s board of directors with the interested director abstaining from voting.

Capital

We and our bank subsidiary are each required to comply with applicable capital adequacy standards established by the Federal Reserve Board and the OCC, respectively. The current risk-based capital standards applicable to us and our bank subsidiary, parts of which are currently in the process of being phased-in, are based on the December 2010 final capital framework for strengthening international capital standards, known as Basel III, of the Basel Committee on Banking Supervision (the Basel Committee).

In July 2013, the federal bank regulators approved final rules (the Basel III Rules) implementing the Basel III framework as well as certain provisions of the Dodd-Frank Act. The Basel III Rules substantially revised the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries. The Basel III Rules became effective for us and our subsidiary bank on January 1, 2015 (subject to a phase-in period for certain provisions).

The Basel III Rules established three components of regulatory capital: (1) common equity tier 1 capital (CET1), (2) additional tier 1 capital, and (3) tier 2 capital. Tier 1 capital is the sum of CET1 and additional tier 1 capital instruments meeting certain revised requirements. Total capital is the sum of tier 1 capital and tier 2 capital. Under the Basel III Rules, for most banking organizations, the most common form of additional tier 1 capital is non-cumulative perpetual preferred stock and the most common form of tier 2 capital is subordinated notes and a portion of the allocation for loan and lease losses, in each case, subject to the Basel III Rules specific requirements. As of December 31, 2016, we do not have any non-cumulative perpetual preferred stock or subordinated notes. CET1, tier 1 capital, and total capital serve as the numerators for the three prescribed regulatory capital ratios. Risk-weighted assets, calculated using the standardized approach in the Basel III Capital Rules for us and our subsidiary bank, provide the denominator for such ratios. There is also a leverage ratio that compares tier 1 capital to average total assets.

Pursuant to the Basel III Rules, the effects of certain accumulated other comprehensive income or loss (AOCI) items are not excluded; however, non-advanced approaches banking organizations, including us and our subsidiary bank, could make a one-time permanent election to continue to exclude these items. The Company made its a one-time, permanent election to continue to exclude AOCI from capital in its filing with the Federal Reserve Board for the quarter ended March 31, 2015. If the Company would not have made this election, unrealized gains and losses would have been included in the calculation of its regulatory capital. The Basel III Rules also preclude certain hybrid securities, such as trust preferred securities issued prior to May 19, 2010, from inclusion in our Tier 1 capital, subject to grandfathering in the case of companies, such as us, that had less than $15 billion in total consolidated assets as of December 31, 2009.

Under the Basel III Rules, the minimum capital ratios effective as of January 1, 2015 are:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital to risk-weighted assets;
- 8.0% Total capital to risk-weighted assets; and

4.0% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the leverage ratio).

The Basel III Rules also establish a fully-phased capital conservation buffer of 2.5% above the new regulatory minimum risk-based capital requirements. The conservation buffer, when added to the capital requirements, results in the following minimum ratios: (i) a CET1 risk-based capital ratio of 7.0%, (ii) a Tier 1 risk-based capital ratio of 8.5%, and (iii) a total risk-based capital ratio of 10.5%. The new capital conservation buffer requirement is being phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution is subject to limitations on certain activities including payment of dividends, share repurchases and discretionary bonuses to executive officers if its capital level is below the buffer amount.

The Basel III Rules prescribe a standardized approach for risk weightings that expanded the risk-weighting categories from the general risk-based capital rules to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories.

With respect to our bank subsidiary, the Basel III Rules also revise the prompt corrective action regulations pursuant to Section 38 of the Federal Deposit Insurance Act, as discussed below under Prompt Corrective Action.

As of December 31, 2016, we had a total risk-based capital ratio of 18.45%, a Tier 1 capital to risk-weighted asset ratio of 17.30%, a common equity Tier 1 to risk-weighted assets ratio of 17.30% and a Tier 1 leverage ratio of 10.71%. These regulatory capital ratios were calculated under Basel III rules.

Prompt Corrective Action.

A banking organization s capital plays an important role in connection with regulatory enforcement as well. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators powers depends on whether the institution in question is adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized, in each case a defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution s asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate that the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

Under current regulations, our subsidiary bank was well capitalized as of December 31, 2016.

Our Support of Our Subsidiaries

Under Federal Reserve Board policy, we are expected to commit resources to act as a source of strength to support each of our subsidiaries. The Dodd-Frank Act codified this policy as a statutory requirement. This support may be required at times when, absent such Federal Reserve Board policy, we would not otherwise be required to provide it. In addition, any loans we make to our subsidiaries would be subordinate in right of payment to deposits and to other indebtedness of our subsidiaries. In the event of a bank holding company s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and be subject to a priority of payment.

Under the Federal Deposit Insurance Act, in the event of a loss suffered or anticipated by the FDIC (either as a result of the default of a banking subsidiary or related to FDIC assistance provided to a subsidiary in danger of default) our other subsidiaries may be assessed for the FDIC s loss.

Safe and Sound Banking Practices.

Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve Board s Regulation Y, for example, generally requires a holding company to give the Federal Reserve Board 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 Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. Depending upon the circumstances, the Federal Reserve Board could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

The Federal Reserve Board 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 $1.0 million for each day the activity continues.

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Interstate Banking and Branching

Effective June 1, 1997, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 amended the Federal Deposit Insurance Act and certain other statutes to permit state and national banks with different home states to merge across state lines, with approval of the appropriate federal banking agency, unless the home state of a participating bank had passed legislation prior to May 31, 1997 expressly prohibiting interstate mergers. Under the Riegle-Neal Act amendments, once a state or national bank has established branches in a state, that bank may establish and acquire additional branches at any location in the state at which any bank involved in the interstate merger transaction could have established or acquired branches under applicable federal or state law. If a state opted out of interstate branching within the specified time period, no bank in any other state may establish a branch in the state which has opted out, whether through an acquisition or de novo.

However, under the Dodd-Frank Act, the national branching requirements have been relaxed and national banks and state banks are able to establish branches in any state if that state would permit the establishment of the branch by a state bank chartered in that state.

The Federal Deposit Insurance Act, or FDIA, requires that the FDIC review (1) any merger or consolidation by or with an insured bank, or (2) any establishment of branches by an insured bank. Additionally, the Banking Department accepts applications for interstate merger and branching transactions, subject to certain limitations on ages of the banks to be acquired and the total amount of deposits within the state a bank or financial holding company may control. Since our primary service area is Texas, we do not expect that the ability to operate in other states will have any material impact on our growth strategy. We may, however, face increased competition from out-of-state banks that branch or make acquisitions in our primary markets in Texas.

Community Reinvestment Act of 1977

The Community Reinvestment Act of 1977, or CRA, subjects a bank to regulatory assessment to determine if the institution meets the credit needs of its entire community, including low- and moderate-income neighborhoods served by the bank, and to take that determination into account in its evaluation of any application made by such bank for, among other things, approval of the acquisition or establishment of a branch or other depository facility, an office relocation, a merger, or the acquisition of shares of capital stock of another financial institution. The regulatory authority prepares a written evaluation of an institution s record of meeting the credit needs of its entire community and assigns a rating. These ratings are Outstanding, Satisfactory, Needs Improvement and Substantial Non-Compliance. Institutions with ratings lower than Satisfactory may be restricted from engaging in the aforementioned activities. We believe our subsidiary bank has taken and takes significant actions to comply with the CRA, and received a satisfactory rating in its most recent review by federal regulators with respect to its compliance with the CRA.

Monitoring and Reporting Suspicious Activity

Under the Bank Secrecy Act, or BSA, we are required to monitor and report unusual or suspicious account activity that might signify money laundering, tax evasion or other criminal activities, as well as transactions involving the transfer or withdrawal of amounts in excess of prescribed limits. The BSA is sometimes referred to as an anti-money laundering law (AML). Several AML acts, including provisions in Title III of the USA PATRIOT Act of 2001, have been enacted up to the present to amend the BSA. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and know your customer standards in their dealings with financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures and controls generally require financial institutions to take reasonable

steps:

to conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction;

to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;

to ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and

to ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

Under the USA PATRIOT Act, financial institutions are also required to establish anti-money laundering programs. The USA PATRIOT Act sets forth minimum standards for these programs, including:

the development of internal policies, procedures, and controls;

the designation of a compliance officer;

an ongoing employee training program; and

an independent audit function to test the programs.

In addition, under the USA PATRIOT Act, the Secretary of the U.S. Department of the Treasury, or Treasury, has adopted rules addressing a number of related issues, including increasing the cooperation and information sharing between financial institutions, regulators, and law enforcement authorities regarding individuals, entities and organizations engaged in, or reasonably suspected based on credible evidence of engaging in, terrorist acts or money laundering activities. Any financial institution complying with these rules will not be deemed to violate the privacy provisions of the Gramm-Leach-Bliley Act that are discussed below. Finally, under the regulations of the Office of Foreign Asset Control, or OFAC, we are required to monitor and block transactions with certain specially designated nationals who OFAC has determined pose a risk to U.S. national security.

Incentive Compensation

In June 2010, the Federal Reserve Board, OCC and 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.

The Federal Reserve Board 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.

In addition, Section 956 of the Dodd-Frank Act required certain regulators (including the FDIC, SEC and Federal Reserve Board) to adopt requirements or guidelines prohibiting excessive compensation. In April and May 2016, the Federal Reserve, jointly with five other federal regulators, published a proposed rule in response to Section 956 of the Dodd-Frank Act, which requires implementation of regulations or guidelines to: (1) prohibit

incentive-based payment arrangements that encourage inappropriate risks by certain financial institutions by providing excessive compensation or that could lead to material financial loss, and (2) require those financial institutions to disclose information concerning incentive-based compensation arrangements to the appropriate federal regulator.

The proposed rule identifies three categories of institutions that would be covered by these regulations based on average total consolidated assets, applying less prescriptive incentive-based compensation program requirements to the smallest covered institutions (Level 3) and progressively more rigorous requirements to the larger covered institutions (Level 1). Under the proposed rule, we would fall into the smallest category (Level 3), which applies to financial institutions with average total consolidated assets greater than $1 billion and less than $50 billion. The proposed rules would establish general qualitative requirements applicable to all covered entities, which would include (i) prohibiting incentive arrangements that encourage inappropriate risks by providing excessive compensation; (ii) prohibiting incentive arrangements that encourage inappropriate risks that could lead to a material financial loss; (iii) establishing requirements for performance measures to appropriately balance risk and reward; (iv) requiring board of director oversight of incentive arrangements; and (v) mandating appropriate recordkeeping. Under the proposed rule, larger financial institutions with total consolidated assets of at least $50 billion would also be subject to additional requirements applicable to such institutions senior executive officers and significant risk-takers. These additional requirements would not be applicable to us because we currently have less than $50 billion in total consolidated assets. Comments on the proposed rule were due by July 22, 2016. As of the date of this document, the final rule has not yet been published by these regulators.

In addition, the Dodd-Frank Act requires publicly traded companies to give stockholders a non-binding vote on executive compensation at their first annual meeting taking place six months after the date of enactment and at least every three years thereafter and on so-called golden parachute payments in connection with approvals of mergers and acquisitions unless previously voted on by shareholders. The new legislation also authorizes the Securities and Exchange Commission (SEC) to promulgate rules that would allow stockholders to nominate their own candidates using a company s proxy materials. Additionally, the Dodd-Frank Act directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of $1.0 billion, regardless of whether the company is publicly traded or not. The Dodd-Frank Act gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

Consumer Laws and Regulations

We are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the following list 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, The Fair and Accurate Credit Transactions Act, The Real Estate Settlement Procedures Act and the Fair Housing Act, among others. These laws and regulations, among other things, prohibit discrimination on the basis of race, gender or other designated characteristics and mandate various disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. These and other laws also limit finance charges or other fees or charges earned in our activities. We must comply with the applicable provisions of these consumer protection laws and regulations as part of our ongoing customer relations.

Consumer Financial Protection Bureau

The Dodd-Frank Act created a new, independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer

financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act permits states to

adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits the state attorney general to enforce compliance with both the state and federal laws and regulations.

The CFPB has finalized rules relating to, among other things, remittance transfers under the Electronic Fund Transfer Act, which requires companies to provide consumers with certain disclosures before the consumer pays for a remittance transfer. These rules became effective in October 2013. The CFPB has also amended certain rules under Regulation C relating to home mortgage disclosure to reflect a change in the asset-size exemption threshold for depository institutions based on the annual percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers. In addition, on January 10, 2013, the CFPB released its final Ability-to-Repay/Qualified Mortgage rules, which amended the Truth in Lending Act (Regulation Z). Regulation Z prohibits a creditor from making a higher-priced mortgage loan without regard to the consumer s ability to repay the loan. The final amended rule implemented sections 1411 and 1412 of the Dodd-Frank Act, which generally require creditors to make a reasonable, good faith determination of a consumer s ability to repay any consumer credit transaction secured by a dwelling (excluding an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan) and establishes certain protections from liability under this requirement for qualified mortgages. The final rule also implemented section 1414 of the Dodd-Frank Act, which limits prepayment penalties. Finally, the final rule requires creditors to retain evidence of compliance with the rule for three years after a covered loan is consummated. This rule became effective January 10, 2014.

Technology Risk Management and Consumer Privacy

State and federal banking regulators have issued various policy statements emphasizing the importance of technology risk management and supervision in evaluating the safety and soundness of depository institutions with respect to banks that contract with outside vendors to provide data processing and core banking functions. The use of technology-related products, services, delivery channels and processes exposes a bank to various risks, particularly operational, privacy, security, strategic, reputation and compliance risk. Banks are generally expected to prudently manage technology-related risks as part of their comprehensive risk management policies by identifying, measuring, monitoring and controlling risks associated with the use of technology.

Under Section 501 of the Gramm-Leach-Bliley Act, the federal banking agencies have established appropriate standards for financial institutions regarding the implementation of safeguards to ensure the security and confidentiality of customer records and information, protection against any anticipated threats or hazards to the security or integrity of such records and protection against unauthorized access to or use of such records or information in a way that could result in substantial harm or inconvenience to a customer. Among other matters, the rules require each bank to implement a comprehensive written information security program that includes administrative, technical and physical safeguards relating to customer information.

Under the Gramm-Leach-Bliley Act, a financial institution must also provide its customers with a notice of privacy policies and practices. Section 502 prohibits a financial institution from disclosing nonpublic personal information about a customer to nonaffiliated third parties unless the institution satisfies various notice and opt-out requirements and the customer has not elected to opt out of the disclosure. Under Section 504, the agencies are authorized to issue regulations as necessary to implement notice requirements and restrictions on a financial institution s ability to disclose nonpublic personal information about customers to nonaffiliated third parties. Under the final rule the regulators adopted, all banks must develop initial and annual privacy notices which describe in general terms the bank s information sharing practices. Banks that share nonpublic personal information about customers with nonaffiliated third parties must also provide customers with an opt-out notice and a reasonable period of time for the customer to opt out of any such disclosure (with certain exceptions). Limitations are placed on the extent to which a bank can

disclose an account number or access code for credit card, deposit or transaction accounts to any nonaffiliated third party for use in marketing.

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 non-farm 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.

UDAP and UDAAP

Banking regulatory agencies have increasingly used a general consumer protection statute to address unethical or otherwise bad business practices that may not necessarily fall directly under the purview of a specific banking or consumer finance law. The law of choice for enforcement against such business practices has been Section 5 of the Federal Trade Commission Act, referred to as the FTC Act, which is the primary federal law that prohibits unfair or deceptive acts or practices, referred to as UDAP, and unfair methods of competition in or affecting commerce. Unjustified consumer injury is the principal focus of the FTC Act. Prior to the Dodd-Frank Act, there was little formal guidance to provide insight to the parameters for compliance with UDAP laws and regulations. However, UDAP laws and regulations have been expanded under the Dodd-Frank Act to apply to unfair, deceptive or abusive acts or practices, referred to as UDAAP, which have been delegated to the CFPB for supervision. The CFPB has published its first Supervision and Examination Manual that addresses compliance with and the examination of UDAAP.

Monetary Policy

Banks are affected by the credit policies of monetary authorities, including the Federal Reserve Board, that affect the national supply of credit. The Federal Reserve Board regulates the supply of credit in order to influence general economic conditions, primarily through open market operations in United States government obligations, varying the discount rate on financial institution borrowings, varying reserve requirements against financial institution deposits, and restricting certain borrowings by financial institutions and their subsidiaries. The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banks in the past and are expected to continue to do so in the future.

Enforcement Powers of Federal Banking Agencies

The Federal Reserve and other state and federal banking agencies and regulators have broad enforcement powers, including the power to terminate deposit insurance, issue cease-and-desist orders, impose substantial fines and other civil and criminal penalties and appoint a conservator or receiver. Our failure to comply with applicable laws, regulations and other regulatory pronouncements could subject us, as well as our officers and directors, to administrative sanctions and potentially substantial civil penalties.

Regulatory Reform and Legislation

From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of the Company in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and

other financial institutions. The Company cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on the financial condition or results of operations of the Company. A change in statutes, regulations or regulatory policies applicable to the Company or our subsidiaries could have a material effect on the Company s business, financial condition and results of operations.

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Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Act, which was enacted in July 2010, effected a fundamental restructuring of federal banking regulation. In addition to those provisions discussed above, among the Dodd-Frank Act provisions that have affected us are the following:

- creation of a new Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators new authority to take control of and liquidate financial firms;

- elimination of the federal statutory prohibition against the payment of interest on business checking accounts;

- prohibition on state-chartered banks engaging in derivatives transactions unless the loans to one borrower of the state in which the bank is chartered takes into consideration credit exposure to derivative transactions. For this purpose, derivative transactions include any contract, agreement, swap, warrant, note or option that is based in whole or in part on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodity securities, currencies, interest or other rates, indices or other assets;

- requirement that the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction must be reasonable and proportional to the cost incurred by the issuer. On June 29, 2011, the Federal Reserve Board set the interchange rate cap at $0.21 per transaction and 5 basis points multiplied by the value of the transaction. While the restrictions on interchange fees do not apply to banks that, together with their affiliates, have assets of less than $10 billion, the rule could affect the competitiveness of debit cards issued by smaller banks; and

- restrictions under the Volcker Rule of the Company s ability to engage in proprietary trading and to invest in, sponsor and engage in certain types of transactions with certain private funds. The Company had until July 15, 2015 to fully conform to the Volcker Rules restrictions.

Many of the Dodd-Frank Act s provisions are still subject to the final rulemaking by federal banking agencies, and the implication of the Dodd-Frank Act for the Company s business will depend to a large extent on how such rules are adopted and implemented. The Company s management continues to review actively the provisions of the Dodd Frank Act and assess its probable impact on its business, financial condition, and results of operations.

Available Information

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any document we file at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. Our SEC filings are also available to the public at the SEC s web site at http://www.sec.gov. Our web site is http://www.ffin.com. You may also obtain copies of our annual, quarterly and special reports, proxy statements and certain other information filed with the SEC, as well as amendments thereto, free of charge from our web site. These documents are posted to our web site

after we have filed them with the SEC. Our corporate governance guidelines, including our code of conduct applicable to all our employees, officers and directors, as well as the charters of our audit and nominating committees, are available at www.ffin.com. The foregoing information is also available in print to any shareholder who requests it. Except as explicitly provided, information on any web site is not incorporated into this Form 10-K or our other securities filings and is not a part of them.

ITEM 1A. RISK FACTORS

Our business, financial condition, operating results and cash flows can be impacted by a number of factors, including but not limited to those set forth below, any one of which could cause our actual results to vary materially from recent results or from our anticipated future results and other forward-looking statements that we make from time to time in our news releases, annual reports and other written communications, as well as oral forward-looking statements, and other statements made from time to time by our representatives.

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Our business faces unpredictable economic conditions, which could have an adverse effect on us.

General economic conditions impact the banking industry. The credit quality of our loan portfolio necessarily reflects, among other things, the general economic conditions in the areas in which we conduct our business. Our continued financial success depends somewhat on factors beyond our control, including:

- general economic conditions, including national and local real estate markets and the price of oil and gas and other commodity prices;
- the supply of and demand for investable funds;
- demand for loans and access to credit;
- interest rates; and
- federal, state and local laws affecting these matters.

Any substantial deterioration in any of the foregoing conditions could have a material adverse effect on our financial condition, results of operations and liquidity, which would likely adversely affect the market price of our common stock.

Our business is concentrated in Texas and a downturn in the economy of Texas may adversely affect our business.

Our network of bank regions is concentrated in Texas, primarily in the Central, North Central, Southeast and Western regions of the state. Most of our customers and revenue are derived from this area. These economies include dynamic centers of higher education, agriculture, energy and natural resources, retail, military, healthcare, tourism, retirement living, manufacturing and distribution. Because we generally do not derive revenue or customers from other parts of the state or nation, our business and operations are dependent on economic conditions in our Texas markets. Any significant decline in one or more segments of the local economies could adversely affect our business, revenue, operations and properties.

The significant decline and volatility in oil and gas prices has resulted in uncertainty about the Texas economy. While we consider our exposure to credits related to the oil and gas industry to not be significant, at approximately 2.32% of total loans as of December 31, 2016, should the price of oil and gas decline further and/or remain at the current low price for an extended period, the general economic conditions in our Texas markets could be negatively affected, which could have a material adverse affect on our business, financial condition and results of operations.

In our business, we must effectively manage our credit risk.

As a lender, we are exposed to the risk that our loan customers may not repay their loans according to the terms of these loans and the collateral securing the payment of these loans may be insufficient to fully compensate us for the outstanding balance of the loan plus the costs to dispose of the collateral. We may experience significant loan losses, which could have a material adverse effect on our operating results and financial condition. Management makes

various assumptions and judgments about the collectability of our loan portfolio, including the diversification by industry of our commercial loan portfolio, the amount of nonperforming loans and related collateral, the volume, growth and composition of our loan portfolio, the effects on the loan portfolio of current economic indicators and their probable impact on borrowers and the evaluation of our loan portfolio through our internal loan review process and other relevant factors.

We maintain an allowance for credit losses, which is an allowance established through a provision for loan losses charged to expense that represents management s best estimate of probable losses inherent in our loan portfolio. Additional credit losses will likely occur in the future and may occur at a rate greater than we have experienced to date. In determining the amount of the allowance, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions. If our assumptions prove to be incorrect, our current allowance may not be sufficient and adjustments may be necessary to allow for different economic conditions or adverse developments in our loan portfolio. Material additions to the allowance could materially decrease our net income.

In addition, banking regulators periodically review our allowance for credit losses and may require us to increase our provision for credit losses or recognize further charge-offs, based on judgments different than those of our management. Any increase in our allowance for credit losses or charge-offs as required by these regulatory agencies could have a material negative effect on our operating results, financial condition and liquidity.

Extended drought conditions, severe weather and natural disasters could significantly impact the Company s business.

Extended drought conditions, severe weather and natural disasters and other adverse external events could have a significant impact on the Company s ability to conduct business. In addition, such events could affect the stability of the Company s deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of the collateral securing our loans, cause significant property damage, result in loss of revenue and/or cause the Company to incur additional expenses. The occurrence of any such event in the future could have a material adverse effect on the Company s business, which in turn, could have a material adverse effect on the Company s business, financial condition and result of operations.

Changes in economic conditions could cause an increase in delinquencies and non-performing assets, including loan charge-offs, which could depress our net income and growth.

Our loan portfolio includes many real estate secured loans, demand for which may decrease during economic downturns as a result of, among other things, an increase in unemployment, a decrease in real estate values and a slowdown in housing. If we see negative economic conditions develop in the United States as a whole or in the portions of Texas that we serve, we could experience higher delinquencies and loan charge-offs, which would reduce our net income and adversely affect our financial condition. Furthermore, to the extent that real estate collateral is obtained through foreclosure, the costs of holding and marketing the real estate collateral, as well as the ultimate values obtained from disposition, could reduce our earnings and adversely affect our financial condition.

The value of real estate collateral may fluctuate significantly resulting in an under-collateralized loan portfolio.

The market value of real estate, particularly real estate held for investment, can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. If the value of the real estate serving as collateral for our loan portfolio were to decline materially, a significant part of our loan portfolio could become under-collateralized. If the loans that are collateralized by real estate become troubled during a time when market conditions are declining or have declined, then, in the event of foreclosure, we may not be able to realize the amount of collateral that we anticipated at the time of originating the loan. This could have a material adverse effect on our provision for loan losses and our operating results and financial condition.

New lines of business or new products and services may subject the Company to additional risks.

From time to time, the Company may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or products and services the Company may invest significant time and resources. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. If we are unable to successfully manage these risks in the development and implementation of new lines of business or new products or services, it could have a material adverse effect on the Company s business, financial condition and result of operations.

We are subject to environmental liability risk associated with lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable

for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property s value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Environmental reviews of real property before initiating foreclosure actions may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our business, financial condition and results of operations.

We depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions, we must rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. We also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on our business, financial condition and results of operations.

The repeal of prohibitions on paying interest on demand deposits could increase our interest expense.

Effective July 2011, all federal prohibitions on financial institutions paying interest on demand deposit accounts were repealed as part of the Dodd-Frank Act. As a result, some financial institutions have commenced and are considering offering interest on demand deposits to compete for customers. If interest rates begin to rise, our interest expense could increase and our net interest margin could decrease if we begin offering interest on demand deposits to maintain current customers or attract new customers, which could have a material adverse effect on our financial condition and results of operations.

We do business with other financial institutions that could experience financial difficulty.

We do business through the purchase and sale of Federal funds, check clearing and through the purchase and sale of loan participations with other financial institutions. Because these financial institutions have many risks, as do we, we could be adversely affected should one of these financial institutions experience significant financial difficulties or fail to comply with our agreements with them.

If we are unable to continue to originate residential real estate loans and sell them into the secondary market for a profit, our earnings could decrease.

We derive a portion of our noninterest income from the origination of residential real estate loans and the subsequent sale of such loans into the secondary market. If we are unable to continue to originate and sell residential real estate loans at historical or greater levels, our residential real estate loan volume would decrease, which could decrease our earnings. A rising interest rate environment, general economic conditions or other factors beyond our control could adversely affect our ability to originate residential real estate loans. We also are experiencing an increase in regulations and compliance requirements related to mortgage loan originations necessitating technology upgrades and other changes. If new regulations continue to increase and we are unable to make technology upgrades, our ability to originate mortgage loans will be reduced or eliminated. Additionally, we sell a large portion of our residential real estate loans to third party investors, and rising interest rates could negatively affect our ability to generate suitable profits on the sale of such loans. If interest rates increase after we originate the loans, our ability to market those loans is impaired as the profitability on the loans decreases. These fluctuations can have an adverse effect on the revenue we generate from residential real estate loans and in certain instances, could result in a loss on the sale of the loans.

Further, for the mortgage loans we sell in the secondary market, the mortgage loan sales contracts contain indemnification clauses should the loans default, generally in the first sixty to ninety days, or if documentation is determined not to be in compliance with regulations. While the Company s historic losses as a result of these indemnities have been insignificant, we could be required to repurchase the mortgage loans or reimburse the purchaser of our loans for losses incurred. Both of these situations could have an adverse effect on the profitability of our mortgage loan activities and negatively impact our net income.

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We may need to raise additional capital and such funds may not be available when needed.

We may need to raise additional capital in the future to provide us with sufficient capital resources to meet our commitments and business needs, particularly if our asset quality or earnings were to deteriorate significantly. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital and financial markets at that time, which are outside of our control, and our financial performance. Economic conditions and the loss of confidence in financial institutions may increase our cost of funding and limit access to certain customary sources of capital, other financial institution borrowings and borrowings from the discount window of the Federal Reserve. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of other financial institutions, or counterparties participating in the capital markets, may adversely affect our costs and our ability to raise capital. An inability to raise additional capital on acceptable terms when needed could have a materially adverse effect on our financial condition and results of operations.

We may be subject to more stringent capital and liquidity requirements which would adversely affect our net income and future growth.

On July 2, 2013, the Federal Reserve Board, and on July 9, 2013, the FDIC and OCC, adopted a final rule that implements the Basel III changes to the international regulatory capital framework and revises the U.S. risk-based and leverage capital requirements for U.S. banking organizations to strengthen identified areas of weakness in capital rules and to address relevant provisions of the Dodd-Frank Act.

The final rule established a stricter regulatory capital framework that requires banking organizations to hold more and higher-quality capital to act as a financial cushion to absorb losses and help banking organizations better withstand periods of financial stress. The final rule increased capital ratios for all banking organizations and introduced a capital conservation buffer which is in addition to each capital ratio. If a banking organization dips into its capital conservation buffer, it may be restricted in its ability to pay dividends and discretionary bonus payments to its executive officers. The final rule assigned a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also required unrealized gains and losses on certain available-for-sale securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt-out is exercised. We exercised this opt-out right in our March 31, 2015 quarterly financial filing. The final rule also included changes in what constitutes regulatory capital, some of which are subject to a two-year transition period. These changes included the phasing-out of certain instruments as qualifying capital. In addition, Tier 2 capital is no longer limited to the amount of Tier 1 capital included in total capital. Mortgage servicing rights, certain deferred tax assets and investments in unconsolidated subsidiaries over designated percentages of common stock are required to be deducted from capital, subject to a two-year transition period.

The final rule became effective for us on January 1, 2015. As of December 31, 2016, we met all of these new requirements, including the full capital conservation buffer.

Although we currently cannot predict the specific impact and long-term effects that Basel III will have on our Company and the banking industry more generally, the Company will be required to maintain higher regulatory capital levels which could impact our operations, net income and ability to grow. Furthermore, the Company s failure to comply with the minimum capital requirements could result in our regulators taking formal or informal actions against us which could restrict our future growth or operations.

The trust wealth management fees we receive may decrease as a result of poor investment performance, in either relative or absolute terms, which could decrease our revenues and net earnings.

Our trust company subsidiary derives its revenues primarily from investment management fees based on assets under management. Our ability to maintain or increase assets under management is subject to a number of factors, including investors perception of our past performance, in either relative or absolute terms, market and economic conditions, including changes in oil and gas prices, and competition from investment management companies. Financial markets are affected by many factors, all of which are beyond our control, including general economic conditions, including changes in oil and gas prices; securities market conditions; the level and volatility of interest rates and equity prices; competitive conditions; liquidity of global markets; international and regional political

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conditions; regulatory and legislative developments; monetary and fiscal policy; investor sentiment; availability and cost of capital; technological changes and events; outcome of legal proceedings; changes in currency values; inflation; credit ratings; and the size, volume and timing of transactions. A decline in the fair value of the assets under management, caused by a decline in general economic conditions, would decrease our wealth management fee income.

Investment performance is one of the most important factors in retaining existing clients and competing for new wealth management clients. Poor investment performance could reduce our revenues and impair our growth in the following ways:

- existing clients may withdraw funds from our wealth management business in favor of better performing products;
- asset-based management fees could decline from a decrease in assets under management;
- our ability to attract funds from existing and new clients might diminish; and
- our wealth managers and investment advisors may depart, to join a competitor or otherwise.

Even when market conditions are generally favorable, our investment performance may be adversely affected by the investment style of our wealth management and investment advisors and the particular investments that they make. To the extent our future investment performance is perceived to be poor in either relative or absolute terms, the revenues and profitability of our wealth management business will likely be reduced and our ability to attract new clients will likely be impaired. As such, fluctuations in the equity and debt markets can have a direct impact upon our net earnings.

Certain of our investment advisory and wealth management contracts are subject to termination on short notice, and termination of a significant number of investment advisory contracts could have a material adverse impact on our revenue.

Certain of our investment advisory and wealth management clients can terminate, with little or no notice, their relationships with us, reduce their aggregate assets under management, or shift their funds to other types of accounts with different rate structures for any number of reasons, including investment performance, changes in prevailing interest rates, inflation, changes in investment preferences of clients, changes in our reputation in the marketplace, change in management or control of clients, loss of key investment management personnel and financial market performance. We cannot be certain that our trust company subsidiary will be able to retain all of its clients. If its clients terminate their investment advisory and wealth management contracts, our trust company subsidiary, and consequently we, could lose a substantial portion of our revenues.

We are subject to possible claims and litigation pertaining to fiduciary responsibility.

From time to time, customers could make claims and take legal action pertaining to our performance of our fiduciary responsibilities. Whether customer claims and legal action related to our performance of our fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to us, they may

result in significant financial liability and/or adversely affect our market perception of our products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Our business is subject to significant government regulation.

We operate in a highly regulated environment and are subject to supervision and regulation by a number of governmental regulatory agencies, including the Texas Department of Banking, the Federal Reserve Board, the OCC, and the FDIC. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of shareholders, govern a comprehensive range of matters relating to ownership and control of our shares, our acquisition of other companies and businesses, permissible activities for us to engage in, maintenance of adequate capital levels and other aspects of our operations. The bank regulatory agencies possess broad authority to prevent or remedy unsafe or unsound practices or violations of law.

The Dodd-Frank Act, enacted in July 2010, instituted major changes to the banking and financial institutions regulatory regimes in light of the recent performance of and government intervention in the financial services sector. Other changes to statues, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to reduced revenues, additional costs, limit the types of financial services and products the Company may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company s business, financial condition and results of operations. Additionally, the banking regulations could prohibit and significantly delay the Company s acquisition of other financial institutions.

Included in the Dodd-Frank Act are, for example, changes related to interchange fees and overdraft services. While the changes for interchange fees that can be charged for electronic debit transactions by payment card issuers relate only to banks with assets greater than $10 billion, concern exists that the regulations will also impact our Company. Beginning in the third quarter of 2010, we were prohibited from charging customers fees for paying overdrafts on automated teller machine and debit card transactions, unless the consumer opts in. We continue to monitor the impact of these new regulations and other developments on our service charge revenue.

Our FDIC insurance assessments could increase substantially resulting in higher operating costs.

We have historically paid the lowest premium rate available due to our sound financial position. Should the number of bank failures increase, FDIC premiums could increase or additional special assessments could be imposed. These increased premiums would have an adverse effect on our net income and results of operations.

We compete with many larger financial institutions which have substantially greater financial resources than we have.

Competition among financial institutions in Texas is intense. We compete with other bank holding companies, state and national commercial banks, savings and loan associations, consumer financial companies, credit unions, securities brokers, insurance companies, mortgage banking companies, money market mutual funds, asset-based non-bank lenders and other financial institutions. Many of these competitors have substantially greater financial resources, larger lending limits, larger branch networks and less regulatory oversight than we do, and are able to offer a broader range of products and services than we can. Failure to compete effectively for deposit, loan and other banking customers in our markets could cause us to lose market share, slow our growth rate and may have an adverse effect on our financial condition, results of operations and liquidity.

We are subject to interest rate risk.

Our profitability is dependent to a large extent on our net interest income, which is the difference between interest income we earn as a result of interest paid to us on loans and investments and interest we pay to third parties such as our depositors and those from whom we borrow funds. Like most financial institutions, we are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and the amount of interest we pay on deposits and borrowings, but such changes could also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, and (iii) the average duration of the Company s securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and investments, our net interest income, and earnings, could be adversely affected. Earnings

could also be adversely affected if the interest rates received on loans and investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although we have implemented strategies which we believe reduce the potential effects of adverse changes in interest rates on our results of operations, these strategies may not always be successful. In addition, any substantial

and prolonged increase in market interest rates could reduce our customers desire to borrow money from us or adversely affect their ability to repay their outstanding loans by increasing their credit costs since most of our loans have adjustable interest rates that reset periodically. Any of these events could adversely affect our results of operations, financial condition and liquidity.

We are subject to liquidity risk.

The Company requires liquidity to meet our deposit and other obligations as they come due. The Company s access to funding sources in amounts adequate to finance its activities or on terms that are acceptable to it could be impaired by factors that affect it specifically or the financial services industry or the general economy. Factors that could reduce its access to liquidity sources include a downturn in the Texas market, difficult credit markets or adverse regulatory actions against the Company. The Company s access to deposits may also be affected by the liquidity needs of its depositors. In particular, a substantial majority of the Company s liabilities are demand, savings, interest checking and money market deposits, which are payable on demand or upon several days notice, while by comparison, a substantial portion of its assets are loans, which cannot be called or sold in the same time frame. The Company may not be able to replace maturing deposits and advances as necessary in the future, especially if a large number of its depositors sought to withdraw their accounts, regardless of the reason. A failure to maintain adequate liquidity could have a material adverse effect on the Company s business, financial condition and result of operations.

The value of certain securities in our investment portfolio may be negatively affected by changes or disruptions in the market for these securities.

Our investment portfolio securities include obligations of, and mortgage-backed securities guaranteed by, government sponsored enterprises such as the Federal National Mortgage Association, referred to as Fannie Mae, the Government National Mortgage Association, referred to as Ginnie Mae, the Federal Home Loan Mortgage Corporation, referred to as Freddie Mac, and the Federal Home Loan Bank or otherwise backed by Federal Housing Administration or Veteran s Administration guaranteed loans; however, volatility or illiquidity in financial markets may cause investment securities held within our investment portfolio to fall in value or become less liquid. The FRB s actions to increase interest rates may cause a decline in the value of securities held by the Company. Uncertainty surrounding the credit risk associated with mortgage collateral or guarantors may cause material discrepancies in valuation estimates obtained from third parties. Volatile market conditions may reduce valuations due to the perception of heightened credit and liquidity risks in addition to interest rate risk typically associated with these securities. There can be no assurance that declines in market value associated with these disruptions will not result in impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our results of operations, equity and capital ratios.

First Financial Bankshares, Inc. relies on dividends from its subsidiaries for most of its revenue.

First Financial Bankshares, Inc. is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenue from dividends paid by its subsidiaries. These dividends are the principal source of funds to pay dividends on the Company s common stock and interest and principal on First Financial Bankshares, Inc. debt (if we had balances outstanding). Various federal and/or state laws and regulations limit the amount of dividends that our bank and trust subsidiaries may pay to First Financial Bankshares, Inc. In the event our subsidiaries are unable to pay dividends to First Financial Bankshares, Inc., First Financial Bankshares, Inc. may not be able to service debt, if any, or pay dividends on the Company s common stock. The inability to receive dividends from our subsidiaries could have a material adverse effect on the Company s business, financial condition, results of operations and liquidity.

To continue our growth, we are affected by our ability to identify and acquire other financial institutions.

We intend to continue our current growth strategy. This strategy includes opening new branches and acquiring other banks that serve customers or markets we find desirable. The market for acquisitions remains highly competitive, and we may be unable to find satisfactory acquisition candidates in the future that fit our acquisition and growth strategy. To the extent that we are unable to find suitable acquisition candidates, an important component of our growth strategy may be lost. Additionally, our completed acquisitions, or any future acquisitions, may not produce the revenue, earnings or synergies that we anticipated.

We may not be able to complete future acquisitions, may not be successful in realizing the benefits of any future acquisitions that are completed, or may choose not to pursue acquisition opportunities we might find beneficial.

A substantial part of our historical growth has been a result of acquisitions of other financial institutions, and we may, from time to time, evaluate and engage in the acquisition of other financial institutions. We must generally satisfy a number of conditions prior to completing any such transaction, including certain bank regulatory approvals. Bank regulators consider a number of factors with regard to all institutions involved in the transaction when determining whether to approve a proposed transaction, including, among others, the ratings and compliance history, anti-money laundering and Bank Secrecy Act compliance history, CRA examination results and the effect of the proposed transaction on the financial stability of the institutions involved and the market as a whole.

The process for obtaining required regulatory approvals has become substantially more difficult, time-consuming and unpredictable as a result of the financial crisis. We may fail to pursue, evaluate or complete strategic and competitively significant business opportunities as a result of our inability, or our perceived inability, to obtain required regulatory approvals in a timely manner or at all.

Assuming we are able to successfully complete one or more transactions, we may not be able to successfully integrate and realize the expected synergies from any completed transaction in a timely manner or at all. In particular, we may be charged by federal and state regulators with regulatory and compliance failures at an acquired business prior to the date of the acquisition, and these failures by the acquired company may have negative consequences for us, including the imposition of formal or informal enforcement actions. Completion and integration of any transaction may also divert management s attention from other matters, result in additional costs and expenses, or adversely affect our relationships with our customers and employees, any of which may adversely affect our business or results of operations. As a result, our financial condition may be affected, and we may become more susceptible to general economic conditions and competitive pressures.

Use of our common stock for future acquisitions or to raise capital may be dilutive to existing stockholders.

When we determine that appropriate strategic opportunities exist, we may acquire other financial institutions and related businesses, subject to applicable regulatory requirements. We may use our common stock for such acquisitions. We may also seek to raise capital through selling additional common stock, although we have not historically done so. It is possible that the issuance of additional common stock in such acquisition or capital transactions may be dilutive to the interests of our existing shareholders.

Our accounting estimates and risk management processes rely on analytical and forecasting models.

The processes we use to estimate our allowance for loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates depends upon the use of analytical and forecasting models. In addition, these models are used to calculate fair value of our assets and liabilities when we acquire other financial institutions. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models we use for interest rate risk and asset-liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models we use for determining our probable loan losses are inadequate, the allowance for loan losses may not be sufficient to support future charge-offs. If the models we use to measure the fair value financial instruments is inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we could realize upon sale or settlement of such financial instruments. Such failure in our analytical or forecasting models could have a material adverse effect on our business,

financial condition and results of operations.

The value of our goodwill and other intangible assets may decline in the future.

As of December 31, 2016, we had $143.60 million of goodwill and other intangible assets. A significant decline in our financial condition, a significant adverse change in the business climate, slower growth rates or a significant and sustained decline in the price of our common stock may necessitate taking charges in the future related to the impairment of our goodwill and other intangible assets. If we were to conclude that a future write-down of goodwill and other intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our financial condition and results of operations.

We rely heavily on our management team, and the unexpected loss of key management or inability to recruit qualified personnel in the future may adversely affect our operations.

Our success to date has been strongly influenced by our ability to attract and to retain senior management experienced in banking in the markets we serve. Our ability to retain executive officers and the current management teams will continue to be important to the successful implementation of our strategies. We do not have employment agreements with these key employees other than executive agreements in the event of a change of control and a confidential information, non-solicitation and non-competition agreements related to our stock options. The unexpected loss of services of any key management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business and financial results. In addition, the scope and content of U.S. banking regulators policies on incentive compensation, as well as changes to these policies, could adversely affect our ability to hire, retain and motivate our key employees.

The Company s stock price can be volatile.

Stock price volatility may make it more difficult for our shareholders to resell their common stock when they want and at prices they find attractive. The Company s stock price can fluctuate significantly in response to a variety of factors including, among other things:

- actual or anticipated variations in quarterly results of operations;
- recommendations by securities analysts;
- operating and stock price performance of other companies that investors deem comparable to the Company;
- new reports relating to trends, concerns and other issues in the financial services industry or Texas economy, including oil and gas and cattle prices;
- perceptions in the marketplace regarding the Company and/or its competitors;
- new technology used, or services offered, by competitors;

significant acquisitions or business combinations involving the Company or its competitors; and

changes in government regulations, including tax laws.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends could also cause the Company s stock price to decrease regardless of operational results.

We may not continue to pay dividends on our common stock in the future.

Holders of our common stock are only entitled to receive such dividends as our board of directors may declare out of funds legally available for such payments. Although we have historically declared cash dividends on our common stock, we are not required to do so and may reduce or eliminate our common stock dividends in the future. This could adversely affect the market price of our common stock. Also, we are a bank holding company, and our ability to declare and pay dividends is dependent on certain federal regulatory considerations, including the guidelines of the Federal Reserve Board regarding capital adequacy and dividends.

Certain banking laws may have an anti-takeover effect.

Provisions of federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire us, even if doing so would be perceived to be beneficial to our shareholders. These provisions effectively inhibit a non-negotiated merger or other business combination, which, in turn, could adversely affect the market price of our common stock.

The trading volume in our common stock is less than other larger financial institutions.

Although the Company s common stock is listed for trading on the Nasdaq Global Select Market, the trading volume in our common stock is less than that of other, larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the Company s common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Company has no control. Given the lower trading volume of the Company s common stock, significant sales of the Company s common stock, or the expectation of these sales, could cause the Company s stock price to fall.

Breakdowns in our internal controls and procedures could have an adverse effect on us.

We believe our internal control system as currently documented and functioning is adequate to provide reasonable assurance over our internal controls. Nevertheless, because of the inherent limitation in administering a cost effective control system, misstatements due to error or fraud may occur and not be detected. Breakdowns in our internal controls and procedures could occur in the future, and any such breakdowns could have an adverse effect on us. See Item 9A Controls and Procedures for additional information.

Our operations rely on certain external vendors.

We rely on certain external vendors to provide products and services necessary to maintain our day-to-day operations. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with the contracted agreements under service level agreements. The failure of an external vendor to perform in accordance with the contracted arrangements under service level agreements, because of changes in the vendor s organizational structure, financial condition, support for existing products or services or strategic focus or for any other reason, could be disruptive to our operations, which could have a material adverse effect on our business and, in turn, our financial condition and results of operations.

We compete in an industry that continually experiences technological change, and we may have fewer resources than many of our competitors to continue to invest in technological improvements.

The financial services industry is undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. In addition to improving the ability to serve customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for conveniences, as well as to create additional efficiencies in our operations. Many of our larger competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

System failure or cybersecurity breaches of our network security could subject us to increased operating costs as well as litigation and other potential losses.

The computer systems and network infrastructure we use could be vulnerable to unforeseen hardware and cybersecurity issues, including hacking and identity theft. Our operations are dependent upon our ability to protect our computer equipment against damage from fire, power loss, telecommunications failure or a similar catastrophic event. Any damage or failure that causes an interruption in our operations could have an adverse effect on our financial condition and results of operations. In addition, our operations are dependent upon our ability to protect the computer systems and network infrastructure utilized by us, including our Internet banking activities,

against damage from physical break-ins, cybersecurity breaches and other disruptive problems caused by the Internet or other users. Such computer break-ins and other disruptions would jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us, damage our reputation and inhibit current and potential customers from our Internet banking services. Each year, we add additional security measures to our computer systems and network infrastructure to mitigate the possibility of cybersecurity breaches including firewalls and penetration testing. We continue to investigate cost effective measures as well as insurance protection.

Furthermore, our customers could incorrectly blame the Company and terminate their accounts with the Company for a cyber-incident which occurred on their own system or with that of an unrelated third party. In addition, a security breach could also subject us to additional regulatory scrutiny and expose us to civil litigation and possible financial liability.

Our business may be adversely affected by security breaches at third parties.

Our customers interact with their own and other third party systems, which pose operational risks to us. We may be adversely affected by data breaches at retailers and other third parties who maintain data relating to our customers that involve the theft of customers data, including the theft of customers debit card, merchant credit card, wire transfer and other identifying and/or access information used to make purchases or payments at such retailers and to other third parties.

In the event of a data breach at one or more retailers of considerable magnitude, the Company s business, financial condition and results of operations may be adversely affected.

We are subject to claims and litigation pertaining to intellectual property.

We rely on technology companies to provide information technology products and services necessary to support our day-to-day operations. Technology companies frequently enter into litigation based on allegations of patent infringement or other violations of intellectual property rights. In addition, patent holding companies seek to monetize patents they have purchased or otherwise obtained. Competitors of our vendors, or other individuals or companies, have from time to time claimed to hold intellectual property sold to us by its vendors. Such claims may increase in the future as the financial services sector becomes more reliant on information technology vendors. The plaintiffs in these actions frequently seek injunctions and substantial damages.

Regardless of the scope or validity of such patents or other intellectual property rights, or the merits of any claims by potential or actual litigants, we may have to engage in litigation that could be expensive, time-consuming, disruptive to our operations, and distracting to management. If we are found to infringe one or more patents or other intellectual property rights, we may be required to pay substantial damages or royalties to a third-party. In certain cases, we may consider entering into licensing agreements for disputed intellectual property, although no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. These licenses may also significantly increase our operating expenses. If legal matters related to intellectual property claims were resolved against us or settled, we could be required to make payments in amounts that could have a material adverse effect on our business, financial condition and results of operations.

An investment in our common stock is not an insured deposit.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund, or by any other public or private entity. Investment in our common stock is inherently risky for the

reasons described in this Risk Factors section and elsewhere in this Report. As a result, if you acquire our common stock, you may lose some or all of your investment.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal office is located in the First Financial Bank Building at 400 Pine Street in downtown Abilene, Texas. We lease four spaces in buildings owned by First Financial Bank, National Association, Abilene totaling approximately 11,550 square feet. Our subsidiaries collectively own 63 banking facilities, some of which are detached drive-ins, and also lease 11 banking facilities and 17 ATM locations. Our management considers all our existing locations to be well-suited for conducting the business of banking. We believe our existing facilities are adequate to meet our requirements and our subsidiaries requirements for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

From time to time we and our subsidiaries are parties to lawsuits arising in the ordinary course of our banking business. However, there are no material pending legal proceedings to which we, our subsidiaries or our other direct and indirect subsidiaries, or any of their properties, are currently subject. Other than regular, routine examinations by state and federal banking authorities, there are no proceedings pending or known to be contemplated by any governmental authorities.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock, par value $0.01 per share, is traded on the Nasdaq Global Select Market under the trading symbol FFIN. See Item 8 Financial Statements and Supplementary Data Quarterly Financial Data for the high, low and closing sales prices as reported by the Nasdaq Global Select Market for our common stock for the periods indicated.

Record Holders

As of February 1, 2017, we had 1,050 registered shareholders of record with our stock transfer agent.

Dividends

See Item 8 Financial Statements and Supplementary Data Quarterly Results of Operations for the frequency and amount of cash dividends paid by us. Also, see Item 1 Business Supervision and Regulation Payment of Dividends and Item 7 Management s Discussion and Analysis of the Financial Condition and Results of Operations Liquidity Dividends for restrictions on our present or future ability to pay dividends, particularly those restrictions arising under federal and state banking laws.

Equity Compensation Plans

See Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters .

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PERFORMANCE GRAPH

The following performance graph compares cumulative total shareholder returns for our common stock, the Russell 3000 Index, and the SNL Bank Index, which is a banking index prepared by SNL Financial LC and is comprised of banks with $5 billion to $10 billion in total assets, for a five-year period (December 31, 2011 to December 31, 2016). The performance graph assumes $100 invested in our common stock at its closing price on December 31, 2011, and in each of the Russell 3000 Index and the SNL Bank Index on the same date. The performance graph also assumes the reinvestment of all dividends. The dates on the performance graph represent the last trading day of each year indicated. The amounts noted on the performance graph have been adjusted to give effect to all stock splits and stock dividends.

First Financial Bankshares, Inc.

	Period Ending					
Index	**12/31/11**	**12/31/12**	**12/31/13**	**12/31/14**	**12/31/15**	**12/31/16**
First Financial Bankshares, Inc.	100.00	119.99	207.18	190.70	196.49	300.33
Russell 3000	100.00	116.42	155.47	175.00	175.84	198.23
SNL Bank $5B-$10B Index	100.00	117.63	181.48	186.94	212.96	305.09

Source : SNL Financial, an offering of S&P Global Market Intelligence

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ITEM 6. SELECTED FINANCIAL DATA

The selected financial data presented below as of and for the years ended December 31, 2016, 2015, 2014, 2013, and 2012, have been derived from our audited consolidated financial statements. The selected financial data should be read in conjunction with Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and accompanying notes presented elsewhere in this Form 10-K. The results of operations presented below are not necessarily indicative of the results of operations that may be achieved in the future. Management s Discussion and Analysis of Financial Condition and Results of Operations incorporates information required to be disclosed by the SEC s Industry Guide 3, Statistical Disclosure by Bank Holding Companies.

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(dollars in thousands, except per share data)				
Summary Income Statement Information:					
Interest income	$ 232,288	$ 221,623	$ 198,539	$ 176,369	$ 159,796
Interest expense	5,451	4,088	4,181	4,088	5,112
Net interest income	226,837	217,535	194,358	172,281	154,684
Provision for loan losses	10,212	9,685	4,465	3,753	3,484
Noninterest income	85,132	73,432	66,624	62,052	57,209
Noninterest expense	165,830	149,464	137,925	126,012	109,049
Earnings before income taxes	135,927	131,818	118,592	104,568	99,360
Income tax expense	31,153	31,437	29,033	25,700	25,135
Net earnings	$ 104,774	$ 100,381	$ 89,559	$ 78,868	$ 74,225
Per Share Data:					
Earnings per share, basic	$ 1.59	$ 1.55	$ 1.40	$ 1.24	$ 1.18
Earnings per share, assuming dilution	1.59	1.54	1.39	1.24	1.18
Cash dividends declared	0.70	0.62	0.55	0.52	0.50
Book value at period-end	12.68	12.20	10.63	9.18	8.84
Earnings performance ratios:					
Return on average assets	1.59%	1.61%	1.65%	1.64%	1.75%
Return on average equity	12.36	13.60	14.00	13.75	13.85
Summary Balance Sheet Data (Period-end):					
Securities	$ 2,860,958	$ 2,734,177	$ 2,416,297	$ 2,058,407	$ 1,820,096
Loans	3,384,205	3,350,593	2,937,991	2,689,448	2,088,623
Total assets	6,809,931	6,665,070	5,848,202	5,222,208	4,502,012
Deposits	5,478,539	5,190,169	4,750,255	4,135,075	3,632,584
Total liabilities	5,972,046	5,860,084	5,166,665	4,634,561	3,945,049
Total shareholders equity	837,885	804,986	681,537	587,647	556,963
Asset quality ratios:					

Allowance for loan losses/period-end loans	1.35%	1.25%	1.25%	1.26%	1.67%
Nonperforming assets/period-end loans plus foreclosed assets	0.86	0.89	0.74	1.16	1.22
Net charge offs/average loans	0.19	0.15	0.06	0.15	0.15
Capital ratios:					
Average shareholders equity/average assets	12.85%	11.86%	11.78%	11.95%	12.62%
Leverage ratio (1)	10.71	9.96	9.89	9.84	10.60
Tier 1 risk-based capital (2)	17.30	15.90	16.05	15.82	17.43
Total risk-based capital (3)	18.45	16.97	17.16	16.92	18.68
Common equity tier 1 capital (4)	17.30	15.90			
Dividend payout ratio	44.14	40.20	39.34	41.62	41.99

(1) Calculated by dividing at period-end, shareholders equity (before accumulated other comprehensive earnings/loss) less intangible assets by fourth quarter average assets less intangible assets.
(2) Calculated by dividing at period-end, shareholders equity (before accumulated other comprehensive earnings/loss) less intangible assets by risk-adjusted assets.
(3) Calculated by dividing at period-end, shareholders equity (before accumulated other comprehensive earnings/loss) less intangible assets plus allowance for loan losses to the extent allowed under regulatory guidelines by risk-adjusted assets.
(4) Calculated by dividing at period-end, shareholders equity (before accumulated other comprehensive earnings/loss) less intangible assets by risk-adjusted assets.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion contains forward-looking statements that are subject to risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements as a result of certain factors, including but not limited to those listed in Item 1A Risk Factors and in the Cautionary Statement Regarding Forward-Looking Statements notice on page 1.

Introduction

As a financial holding company, we generate most of our revenue from interest on loans and investments, trust fees, and service charges. Our primary source of funding for our loans and investments are deposits held by our bank subsidiary, First Financial Bank, National Association, Abilene, Texas. Our largest expenses are salaries and related employee benefits. We measure our performance by calculating our return on average assets, return on average equity, our regulatory leverage and risk based capital ratios and our efficiency ratio, which is calculated by dividing noninterest expense by the sum of net interest income on a tax equivalent basis and noninterest income.

The following discussion and analysis of the major elements of our consolidated balance sheets as of December 31, 2016 and 2015, and consolidated statements of earnings for the years 2014 through 2016 should be read in conjunction with our consolidated financial statements, accompanying notes, and selected financial data presented elsewhere in this Form 10-K.

Critical Accounting Policies

We prepare consolidated financial statements based on generally accepted accounting principles (GAAP) and customary practices in the banking industry. These policies, in certain areas, require us to make significant estimates and assumptions.

We deem a policy critical if (1) the accounting estimate required us to make assumptions about matters that are highly uncertain at the time we make the accounting estimate; and (2) different estimates that reasonably could have been used in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, would have a material impact on the financial statements.

We deem our most critical accounting policies to be (1) our allowance for loan losses and our provision for loan losses and (2) our valuation of securities. We have other significant accounting policies and continue to evaluate the materiality of their impact on our consolidated financial statements, but we believe these other policies either do not generally require us to make estimates and judgments that are difficult or subjective, or it is less likely they would have a material impact on our reported results for a given period. A discussion of (1) our allowance for loan losses and our provision for loan losses and (2) our valuation of securities is included in Note 1 to our Consolidated Financial Statements beginning on page F-7.

Acquisitions and Asset Purchase

On April 1, 2015, we entered into an agreement and plan of reorganization to acquire FBC Bancshares, Inc. and its wholly owned bank subsidiary, First Bank, N.A., Conroe, Texas. On July 31, 2015, the transaction was completed, which we refer to herein as the Conroe acquisition. Pursuant to the agreement, we issued 1,755,374 shares of the Company s common stock in exchange for all of the outstanding shares of FBC Bancshares, Inc. At closing, FBC Bancshares, Inc. was merged into the Company and First Bank, N.A., Conroe, Texas, was merged into First Financial Bank, National Association, Abilene, Texas, a wholly owned subsidiary of the Company. The total purchase price

exceeded the estimated fair value of assets acquired by approximately $43.92 million and the Company recorded such excess as goodwill.

On April 8, 2015, the Company announced that it had entered into an asset purchase agreement with 4Trust Mortgage, Inc. for a cash purchase price of $1.90 million. The asset purchase was finalized on June 1, 2015, which we refer to herein as the 4Trust asset purchase. The total asset purchase price exceeded the estimated fair value of assets purchased by approximately $1.75 million and the Company recorded such excess as goodwill.

Stock Split

On April 22, 2014 the Company s Board of Directors declared a two-for-one stock split in the form of a 100% stock dividend effective for shareholders of record on May 15, 2014 that was distributed on June 2, 2014. All share and per share amounts in this report have been restated to reflect this stock split. An amount equal to the par value of the additional common shares to be issued pursuant to the stock split was reflected as a transfer from retained earnings to common stock on the consolidated financial statements as of and for the year ended December 31, 2014.

Results of Operations

Performance Summary. Net earnings for 2016 were $104.77 million, an increase of $4.39 million, or 4.38%, over net earnings for 2015 of $100.38 million. Net earnings for 2014 were $89.56 million. The increases in net earnings for 2016 over 2015 and 2015 over 2014 were primarily attributable to growth in net interest income and noninterest income.

On a basic net earnings per share basis, net earnings were $1.59 for 2016 as compared to $1.55 for 2015 and $1.40 for 2014. The return on average assets was 1.59% for 2016 as compared to 1.61% for 2015 and 1.65% for 2014. The return on average equity was 12.36% for 2016 as compared to 13.60% for 2015 and 14.00% for 2014.

Net Interest Income. Net interest income is the difference between interest income on earning assets and interest expense on liabilities incurred to fund those assets. Our earning assets consist primarily of loans and investment securities. Our liabilities to fund those assets consist primarily of noninterest-bearing and interest-bearing deposits. Tax-equivalent net interest income was $251.78 million in 2016, as compared to $240.48 million in 2015 and $213.49 million in 2014. The increases in 2016 compared to 2015 and in 2015 compared to 2014 were largely attributable to increases in the volume of earning assets, primarily from our Conroe acquisition. Average earning assets were $6.17 billion in 2016, as compared to $5.84 billion in 2015 and $5.08 billion in 2014. Average earning assets increased $333.39 million in 2016, when compared to 2015, due primarily from increases in loans and tax exempt securities. Average earning assets increased $757.55 million in 2015, when compared to 2014, with increases in all categories of earning assets, except for short-term investments. Average interest bearing liabilities were $4.02 billion in 2016, as compared to $3.80 billion in 2015 and $3.30 billion in 2014. The yield on earning assets decreased two basis points in 2016, whereas the rate paid on interest-bearing liabilities increased three basis point when compared to 2015. The yield on earning assets decreased nine basis points in 2015, whereas the rate paid on interest-bearing liabilities decreased two basis points when compared to 2014.

Table 1 allocates the change in tax-equivalent net interest income between the amount of change attributable to volume and to rate.

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Table 1 Changes in Interest Income and Interest Expense (in thousands):

	2016 Compared to 2015			2015 Compared to 2014		
	Change Attributable to		Total	Change Attributable to		Total
	Volume	Rate	Change	Volume	Rate	Change
Short-term investments	$ 23	$ 111	$ 134	$ (88)	$ (74)	$ (162)
Taxable investment securities	(1,218)	(829)	(2,047)	4,777	(3,506)	1,271
Tax-exempt investment securities (1)	6,548	(1,687)	4,861	13,241	(2,491)	10,750
Loans (1) (2)	12,037	(2,320)	9,717	15,110	(73)	15,037
Interest income	17,390	(4,725)	12,665	33,040	(6,144)	26,896
Interest-bearing deposits	219	643	862	490	(731)	(241)
Short-term borrowings	24	477	501	95	53	148
Interest expense	243	1,120	1,363	585	(678)	(93)
Net interest income	$ 17,147	$ (5,845)	$ 11,302	$ 32,455	$ (5,466)	$ 26,989

(1) Computed on tax-equivalent basis assuming marginal tax rate of 35%.
(2) Non-accrual loans are included in loans.

The net interest margin in 2016 was 4.08%, a decrease of four basis points from 2015 which also decreased an additional 8 basis points from 2014. The continued decrease in our net interest margin in 2016 was largely the result of the extended period of historically low levels of short-term interest rates. We have been able to somewhat mitigate the impact of low short-term interest rates by establishing minimum interest rates on certain of our loans, improving the pricing for loan risk, and reducing rates paid on interest bearing liabilities. Although the Federal Reserve increased rates 25 basis points in both December 2016 and December 2015 and continues to issue forward guidance plans to increase rates further in 2017 and future years, we expect interest rates to remain at lower levels, which will continue the downward pressure on our net interest margin.

The net interest margin, which measures tax-equivalent net interest income as a percentage of average earning assets, is illustrated in Table 2 for the years 2014 through 2016.

Table 2 Average Balances and Average Yields and Rates (in thousands, except percentages):

	2016			2015			2014		
	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
Assets									
Short-term investments (1)	$ 63,882	$ 342	0.54%	$ 57,500	$ 208	0.36%	$ 75,093	$ 370	0.49%
	1,314,820	27,626	2.10	1,371,110	29,673	2.16	1,173,725	28,402	2.42

Taxable investment securities (2)									
Tax-exempt investment securities (2)(3)	1,459,121	66,268	4.54	1,318,531	61,407	4.66	1,045,304	50,657	4.85
Loans (3)(4)	3,333,241	162,994	4.89	3,090,538	153,277	4.96	2,786,011	138,240	4.96
Total earning assets	6,171,064	$ 257,230	4.17%	5,837,679	$ 244,565	4.19%	5,080,133	$ 217,669	4.28%
Cash and due from banks	152,648			148,369			144,029		
Bank premises and equipment, net	120,538			109,725			98,828		
Other assets	55,694			49,647			43,749		
Goodwill and other intangible assets, net	143,986			117,491			97,443		
Allowance for loan losses	(44,811)			(39,107)			(35,599)		
Total assets	$ 6,599,119			$ 6,223,804			$ 5,428,583		
Liabilities and Shareholders Equity									
Interest-bearing deposits	$ 3,469,005	$ 4,504	0.13%	$ 3,272,150	$ 3,642	0.11%	$ 2,905,734	$ 3,883	0.13%
Short-term borrowings	552,041	947	0.17	524,365	446	0.08	397,738	298	0.07
Total interest-bearing liabilities	4,021,046	$ 5,451	0.14%	3,796,515	$ 4,088	0.11%	3,303,472	$ 4,181	0.13%
Noninterest-bearing deposits	1,666,598			1,634,669			1,441,125		
Other liabilities	63,609			54,331			44,242		
Total liabilities	5,751,253			5,485,515			4,788,839		
Shareholders equity	847,866			738,289			639,744		
Total liabilities and shareholders equity	$ 6,599,119			$ 6,223,804			$ 5,428,583		
Net interest income		$ 251,779			$ 240,477			$ 213,488	
Rate Analysis:									
Interest income/earning assets			4.17%			4.19%			4.28%
Interest expense/earning assets			0.09			0.07			0.08

Net yield on earning assets	4.08%	4.12%	4.20%

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(1) Short-term investments are comprised of Fed Funds sold, interest bearing deposits in banks and interest bearing time deposits in banks.
(2) Average balances include unrealized gains and losses on available-for-sale securities.
(3) Computed on a tax-equivalent basis assuming a marginal tax rate of 35%.
(4) Nonaccrual loans are included in loans.

Noninterest Income. Noninterest income for 2016 was $85.13 million, an increase of $11.70 million, or 15.93%, as compared to 2015. Increases in certain categories of noninterest income included (1) real estate mortgage fees of $5.68 million, (2) ATM, interchange and credit card fees of $2.05 million (3) service charges on deposit accounts of $1.22 million and (4) trust fees of $384 thousand when compared to 2015. The increase in real estate mortgage fees primarily resulted from a stronger mortgage market and the 4Trust asset purchase on June 1, 2015. The increases in ATM, interchange and credit card fees and service charges on deposit accounts are primarily a result of increases in the number of net new accounts and debit cards boosted by the Conroe acquisition on July 31, 2015. The increase in trust fees resulted from an increase in assets under management over the prior year offsetting the effect of the decline in oil and gas prices that reduced related trust fees by $296 thousand in 2016 compared to 2015. The fair value of our trust assets managed, which are not reflected in our consolidated balance sheets, totaled $4.37 billion at December 31, 2016 as compared to $3.87 billion at December 31, 2015.

Noninterest income for 2015 was $73.43 million, an increase of $6.81 million, or 10.22%, as compared to 2014. Increases in certain categories of noninterest income included (1) real estate mortgage fees of $3.90 million, (2) ATM, interchange and credit card fees of $2.43 million and (3) trust fees of $486 thousand when compared to 2014. The increase in real estate mortgage fees primarily resulted from a stronger mortgage market and the 4Trust asset purchase on June 1, 2015. The increases in ATM, interchange and credit card fees are primarily a result of increases in the number of net new accounts and debit cards boosted by the Conroe acquisition on July 31, 2015. The increase in trust fees resulted from an increase in assets under management over the prior year offsetting the effect of the decline in oil and gas prices that reduced related trust fees by $1.15 million in 2015 compared to 2014. The fair value of our trust assets managed, which are not reflected in our consolidated balance sheets, totaled $3.87 billion at December 31, 2015 as compared to $3.76 at December 31, 2014.

Offsetting the increases in 2015 was a loss on sale of assets of $820 thousand and a decline in net gains on sale of foreclosed assets of $366 thousand when compared to 2014.

ATM and interchange fees are charges that merchants pay to us and other card-issuing banks for processing electronic payment transactions. ATM and interchange fees consist of income from debit card usage, point of sale income for debit card transactions and ATM service fees. Federal Reserve rules applicable to financial institutions that have assets of $10 billion or more provide that the maximum permissible interchange fee for an electronic debit transaction in the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction. While we currently have assets under $10 billion, we are monitoring the effect of this reduction in per transaction fee income as we approach the $10 billion asset level.

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Table 3 Noninterest Income (in thousands):

	2016	Increase (Decrease)	2015	Increase (Decrease)	2014
Trust fees	$ 19,636	$ 384	$ 19,252	$ 486	$ 18,766
Service charges on deposit accounts	18,386	1,215	17,171	261	16,910
ATM, interchange and credit card fees	23,910	2,050	21,860	2,433	19,427
Real estate mortgage operations	16,086	5,677	10,409	3,898	6,511
Net gain on sale of available-for-sale securities	1,270	838	432	436	(4)
Net gain (loss) on sale of foreclosed assets	456	(82)	538	(366)	904
Net gain (loss) on sale of assets	168	988	(820)	(830)	10
Interest on loan recoveries	2,112	1,062	1,050	449	601
Other:					
Check printing fees	190	(40)	230	7	223
Safe deposit rental fees	531	7	524	(9)	533
Credit life and debt protection fees	619	(44)	663	449	214
Brokerage commissions	573	(190)	763	(108)	871
Miscellaneous income	1,195	(165)	1,360	(298)	1,658
Total other	3,108	(432)	3,540	41	3,499
Total Noninterest Income	$ 85,132	$ 11,700	$ 73,432	$ 6,808	$ 66,624

Noninterest Expense. Total noninterest expense for 2016 was $165.83 million, an increase of $16.37 million, or 10.95%, as compared to 2015. Noninterest expense for 2015 amounted to $149.46 million, an increase of $11.54 million, or 8.37%, as compared to 2014. An important measure in determining whether a financial institution effectively manages noninterest expenses is the efficiency ratio, which is calculated by dividing noninterest expense by the sum of net interest income on a tax-equivalent basis and noninterest income. Lower ratios indicate better efficiency since more income is generated with a lower noninterest expense total. Our efficiency ratio for 2016 was 49.22%, as compared to 47.61% for 2015 and 49.24% for 2014.

Salaries and employee benefits for 2016 totaled $90.74 million, an increase of $9.74 million, or 12.02%, as compared to 2015. The increase was primarily driven by the addition of employees from the Conroe acquisition and the 4Trust asset purchase, annual merit pay increases and increases in healthcare claims. Offsetting these increases was a reduction in profit sharing and officer bonus expenses in 2016 when compared to 2015, which was caused by less net income growth in 2016 when compared to the prior year.

All other categories of noninterest expense for 2016 totaled $75.09 million, an increase of $6.63 million, or 9.68%, as compared to 2015. The increase in noninterest expense was largely attributable to increases in equipment expense of $1.26 million, largely resulting from the Company s acquisition of Conroe. Telephone expenses increased $1.05 million due to costs to improve our technology infrastructure and professional and service fees increased $2.05 million due primarily to outsourcing expenses for certain technology providers, which offset salary costs. Offsetting these increases in 2016 were a decrease of $473 thousand in FDIC insurance due to the lower rate charged by the FDIC beginning in the third quarter of 2016.

Salaries and employee benefits for 2015 totaled $81.00 million, an increase of $10.54 million, or 14.96%, as compared to 2014. The increase was largely the result of the addition of employees in compliance-related areas, the addition of employees from the 4Trust asset purchase and Conroe acquisition, increases in healthcare claims and annual merit pay increases.

All other categories of noninterest expense for 2015 totaled $68.47 million, an increase of $996 thousand, or 1.48%, as compared to 2014. The increase in noninterest expense was largely attributable to increases in equipment expense of $1.48 million, net occupancy expense of $1.21 million, legal expense of $1.13 million and software amortization and expense of $696 thousand, largely resulting from the Company s 4Trust asset purchase and Conroe acquisition in 2015. Offsetting these increases in 2015 were declines in pension expense and the litigation settlement and expenses related to storm damage that were recognized in 2014.

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Table 4 Noninterest Expense (in thousands):

	2016	Increase (Decrease)	2015	Increase (Decrease)	2014
Salaries	$ 69,997	$ 7,294	$ 62,703	$ 9,220	$ 53,483
Medical	8,759	3,066	5,693	508	5,185
Profit sharing	3,221	(2,234)	5,455	131	5,324
Pension	359	342	17	(155)	172
401(k) match expense	2,331	288	2,043	344	1,699
Payroll taxes	4,809	427	4,382	498	3,884
Stock option expense	882	238	644	(65)	709
Restricted stock expense	381	319	62	62	
Total salaries and employee benefits	90,739	9,740	80,999	10,543	70,456
Loss from partial settlement of pension plan	267	267		(2,909)	2,909
Net occupancy expense	10,420	106	10,314	1,214	9,100
Equipment expense	13,479	1,257	12,222	1,482	10,740
FDIC insurance premiums	2,680	(473)	3,153	428	2,725
ATM, interchange and credit card expenses	7,231	847	6,384	(486)	6,870
Professional and service fees	6,877	2,046	4,831	536	4,295
Printing, stationery and supplies	2,093	(185)	2,278	(359)	2,637
Amortization of intangible assets	738	177	561	286	275
Other:					
Data processing fees	463	63	400	91	309
Postage	1,664	(41)	1,705	35	1,670
Advertising	3,536	353	3,183	(407)	3,590
Correspondent bank service charges	964	39	925	38	887
Telephone	3,253	1,053	2,200	62	2,138
Public relations and business development	2,748	48	2,700	343	2,357
Directors fees	1,320	218	1,102	237	865
Audit and accounting fees	1,712	55	1,657	96	1,561
Legal fees	2,096	95	2,001	1,134	867
Regulatory exam fees	1,131	43	1,088	161	927
Travel	1,242	28	1,214	256	958
Courier expense	848	39	809	25	784
Operational and other losses	2,170	281	1,889	(1,792)	3,681
Other real estate	182	58	124	(346)	470
Software amortization and expense	2,006	(116)	2,122	696	1,426
Other miscellaneous expense	5,971	368	5,603	175	5,428
Total other	31,306	2,584	28,722	804	27,918
Total Noninterest Expense	$ 165,830	$ 16,366	$ 149,464	$ 11,539	$ 137,925

Income Taxes. Income tax expense was $31.15 million for 2016, as compared to $31.44 million for 2015 and $29.03 million for 2014. Our effective tax rates on pretax income were 22.92%, 23.85% and 24.48%, respectively, for the years 2016, 2015 and 2014. The effective tax rates differ from the statutory federal tax rate of 35.0% largely due to tax exempt interest income earned on certain investment securities and loans, the deductibility of dividends paid to our employee stock ownership plan and income tax deductions from the partial donation of two of our branch buildings to municipalities.

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Balance Sheet Review

Loans. Our portfolio is comprised of loans made to businesses, professionals, individuals, and farm and ranch operations located in the primary trade areas served by our subsidiary bank. Real estate loans represent loans primarily for 1-4 family residences and commercial real estate, which are primarily owner-occupied. The structure of loans in the real estate mortgage area generally provides re-pricing intervals to minimize the interest rate risk inherent in long-term fixed rate loans. As of December 31, 2016, total loans held for investment were $3.36 billion, an increase of $40.26 million, as compared to December 31, 2015. As compared to year-end 2015, real estate loans increased $53.61 million, commercial loans decreased $21.75 million, agricultural loans decreased $18.33 million and consumer loans increased $26.73 million. Loans averaged $3.33 billion during 2016, an increase of $242.70 million over the 2015 average balances.

Table 5 Composition of Loans (in thousands):

	December 31,				
	2016	2015	2014	2013	2012
Commercial	$ 674,410	$ 696,163	$ 639,954	$ 596,730	$ 509,609
Agricultural	84,021	102,351	105,694	75,928	68,306
Real estate	2,189,844	2,136,233	1,822,854	1,678,514	1,226,823
Consumer	409,032	382,303	360,686	333,113	272,428
Total loans held-for-investment	$ 3,357,307	$ 3,317,050	$ 2,929,188	$ 2,684,285	$ 2,077,166

As of December 31, 2016, our real estate loans represent approximately 65.23% of our loan portfolio and are comprised of (i) commercial real estate loans of 23.92%, generally owner occupied, (ii) 1-4 family residence loans of 45.19%, (iii) residential development and construction loans of 8.59%, which includes our custom and speculation home construction loans, (iv) commercial development and construction loans of 5.25% and (v) other loans, which includes ranches, hospitals and universities of 17.05%.

Loans held-for-sale, consisting of secondary market mortgage loans, totaled $26.90 million and $33.54 million at December 31, 2016 and 2015, respectively, which are valued using the lower of cost or market method.

The Company has certain lending policies and procedures in place that are designed to maximize loan income with an acceptable level of risk. Management reviews and approves these policies and procedures on an annual basis and makes changes as appropriate. Management receives and reviews monthly reports related to loan originations, quality, concentrations, delinquencies, nonperforming and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions, both by type of loan and geographic location.

Commercial loans are underwritten after evaluating and understanding the borrower s ability to operate profitably and effectively. Underwriting standards are designed to determine whether the borrower possesses sound business ethics and practices and to evaluate current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and include personal guarantees.

Agricultural loans are subject to underwriting standards and processes similar to commercial loans. These agricultural loans are based primarily on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. Most agricultural loans are secured by the agriculture related assets being financed, such as farm land, cattle or equipment, and include personal guarantees.

Real estate loans are also subject to underwriting standards and processes similar to commercial and agricultural loans. These loans are underwritten primarily based on projected cash flows and, secondarily, as loans secured by real estate. The repayment of real estate loans is generally largely dependent on the successful operation of the property securing the loans or the business conducted on the property securing the loan. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing

the Company s real estate portfolio are generally diverse in terms of type and geographic location within Texas. This diversity helps reduce the exposure to adverse economic events that affect any single market or industry. Generally, real estate loans are owner-occupied which further reduces the Company s risk.

Consumer loan underwriting utilizes methodical credit standards and analysis to supplement the Company s underwriting policies and procedures. The Company s loan policy addresses types of consumer loans that may be originated and the collateral, if secured, which must be perfected. The relatively smaller individual dollar amounts of consumer loans that are spread over numerous individual borrowers also minimize the Company s risk.

Table 6 Maturity Distribution and Interest Sensitivity of Loans at December 31, 2016 (in thousands):

The following tables summarize maturity and repricing information for the commercial and agricultural and the real estate-construction portion of our loan portfolio as of December 31, 2016:

	One Year or less	After One Year Through Five Years	After Five Years	Total
Commercial and agricultural	$ 308,973	$ 245,900	$ 203,558	$ 758,431
Real estate - construction	110,970	58,294	164,776	334,040

	Maturities After One Year
Loans with fixed interest rates	$ 442,747
Loans with floating or adjustable interest rates	229,781

Asset Quality. Our loan portfolio is subject to periodic reviews by our centralized independent loan review group as well as periodic examinations by bank regulatory agencies. Loans are placed on nonaccrual status when, in the judgment of management, the collectability of principal or interest under the original terms becomes doubtful. Nonaccrual, past due 90 days or more and still accruing, and restructured loans plus foreclosed assets were $29.00 million at December 31, 2016, as compared to $29.77 million at December 31, 2015 and $21.72 million at December 31, 2014. As a percent of loans and foreclosed assets, these assets were 0.86% at December 31, 2016, as compared to 0.89% at December 31, 2015 and 0.74% at December 31, 2014. As a percent of total assets, these assets were 0.43% at December 31, 2016, as compared to 0.45% at December 31, 2015 and 0.37% at December 31, 2014. We believe the level of these assets to be manageable and are not aware of any material classified credits not properly disclosed as nonperforming at December 31, 2016.

Supplemental Oil and Gas Information. At December 31, 2016, the Company s exposure to the oil and gas industry was 2.32% of gross loans, or $78.48 million, down 18.85% from December 31, 2015 year-end levels, and consisted (based on collateral supporting the loan) of (i) development and production loans of 4.55%, (ii) oil and gas field servicing loans of 14.09%, (iii) real estate loans of 42.08%, (iv) accounts receivable and inventory of 22.47% and (v) other of 16.81%. These loans have experienced increased stress due to continued depressed oil and gas prices. The Company has instituted additional monitoring procedures for these loans and has classified, downgraded and charged-off loans as appropriate. The following oil and gas information is as of and for the years ended December 31, 2016 and 2015:

	December 31	
	2016	**2015**
Oil and gas related loans	$ 78,483	$ 96,712
Oil and gas related loans as a % of total loans	2.32%	2.89%
Classified oil and gas related loans	$ 32,518	$ 34,506
Nonaccrual oil and gas related loans	4,092	5,404
Net charge-offs for oil and gas related loans	1,145	1,947
Allowance for oil and gas related loans as a % of oil and gas loans	6.28%	6.35%

Table 7 Nonaccrual, Past Due 90 Days or More and Still Accruing, Restructured Loans and Foreclosed Assets (in thousands, except percentages):

	At December 31,				
	2016	**2015**	**2014**	**2013**	**2012**
Nonaccrual loans*	$ 27,371	$ 28,601	$ 20,194	$ 27,926	$ 21,800
Loans still accruing and past due 90 days or more	284	341	261	133	97
Troubled debt restructured loans**	701	199	226		
Nonperforming loans	28,356	29,141	20,681	28,059	21,897
Foreclosed assets	644	627	1,035	3,069	3,565
Total nonperforming assets	$ 29,000	$ 29,768	$ 21,716	$ 31,128	$ 25,462
As a % of loans and foreclosed assets	0.86%	0.89%	0.74%	1.16%	1.22%
As a % of total assets	0.43	0.45	0.37	0.60	0.57

* Includes $1.26 million, $2.18 million, $2.15 million and $2.71 million, respectively, of purchased credit impaired loans as of December 31, 2016, 2015, 2014 and 2013. There were no purchased credit impaired loan balances in 2012.

** Other troubled debt restructured loans of $6.86 million, $6.11 million, $9.07 million, $13.30 million and $14.36 million, respectively, whose interest collection, after considering economic and business conditions and collection efforts, is doubtful are included in non-accrual loans as of December 31, 2016, 2015, 2014, 2013, and

2012.

We record interest payments received on non-accrual loans as reductions of principal. Prior to the loans being placed on non-accrual, we recognized interest income on impaired loans as of December 31, 2016 of approximately $790 thousand during the year ended December 31, 2016. If interest on these impaired loans had been recognized on a full accrual basis during the year ended December 31, 2016, such income would have approximated $2.90 million.

See Note 3 to the Consolidated Financial Statements beginning on page F-16 for more information on these assets.

Provision and Allowance for Loan Losses. The allowance for loan losses is the amount we determine as of a specific date to be appropriate to absorb probable losses on existing loans in which full collectability is unlikely based on our review and evaluation of the loan portfolio. For a discussion of our methodology, see our accounting policies in Note 1 to the Consolidated Financial Statements beginning on page F-7. The provision for loan losses was $10.21 million in 2016 as compared to $9.69 million in 2015 and $4.47 million in 2014. The continued provision for loan losses in 2016 and 2015 reflects the continued levels of nonperforming and classified assets, gross charge-offs, as well as the economic effects related to the oil and gas and cattle industries. As a percent of average loans, net loan charge-offs were 0.19% during 2016, 0.15% during 2015 and 0.06% during 2014. During 2016, the Company charged down $4.3 million related to one commercial loan that is now in liquidation. The allowance for loan losses as a percent of loans was 1.35% as of December 31, 2016 as compared to 1.25% as of December 31, 2015 and 1.25% at December 31, 2014. Included in Tables 8 and 9 are further analysis of our allowance for loan losses.

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Although we believe we use the best information available to make loan loss allowance determinations, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making our initial determinations. A downturn in the economy or lower employment could result in increased levels of nonaccrual, past due 90 days or more and still accruing, restructured loans, foreclosed assets, charge-offs, increased loan loss provisions and reductions in income. Additionally, as an integral part of their examination process, bank regulatory agencies periodically review the adequacy of our allowance for loan losses. The banking agencies could require additions to the loan loss allowance based on their judgment of information available to them at the time of their examinations of our bank subsidiary.

Table 8 Loan Loss Experience and Allowance for Loan Losses (in thousands, except percentages):

	2016	2015	2014	2013	2012
Balance at January 1,	$ 41,877	$ 36,824	$ 33,900	$ 34,839	$ 34,315
Charge-offs:					
Commercial	6,990	3,734	583	1,283	499
Agricultural	219	164	2	100	53
Real estate	682	441	1,075	1,970	2,951
Consumer	1,925	1,700	1,222	1,268	852
Total charge-offs	9,816	6,039	2,882	4,621	4,355
Recoveries:					
Commercial	952	344	346	402	281
Agricultural	25	55	18	39	54
Real estate	2,021	558	505	239	639
Consumer	508	450	472	337	421
Total recoveries	3,506	1,407	1,341	1,017	1,395
Net charge-offs	6,310	4,632	1,541	3,604	2,960
Transfer of off-balance sheet exposure to other liabilities				(1,088)	
Provision for loan losses	10,212	9,685	4,465	3,753	3,484
Balance at December 31,	$ 45,779	$ 41,877	$ 36,824	$ 33,900	$ 34,839
Loans at year-end	$ 3,384,205	$ 3,350,593	$ 2,937,991	$ 2,689,448	$ 2,088,623
Average loans	3,333,241	3,090,538	2,786,011	2,431,872	1,909,890
Net charge-offs/average loans	0.19%	0.15%	0.06%	0.15%	0.15%
Allowance for loan losses/year-end loans*	1.35	1.25	1.25	1.26	1.67
Allowance for loan	161.44	143.70	178.06	120.82	159.10

losses/nonaccrual, past due 90 days
still accruing and restructured loans

* Reflects the impact of loans acquired in the Orange acquisition in 2013 and the Conroe acquisition in 2015, which were initially recorded at fair value with no allocated allowance for loan losses.

Table 9 Allocation of Allowance for Loan Losses (in thousands):

	2016 Allocation Amount	2015 Allocation Amount	2014 Allocation Amount	2013 Allocation Amount	2012 Allocation Amount
Commercial	$ 11,707	$ 12,644	$ 7,990	$ 6,440	$ 7,343
Agricultural	1,101	1,191	527	383	1,541
Real estate	26,864	24,375	26,657	24,940	24,063
Consumer	6,107	3,667	1,650	2,137	1,892
Total	$ 45,779	$ 41,877	$ 36,824	$ 33,900	$ 34,839

Percent of Loans in Each Category of Total Loans:

	2016	2015	2014	2013	2012
Commercial	20.09%	20.99%	21.84%	22.23%	24.53%
Agricultural	2.50	3.09	3.61	2.83	3.29
Real estate	65.23	64.40	62.23	62.53	59.06
Consumer	12.18	11.52	12.32	12.41	13.12

Included in our loan portfolio are certain other loans not included in Table 7 that are deemed to be potential problem loans. Potential problem loans are those loans that are currently performing, but for which known information about trends, uncertainties or possible credit problems of the borrowers causes management to have serious doubts as to the ability of such borrowers to comply with present repayment terms, possibly resulting in the transfer of such loans to nonperforming status. These potential problem loans totaled $6.58 million as of December 31, 2016.

Interest-Bearing Deposits in Banks. The Company had interest-bearing deposits in banks of $50.28 million, $93.43 million and $71.33 million at December 31, 2016, 2015, and 2014, respectively. At December 31, 2016, our interest-bearing deposits in banks included $47.91 million maintained at the Federal Reserve Bank of Dallas, $1.71 million invested in FDIC-insured certificates of deposit and $663 thousand on deposit with the Federal Home Loan Bank of Dallas (FHLB). The average balance of interest-bearing deposits in banks was $58.25 million, $49.69 million and $66.68 million in 2016, 2015 and 2014, respectively. The average yield on interest-bearing deposits in banks was 0.55%, 0.36% and 0.51% in 2016, 2015 and 2014, respectively.

Available-for-Sale and Held-to-Maturity Securities. At December 31, 2016, securities with a fair value of $2.86 billion were classified as securities available-for-sale and securities with an amortized cost of $121 thousand were classified as securities held-to-maturity. As compared to December 31, 2015, the available-for-sale portfolio at December 31, 2016, reflected (1) a decrease of $127 thousand in U.S. Treasury securities; (2) a decrease of $34.85 million in obligations of U.S. government sponsored enterprises and agencies; (3) an increase of $113.15 million in obligations of states and political subdivisions; (4) a decrease of $35.56 million in corporate bonds and other; and (5) an increase of $84.33 million in mortgage-backed securities. As compared to December 31, 2014, the available-for-sale portfolio at December 31, 2015, reflected (1) an increase of $10.28 million in U.S. Treasury securities; (2) an increase of $18.80 million in obligations of U.S. government sponsored enterprises and agencies; (3) an increase of $283.50 million in obligations of states and political subdivisions; (4) a decrease of $10.80 million in corporate bonds and other; and (5) an increase of $16.27 million in mortgage-backed securities. Securities-available-for-sale included fair value adjustments of $33.07 million, $79.01 million and $77.17 million at December 31, 2016, 2015, and 2014, respectively. The decrease in unrealized gain at December 31, 2016 was due to increase in interest rates in the fourth quarter of 2016. We did not hold any collateralized mortgage obligations or structured notes as of December 31, 2016 that we consider to be high risk. Our mortgage related securities are backed by GNMA, FNMA or FHLMC or are collateralized by securities backed by these agencies.

See Table 10 and Note 2 to the Consolidated Financial Statements for additional disclosures relating to the maturities and fair values of the investment portfolio at December 31, 2016 and 2015.

Table 10 Maturities and Yields of Available-for-Sale Held at December 31, 2016 (in thousands, except percentages):

	Maturing									
	One Year or Less		After One Year Through Five Years		After Five Years Through Ten Years		After Ten Years		Total	
Available-for-Sale:	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**
U.S. Treasury securities	$ 5,313	1.07%	$ 5,355	1.18%	$	%	$	%	$ 10,668	1.12%
Obligations of U.S. government sponsored enterprises and agencies	52,787	1.15	60,916	1.38					113,703	1.28
Obligations of states and political subdivisions	103,867	4.39	611,494	5.13	845,257	4.68	3,658	6.03	1,564,276	4.84
Corporate bonds and other securities	45,309	2.53	7,084	3.43					52,393	2.66
Mortgage-backed securities	35,440	2.11	934,661	2.13	149,540	2.49	156	3.05	1,119,797	2,18
Total	$ 242,716	2.93%	$ 1,619,510	3.24%	$ 994,797	4.35%	$ 3,814	5.91%	$ 2,860,837	3.60%

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Amounts for held-to-maturity securities are not included herein due to insignificance.

All yields are computed on a tax-equivalent basis assuming a marginal tax rate of 35%. Yields on available-for-sale securities are based on amortized cost. Maturities of mortgage-backed securities are based on contractual maturities and could differ due to prepayments of underlying mortgages. Maturities of other securities are reported at the earlier of maturity date or call date.

As of December 31, 2016, the investment portfolio had an overall tax equivalent yield of 3.60%, a weighted average life of 4.14 years and modified duration of 3.69 years.

Deposits. Deposits held by our subsidiary bank represent our primary source of funding. Total deposits were $5.48 billion as of December 31, 2016 as compared to $5.19 billion as of December 31, 2015 and $4.75 billion as of December 31, 2014. Table 11 provides a breakdown of average deposits and rates paid over the past three years and the remaining maturity of time deposits of $100,000 or more:

Table 11 Composition of Average Deposits and Remaining Maturity of Time Deposits of $100,000 or More (in thousands, except percentages):

	2016		2015		2014	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing deposits	$ 1,666,598		$ 1,634,669		$ 1,441,125	
Interest-bearing deposits						
Interest-bearing checking	1,713,498	0.12%	1,622,331	0.09%	1,341,754	0.11%
Savings and money market accounts	1,195,671	0.09	1,021,222	0.05	888,108	0.06
Time deposits under $100,000	237,419	0.18	261,255	0.20	279,734	0.22
Time deposits of $100,000 or more	322,417	0.31	367,342	0.31	396,138	0.32
Total interest-bearing deposits	3,469,005	0.13%	3,272,150	0.11%	2,905,734	0.13%
Total average deposits	$ 5,135,603		$ 4,906,819		$ 4,346,859	

	As of December 31, 2016
Three months or less	$ 102,046
Over three through six months	67,956
Over six through twelve months	63,108
Over twelve months	52,736
Total time deposits of $100,000 or more	$ 285,846

Borrowings. Included in borrowings were federal funds purchased, securities sold under repurchase agreements and advances from the FHLB of $445.77 million, $615.68 million and $367.11 million at December 31, 2016, 2015 and 2014, respectively. Securities sold under repurchase agreements are generally with significant customers of the Company that require short-term liquidity for their funds for which we pledge certain securities that have a fair value equal to at least the amount of the short-term borrowing. The average balances of federal funds purchased, securities sold under repurchase agreements and advances from the FHLB were $552.04 million, $524.37 million and $397.74 million in 2016, 2015 and 2014, respectively. The average rates paid on federal funds purchased, securities sold under repurchase agreements and advances from the FHLB were 0.17%, 0.08% and 0.07% for the years ended December 31, 2016, 2015 and 2014, respectively. The weighted average interest rate on federal funds purchased, securities sold under repurchase agreements and advances from the FHLB was 0.12%, 0.17% and 0.04% at December 31, 2016, 2015 and 2014, respectively. The highest amount of federal funds purchased, securities sold under repurchase agreements and advances from the FHLB at any month end during 2016, 2015 and 2014 was $598.77 million, $647.72 million and $497.31 million, respectively.

Capital Resources

We evaluate capital resources by our ability to maintain adequate regulatory capital ratios to do business in the banking industry. Issues related to capital resources arise primarily when we are growing at an accelerated rate but not retaining a significant amount of our profits or when we experience significant asset quality deterioration.

Total shareholders equity was $837.89 million, or 12.30% of total assets at December 31, 2016, as compared to $804.99 million, or 12.08% of total assets at December 31, 2015. During 2016, total shareholders equity averaged $847.87 million, or 12.85% of average assets, as compared to $738.29 million, or 11.86% of average assets during 2015.

Banking regulators measure capital adequacy by means of the risk-based capital ratios and leverage ratio under the Basel III regulatory capital framework and prompt corrective action regulations. The risk-based capital rules provide for the weighting of assets and off-balance-sheet commitments and contingencies according to prescribed risk categories. Regulatory capital is then divided by risk-weighted assets to determine the risk-adjusted capital ratios. The leverage ratio is computed by dividing shareholders equity less intangible assets by quarter-to-date average assets less intangible assets.

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

As of December 31, 2016 and 2015, we had a total risk-based capital ratio of 18.45% and 16.97%, a Tier 1 capital to risk-weighted assets ratio of 17.30% and 15.90%, a common equity Tier 1 capital to risk-weighted ratio of 17.30% and 15.90% and a Tier 1 leverage ratio of 10.71% and 9.96%, respectively. The regulatory capital ratios as of December 31, 2016 and 2015 were calculated under Basel III rules. There is no threshold for well-capitalized status for bank holding companies.

We performed a preliminary assessment using the regulatory capital estimation tool made available by the OCC and believe the Company and Bank are prepared to meet the new requirements upon adoption of the Basel III that will be effective December 31, 2019.

Our subsidiary bank made the election to continue to exclude most AOCI from capital in connection with its March 31, 2015 quarterly financial filing and, in effect, to retain the AOCI treatment under the prior capital rules.

Interest Rate Risk. Interest rate risk results when the maturity or repricing intervals of interest-earning assets and interest-bearing liabilities are different. Our exposure to interest rate risk is managed primarily through our strategy of selecting the types and terms of interest-earning assets and interest-bearing liabilities that generate favorable earnings while limiting the potential negative effects of changes in market interest rates. We use no off-balance-sheet financial instruments to manage interest rate risk.

Our subsidiary bank has an asset liability management committee that monitors interest rate risk and compliance with investment policies. The subsidiary bank utilizes an earnings simulation model as the primary quantitative tool in measuring the amount of interest rate risk associated with changing market rates. The model quantifies the effects of

various interest rate scenarios on projected net interest income and net income over the next twelve months. The model measures the impact on net interest income relative to a base case scenario of hypothetical fluctuations in interest rates over the next twelve months. These simulations incorporate assumptions regarding balance sheet growth and mix, pricing and the re-pricing and maturity characteristics of the existing and projected balance sheet.

As of December 31, 2016, the model simulations projected that 100 and 200 basis point increases in interest rates would result in variances in net interest income of positive 0.29% and positive 0.31%, respectively, relative to

the current financial statement structure over the next twelve months, while a decrease in interest rates of 100 basis points would result in a variance in a net interest income of negative 4.07% relative to the current financial statement structure over the next twelve months**.** We consider the likelihood of a decrease in interest rates beyond 100 basis points after December 31, 2016 remote given current interest rate levels. These are good faith estimates and assume that the composition of our interest sensitive assets and liabilities existing at each year-end will remain constant over the relevant twelve month measurement period and that changes in market interest rates are instantaneous and sustained across the yield curve regardless of duration of pricing characteristics on specific assets or liabilities. Also, this analysis does not contemplate any actions that we might undertake in response to changes in market interest rates. We believe these estimates are not necessarily indicative of what actually could occur in the event of immediate interest rate increases or decreases of this magnitude. As interest-bearing assets and liabilities re-price in different time frames and proportions to market interest rate movements, various assumptions must be made based on historical relationships of these variables in reaching any conclusion. Since these correlations are based on competitive and market conditions, we anticipate that our future results will likely be different from the foregoing estimates, and such differences could be material.

Should we be unable to maintain a reasonable balance of maturities and repricing of our interest-earning assets and our interest-bearing liabilities, we could be required to dispose of our assets in an unfavorable manner or pay a higher than market rate to fund our activities. Our asset liability committee oversees and monitors this risk.

Liquidity

Liquidity is our ability to meet cash demands as they arise. Such needs can develop from loan demand, deposit withdrawals or acquisition opportunities. Potential obligations resulting from the issuance of standby letters of credit and commitments to fund future borrowings to our loan customers are other factors affecting our liquidity needs. Many of these obligations and commitments are expected to expire without being drawn upon; therefore the total commitment amounts do not necessarily represent future cash requirements affecting our liquidity position. The potential need for liquidity arising from these types of financial instruments is represented by the contractual notional amount of the instrument, as detailed in Tables 12 and 13. Asset liquidity is provided by cash and assets which are readily marketable or which will mature in the near future. Liquid assets include cash, federal funds sold, and short-term investments in time deposits in banks. Liquidity is also provided by access to funding sources, which include core depositors and correspondent banks that maintain accounts with and sell federal funds to our subsidiary bank. Other sources of funds include our ability to borrow from short-term sources, such as purchasing federal funds from correspondent banks, sales of securities under agreements to repurchase and advances from the FHLB, which amounted to $445.77 million at December 31, 2016, and an unfunded $25.00 million revolving line of credit established with Frost Bank, a nonaffiliated bank, which matures on June 2017 (see next paragraph). Our subsidiary bank also has federal funds purchased lines of credit with two non-affiliated banks totaling $130.00 million. At December 31, 2016, there were no amounts drawn on these lines of credit. Our subsidiary bank also has available a line of credit with the FHLB totaling $1.15 billion at December 31, 2016, secured by portions of our loan portfolio and certain investment securities. At December 31, 2016, $75.00 million in advances was outstanding under this line of credit.

The Company renewed its loan agreement, effective June 30, 2015, with Frost Bank. Under the loan agreement, as renewed and amended, we are permitted to draw up to $25.00 million on a revolving line of credit. Prior to June 30, 2017, interest is paid quarterly at *The Wall Street Journal* Prime Rate and the line of credit matures June 30, 2017. If a balance exists at June 30, 2017, the principal balance converts to a term facility payable quarterly over five years and interest is paid quarterly at our election at *The Wall Street Journal* Prime Rate plus 50 basis points or LIBOR plus 250 basis points. The line of credit is unsecured. Among other provisions in the credit agreement, we must satisfy certain financial covenants during the term of the loan agreement, including, without limitation, covenants that require us to

maintain certain capital, tangible net worth, loan loss reserve, non-performing asset and cash flow coverage ratios. In addition, the credit agreement contains certain operational covenants, which among others, restricts the payment of dividends above 55% of consolidated net income, limits the incurrence of debt (excluding any amounts acquired in an acquisition) and prohibits the disposal of assets except in the ordinary course of business. Since 1995, we have historically declared dividends as a percentage of our consolidated net income in a range of 37% (low) in 1995 to 53% (high) in 2003 and 2006. The Company was in compliance with the financial and operational covenants at December 31, 2016. There was no outstanding balance under the line of credit as of December 31, 2016 or 2015.

In addition, we anticipate that any future acquisition of financial institutions, expansion of branch locations or offering of new products could also place a demand on our cash resources. Available cash and cash equivalents at our parent company, which totaled $93.25 million at December 31, 2016, investment securities which totaled $11.59 million at December 31, 2016 which matures over 7 to 14 years, available dividends from our subsidiaries which totaled $170.73 million at December 31, 2016, utilization of available lines of credit, and future debt or equity offerings are expected to be the source of funding for these potential acquisitions or expansions.

Given the strong core deposit base and relatively low loan to deposit ratios maintained at our subsidiary bank, we consider our current liquidity position to be adequate to meet our short-term and long-term liquidity needs.

Table 12 Contractual Obligations as of December 31, 2016 (in thousands):

	Payment Due by Period				
	Total Amounts	**Less than 1 year**	**More than 1 year but less than 3 years**	**More than 3 year but less than 5 years**	**Over 5 years**
Deposits with stated maturity dates	$ 508,996	$ 419,326	$ 72,606	$ 17,032	$ 32
Pension obligation	9,329	856	1,764	1,848	4,861
Operating leases	1,583	774	637	172	
Outsourcing service contracts	8,374	3,141	3,811	1,422	
Total Contractual Obligations	$ 528,282	$ 424,097	$ 78,818	$ 20,474	$ 4,893

Amounts above for deposits do not include related accrued interest.

Off-Balance Sheet Arrangements. We are a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include unfunded lines of credit, commitments to extend credit and federal funds sold to correspondent banks and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

Our exposure to credit loss in the event of nonperformance by the counterparty to the financial instrument for unfunded lines of credit, commitments to extend credit and standby letters of credit is represented by the contractual notional amount of these instruments. We generally use the same credit policies in making commitments and conditional obligations as we do for on-balance-sheet instruments.

Unfunded lines of credit and commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. These commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, as we deem necessary upon extension of credit, is based on our credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant, and equipment and income-producing commercial properties.

Standby letters of credit are conditional commitments we issue to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The average collateral value held on letters of credit usually exceeds the contract amount.

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Table 13 Commitments as of December 31, 2016 (in thousands):

	Total Notional Amounts Committed	Less than 1 year	More than 1 year but less than 3 years	More than 3 year but less than 5 years	Over 5 years
Unfunded lines of credit	$ 549,000	$ 495,712	$ 29,548	$ 14,106	$ 9,634
Unfunded commitments to extend credit	199,235	122,887	7,629	18,647	50,072
Standby letters of credit	27,380	22,284	2,429	2,667	
Total Commercial Commitments	$ 775,615	$ 640,883	$ 39,606	$ 35,420	$ 59,706

We believe we have no other off-balance sheet arrangements or transactions with unconsolidated, special purpose entities that would expose us to liability that is not reflected on the face of the financial statements.

Parent Company Funding. Our ability to fund various operating expenses, dividends, and cash acquisitions is generally dependent on our own earnings (without giving effect to our subsidiaries), cash reserves and funds derived from our subsidiaries. These funds historically have been produced by intercompany dividends and management fees that are limited to reimbursement of actual expenses. We anticipate that our recurring cash sources will continue to include dividends and management fees from our subsidiaries. At December 31, 2016, approximately $170.73 million was available for the payment of intercompany dividends by our subsidiaries without the prior approval of regulatory agencies. Our subsidiaries paid aggregate dividends to us of $48.80 million in 2016 and $51.20 million in 2015.

Dividends. Our long-term dividend policy is to pay cash dividends to our shareholders of approximately 40% of annual net earnings while maintaining adequate capital to support growth. We are also restricted by a loan covenant within our line of credit agreement with Frost Bank to dividend no greater than 55% of net income, as defined in such loan agreement. The cash dividend payout ratios have amounted to 44.14%, 40.20% and 39.34% of net earnings, respectively, in 2016, 2015 and 2014. Given our current capital position, projected earnings and asset growth rates, we do not anticipate any significant change in our current dividend policy.

Our bank subsidiary, which is a national banking association and a member of the Federal Reserve System, is required by federal law to obtain the prior approval of the OCC to declare and pay dividends if the total of all dividends declared in any calendar year would exceed the total of (1) such bank s net profits (as defined and interpreted by regulation) for that year plus (2) its retained net profits (as defined and interpreted by regulation) for the preceding two calendar years, less any required transfers to surplus.

To pay dividends, we and our subsidiary bank must maintain adequate capital above regulatory guidelines. In addition, if the applicable regulatory authority believes that a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which, depending on the financial condition of the bank, could include the payment of dividends), the authority may require, after notice and hearing, that such bank cease and desist from the unsafe practice. The Federal Reserve, the FDIC and the OCC have each indicated that paying dividends that deplete a bank s capital base to an inadequate level would be an unsafe and unsound banking practice. The Federal Reserve, the OCC and the FDIC have issued policy statements that recommend that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Management considers interest rate risk to be a significant market risk for the Company. See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Capital Resources Interest Rate Risk for disclosure regarding this market risk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and the report of our independent registered public accounting firm begin on page F-1.

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Quarterly Results of Operations (in thousands, except per share and common stock data):

The following tables set forth certain unaudited historical quarterly financial data for each of the eight consecutive quarters in the fiscal years of 2016 and 2015. This information is derived from unaudited consolidated financial statements that include, in our opinion, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation when read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this Form 10-K.

	2016			
	4th	3rd	2nd	1st
	(dollars in thousands, except per share amounts)			
Summary Income Statement Information:				
Interest income	$ 57,979	$ 58,093	$ 57,881	$ 58,335
Interest expense	1,443	1,366	1,330	1,312
Net interest income	56,536	56,727	56,551	57,023
Provision for loan losses	1,993	3,833	2,058	2,328
Net interest income after provision for loan losses	54,543	52,894	54,493	54,695
Noninterest income	21,604	21,913	20,526	19,819
Net gain on securities transactions	117	239	912	2
Noninterest expense	41,990	42,003	40,756	41,081
Earnings before income taxes	34,274	33,043	35,175	33,435
Income tax expense	7,608	7,440	8,366	7,739
Net earnings	$ 26,666	$ 25,603	$ 26,809	$ 25,696
Per Share Data:				
Earnings per share, basic	$ 0.40	$ 0.39	$ 0.41	$ 0.39
Earnings per share, assuming dilution	0.40	0.39	0.41	0.39
Cash dividends declared	0.18	0.18	0.18	0.16
Book value at period-end	12.68	13.14	13.11	12.70
Common stock sales price:				
High	$ 46.70	$ 37.06	$ 34.50	$ 30.75
Low	35.05	30.95	27.72	24.12
Close	45.20	36.44	32.79	29.58

	2015			
	4th	3rd	2nd	1st
	(dollars in thousands, except per share amounts)			
Summary Income Statement Information:				
Interest income	$ 59,047	$ 57,163	$ 53,344	$ 52,069
Interest expense	1,046	1,065	1,008	970
Net interest income	58,001	56,098	52,336	51,099
Provision for loan losses	4,177	2,664	1,554	1,290
Net interest income after provision for loan losses	53,824	53,434	50,782	49,809
Noninterest income	19,229	20,310	17,570	15,892
Net gain (loss) on securities transactions	51	136	239	5
Noninterest expense	40,342	39,973	35,204	33,943
Earnings before income taxes	32,762	33,907	33,387	31,763
Income tax expense	7,570	8,021	8,080	7,766
Net earnings	$ 25,192	$ 25,886	$ 25,307	$ 23,997
Per Share Data:				
Earnings per share, basic	$ 0.38	$ 0.40	$ 0.39	$ 0.37
Earnings per share, assuming dilution	0.38	0.40	0.39	0.37
Cash dividends declared	0.16	0.16	0.16	0.14
Book value at period-end	12.20	12.01	10.93	11.01
Common stock sales price:				
High	$ 36.51	$ 36.20	$ 35.32	$ 30.17
Low	29.56	29.21	27.16	24.46
Close	30.17	31.78	34.64	27.64

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

As of December 31, 2016, we carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934). Our management, which includes our principal executive officer and our principal financial officer, does not expect that our disclosure controls and procedures will prevent all errors and all fraud.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent

limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements

due to error or fraud may occur and not be detected. Our principal executive officer and principal financial officer have concluded, based on our evaluation of our disclosure controls and procedures, that our disclosure controls and procedures were effective at the reasonable assurance level as of December 31, 2016.

Subsequent to our evaluation, there were no significant changes in our internal control over financial reporting or other factors that has materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of First Financial Bankshares, Inc. and subsidiaries is responsible for establishing and maintaining adequate internal control over financial reporting. First Financial Bankshares, Inc. and subsidiaries internal control system was designed to provide reasonable assurance to the Company s management and board of directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

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

First Financial Bankshares, Inc. and subsidiaries management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2016. In making this assessment, it used the criteria for effective internal control over financial reporting set forth by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) (COSO) in *Internal Control Integrated Framework*. Based on our assessment we believe that, as of December 31, 2016, the Company s internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Securities Exchange Act of 1934, is effective based on those criteria.

First Financial Bankshares, Inc. and subsidiaries independent auditors have issued an audit report, dated February 17, 2017, on the effectiveness of the Company s internal control over financial reporting as of December 31, 2016.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

First Financial Bankshares, Inc.

We have audited First Financial Bankshares, Inc. and subsidiaries internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) (the COSO criteria). First Financial Bankshares, Inc. and subsidiaries management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing

and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, First Financial Bankshares, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of earnings, comprehensive earnings, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2016 of First Financial Bankshares, Inc. and subsidiaries and our report dated February 17, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas

February 17, 2017

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 is hereby incorporated by reference from our proxy statement for our 2017 annual meeting of shareholders which will be filed with the SEC not later than 120 days after December 31, 2016.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is hereby incorporated by reference from our proxy statement for our 2017 annual meeting of shareholders which will be filed with the SEC not later than 120 days after December 31, 2016.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 12 related to security ownership of certain beneficial owners and management is hereby incorporated by reference from our proxy statement for our 2017 annual meeting of shareholders. The following chart gives aggregate information under our equity compensation plans as of December 31, 2016.

	Number of Securities To be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available For Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Far Left Column)
Equity compensation plans approved by security holders	1,094,035	$ 27.40	2,681,182
Equity compensation plans not approved by security holders			
Total	1,094,035	$ 27.40	2,681,182

The remainder of the information required by Item 12 is incorporated by reference from our proxy statement for our 2017 annual meeting of shareholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 is hereby incorporated by reference from our proxy statement for our 2017 annual meeting of shareholders which will be filed with the SEC not later than 120 days after December 31, 2016.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 is hereby incorporated by reference from our proxy statement for our 2017 annual meeting of shareholders which will be filed with the SEC not later than 120 days after December 31, 2016.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this report:

(1) Financial Statements:
Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2016 and 2015

Consolidated Statements of Earnings for the years ended December 31, 2016, 2015 and 2014

Consolidated Statements of Comprehensive Earnings for the years ended December 31, 2016, 2015 and 2014

Consolidated Statements of Shareholders Equity for the years ended December 31, 2016, 2015 and 2014

Consolidated Statements of Cash Flows for the years ended December 31, 2016, 2015 and 2014

Notes to the Consolidated Financial Statements

(2) Financial Statement Schedules:
These schedules have been omitted because they are not required, are not applicable or have been included in our consolidated financial statements.

(3) Exhibits:
The information required by this Item 15(a)(3) is set forth in the Exhibit Index immediately following our signature pages. The exhibits listed herein will be furnished upon written request to J. Bruce Hildebrand, Executive Vice President, First Financial Bankshares, Inc., 400 Pine Street, Abilene, Texas 79601, and payment of a reasonable fee that will be limited to our reasonable expense in furnishing such exhibits.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST FINANCIAL BANKSHARES, INC.

Date: February 17, 2017

By: /s/ F. SCOTT DUESER
F. SCOTT DUESER
Chairman of the Board, Director, President and

Chief Executive Officer

(Principal Executive Officer)

The undersigned directors and officers of First Financial Bankshares, Inc. hereby constitute and appoint J. Bruce Hildebrand, with full power to act and with full power of substitution and resubstitution, our true and lawful attorney-in-fact with full power to execute in our name and behalf in the capacities indicated below any and all amendments to this report and to file the same, with all exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission and hereby ratify and confirm all that such attorney-in-fact or his substitute shall lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ F. SCOTT DUESER F. Scott Dueser	Chairman of the Board, Director, President, and Chief Executive Officer (Principal Executive Officer)	February 17, 2017
/s/ J. BRUCE HILDEBRAND J. Bruce Hildebrand	Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	February 17, 2017
/s/ APRIL K. ANTHONY April K. Anthony	Director	February 17, 2017
/s/ STEVEN L. BEAL Steven L. Beal	Director	February 17, 2017
/s/ TUCKER S. BRIDWELL	Director	

Tucker S. Bridwell		February 17, 2017
/s/ DAVID COPELAND David Copeland	Director	February 17, 2017

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Name	Title	Date
/s/ MURRAY EDWARDS Murray Edwards	Director	February 17, 2017
/s/ RON GIDDIENS Ron Giddiens	Director	February 17, 2017
/s/ TIM LANCASTER Tim Lancaster	Director	February 17, 2017
/s/ KADE L. MATTHEWS Kade L. Matthews	Director	February 17, 2017
/s/ ROSS H. SMITH, JR. Ross H. Smith, Jr.	Director	February 17, 2017
/s/ JOHNNY TROTTER Johnny Trotter	Director	February 17, 2017

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Exhibits Index

The following exhibits are filed as part of this report:

2.1	Agreement and Plan of Reorganization between First Financial Bankshares, Inc., First Financial Bank, N.A., FBC Bancshares, Inc., and First Bank, N.A., Conroe, Texas, dated as of April 1, 2015 (Schedules have been omitted pursuant to Item 601(b)(2) of Regulation S-K) (incorporated by reference from Exhibit 2.1 to Registrant s Form 8-K filed April 3, 2015).
3.1	Amended and Restated Certificate of Formation (incorporated by reference from Exhibit 3.1 of the Registrant s Form 8-K filed April 28, 2015).
3.2	Amended and Restated Bylaws of the Registrant (incorporated by reference from Exhibit 3.2 of the Registrant s Form 8-K filed January 24, 2012).
4.1	Specimen certificate of First Financial Common Stock (incorporated by reference from Exhibit 3 of the Registrant s Amendment No. 1 to Form 8-A filed on Form 8-A/A No. 1 on January 7, 1994).
10.1	2002 Incentive Stock Option Plan (incorporated by reference from Exhibit 10.3 of the Registrant s Form 10-Q filed May 4, 2010).++
10.2	2012 Incentive Stock Option Plan (incorporated by reference from Appendix A of the Registrant s Definitive Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 filed March 1, 2012).++
10.3	Loan Agreement, dated June 30, 2013, between First Financial Bankshares, Inc. and Frost Bank (incorporated by reference from Exhibit 10.1 of the Registrant s Form 8-K filed July 1, 2013).
10.4	First Amendment to Loan Agreement, dated June 30, 2015, between First Financial Bankshares, Inc. and Frost Bank (incorporated by reference from Exhibit 10.1 of the Registrant s Form 8-K filed June 30, 2015).
10.5	2015 Restricted Stock Plan (incorporated by reference from Appendix A of the Registrant s Definitive Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 filed March 2, 2015).++
10.6	Form of Executive Recognition Agreement (incorporated by reference from Exhibit 10.1 of the Registrant s Form 8-K filed August 26, 2016).++
21.1	Subsidiaries of the Registrant.*
23.1	Consent of Ernst & Young LLP.*
24.1	Power of Attorney (included on signature page of this Form 10-K).*
31.1	Rule 13a-14(a) / 15(d)-14(a) Certification of Chief Executive Officer of First Financial Bankshares, Inc.*
31.2	Rule 13a-14(a) / 15(d)-14(a) Certification of Chief Financial Officer of First Financial Bankshares, Inc.*
32.1	Section 1350 Certification of Chief Executive Officer of First Financial Bankshares, Inc.+
32.2	Section 1350 Certification of Chief Financial Officer of First Financial Bankshares, Inc.+
101.INS	XBRL Instance Document.*

101.SCH	XBRL Taxonomy Extension Schema Document.*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.*

* Filed herewith.

\+ Furnished herewith. This Exhibit shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that Section, and shall not be deemed to be incorporated into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

++ Management contract or compensatory plan on arrangement.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

First Financial Bankshares, Inc.

We have audited the accompanying consolidated balance sheets of First Financial Bankshares, Inc. (a Texas corporation) and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of earnings, comprehensive earnings, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of First Financial Bankshares, Inc. and subsidiaries at December 31, 2016 and 2015, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), First Financial Bankshares, Inc. s internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) and our report dated February 17, 2017, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas

February 17, 2017

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FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2016 and 2015

(Dollars in thousands, except share and per share amounts)

	2016	2015
ASSETS		
CASH AND DUE FROM BANKS	$ 204,782	$ 179,140
FEDERAL FUNDS SOLD	3,130	3,810
INTEREST-BEARING DEPOSITS IN BANKS	48,574	89,936
Total cash and cash equivalents	256,486	272,886
INTEREST-BEARING TIME DEPOSITS IN BANKS	1,707	3,495
SECURITIES AVAILABLE-FOR-SALE, at fair value	2,860,837	2,733,899
SECURITIES HELD-TO-MATURITY (fair value of $124 and $283 at December 31, 2016 and 2015, respectively)	121	278
LOANS:		
Held for investment	3,357,307	3,317,050
Less allowance for loan losses	(45,779)	(41,877)
Net loans held for investment	3,311,528	3,275,173
Held for sale	26,898	33,543
Net loans	3,338,426	3,308,716
BANK PREMISES AND EQUIPMENT, net	122,685	115,712
INTANGIBLE ASSETS	143,603	144,449
OTHER ASSETS	86,066	85,635
Total assets	$ 6,809,931	$ 6,665,070
LIABILITIES AND SHAREHOLDERS EQUITY		
NONINTEREST-BEARING DEPOSITS	$ 1,717,722	$ 1,745,952
INTEREST-BEARING DEPOSITS	3,760,817	3,444,217
Total deposits	5,478,539	5,190,169

DIVIDENDS PAYABLE	11,897	10,558
BORROWINGS	445,770	615,675
OTHER LIABILITIES	35,840	43,682
Total liabilities	5,972,046	5,860,084
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS EQUITY:		
Common stock - $0.01 par value; authorized 120,000,000 shares; 66,094,695 and 65,990,234 shares issued at December 31, 2016 and 2015, respectively	661	660
Capital surplus	372,245	368,925
Retained earnings	446,534	388,006
Treasury stock (shares at cost: 507,409 and 520,651 at December 31, 2016 and 2015, respectively)	(6,671)	(6,296)
Deferred Compensation	6,671	6,296
Accumulated other comprehensive earnings	18,445	47,395
Total shareholders equity	837,885	804,986
Total liabilities and shareholders equity	$ 6,809,931	$ 6,665,070

The accompanying notes are an integral part of these consolidated financial statements.

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FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Consolidated Statement of Earnings

December 31, 2016, 2015 and 2014

(Dollars in thousands, except share and per share amounts)

	2016	2015	2014
INTEREST INCOME:			
Interest and fees on loans	$ 161,018	$ 151,662	$ 136,684
Interest on investment securities:			
Taxable	27,626	29,673	28,402
Exempt from federal income tax	43,302	40,080	33,081
Interest on federal funds sold and interest-bearing deposits in banks	342	208	372
Total interest income	232,288	221,623	198,539
INTEREST EXPENSE:			
Interest on deposits	4,503	3,642	3,883
Other	948	446	298
Total interest expense	5,451	4,088	4,181
Net interest income	226,837	217,535	194,358
PROVISION FOR LOAN LOSSES	10,212	9,685	4,465
Net interest income after provision for loan losses	216,625	207,850	189,893
NONINTEREST INCOME:			
Trust fees	19,636	19,252	18,766
Service charges on deposit accounts	18,386	17,171	16,910
ATM, interchange and credit card fees	23,910	21,860	19,427
Real estate mortgage operations	16,086	10,409	6,511
Net gain (loss) on sale of available-for-sale securities (includes $1,270, $432 and ($4) for the years ended December 31, 2016, 2015 and 2014, respectively, related to accumulated comprehensive earnings reclassifications)	1,270	432	(4)
Net gain on sale of foreclosed assets	456	538	904
Net gain (loss) on sale of assets	168	(820)	10
Interest on loan recoveries	2,112	1,050	601
Other	3,108	3,540	3,499

Total noninterest income	85,132	73,432	66,624
NONINTEREST EXPENSE:			
Salaries and employee benefits	90,739	80,999	70,456
Loss from partial settlement of pension plan	267		2,909
Net occupancy expense	10,420	10,314	9,100
Equipment expense	13,479	12,222	10,740
FDIC insurance premiums	2,680	3,153	2,725
ATM, interchange and credit card expenses	7,231	6,384	6,870
Professional and service fees	6,877	4,831	4,295
Printing, stationery and supplies	2,093	2,278	2,637
Amortization of intangible assets	738	561	275
Other	31,306	28,722	27,918
Total noninterest expense	165,830	149,464	137,925
EARNINGS BEFORE INCOME TAXES	135,927	131,818	118,592
INCOME TAX EXPENSE (includes $445, $151 and ($1) for the years ended December 31, 2016, 2015 and 2014, respectively, related to income tax expense from reclassification items)	31,153	31,437	29,033
NET EARNINGS	$ 104,774	$ 100,381	$ 89,559
NET EARNINGS PER SHARE, BASIC	$ 1.59	$ 1.55	$ 1.40
NET EARNINGS PER SHARE, ASSUMING DILUTION	$ 1.59	$ 1.54	$ 1.39

The accompanying notes are an integral part of these consolidated financial statements.

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FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Earnings

Years Ended December 31, 2016, 2015 and 2014

(Dollars in thousands)

	2016	2015	2014
NET EARNINGS	$ 104,774	$ 100,381	$ 89,559
OTHER ITEMS OF COMPREHENSIVE EARNINGS (LOSS):			
Change in unrealized gain (loss) on investment securities available-for-sale, before income tax	(44,679)	2,273	54,571
Reclassification adjustment for realized losses (gains) on investment securities included in net earnings, before income tax	(1,270)	(432)	4
Minimum liability pension adjustment, before income tax	1,410	(1,986)	2,540
Total other items of comprehensive earnings (losses)	(44,539)	(145)	57,115
Income tax benefit (expense) related to:			
Investment securities	16,082	(644)	(19,101)
Minimum liability pension adjustment	(493)	695	(889)
Total income tax benefit (expense)	15,589	51	(19,990)
COMPREHENSIVE EARNINGS	$ 75,824	$ 100,287	$ 126,684

The accompanying notes are an integral part of these consolidated financial statements.

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FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Consolidated Statements of Shareholders Equity

Years Ended December 31, 2016, 2015 and 2014

(Dollars in thousands)

	Common Stock		Capital	Retained	Treasury Stock		Deferred	Accumulated Other Comprehensive Earnings	Total Shareholders
	Shares	Amount	Surplus	Earnings	Shares	Amounts	Compensation	(Losses)	Equity
BALANCE, December 31, 2013	31,992,497	$ 320	$ 302,991	$ 273,972	(269,467)	$ (5,490)	$ 5,490	$ 10,364	$ 587,647
Net earnings				89,559					89,559
Stock option exercises	74,664	1	1,436						1,437
Cash dividends declared, $0.55 per share				(35,233)					(35,233)
Minimum liability pension adjustment, net of related income taxes								1,651	1,651
Change in unrealized gain (loss) in investment securities available-for-sale, net of related income taxes								35,474	35,474
Additional tax benefit related to directors deferred compensation plan			293						293
Shares purchased in connection with directors deferred compensation plan, net					8,038	(388)	388		

Stock option expense			709						709
Two-for-one stock split in the form of 100% stock dividend	32,022,760	320		(320)	(268,134)				
BALANCE, December 31, 2014	64,089,921	641	305,429	327,978	(529,563)	(5,878)	5,878	47,489	681,537
Net earnings				100,381					100,381
Stock issued in acquisition of FBC Bancshares, Inc.	1,755,374	18	59,630						59,648
Stock option exercises	105,121	1	1,544						1,545
Restricted Stock grant	39,818		1,350						1,350
Cash dividends declared, $0.62 per share				(40,353)					(40,353)
Minimum liability pension adjustment, net of related income taxes								(1,291)	(1,291)
Change in unrealized gain (loss) in investment securities available-for-sale, net of related income taxes								1,197	1,197
Additional tax benefit related to directors deferred compensation plan			328						328
Shares purchased in connection with directors deferred compensation plan, net					8,912	(418)	418		
Stock option expense			644						644
	65,990,234	660	368,925	388,006	(520,651)	(6,296)	6,296	47,395	804,986

BALANCE, December 31, 2015									
Net earnings				104,774					104,774
Stock option exercises	82,871	1	1,259						1,260
Restricted Stock grant	21,590		809						809
Cash dividends declared, $0.70 per share				(46,246)					(46,246)
Minimum liability pension adjustment, net of related income taxes								917	917
Change in unrealized gain (loss) in investment securities available-for-sale, net of related income taxes								(29,867)	(29,867)
Additional tax benefit related to directors deferred compensation plan			370						370
Shares purchased in connection with directors deferred compensation plan, net					13,242	(375)	375		
Stock option expense			882						882
BALANCE, December 31, 2016	66,094,695	$ 661	$ 372,245	$ 446,534	(507,409)	$ (6,671)	$ 6,671	$ 18,445	$ 837,885

The accompanying notes are an integral part of these consolidated financial statements.

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FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years Ended December 31, 2016, 2015 and 2014

(Dollars in thousands)

	2016	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net earnings	$ 104,774	$ 100,381	$ 89,559
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	11,573	11,145	9,262
Provision for loan losses	10,212	9,685	4,465
Securities premium amortization (discount accretion), net	29,005	27,705	20,221
Gain on sale of assets, net	(1,894)	(150)	(910)
Deferred federal income tax expense (benefit)	673	320	(893)
Change in loans held for sale	6,645	(24,739)	(3,640)
Change in other assets	2,397	(16,919)	9,852
Change in other liabilities	(2,643)	1,664	3,486
Total adjustments	55,968	8,711	41,843
Net cash provided by operating activities	160,742	109,092	131,402
CASH FLOWS FROM INVESTING ACTIVITIES:			
Cash paid for asset acquisition of 4Trust Mortgage, Inc., net		(1,931)	
Cash received in acquisition of FBC Bancshares, Inc., net		65,197	
Net decrease in interest-bearing time deposits in banks	1,788	13,507	14,915
Activity in available-for-sale securities:			
Sales	40,510	35,580	1,619
Maturities	3,509,113	2,717,724	2,917,407
Purchases	(3,737,865)	(3,055,117)	(3,248,804)
Activity in held-to-maturity securities maturities	157	163	243
Net increase in loans	(48,836)	(144,320)	(247,829)
Purchases of bank premises and equipment and other assets	(20,399)	(17,433)	(17,412)
Proceeds from sale of bank premises and equipment and other assets	3,572	2,405	4,656
Net cash used in investing activities	(251,960)	(384,225)	(575,205)
CASH FLOWS FROM FINANCING ACTIVITIES:			

Net increase (decrease) in noninterest-bearing deposits	(28,230)	23,473	208,146
Net increase in interest-bearing deposits	316,600	72,857	407,035
Net increase (decrease) in borrowings	(169,905)	235,440	(96,778)
Common stock transactions:			
Proceeds from stock issuances	1,260	1,545	1,437
Dividends paid	(44,907)	(38,767)	(34,578)
Net cash provided by financing activities	74,818	294,548	485,262
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(16,400)	19,415	41,459
CASH AND CASH EQUIVALENTS, beginning of year	272,886	253,471	212,012
CASH AND CASH EQUIVALENTS, end of year	$ 256,486	$ 272,886	$ 253,471

The accompanying notes are an integral part of these consolidated financial statements.

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FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016, 2015 and 2014

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Nature of Operations

First Financial Bankshares, Inc. (a Texas corporation) (Bankshares , Company , we or us) is a financial holding company which owns all of the capital stock of one bank with 69 locations located in Texas as of December 31, 2016. The subsidiary bank is First Financial Bank, National Association, Abilene. The bank s primary source of revenue is providing loans and banking services to consumers and commercial customers in the market area in which the subsidiary is located. In addition, the Company also owns First Financial Trust & Asset Management Company, National Association, First Financial Insurance Agency, Inc., and First Technology Services, Inc.

A summary of significant accounting policies of Bankshares and its subsidiaries applied in the preparation of the accompanying consolidated financial statements follows. The accounting principles followed by the Company and the methods of applying them are in conformity with both U.S. GAAP and prevailing practices of the banking industry.

The Company evaluated subsequent events for potential recognition through the date the consolidated financial statements were issued.

Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company s significant estimates include its allowance for loan losses and its valuation of financial instruments.

Consolidation

The accompanying consolidated financial statements include the accounts of Bankshares and its subsidiaries, all of which are wholly-owned. All significant intercompany accounts and transactions have been eliminated.

Stock Repurchase

On October 28, 2014, the Company s Board of Directors authorized the repurchase of up to 1,500,000 common shares through September 30, 2017. The stock buyback plan authorizes management to repurchase the stock at such time as repurchases are considered beneficial to stockholders. Any repurchase of stock will be made through the open market, block trades or in privately negotiated transactions in accordance with applicable laws and regulations. Under the repurchase plan, there is no minimum number of shares that the Company is required to repurchase. For the years ended December 31, 2016, 2015 and 2014, no shares were repurchased under this or the prior authorization that expired September 30, 2014.

Stock Split

On April 22, 2014, the Company s Board of Directors declared a two-for-one stock split in the form of a 100% stock dividend effective for shareholders of record on May 15, 2014 that was distributed on June 2, 2014. All share and per share amounts in this report have been restated to reflect this stock split. An amount equal to the par value of the additional common shares issued pursuant to the stock split was reflected as a transfer from retained earnings to common stock on the consolidated financial statements as of and for the year ended December 31, 2014.

Acquisitions and Asset Purchase

On July 31, 2015, the Company acquired 100% of the outstanding capital stock of FBC Bancshares, Inc. through the merger of a wholly-owned subsidiary with and into FBC Bancshares, Inc. Following such merger, FBC Bancshares, Inc. and its wholly-owned subsidiary, First Bank, N.A. were merged into the Company and First Financial Bank, National Association, respectively. The results of operations of FBC Bancshares, Inc. subsequent to the acquisition date, are included in the consolidated earnings of the Company. See Note 18 for additional information.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016, 2015 and 2014

On June 1, 2015, the Company completed the asset purchase of 4Trust Mortgage, Inc. The results of operation of 4Trust Mortgage Inc. subsequent to the asset purchase date, are included in the consolidated earnings of the Company. See Note 18 for additional information.

Increase in Authorized Shares

On April 28, 2015, the Company s shareholders approved an amendment to the Company s Amended and Restated Certificate of Formation to increase the number of authorized common shares to 120,000,000.

Investment Securities

Management classifies debt and equity securities as held-to-maturity, available-for-sale, or trading based on its intent. Debt securities that management has the positive intent and ability to hold to maturity are classified as held-to-maturity and recorded at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to interest income using the interest method. Securities not classified as held-to-maturity or trading are classified as available-for-sale and recorded at fair value, with all unrealized gains and unrealized losses judged to be temporary, net of deferred income taxes, excluded from earnings and reported in the consolidated statements of comprehensive earnings. Available-for-sale securities that have unrealized losses that are judged other-than-temporary are included in gain (loss) on sale of securities and a new cost basis is established. Securities classified as trading are recorded at fair value with unrealized gains and losses included in earnings.

The Company records its available-for-sale and trading securities portfolio at fair value. Fair values of these securities are determined based on methodologies in accordance with current authoritative accounting guidance. Fair values are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates, credit ratings and yield curves. Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments or an estimate of fair value by using a range of fair value estimates in the market place as a result of the illiquid market specific to the type of security.

When the fair value of a security is below its amortized cost, and depending on the length of time the condition exists and the extent the fair value is below amortized cost, additional analysis is performed to determine whether an other-than-temporary impairment condition exists. Available-for-sale and held-to-maturity securities are analyzed quarterly for possible other-than-temporary impairment. The analysis considers (i) whether we have the intent to sell our securities prior to recovery and/or maturity, (ii) whether it is more likely than not that we will have to sell our securities prior to recovery and/or maturity, (iii) the length of time and extent to which the fair value has been less than amortized cost, and (iv) the financial condition of the issuer. Often, the information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the security may be different than previously estimated, which could have a material effect on the Company s results of operations and financial condition.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016, 2015 and 2014

The Company s investment portfolio consists of U.S. Treasury securities, obligations of U.S. government sponsored enterprises and agencies, obligations of state and political subdivisions, mortgage pass-through securities, corporate bonds and general obligation or revenue based municipal bonds. Pricing for such securities is generally readily available and transparent in the market. The Company utilizes independent third party pricing services to value its investment securities, which the Company reviews as well as the underlying pricing methodologies for reasonableness and to ensure such prices are aligned with pricing matrices. The Company validates quarterly, on a sample basis, prices supplied by the independent pricing services by comparison to prices obtained from other third party sources.

Loans and Allowance for Loan Losses

Loans held for investment are stated at the amount of unpaid principal, reduced by unearned income and an allowance for loan losses. Interest on loans is calculated by using the simple interest method on daily balances of the principal amounts outstanding. The Company defers and amortizes net loan origination fees and costs as an adjustment to yield. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes the collectability of the principal is unlikely.

The allowance for loan losses is an amount which represents management s best estimate of probable losses that are inherent in the Company s loan portfolio as of the balance sheet date. The allowance for loan losses is comprised of three elements: (i) specific reserves determined based on probable losses on specific classified loans; (ii) a historical valuation reserve component that considers historical loss rates and estimated loss emergence periods; and (iii) qualitative reserves based upon general economic conditions and other qualitative risk factors both internal and external to the Company. The allowance for loan losses is increased by charges to income and decreased by charge-offs (net of recoveries). Management s periodic evaluation of the appropriateness of the allowance is based on general economic conditions, the financial condition of borrowers, the value and liquidity of collateral, delinquency, prior loan loss experience, and the results of periodic reviews of the portfolio. For purposes of determining our historical valuation reserve, the loan portfolio, less cash secured loans, government guaranteed loans and classified loans, is multiplied by the Company s historical loss rate. Specific allocations are increased or decreased in accordance with deterioration or improvement in credit quality and a corresponding increase or decrease in risk of loss on a particular loan. In addition, we adjust our allowance for qualitative factors such as current local economic conditions and trends, including, without limitations, unemployment, oil and gas prices, drought conditions, changes in lending staff, policies and procedures, changes in credit concentrations, changes in the trends and severity of problem loans and changes in trends in volume and terms of loans. This qualitative reserve serves to estimate for additional areas of losses inherent in our portfolio that are not reflected in our historic loss factors.

Although we believe we use the best information available to make loan loss allowance determinations, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making our initial determinations. A decline in the economy and employment could result in increased levels of non-performing assets and charge-offs, increased loan provisions and reductions in income. Additionally, bank regulatory agencies periodically review our allowance for loan losses and methodology and could require, in accordance with U.S. GAAP, additional provisions to the allowance for loan losses based on their judgment of

information available to them at the time of their examination as well as changes to our methodology.

Accrual of interest is discontinued on a loan and payments are applied to principal when management believes, after considering economic and business conditions and collection efforts, the borrower s financial condition is such that collection of interest is doubtful. Except consumer loans, generally all loans past due greater than 90 days, based on contractual terms, are placed on non-accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Consumer loans are generally charged-off when a loan becomes past due 90 days. For other loans in the portfolio, facts and circumstances are evaluated in making charge-off decisions.

Loans are considered impaired when, based on current information and events, management determines that it is probable we will be unable to collect all amounts due in accordance with the loan agreement, including scheduled principal and interest payments. If a loan is impaired, a specific valuation allowance is allocated, if necessary.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016, 2015 and 2014

Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectable.

The Company s policy requires measurement of the allowance for an impaired, collateral dependent loan based on the fair value of the collateral. Other loan impairments for non-collateral dependent loans are measured based on the present value of expected future cash flows or the loan s observable market price. At December 31, 2016 and 2015, all significant impaired loans have been determined to be collateral dependent and the allowance for loss has been measured utilizing the estimated fair value of the collateral.

From time to time, the Company modifies its loan agreement with a borrower. A modified loan is considered a troubled debt restructuring when two conditions are met: (i) the borrower is experiencing financial difficulty and (ii) concessions are made by the Company that would not otherwise be considered for a borrower with similar credit risk characteristics. Modifications to loan terms may include a lower interest rate, a reduction of principal, or a longer term to maturity. For all impaired loans, including the Company s troubled debt restructurings, the Company performs a periodic, well-documented credit evaluation of the borrower s financial condition and prospects for repayment to assess the likelihood that all principal and interest payments required under the terms of the agreement will be collected in full. When doubt exists about the ultimate collectability of principal and interest, the troubled debt restructuring remains on non-accrual status and payments received are applied to reduce principal to the extent necessary to eliminate such doubt. This determination of accrual status is judgmental and is based on facts and circumstances related to each troubled debt restructuring. Each of these loans is individually evaluated for impairment and a specific reserve is recorded based on probable losses, taking into consideration the related collateral, modified loan terms and cash flow. As of December 31, 2016 and 2015, substantially all of the Company s troubled debt restructured loans are included in the non-accrual totals.

The Company originates certain mortgage loans for sale in the secondary market. Accordingly, these loans are classified as held-for-sale and are carried at the lower of cost or fair value on an aggregate basis. The mortgage loan sales contracts contain indemnification clauses should the loans default, generally in the first three to six months, or if documentation is determined not to be in compliance with regulations. The Company s historic losses as a result of these indemnities have been insignificant.

Loans acquired, including loans acquired in a business combination, are initially recorded at fair value with no valuation allowance. Acquired loans are segregated between those considered to be credit impaired and those deemed performing. To make this determination, management considers such factors as past due status, non-accrual status and credit risk ratings. The fair value of acquired performing loans is determined by discounting expected cash flows, both principal and interest, at prevailing market interest rates. The difference between the fair value and principal balances at acquisition date, the fair value discount, is accreted into interest income over the estimated life of the acquired portfolio.

Purchased credit impaired loans are those loans that showed evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all amounts contractually owed. Their acquisition fair value, which includes a credit component at the acquisition date, was based on the estimate of cash flows, both principal and interest, expected to be collected or estimated collateral values if cash flows are not estimable, discounted at prevailing market rates of interest. The difference between the discounted cash flows expected at acquisition and the investment in the loan is recognized as interest income on a level-yield method over the life of the loan, unless management was unable to reasonably forecast cash flows in which case the loans were placed on nonaccrual. Contractually required payments for interest and principal that exceed the cash flows expected at acquisition are not recognized as a yield adjustment. Increases in expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining life. Decreases in expected cash flows subsequent to acquisition are recognized as impairment. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition. The carrying amount of purchased credit impaired loans at December 31, 2016 and 2015 were $1,256,000 and $2,178,000, respectively, compared to a contractual balance of $1,865,000 and $2,936,000, respectively. Other purchased credit impaired loan disclosures were omitted due to immateriality.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016, 2015 and 2014

Other Real Estate

Other real estate owned is foreclosed property held pending disposition and is initially recorded at fair value, less estimated costs to sell. At foreclosure, if the fair value of the real estate, less estimated costs to sell, is less than the Company s recorded investment in the related loan, a write-down is recognized through a charge to the allowance for loan losses. Any subsequent reduction in value is recognized by a charge to income. Operating and holding expenses of such properties, net of related income, and gains and losses on their disposition are included in net gain (loss) on sale of foreclosed assets as incurred.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed principally on a straight-line basis over the estimated useful lives of the related assets. Leasehold improvements are amortized over the life of the respective lease or the estimated useful lives of the improvements, whichever is shorter.

Business Combinations, Goodwill and Other Intangible Assets

The Company accounts for all business combinations under the purchase method of accounting. Tangible and intangible assets and liabilities of the acquired entity are recorded at fair value. Intangible assets with finite useful lives represent the future benefit associated with the acquisition of the core deposits and are amortized over seven years, utilizing a method that approximates the expected attrition of the deposits. Goodwill with an indefinite life is not amortized, but rather tested annually for impairment as of June 30 each year and totaled $139,971,000 at both December 31, 2016 and 2015. There was no impairment recorded for the years ended December 31, 2016, 2015 and 2014.

The carrying amount of goodwill arising from acquisitions that qualify as an asset purchase for federal income tax purposes was $74,376,000 both at December 31, 2016 and 2015, and is deductible for federal income tax purposes.

Also included in other intangible assets are mortgage servicing rights totaling $1,795,000 and $1,902,000 at December 31, 2016 and 2015, respectively.

Securities Sold Under Agreements To Repurchase

Securities sold under agreements to repurchase, which are classified as borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of the cash received in connection with the transaction. The Company may be required to provide additional collateral based on the estimated fair value of the underlying securities.

Segment Reporting

The Company has determined that its banking regions meet the aggregation criteria of the current authoritative accounting guidance since each of its banking regions offer similar products and services, operate in a similar manner, have similar customers and report to the same regulatory authority, and therefore operate one line of business (community banking) located in a single geographic area (Texas).

Statements of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents includes cash on hand, amounts due from banks, including interest-bearing deposits in banks with original maturity of 90 days or less, and federal funds sold.

Accumulated Other Comprehensive Income (Loss)

Unrealized net gains on the Company s available-for-sale securities (after applicable income tax expense) totaling $21,492,000 and $51,359,000 at December 31, 2016 and 2015, respectively, and the minimum pension liability (after applicable income tax benefit) totaling $3,047,000 and $3,964,000 at December 31, 2016 and 2015, respectively, are included in accumulated other comprehensive income.

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016, 2015 and 2014

Income Taxes

The Company s provision for income taxes is based on income before income taxes adjusted for permanent differences between financial reporting and taxable income. Deferred tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

Stock Based Compensation

The Company grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the grant date. The Company recorded stock option expense totaling $882,000, $644,000 and $709,000 for the years ended December 31, 2016, 2015 and 2014, respectively.

The Company also grants restricted stock for a fixed number of shares. The Company recorded expenses associated with its director and officer restricted stock grants totaling $278,000 and $381,000, respectively, for the year ended December 31, 2016 and $139,000 and $62,000, respectively, for the year ended December 31, 2015. As the restricted stock plan was approved by shareholders in April 2015, there were no such expenses in 2014.

See Note 15 for further information.

Advertising Costs

Advertising costs are expensed as incurred.

Per Share Data

Net earnings per share (EPS) are computed by dividing net earnings by the weighted average number of common stock shares outstanding during the period. The Company calculates dilutive EPS assuming all outstanding stock options to purchase common stock have been exercised at the beginning of the year (or the time of issuance, if later.) The dilutive effect of the outstanding options and restricted stock is reflected by application of the treasury stock method, whereby the proceeds from the exercised options and restricted stock are assumed to be used to purchase common stock at the average market price during the respective year. The following table reconciles the computation of basic EPS to dilutive EPS:

	Net Earnings (in thousands)	Weighted Average Shares	Per Share Amount

For the year ended December 31, 2016:					
Net earnings per share, basic	$	104,774	66,013,004	$	1.59
Effect of stock options and stock grants			89,882		
Net earnings per share, assuming dilution	$	104,774	66,102,886	$	1.59
For the year ended December 31, 2015:					
Net earnings per share, basic	$	100,381	64,892,934	$	1.55
Effect of stock options and stock grants			175,096		(0.01)
Net earnings per share, assuming dilution	$	100,381	65,068,030	$	1.54
For the year ended December 31, 2014:					
Net earnings per share, basic	$	89,559	64,047,803	$	1.40
Effect of stock options			260,732		(0.01)
Net earnings per share, assuming dilution	$	89,559	64,308,535	$	1.39

FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2016, 2015 and 2014

Recently Issued Authoritative Accounting Guidance

Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. ASU 2014-09 implements a comprehensive new revenue recognition standard that will supersede substantially all existing revenue recognition guidance. The new standard s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2015-4 Revenue from Contracts with Customers Deferral of the Effective Date deferred the effective date of ASU 2014-09 by one year and as a result, the new standard will be effective the first quarter of 2018. The Company s revenue is comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and non-interest income. The Company expects that ASU 2014-09 will require a change in how the Company recognizes certain recurring revenue streams within trust management fees; however, these changes are not expected to have a significant impact on the Company s financial statements. The Company continues to evaluate the impact of ASU 2014-09 on other components of non-interest income and expects to adopt the standard in the first quarter of 2018 with a cumulative effective adjustment to opening retained earnings, if such adjustment is deemed to be significant.

ASU 2014-11, Transfers and Servicing. ASU 2014-11 amended guidance related to repurchase-to-maturity transactions to require that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, the amendment requires separate accounting for repurchase financings, which entails the transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty. The amendment requires entities to disclose certain information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements. In addition, the amendment requires disclosures related to collateral, remaining contractual term and of the potential risks associated with repurchase agreements, securities lending transactions and repurchase-to-maturity transactions. The amendment was effective for the Company on January 1, 2015 and did not have a significant impact on the Company s financial statements.

ASU 2014-14, Receivables Troubled Debt Restructuring by Creditors. ASU 2014-14 clarified that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendment requires interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The new guidance was effective for the

Company on January 1, 2015 and did not have a significant impact to the Company s financial statements.

ASU 2014-15, Presentation of Financial Statements Going Concern. ASU 2014-15 requires management to evaluate an entity s ability to continue as a going concern within one year after the date that the financial statements are issued. Management must evaluate whether conditions and events raise substantial doubt about an entity s ability to continue as a going concern and then whether its plans alleviate that doubt. ASU 2014-15 was effective in 2016 and management performed such required evaluation and concluded there were no such conditions or events that raised substantial doubt about the Company s ability to continue as a going concern.

ASU 2015-01, Income Statement Extraordinary and Unusual Items. ASU 2015-01 eliminated from U.S. GAAP the concept of extraordinary items, which, among other things, required an entity to show the item separately in the income statement, net of tax, after income from continuing operations. The new guidance became effective for the Company beginning January 1, 2016, and did not have a significant impact on the Company s financial statements.

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ASU 2015-05, Intangibles Goodwill and Other Internal-Use Software Customer s Accounting for Fees Paid in a Cloud Computing Arrangement. ASU 2015-05 addresses accounting for fees paid by a customer in cloud computing arrangements such as (i) software as a service, (ii) platform as a service, (iii) infrastructure as a service and (iv) other similar hosting arrangements. ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 became effective on January 1, 2016 and did not have a significant impact on the Company s financial statements.

ASU 2015-16, Business Combinations Simplifying the Accounting Measurement Period Adjustments. ASU 2015-16 amended business combination guidance to require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The acquirer must record, in the same period s financial statements, the effect of earnings on changes in depreciation, amortization, or other income effects, if any, as a result of the changes to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Additionally, the entity is required to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The amended guidance became effective for the Company on January 1, 2016, and did not have a significant impact on the Company s financial statements.

ASU 2016-1, Financial Instruments Overall: Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-1, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities. ASU 2016-1 will be effective for us on January 1, 2018 and is not expected to have a significant impact on the Company s financial statements.

ASU 2016-02, Leases. ASU 2016-02 will amend current lease accounting to require lessees to recognize (i) a lease liability, which is a lessee s obligation to make lease payments arising from a lease, measured on a discounted basis, and (ii) a right-of-use asset, which is an asset that represents the lessee s right to use, or control the use of, a specified

asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model. The amended guidance will be effective in the first quarter of 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company continues to evaluate the provision of the new lease standard but, due to the small number of lease agreements presently in effect for the Company, has concluded the new guidance will not have a significant impact on the Company s financial statements.

ASU 2016-09, Compensation Stock Compensation: Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 will amend current guidance such that all excess tax benefits and tax deficiencies related to share-based payment awards will be recognized as income tax expense or benefit in the income statement during the period in which they occur. Additionally, excess tax benefits will be classified along with other income tax cash flows as an operating activity rather than a financing activity. ASU 2016-09 also provides that any entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest, which is the current requirement, or account for forfeitures when they occur. ASU 2016-09 will be effective January 1, 2017 and is not expected to have a significant impact on the Company s financial statements.

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ASU 2016-13, Financial Instruments Credit Losses. ASU 2016-13 implements a comprehensive change in estimating the allowances for loan losses from the current model of losses inherent in the loan portfolio to a current expected credit loss model that generally is expected to result in earlier recognition of allowances for losses. Additionally, purchase accounting rules have been modified as well as credit losses on held-to-maturity debt securities. ASU 2016-13 will be effective in the first quarter of 2020. While the Company generally expects that the implementation of ASU 2016-13 will increase their allowance for loan losses balance, the Company is continuing to evaluate the potential impact on the Company s financial statements.

ASU 2017-04, Intangibles Goodwill and Other. ASU 2017-04 will amend and simplify current goodwill impairment testing to eliminate Step 2 from the current provisions. Under the new guidance, an entity should perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying value and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit s fair value. An entity still has the option to perform the quantitative assessment for a reporting unit to determine if a quantitative impairment test is necessary. ASU 2017-04 will be effective for the Company on January 1, 2020 and is not expected to have a significant impact on the Company s financial statements.

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2. INTEREST-BEARING TIME DEPOSITS IN BANKS AND SECURITIES:

Interest-bearing time deposits in banks totaled $1,707,000 and $3,495,000 at December 31, 2016 and 2015, respectively, and have original maturities generally ranging from one to three years.

A summary of the Company s available-for-sale securities as of December 31, 2016 and 2015 are as follows (in thousands):

	December 31, 2016			
	Amortized Cost Basis	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Securities available-for-sale:				
U.S. Treasury securities	$ 10,649	$ 19	$	$ 10,668
Obligations of U.S. government sponsored enterprises and agencies	113,450	253		113,703
Obligations of state and political subdivisions	1,534,095	40,194	(10,013)	1,564,276
Corporate bonds and other	51,920	476	(3)	52,393
Residential mortgage-backed securities	848,614	8,260	(5,513)	851,361
Commercial mortgage-backed securities	269,044	622	(1,230)	268,436
Total securities available-for-sale	$ 2,827,772	$ 49,824	$ (16,759)	$ 2,860,837

	December 31, 2015			
	Amortized Cost Basis	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Securities available-for-sale:				
U.S. Treasury securities	$ 10,792	$ 5	$ (2)	$ 10,795
Obligations of U.S. government sponsored enterprises and agencies	148,393	268	(107)	148,554
Obligations of state and political subdivisions	1,379,879	71,382	(134)	1,451,127
Corporate bonds and other	86,182	1,778	(5)	87,955
Residential mortgage-backed securities	781,648	10,993	(3,759)	788,882

Commercial mortgage-backed securities	247,991	429	(1,834)	246,586
Total securities available-for-sale	$ 2,654,885	$ 84,855	$ (5,841)	$ 2,733,899

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Disclosures related to the Company s held-to-maturity securities, which totaled $121,000 and $278,000 at December 31, 2016 and 2015, respectively, have not been presented due to insignificance.

The Company invests in mortgage-backed securities that have expected maturities that differ from their contractual maturities. These differences arise because borrowers may have the right to call or prepay obligations with or without a prepayment penalty. These securities include collateralized mortgage obligations (CMOs) and other asset backed securities. The expected maturities of these securities at December 31, 2016, were computed by using scheduled amortization of balances and historical prepayment rates. At December 31, 2016 and 2015, the Company did not hold any CMOs that entail higher risks than standard mortgage-backed securities.

The amortized cost and estimated fair value of available-for-sale securities at December 31, 2016, by contractual and expected maturity, are shown below (in thousands):

	Amortized Cost Basis	Estimated Fair Value
Due within one year	$ 206,182	$ 207,276
Due after one year through five years	664,151	684,849
Due after five years through ten years	836,421	845,257
Due after ten years	3,360	3,658
Mortgage-backed securities	1,117,658	1,119,797
Total	$ 2,827,772	$ 2,860,837

The following tables disclose, as of December 31, 2016 and 2015, the Company s investment securities that have been in a continuous unrealized-loss position for less than 12 months and for 12 or more months (in thousands):

	Less than 12 Months		12 Months or Longer		Total	
December 31, 2016	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Obligations of state and political subdivisions	$ 446,052	$ 9,997	$ 1,209	$ 16	$ 447,261	$ 10,013
Corporate bonds and other	244	3			244	3
Residential mortgage-backed securities	372,331	4,532	33,227	981	405,558	5,513

Commercial mortgage-backed securities	193,495	1,180	13,263	50	206,758	1,230
Total	$ 1,012,122	$ 15,712	$ 47,699	$ 1,047	$ 1,059,821	$ 16,759

	Less than 12 Months		12 Months or Longer		Total	
December 31, 2015	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury securities	$ 5,110	$ 2	$	$	$ 5,110	$ 2
Obligations of U.S. government sponsored enterprises and agencies	50,388	107			50,388	107
Obligations of state and political subdivisions	32,929	127	1,513	7	34,442	134
Corporate bonds and other	7,004	5			7,004	5
Residential mortgage-backed securities	231,481	1,765	63,919	1,994	295,400	3,759
Commercial mortgage-backed securities	196,163	1,752	9,345	82	205,508	1,834
Total	$ 523,075	$ 3,758	$ 74,777	$ 2,083	$ 597,852	$ 5,841

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The number of investments in an unrealized loss position totaled 466 at December 31, 2016. We do not believe these unrealized losses are other-than-temporary as (i) we do not have the intent to sell our securities prior to recovery and/or maturity and, (ii) it is more likely than not that we will not have to sell our securities prior to recovery and/or maturity. In making this determination, we also consider the length of time and extent to which fair value has been less than cost and the financial condition of the issuer. The unrealized losses noted are interest rate related due to the level of interest rates at December 31, 2016 compared to the time of purchase. We have reviewed the ratings of the issuers and have not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities. Our mortgage related securities are backed by GNMA, FNMA and FHLMC or are collateralized by securities backed by these agencies. At December 31, 2016, 82.13% of our available-for-sale securities that are obligations of states and political subdivisions were issued within the State of Texas, of which 33.91% are guaranteed by the Texas Permanent School Fund.

Securities, carried at approximately $1,940,460,000 and $1,759,570,000 at December 31, 2016 and 2015, respectively, were pledged as collateral for public or trust fund deposits, repurchase agreements and for other purposes required or permitted by law.

During 2016, 2015, and 2014, sales of investment securities that were classified as available-for-sale totaled $40,510,000, $35,580,000 and $1,619,000. Gross realized gains from 2016, 2015, and 2014, securities sales were $1,579,000, $443,000 and $2,000, respectively. Gross realized losses from 2016, 2015 and 2014 securities sales were $309,000, $11,000 and $6,000, respectively. The specific identification method was used to determine cost in order to compute the realized gains and losses.

3. LOANS AND ALLOWANCE FOR LOAN LOSSES:

Loans held-for-investment by class of financing receivables are as follows (in thousands):

	December 31,	
	2016	2015
Commercial	$ 674,410	$ 696,163
Agricultural	84,021	102,351
Real estate	2,189,844	2,136,233
Consumer	409,032	382,303
Total loans held-for-investment	$ 3,357,307	$ 3,317,050

Loans held-for-sale totaled $26,898,000 and $33,543,000 at December 31, 2016 and 2015, respectively, which are valued using the lower of cost or fair value.

The Company s non-accrual loans, loan still accruing and past due 90 days or more and restructured loans are as follows (in thousands):

	December 31,	
	2016	2015
Non-accrual loans*	$ 27,371	$ 28,601
Loans still accruing and past due 90 days or more	284	341
Troubled debt restructured loans**	701	199
Total	$ 28,356	$ 29,141

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* Includes $1,256,000 and $2,178,000, respectively, of purchased credit impaired loans as of December 31, 2016 and 2015.

** Our troubled debt restructured loans of $6,863,000 and $6,113,000, whose interest collection, after considering economic and business conditions and collection efforts, is doubtful are included in non-accrual loans as of December 31, 2016 and 2015, respectively.

The Company s recorded investment in impaired loans and the related valuation allowance are as follows (in thousands):

December 31, 2016		December 31, 2015	
Recorded Investment	Valuation Allowance	Recorded Investment	Valuation Allowance
$ 27,371	$ 5,012	$ 28,601	$ 5,071

The Company had $29,000,000 and $29,768,000 in non-accrual, past due 90 days or more and still accruing, restructured loans and foreclosed assets at December 31, 2016 and 2015, respectively. Non-accrual loans totaled $27,371,000 and $28,601,000 at December 31, 2016 and 2015, respectively, and consisted of the following amounts by type (in thousands):

	December 31,	
	2016	2015
Commercial	$ 7,284	$ 8,761
Agricultural	99	97
Real Estate	18,754	18,766
Consumer	1,234	977
Total	$ 27,371	$ 28,601

No significant additional funds are committed to be advanced in connection with impaired loans as of December 31, 2016.

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The Company s impaired loans and related allowance as of December 31, 2016 and 2015 are summarized in the following tables by class of financing receivables (in thousands). No interest income was recognized on impaired loans subsequent to their classification as impaired.

December 31, 2016	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance*	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	12 Month Average Recorded Investment
Commercial	$ 13,389	$ 1,148	$ 6,136	$ 7,284	$ 2,128	$ 4,921
Agricultural	103		99	99	25	50
Real Estate	23,466	6,229	12,525	18,754	2,428	16,170
Consumer	1,421	280	954	1,234	431	914
Total	$ 38,379	$ 7,657	$ 19,714	$ 27,371	$ 5,012	$ 22,055

* Includes $1,256,000 of purchased credit impaired loans.

December 31, 2015	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance*	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	12 Month Average Recorded Investment
Commercial	$ 10,056	$ 608	$ 8,153	$ 8,761	$ 2,030	$ 5,812
Agricultural	97		97	97	70	48
Real Estate	23,710	5,314	13,452	18,766	2,827	15,211
Consumer	1,167	624	353	977	144	664
Total	$ 35,030	$ 6,546	$ 22,055	$ 28,601	$ 5,071	$ 21,735

* Includes $2,178,000 of purchased credit impaired loans.

The Company recognized interest income on impaired loans prior to being recognized as impaired of approximately $829,000, $922,000 and $162,000 during the years ended December 31, 2016, 2015, and 2014, respectively.

From a credit risk standpoint, the Company rates its loans in one of four categories: (i) pass, (ii) special mention, (iii) substandard or (iv) doubtful. Loans rated as loss are charged-off.

The ratings of loans reflect a judgment about the risks of default and loss associated with the loan. The Company reviews the ratings on our credits as part of our on-going monitoring of the credit quality of our loan portfolio. Ratings are adjusted to reflect the degree of risk and loss that are felt to be inherent in each credit as of each reporting period. Our methodology is structured so that specific allocations are increased in accordance with deterioration in credit quality (and a corresponding increase in risk and loss) or decreased in accordance with improvement in credit quality (and a corresponding decrease in risk and loss).

Credits rated special mention show clear signs of financial weaknesses or deterioration in credit worthiness, however, such concerns are not so pronounced that the Company generally expects to experience significant loss within the short-term. Such credits typically maintain the ability to perform within standard credit terms and credit exposure is not as prominent as credits rated more harshly.

Credits rated substandard are those in which the normal repayment of principal and interest may be, or has been, jeopardized by reason of adverse trends or developments of a financial, managerial, economic or political nature, or important weaknesses exist in collateral. A protracted workout on these credits is a distinct possibility. Prompt corrective action is therefore required to strengthen the Company s position, and/or to reduce exposure and to assure that adequate remedial measures are taken by the borrower. Credit exposure becomes more likely in such credits and a serious evaluation of the secondary support to the credit is performed.

Credits rated doubtful are those in which full collection of principal appears highly questionable, and which some degree of loss is anticipated, even though the ultimate amount of loss may not yet be certain and/or other factors exist which could affect collection of debt. Based upon available information, positive action by the Company is required to avert or minimize loss. Credits rated doubtful are generally also placed on non-accrual.

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The following summarizes the Company s internal ratings of its loans held-for-investment by class of financing receivables and portfolio segments, which classes are the same, at December 31, 2016 and 2015 (in thousands):

December 31, 2016	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 629,756	$ 5,769	$ 38,885	$	$ 674,410
Agricultural	81,620	715	1,686		84,021
Real Estate	2,111,947	18,091	59,806		2,189,844
Consumer	406,182	212	2,638		409,032
Total	$ 3,229,505	$ 24,787	$ 103,015	$	$ 3,357,307

December 31, 2015	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 633,083	$ 9,762	$ 53,318	$	$ 696,163
Agricultural	99,862	1,398	1,091		102,351
Real Estate	2,054,738	29,000	52,458	37	2,136,233
Consumer	379,941	416	1,946		382,303
Total	$ 3,167,624	$ 40,576	$ 108,813	$ 37	$ 3,317,050

At December 31, 2016 and 2015, the Company s past due loans are as follows (in thousands):

December 31, 2016	15-59 Days Past Due*	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Total Current	Total Loans	Total 90 Days Past Due Still Accruing
Commercial	$ 3,908	$ 1,122	$ 2,220	$ 7,250	$ 667,160	$ 674,410	$ 10
Agricultural	185			185	83,836	84,021	
Real Estate	13,172	1,301	5,268	19,741	2,170,103	2,189,844	272
Consumer	1,845	368	122	2,335	406,697	409,032	2

Total	$ 19,110	$ 2,791	$ 7,610	$ 29,511	$ 3,327,796	$ 3,357,307	$ 284

December 31, 2015	15-59 Days Past Due*	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Total Current	Total Loans	Total 90 Days Past Due Still Accruing
Commercial	$ 3,099	$ 3,652	$ 1,024	$ 7,775	$ 688,388	$ 696,163	$ 54
Agricultural	348	83		431	101,920	102,351	
Real Estate	12,247	2,226	2,874	17,347	2,118,886	2,136,233	217
Consumer	1,645	183	266	2,094	380,209	382,303	70
Total	$ 17,339	$ 6,144	$ 4,164	$ 27,647	$ 3,289,403	$ 3,317,050	$ 341

* The Company monitors commercial, agricultural and real estate loans after such loans are 15 days past due. Consumer loans are monitored after such loans are 30 days past due.

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The following table details the allowance for loan losses at December 31, 2016 and 2015 by portfolio segment (in thousands). There were no allowances for purchased credit impaired loans at December 31, 2016 or 2015. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

December 31, 2016	Commercial	Agricultural	Real Estate	Consumer	Total
Loans individually evaluated for impairment	$ 2,128	$ 25	$ 2,428	$ 431	$ 5,012
Loan collectively evaluated for impairment	9,579	1,076	24,436	5,676	40,767
Total	$ 11,707	$ 1,101	$ 26,864	$ 6,107	$ 45,779

December 31, 2015	Commercial	Agricultural	Real Estate	Consumer	Total
Loans individually evaluated for impairment	$ 2,030	$ 70	$ 2,827	$ 144	$ 5,071
Loan collectively evaluated for impairment	10,614	1,121	21,548	3,523	36,806
Total	$ 12,644	$ 1,191	$ 24,375	$ 3,667	$ 41,877

Changes in the allowance for loan losses for the years ended December 31, 2016 and 2015 are summarized as follows (in thousands):

December 31, 2016	Commercial	Agricultural	Real Estate	Consumer	Total
Beginning balance	$ 12,644	$ 1,191	$ 24,375	$ 3,667	$ 41,877
Provision for loan losses	5,101	104	1,150	3,857	10,212
Recoveries	952	25	2,021	508	3,506
Charge-offs	(6,990)	(219)	(682)	(1,925)	(9,816)
Ending balance	$ 11,707	$ 1,101	$ 26,864	$ 6,107	$ 45,779

December 31, 2015	Commercial	Agricultural	Real Estate	Consumer	Total
Beginning balance	$ 7,990	$ 527	$ 26,657	$ 1,650	$ 36,824

Provision for loan losses	8,044	773	(2,399)	3,267	9,685
Recoveries	344	55	558	450	1,407
Charge-offs	(3,734)	(164)	(441)	(1,700)	(6,039)
Ending balance	$ 12,644	$ 1,191	$ 24,375	$ 3,667	$ 41,877

The Company s recorded investment in loans as of December 31, 2016 and 2015 related to the balance in the allowance for loan losses on the basis of the Company s impairment methodology was as follows (in thousands). Purchased credit impaired loans of $1,256,000 and $2,178,000, respectively, at December 31, 2016 and 2015 are included in loans individually evaluated for impairment.

December 31, 2016	Commercial	Agricultural	Real Estate	Consumer	Total
Loans individually evaluated for impairment	$ 7,284	$ 99	$ 18,754	$ 1,234	$ 27,371
Loan collectively evaluated for impairment	667,126	83,922	2,171,090	407,798	3,329,936
Total	$ 674,410	$ 84,021	$ 2,189,844	$ 409,032	$ 3,357,307

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December 31, 2015	Commercial	Agricultural	Real Estate	Consumer	Total
Loans individually evaluated for impairment	$ 8,761	$ 97	$ 18,766	$ 977	$ 28,601
Loan collectively evaluated for impairment	687,402	102,254	2,117,467	381,326	3,288,449
Total	$ 696,163	$ 102,351	$ 2,136,233	$ 382,303	$ 3,317,050

The Company s loans that were modified in the years ended December 31, 2016 and 2015, and considered troubled debt restructurings are as follows (in thousands):

	Year Ended December 31, 2016			Year Ended December 31, 2015		
	Number	Pre-Modification Recorded Investment	Post-Modification Recorded Investment	Number	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial	15	$ 3,208	$ 3,208	8	$ 447	$ 447
Agricultural				3	128	128
Real Estate	6	1,460	1,460	5	598	598
Consumer	7	189	189	7	255	255
Total	28	$ 4,857	$ 4,857	23	$ 1,428	$ 1,428

The balances below provide information as to how the loans were modified as troubled debt restructured loans during the years ended December 31, 2016 and 2015 (in thousands):

	Year Ended December 31, 2016			Year Ended December 31, 2015		
	Adjusted Interest Rate	Extended Maturity	Combined Rate and Maturity	Adjusted Interest Rate	Extended Maturity	Combined Rate and Maturity
Commercial	$	$ 2,560	$ 648	$	$ 182	$ 265
Agricultural					128	
Real Estate		298	1,162	15	150	433
Consumer		70	119		56	199

Total	$	$ 2,928	$ 1,929	$ 15	$ 516	$ 897

During the years ended December 31, 2016 and 2015, certain loans were modified as a troubled debt restructured loans within the previous 12 months and for which there was a payment default. A default for purposes of this disclosure is a troubled debt restructured loan in which the borrower is 90 days past or more due or results in the foreclosure and repossession of the applicable collateral. The loans with payment default are as follows (dollars in thousands):

	Year Ended December 31, 2016		Year Ended December 31, 2015	
	Number	Balance	Number	Balance
Commercial	4	$ 1,690	1	$ 66
Agriculture				
Real Estate	3	921	1	15
Consumer			2	32
Total	7	$ 2,611	4	$ 113

As of December 31, 2016, the Company has no commitments to lend additional funds to loan customers whose terms have been modified in troubled debt restructurings.

An analysis of the changes in loans to officers, directors, principal shareholders, or associates of such persons for the year ended December 31, 2016 (determined as of each respective year-end) follows (in thousands):

	Beginning Balance	Additional Loans	Payments	Ending Balance
Year ended December 31, 2016	$ 65,729	$ 49,674	$ 70,974	$ 44,429

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In the opinion of management, those loans are on substantially the same terms, including interest rates and collateral requirements, as those prevailing at the time for comparable transactions with unaffiliated persons.

Our subsidiary bank has established a line of credit with the Federal Home Loan Bank of Dallas (FHLB) to provide liquidity and meet pledging requirements for those customers eligible to have securities pledged to secure certain uninsured deposits. At December 31, 2016, $2,081,615,000 in loans held by our bank subsidiary were subject to blanket liens as security for this line of credit. At December 31, 2016, $75,000,000 in advances were outstanding under this line of credit.

4. BANK PREMISES AND EQUIPMENT:

The following is a summary of bank premises and equipment (in thousands):

	Useful Life	December 31,	
		2016	2015
Land		$ 28,266	$ 29,050
Buildings	20 to 40 years	115,566	106,515
Furniture and equipment	3 to 10 years	58,145	54,353
Leasehold improvements	Lesser of lease term or 5 to 15 years	4,783	4,328
		206,760	194,246
Less- accumulated depreciation and amortization		(84,075)	(78,534)
Total Bank Premises and Equipment		$ 122,685	$ 115,712

Depreciation expense for the years ended December 31, 2016, 2015 and 2014 amounted to $9,390,000, $9,125,000 and $7,833,000, respectively, and is included in the captions net occupancy expense and equipment expense in the accompanying consolidated statements of earnings.

The Company is lessor for portions of its banking premises. Total rental income for all leases included in net occupancy expense is approximately $2,139,000, $1,949,000 and $1,923,000, for the years ended December 31, 2016, 2015, and 2014, respectively.

During the years ended December 31, 2016, 2015 and 2014, the Company recorded gains (losses) on sale the of bank

premises and equipment totaling $168,000, ($820,000) and $10,000. In 2016, the Company sold its Weatherford and Orange main region branch building for $1,385,000 and $2,000,000 and recorded a gain of $560,000 and a loss of $31,000, respectively. The Company recorded a write down of $1,000,000 in 2015 in anticipation of the Orange branch building sale.

5. DEPOSITS AND BORROWINGS:

Time deposits of $250,000 or more totaled approximately $130,385,000 and $190,386,000 at December 31, 2016 and 2015, respectively.

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At December 31, 2016, the scheduled maturities of time deposits (in thousands) were, as follows:

Year ending December 31,	
2017	$ 419,326
2018	54,713
2019	17,893
2020	9,939
2021	7,093
Thereafter	32
	$ 508,996

Deposits received from related parties at December 31, 2016 and 2015 totaled $114,513,000 and $89,006,000, respectively.

Borrowings at December 31, 2016 and 2015 consisted of the following (dollars in thousands):

	December 31,	
	2016	2015
Securities sold under agreements with customers to repurchase	$ 360,820	$ 310,330
Federal funds purchased	9,950	6,325
Advances from Federal Home Loan Bank of Dallas	75,000	299,020
Total	$ 445,770	$ 615,675

Securities sold under repurchase agreements are generally with significant customers of the Company that require short-term liquidity for their funds for which the Company pledges certain securities that have a fair value equal to at least the amount of the borrowings. The agreements mature daily and therefore the risk arising from a decline in the fair value of the collateral pledged is minimal. The securities pledged are mortgage-backed securities. These agreements do not include right of set-off provisions and therefore the Company does not offset such agreements for financial reporting purposes.

At December 31, 2016 and 2015, the Company had advances from the Federal Home Loan Bank of Dallas of $75,000,000 and $299,020,000, respectively, that are scheduled to mature in 2017 and 2018. The interest rate on these advances were 0.46% and 0.31%, respectively, at December 31, 2016 and 2015.

6. LINE OF CREDIT:

The Company renewed its loan agreement, effective June 30, 2015, with Frost Bank. Under the loan agreement, as renewed and amended, we are permitted to draw up to $25,000,000 on a revolving line of credit. Prior to June 30, 2017, interest is paid quarterly at *The Wall Street Journal* Prime Rate and the line of credit matures June 30, 2017. If a balance exists at June 30, 2017, the principal balance converts to a term facility payable quarterly over five years and interest is paid quarterly at our election at *The Wall Street Journal* Prime Rate plus 50 basis points or LIBOR plus 250 basis points. The line of credit is unsecured. Among other provisions in the credit agreement, we must satisfy certain financial covenants during the term of the loan agreement, including, without limitation, covenants that require us to maintain certain capital, tangible net worth, loan loss reserve, non-performing asset and cash flow coverage ratios. In addition, the credit agreement contains certain operational covenants, which among others, restricts the payment of dividends above 55% of consolidated net income, limits the incurrence of debt (excluding any amounts acquired in an acquisition) and prohibits the disposal of assets except in the ordinary course of business. Since 1995, we have historically declared dividends as a percentage of our consolidated net income in a range of 37% (low) in 1995 to 53% (high) in 2003 and 2006. The Company was in compliance with the financial and operational covenants at December 31, 2016. There was no outstanding balance under the line of credit as of December 31, 2016 or 2015.

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7. INCOME TAXES:

The Company files a consolidated federal income tax return. Income tax expense is comprised of the following (dollars in thousands):

	Year Ended December 31,		
	2016	2015	2014
Current federal income tax	$ 30,381	$ 31,014	$ 29,832
Current state income tax	99	103	94
Deferred federal income tax expense (benefit)	673	320	(893)
Income tax expense	$ 31,153	$ 31,437	$ 29,033

Income tax expense, as a percentage of pretax earnings, differs from the statutory federal income tax rate as follows:

	As a Percent of Pretax Earnings		
	2016	2015	2014
Statutory federal income tax rate	35.0%	35.0%	35.0%
Reductions in tax rate resulting from interest income exempt from federal income tax	(12.1)	(11.4)	(10.6)
Effect of state income tax	0.1	0.1	0.1
ESOP tax deduction	(0.2)	(0.2)	(0.2)
Other	0.1	0.3	0.2
Effective income tax rate	22.9%	23.8%	24.5%

The approximate effects of each type of difference that gave rise to the Company s deferred tax assets and liabilities at December 31, 2016 and 2015 are as follows (dollars in thousands):

	2016	2015
Deferred tax assets:		
Tax basis of loans in excess of financial statement basis	$ 17,006	$ 16,326
Minimum liability in defined benefit plan	1,641	2,135

Recognized for financial reporting purposes but not yet for tax purposes:		
Deferred compensation	2,807	2,602
Write-downs and adjustments to other real estate owned and repossessed assets	9	7
Other deferred tax assets	226	224
Total deferred tax assets	21,689	21,294
Deferred tax liabilities:		
Financial statement basis of fixed assets in excess of tax basis	5,870	5,644
Intangible asset amortization deductible for tax purposes, but not for financial reporting purposes	15,191	13,881
Recognized for financial reporting purposes but not yet for tax purposes:		
Accretion on investment securities	1,788	1,813
Pension plan contributions	1,799	1,761
Net unrealized gain on investment securities available-for-sale	11,573	27,655
Other deferred tax liabilities	83	71
Total deferred tax liabilities	36,304	50,825
Net deferred tax asset (liability)	$ (14,615)	$ (29,531)

At December 31, 2016 and 2015, management believes that it is more likely than not that all of the deferred tax amounts shown above will be realized and therefore no valuation allowance was recorded.

Current authoritative accounting guidance prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of cumulative benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. Current authoritative accounting guidance also provides guidance on the accounting for and disclosure of unrecognized tax benefits, interest and penalties. The Company concluded the tax benefits of positions taken and expected to be taken on its tax returns should be recognized in the financial statements under this guidance. The Company files income tax returns in the U.S. federal jurisdiction and several U.S. state jurisdictions. We are no longer subject to U.S. federal income tax examinations by tax authorities for years before 2013 or Texas state tax examinations by tax authorities for years before 2012. As of December 31, 2016 and 2015, the Company believes that there are no uncertain tax positions.

8. FAIR VALUE DISCLOSURES:

The authoritative accounting guidance for fair value measurements defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact, and (iv) willing to transact.

The authoritative accounting guidance requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement costs). Valuation techniques should be consistently applied. Inputs to

valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity s own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the authoritative guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

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

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

Level 3 Inputs Significant unobservable inputs that reflect an entity s own assumptions that market participants would use in pricing the assets or liabilities.

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A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. While management believes the Company s valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Securities classified as available-for-sale and trading are reported at fair value utilizing Level 1 and Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include market spreads, cash flows, the United States Treasury yield curve, live trading levels, trade execution data, dealer quotes, market consensus prepayments speeds, credit information and the security s terms and conditions, among other items.

There were no transfers between Level 2 and Level 3 during the year ended December 31, 2016, 2015 and 2014.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of December 31, 2016, and 2015 segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands):

December 31, 2016	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Available-for-sale investment securities:				
U.S. Treasury securities	$ 10,668	$	$	$ 10,668
Obligations of U. S. government sponsored enterprises and agencies		113,703		113,703
Obligations of state and political subdivisions		1,564,276		1,564,276
Corporate bonds		47,965		47,965
Residential mortgage-backed securities		851,361		851,361
Commercial mortgage-backed securities		268,436		268,436
Other securities	4,428			4,428
Total	$ 15,096	$ 2,845,741	$	$ 2,860,837

December 31, 2015	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Available-for-sale investment securities:				
U.S. Treasury securities	$ 10,795	$	$	$ 10,795
Obligations of U. S. government sponsored enterprises and agencies		148,554		148,554
Obligations of state and political subdivisions		1,451,127		1,451,127
Corporate bonds		83,254		83,254
Residential mortgage-backed securities		788,882		788,882
Commercial mortgage-backed securities		246,586		246,586
Other securities	4,701			4,701
Total	$ 15,496	$ 2,718,403	$	$ 2,733,899

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Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis, that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and financial liabilities measured at fair value on a non-recurring basis include the following at December 31, 2016:

Impaired Loans Impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data. At December 31, 2016, impaired loans with a carrying value of $27,371,000 were reduced by specific valuation reserves totaling $5,012,000 resulting in a net fair value of $22,359,000.

Loans Held-for-Sale Loans held-for-sale are reported at the lower of cost or fair value. The Company originates conforming loans that are sold in the secondary market in which loan pricing is available. In determining whether the fair value of loans held-for-sale is less than cost and quoted prices are available for similar assets. These loans are considered Level 2 of the fair value hierarchy. At December 31, 2016, the Company s mortgage loans held-for-sale fair value was $26,702,000, which approximated cost.

Certain non-financial assets and non-financial liabilities measured at fair value on a non-recurring basis include other real estate owned, goodwill and other intangible assets and other non-financial long-lived assets. Non-financial assets measured at fair value on a non-recurring basis during the year ended December 31, 2016 and 2015 include other real estate owned which, subsequent to their initial transfer to other real estate owned from loans, were re-measured at fair value through a write-down included in gain (loss) on sale of foreclosed assets. During the reported periods, all fair value measurements for foreclosed assets utilized Level 2 inputs based on observable market data, generally third-party appraisals, or Level 3 inputs based on customized discounting criteria. These appraisals are evaluated individually and discounted as necessary due to the age of the appraisal, lack of comparable sales, expected holding periods of property or special use type of the property. Such discounts vary by appraisal based on the above factors but generally range from 5% to 25% of the appraised value. Reevaluation of other real estate owned is performed at least annually as required by regulatory guidelines or more often if particular circumstances arise. The following table presents other real estate owned that were re-measured subsequent to their initial transfer to other real estate owned (dollars in thousands):

	Year Ended December 31,	
	2016	2015
Carrying value of other real estate owned prior to re-measurement	$	$ 351
Write-downs included in gain (loss) on sale of other real estate owned		(95)
Fair value	$	$ 256

At December 31, 2016 and 2015, other real estate owned totaled $413,000 and $153,000, respectively.

The Company is required under current authoritative accounting guidance to disclose the estimated fair value of their financial instrument assets and liabilities including those subject to the requirements discussed above. For the Company, as for most financial institutions, substantially all of its assets and liabilities are considered financial instruments. Many of the Company s financial instruments, however, lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction.

The estimated fair value amounts of financial instruments have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

In addition, reasonable comparability between financial institutions may not be likely due to the wide range of permitted valuation techniques and numerous estimates that must be made given the absence of active secondary markets for many of the financial instruments. This lack of uniform valuation methodologies also introduces a greater degree of subjectivity to these estimated fair values.

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Cash and due from banks, federal funds sold, interest-bearing deposits and time deposits in banks and accrued interest receivable and payable are liquid in nature and considered Levels 1 or 2 of the fair value hierarchy.

Financial instruments with stated maturities have been valued using a present value discounted cash flow with a discount rate approximating current market for similar assets and liabilities and are considered Levels 2 and 3 of the fair value hierarchy. Financial instrument liabilities with no stated maturities have an estimated fair value equal to both the amount payable on demand and the carrying value and are considered Level 1 of the fair value hierarchy.

The carrying value and the estimated fair value of the Company s contractual off-balance-sheet unfunded lines of credit, loan commitments and letters of credit, which are generally priced at market at the time of funding, are not material.

The estimated fair values and carrying values of all financial instruments under current authoritative guidance at December 31, 2016 and 2015, were as follows (dollars in thousands):

	2016		2015		
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value	Fair Value Hierarchy
Cash and due from banks	$ 204,782	$ 204,782	$ 179,140	$ 179,140	Level 1
Federal funds sold	3,130	3,130	3,810	3,810	Level 1
Interest-bearing deposits in banks	48,574	48,574	89,936	89,936	Level 1
Interest-bearing time deposits in banks	1,707	1,709	3,495	3,500	Level 2
Available-for-sale securities	2,860,837	2,860,837	2,733,899	2,733,899	Levels 1 and 2
Held-to-maturity securities	121	124	278	283	Level 2
Loans	3,338,426	3,361,735	3,308,716	3,316,243	Level 3
Accrued interest receivable	36,469	36,469	34,697	34,697	Level 2
Deposits with stated maturities	508,996	510,304	620,852	622,572	Level 2
Deposits with no stated maturities	4,969,543	4,969,543	4,569,317	4,569,317	Level 1
Borrowings	445,770	445,770	615,675	615,675	Level 2
Accrued interest payable	225	225	240	240	Level 2

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9. COMMITMENTS AND CONTINGENCIES:

The Company is engaged in legal actions arising from the normal course of business. In management s opinion, the Company has adequate legal defenses with respect to these actions, and as of December 31, 2016 the resolution of these matters is not expected to have material adverse effects upon the results of operations or financial condition of the Company.

The Company leases a portion of its bank premises and equipment under operating leases. At December 31, 2016, future minimum lease commitments were: 2017 - $774,000, 2018 - $369,000, 2019 - $268,000, 2020 - $140,000, and 2021 - $32,000.

10. FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK:

We are a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include unfunded lines of credit, commitments to extend credit and federal funds sold to correspondent banks and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

Our exposure to credit loss in the event of nonperformance by the counterparty to the financial instrument for unfunded lines of credit, commitments to extend credit and standby letters of credit is represented by the contractual notional amount of these instruments. We generally use the same credit policies in making commitments and conditional obligations as we do for on-balance-sheet instruments.

	Total Notional Amounts Committed December 31, 2016 (in thousands)
Financial instruments whose contract amounts represent credit risk:	
Unfunded lines of credit	$ 549,000
Unfunded commitments to extend credit	199,235
Standby letters of credit	27,380
Total commercial commitments	$ 775,615

Unfunded lines of credit and commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. These commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, as we deem necessary upon extension of credit, is based on our credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant, and equipment and income-producing commercial properties.

Standby letters of credit are conditional commitments we issue to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The average collateral value held on letters of credit usually exceeds the contract amount.

We believe we have no other off-balance sheet arrangements or transactions with unconsolidated, special purpose entities that would expose us to liability that is not reflected on the face of the financial statements.

11. CONCENTRATION OF CREDIT RISK:

The Company grants commercial, retail, agriculture and residential real estate loans to customers primarily in North Central, Southeastern and West Texas. Although the Company has a diversified loan portfolio, a substantial portion of its borrowers ability to honor their commitments is dependent upon each local economic sector. In addition, the Company holds mortgage related securities which are guaranteed by GNMA, FNMA or FHLMC or are collateralized by loans backed by these agencies.

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12. PENSION AND PROFIT SHARING PLANS:

The Company s defined benefit pension plan was frozen effective January 1, 2004, whereby no new participants will be added to the Plan and no additional years of service will accrue to participants, unless the pension plan is reinstated at a future date. The pension plan covered substantially all of the Company s employees at the time. The benefits for each employee were based on years of service and a percentage of the employee s qualifying compensation during the final years of employment. The Company s funding policy was and is to contribute annually the amount necessary to satisfy the Internal Revenue Service s funding standards. Contributions to the pension plan, prior to freezing the plan, were intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. As a result of the Pension Protection Act of 2006 (the Protection Act), the Company will be required to contribute amounts in future years to fund any shortfalls. The Company has evaluated the provisions of the Protection Act as well as the Internal Revenue Service s funding standards to develop a plan for funding in future years. As a result, the Company made a contribution totaling $500,000 in both 2016 and 2015, and is continuing to evaluate future funding amounts.

During 2016 and 2014, as permitted by the Internal Revenue Service, the Company offered settlement of a portion of its pension obligations to those plan participants who no longer were employed by the Company. As a result of the partial settlement of the plan, the Company recognized $267,000 and $2,909,000 for the years ended December 31, 2016 and 2014, respectively, in additional pension expense, before income tax, a component of noninterest expense. The effect of this transaction was relatively neutral to shareholders equity since the recorded pension obligation associated with the plan participants who accepted the settlement closely approximated the amount offered to such plan participants and the amount recognized in pension expense had been previously recognized as unrealized losses in other comprehensive earnings. In connection with this partial settlement, the Company paid $649,000 and $10,626,000 out of pension plan assets and the number of participants was reduced by 38 and 335, in 2016 and 2014, respectively. The Company s investment risk and administrative expense associated with the Company s pension plan has been significantly reduced going forward.

Using an actuarial measurement date of December 31, 2016 and 2015, benefit obligation activity and fair value of plan assets for the years ended December 31, 2016 and 2015, and a statement of the funded status as of December 31, 2016 and 2015, are as follows (dollars in thousands):

	2016	2015
Reconciliation of benefit obligations:		
Benefit obligation at January 1	$ 16,002	$ 15,581
Interest cost on projected benefit obligation	665	622
Actuarial loss (gain)	139	635
Benefits paid, including partial settlement of certain participant balances	(1,353)	(836)

Benefit obligation at December 31	$ 15,453	$ 16,002
Reconciliation of fair value of plan assets:		
Fair value of plan assets at January 1	$ 14,820	$ 15,458
Actual return on plan assets	1,820	(302)
Employer contributions	500	500
Benefits paid, including partial settlement of certain participant balances	(1,353)	(836)
Fair value of plan assets at December 31	15,787	14,820
Funded status	$ 334	$ (1,182)

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Amounts recognized as a component of accumulated other comprehensive earnings as of year-end that have not been recognized as a component of the net period benefit cost of the Company s defined benefit pension plan are as follows (in thousands):

	2016	2015
Net actuarial loss	$ (4,688)	$ (6,098)
Deferred tax benefit	1,641	2,134
Amounts included in accumulated other comprehensive earnings, net of tax	$ (3,047)	$ (3,964)

Net periodic benefit cost for the years ended December 31, 2016, 2015, and 2014, are as follows (dollars in thousands):

	Year Ended December 31,		
	2016	2015	2014
Service cost - benefits earned during the period	$	$	$
Interest cost on projected benefit obligation	665	622	1,131
Expected return on plan assets	(912)	(948)	(1,497)
Amortization of unrecognized net loss	375	222	337
Recognized loss on partial settlement of certain participant balances	267		2,909
Net periodic pension benefit expense (benefit)	$ 395	$ (104)	$ 2,880

The following table sets forth the rates used in the actuarial calculations of the present value of benefit obligations and net periodic pension cost and the rate of return on plan assets:

	2016	2015	2014
Weighted average discount rate	4.25%	4.25%	4.10%
Expected long-term rate of return on assets	6.25%	6.25%	6.25%

The weighted average discount rate is estimated based on setting a discount rate to establish an obligation for pension benefits equivalent to an amount that, if invested in high quality fixed income securities, would produce a return that matches the expected benefit payment stream. The expected long-term rate of return on plan assets is based on historical returns and expectations of future returns based on asset mix, after consultation with our investment advisors and actuaries.

The major type of plan assets in the pension plan and the targeted allocation percentage as of December 31, 2016 and 2015 is as follows:

	December 31, 2016 Allocation	December 31, 2015 Allocation	Targeted Allocation
Equity securities	77%	74%	75%
Debt securities	22%	25%	25%
Cash and equivalents	1%	1%	

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The range and weighted average final maturities of debt securities held in the pension plan as of December 31, 2016 are 2.52 to 11.34 years and approximately 5.08 years, respectively. Assets held in the pension plan are considered either Level 1 consisting of the money market funds, publicly traded common stocks and publically traded mutual funds or Level 2 consisting of obligations of state and political subdivisions, corporate bonds and mortgage-backed securities. There were no Level 3 securities. See note 8 for a discussion of the fair value hierarchy. The breakdown by level is as follows (dollars in thousands):

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Money market fund	$ 100	$	$	$ 100
Obligations of state and political subdivisions		659		659
Corporate bonds		885		885
Mortgage-backed securities		956		956
Corporate stocks and mutual funds	13,187			13,187
Total	$ 13,287	$ 2,500	$	$ 15,787

First Financial Trust & Asset Management Company, National Association, a wholly owned subsidiary of the Company, manages the pension plan assets as well as the profit sharing plan assets (see below). The investment strategy and targeted allocations are based on similar strategies First Financial Trust & Asset Management Company, National Association employs for most of its managed accounts whereby appropriate diversification is achieved. First Financial Trust & Asset Management Company, National Association is prohibited from holding investments deemed to be high risk by the Office of the Comptroller of the Currency.

An estimate of the undiscounted projected future payments to eligible participants for the next five years and the following five years in the aggregate is as follows (in thousands):

Year Ending December 31,	
2017	856
2018	872
2019	892
2020	913
2021	935
2022 forward	4,861

As of December 31, 2016 and 2015, the pension plan s total assets included First Financial Bankshares, Inc. common stock valued at approximately $2,786,000 and $1,859,000, respectively.

The Company also provides a profit sharing plan, which covers substantially all full-time employees. The profit sharing plan is a defined contribution plan and allows employees to contribute a percentage of their base annual salary. Employees are fully vested to the extent of their contributions and become fully vested in the Company s contributions over a six-year vesting period. Costs related to the Company s defined contribution plan totaled approximately $3,221,000, $5,455,000 and $5,324,000 in 2016, 2015 and 2014, respectively, and are included in salaries and employee benefits in the accompanying consolidated statements of earnings. As of December 31, 2016 and 2015, the profit sharing plan s assets included First Financial Bankshares, Inc. common stock valued at approximately $60,270,000 and $41,599,000, respectively.

In 2004, after freezing our pension plan, we added a safe harbor match to the 401(k) plan. We match a maximum of 4% on employee deferrals of 5% of their employee compensation. Total expense for this matching in 2016, 2015 and 2014 was $2,331,000, $2,043,000 and $1,699,000, respectively, and is included in salaries and employee benefits in the statements of earnings.

The Company has a directors deferred compensation plan whereby the directors may elect to defer up to 100% of their directors fees. All deferred compensation is invested in the Company s common stock held in a rabbi trust. The stock is held in nominee name of the trustee, and the principal and earnings of the trust are held separate and apart from other funds of the Company, and are used exclusively for the uses and purposes of the deferred compensation agreement. The accounts of the trust have been consolidated in the financial statements of the Company.

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13. DIVIDENDS FROM SUBSIDIARIES:

At December 31, 2016, approximately $170,730,000 was available for the declaration of dividends by the Company s subsidiaries without the prior approval of regulatory agencies.

14. REGULATORY MATTERS:

Banking regulators measure capital adequacy by means of the risk-based capital ratios and the leverage ratio under the Basel III regulatory capital framework and prompt corrective action regulations. The risk-based capital rules provide for the weighting of assets and off-balance-sheet commitments and contingencies according to prescribed risk categories. Regulatory capital is then divided by risk-weighted assets to determine the risk-adjusted capital ratios. The leverage ratio is computed by dividing shareholders equity less intangible assets by quarter-to-date average assets less intangible assets.

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

As of December 31, 2016 and 2015, we had a total risk-based capital ratio of 18.45% and 16.97%, a Tier 1 capital to risk-weighted assets ratio of 17.30% and 15.90%; a common equity Tier 1 capital to risk-weighted assets ratio of 17.30% and 15.90%, and a Tier 1 leverage ratio of 10.71% and 9.96%, respectively. The regulatory capital ratios as of December 31, 2016 and 2015 were calculated under Basel III rules. There is no threshold for well-capitalized status for bank holding companies.

As of December 31, 2016 and 2015, the regulatory capital ratios of the Company and Bank under the Basel III regulatory capital framework are as follows:

	Actual		Minimum Capital Required Under Basel III Phase-In		Minimum Capital Required-Basel III Fully Phased-In		Required to be Considered Well-Capitalized	
As of December 31, 2016:	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**

Total Capital to Risk-Weighted Assets:								
Consolidated	$ 739,959	18.45%	$ 345,827	8.625%	$ 421,007	10.50%		N/A
First Financial Bank, N.A.	$ 633,403	15.84%	$ 344,930	8.625%	$ 419,915	10.50%	$ 399,919	10.00%
Tier 1 Capital to Risk-Weighted Assets:								
Consolidated	$ 693,584	17.30%	$ 265,635	6.625%	$ 340,815	8.50%		N/A
First Financial Bank, N.A.	$ 587,028	14.68%	$ 264,946	6.625%	$ 339,931	8.50%	$ 319,935	8.00%
Common Equity Tier 1 Capital to Risk-Weighted Assets:								
Consolidated	$ 693,584	17.30%	$ 205,491	5.125%	$ 280,671	7.00%		N/A
First Financial Bank, N.A.	$ 587,028	14.68%	$ 204,959	5.125%	$ 279,943	7.00%	$ 259,947	6.50%
Leverage Ratio:								
Consolidated	$ 693,584	10.71%	$ 258,978	4.00%	$ 258,978	4.00%		N/A
First Financial Bank, N.A.	$ 587,028	9.10%	$ 257,941	4.00%	$ 257,941	4.00%	$ 322,426	5.00%
As of December 31, 2015:								
Total Capital to Risk-Weighted Assets:								
Consolidated	$ 672,920	16.97%	$ 318,528	8.00%	$ 418,068	10.50%		N/A
First Financial Bank, N.A.	$ 570,910	14.37%	$ 317,788	8.00%	$ 417,097	10.50%	$ 397,235	10.00%
Tier 1 Capital to Risk-Weighted Assets:								
Consolidated	$ 630,413	15.90%	$ 238,896	6.00%	$ 338,436	8.50%		N/A
First Financial Bank, N.A.	$ 528,403	13.30%	$ 238,341	6.00%	$ 337,650	8.50%	$ 317,788	8.00%
Common Equity Tier 1 Capital to Risk-Weighted Assets:								
Consolidated	$ 630,413	15.90%	$ 179,172	4.50%	$ 278,712	7.00%		N/A
First Financial Bank, N.A.	$ 528,403	13.30%	$ 178,756	4.50%	$ 278,065	7.00%	$ 258,203	6.50%
Leverage Ratio:								
Consolidated	$ 630,413	9.96%	$ 256,368	4.00%	$ 256,368	4.00%		N/A
First Financial Bank, N.A.	$ 528,403	8.37%	$ 252,419	4.00%	$ 252,419	4.00%	$ 315,524	5.00%

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We have performed a preliminary assessment using the regulatory capital estimation tool made available by the OCC and believe the Company and Bank are prepared to meet the new requirements upon full adoption of Basel III that will be effective December 31, 2019.

In connection with the adoption of the Basel III regulatory capital framework, our subsidiary bank made the election to continue to exclude most accumulated other comprehensive income (AOCI) from capital in connection with its March 31, 2015 quarterly financial filing and, in effect, to retain the AOCI treatment under the prior capital rules.

In connection with the First Financial Trust & Asset Management Company, National Association s (the Trust Company) application to obtain our trust charter, the Trust Company is required to maintain tangible net assets of $2,000,000 at all times. As of December 31, 2016, our Trust Company had tangible net assets totaling $14,300,000.

Our subsidiary bank may be required at times to maintain reserve balances with the Federal Reserve Bank. At December 31, 2016 and 2015, the subsidiary bank s reserve balances were $4,340,000 and $17,725,000, respectively.

15. STOCK OPTION PLAN AND RESTRICTED STOCK PLAN:

The Company has an incentive stock plan to provide for the granting of options to employees of the Company at prices not less than market at the date of grant. At December 31, 2016, the Company had allocated 3,337,000 shares of stock for issuance under the plan. The plan provides that options granted are exercisable after two years from date of grant at a rate of 20% each year cumulatively during the 10-year term of the option. Shares are issued under the stock option plan from available authorized shares. An analysis of stock option activity for the year ended December 31, 2016 is presented in the table and narrative below:

	Shares	Weighted-Average Ex. Price		Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value ($000)	
Outstanding, beginning of year	1,231,346	$	26.70			
Granted						
Exercised	(82,871)		15.69			
Cancelled	(54,440)		(29.52)			
Outstanding, end of year	1,094,035		27.40	6.56	$	19,475
Exercisable at end of year	422,945	$	20.38	4.29	$	10,498

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The options outstanding at December 31, 2016, had exercise prices ranging between $13.66 and $33.89. Stock options have been adjusted retroactively for the effects of stock dividends and splits.

The following table summarizes information concerning outstanding and vested stock options as of December 31, 2016:

Exercise Price	Number Outstanding	Remaining Contracted Life (Years)	Number Vested
$ 13.66	36,522	0.1	36,522
16.78	123,473	2.4	123,473
15.73	180,380	4.8	136,460
30.85	320,410	6.8	126,490
$ 33.89	433,250	8.8	
	1,094,035		422,945

The fair value of the options granted during 2015 were estimated using the Black-Scholes options pricing model with the following weighted-average assumptions: risk-free interest rate of 1.89%; expected dividend yield of 1.89%; expected life of 5.78 years; and expected volatility of 23.36%.

The weighted-average grant-date fair value of options granted during 2015 was $6.72. There were no grants during 2014 and 2016. The total intrinsic value of options exercised during the years ended December 31, 2016, 2015, and 2014, was $1,226,000, $1,539,000 and $1,738,000, respectively.

As of December 31, 2016, there was $3,058,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 2.14 years. The total fair value of shares vested during the years ended December 31, 2016, 2015, and 2014 was $592,000, $810,000 and $382,000.

The aggregate intrinsic value of vested stock options at December 31, 2016 totaled $10,498,000.

On April 28, 2015, shareholders of the Company approved a restricted stock plan for selected employees, officers, non-employee directors and consultants. At December 31, 2016, the Company had allocated 439,000 shares of stock for issuance under the plan.

On July 21, 2015, 7,070 shares were granted to the ten non-employee directors. Total value of these shares totaled $250,000 and was expensed over the period from grant date to April 26, 2016, the next scheduled annual shareholders

meeting at which the directors current term expired. On April 26, 2016, upon re-election of existing directors, 7,660 shares with a total value of $250,000 were granted to the ten non-employee directors and is being expensed over the period from grant day to April 25, 2017, the next scheduled annual shareholders meeting at which the current directors current term will expire. The Company recorded director expense related to these restricted stock grants of $278,000 and $139,000 for the year ended December 31, 2016 and 2015, respectively.

On October 27, 2015, the Company granted 31,273 shares with a total value of $1,060,000 to certain officers that is being expensed over the vesting period of three years. On October 25, 2016, the Company granted 15,405 shares with a total value of $560,000 to certain officers that is being expensed over the vesting period of three years. The Company recorded restricted stock expense for officers of $381,000 and $62,000, respectively, for the year ended December 31, 2016 and 2015.

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16. CONDENSED FINANCIAL INFORMATION - PARENT COMPANY:

Condensed Balance Sheets-December 31, 2016 and 2015

	2016	2015
ASSETS		
Cash in subsidiary bank	$ 15,070	$ 12,311
Cash in unaffiliated banks	2	2
Interest-bearing deposits in subsidiary bank	78,179	78,160
Total cash and cash equivalents	93,251	90,473
Securities available-for-sale, at fair value	11,593	12,062
Investment in and advances to subsidiaries, at equity	744,971	713,909
Intangible assets	723	723
Other assets	2,668	3,693
Total assets	$ 853,206	$ 820,860
LIABILITIES AND SHAREHOLDERS EQUITY		
Total liabilities	$ 15,321	$ 15,874
Shareholders equity:		
Common stock	661	660
Capital surplus	372,245	368,925
Retained earnings	446,534	388,006
Treasury stock	(6,671)	(6,296)
Deferred compensation	6,671	6,296
Accumulated other comprehensive earnings	18,445	47,395
Total shareholders equity	837,885	804,986
Total liabilities and shareholders equity	$ 853,206	$ 820,860

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Condensed Statements of Earnings-

For the Years Ended December 31, 2016, 2015 and 2014

	2016	2015	2014
Income:			
Cash dividends from subsidiaries	$ 48,800	$ 51,200	$ 34,000
Excess of earnings over dividends of subsidiaries	58,809	52,911	58,539
Other	4,184	4,185	3,717
Total Income	111,793	108,296	96,256
Expenses:			
Salaries and employee benefits	5,655	6,067	5,595
Other operating expenses	3,531	4,439	3,309
Total Expense	9,186	10,506	8,904
Earnings before income taxes	102,607	97,790	87,352
Income tax benefit	2,167	2,591	2,207
Net earnings	$ 104,774	$ 100,381	$ 89,559

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Condensed Statements of Cash Flows-

For the Years Ended December 31, 2016, 2015, and 2014

	2016	2015	2014
Cash flows from operating activities:			
Net earnings	$ 104,774	$ 100,381	$ 89,559
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Excess of earnings over dividends of subsidiary bank	(58,809)	(52,911)	(58,539)
Depreciation and amortization, net	208	197	200
Decrease (increase) in other assets	1,702	507	(150)
Increase (decrease) in other liabilities	(1,374)	3,743	(314)
Other	8		
Net cash provided by operating activities	46,509	51,917	30,756
Cash flows from investing activities:			
Cash received (paid) in connection with acquisition of banks		13,125	
Net decrease in interest-bearing time deposits in unaffiliated banks			480
Purchases of bank premises and equipment	(94)	(107)	(780)
Repayment from (of advances to) investment in and advances to subsidiaries, net		5,800	(3,300)
Other	10		
Net cash used in (provided by) investing activities	(84)	18,818	(3,600)
Cash flows from financing activities:			
Repayment of subordinated debt		(13,125)	
Proceeds of stock issuances	1,260	1,545	1,437
Cash dividends paid	(44,907)	(38,767)	(34,578)
Net cash used in financing activities	(43,647)	(50,347)	(33,141)
Net increase (decrease) in cash and cash equivalents	2,778	20,388	(5,985)

Cash and cash equivalents, beginning of year	90,473	70,085	76,070
Cash and cash equivalents, end of year	$ 93,251	$ 90,473	$ 70,085

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17. CASH FLOW INFORMATION:

Supplemental information on cash flows and noncash transactions is as follows (dollars in thousands):

	Year Ended December 31,		
	2016	2015	2014
Supplemental cash flow information:			
Interest paid	$ 5,465	$ 4,085	$ 4,231
Federal income taxes paid	28,348	29,674	28,711
Schedule of noncash investing and financing activities:			
Assets acquired through foreclosure	2,269	203	1,385
Investment securities purchased but not settled	12,381		1,248

18. ACQUISITIONS AND ASSET PURCHASE:

On April 1, 2015, we entered into an agreement and plan of reorganization to acquire FBC Bancshares, Inc. and its wholly owned bank subsidiary, First Bank, N.A., Conroe, Texas. On July 31, 2015, the transaction was completed. Pursuant to the agreement, we issued 1,755,374 shares of the Company s common stock in exchange for all of the outstanding shares of FBC Bancshares, Inc. At closing, FBC Bancshares, Inc. was merged into the Company and First Bank, N.A., Conroe, Texas, was merged into First Financial Bank, National Association, Abilene, Texas, a wholly owned subsidiary of the Company. The primary purpose of the acquisition was to expand the Company s market share along Interstate Highway 45 in southern Texas, north of Houston. Factors that contributed to a purchase price resulting in goodwill include First Bank, N.A. s historic record of earnings, strong local economic environment and opportunity for growth. The results of operations from this acquisition are included in the consolidated earnings of the Company commencing August 1, 2015.

The assets acquired and liabilities assumed were recorded on the consolidated balance sheet at estimated fair value on the acquisition date. The acquisition was not considered to be a significant business combination. The following table presents the amounts recorded on the consolidated balance sheet on the acquisition date (dollars in thousands):

Fair value of consideration paid:	
Common stock issued (1,755,374 shares)	$ 59,648
Fair value of identifiable assets acquired:	
Cash and cash equivalents	65,197

Securities available-for-sale	42,903
Loans	248,380
Identifiable intangible assets	2,343
Other assets	15,262
Total identifiable assets acquired	374,085
Fair value of liabilities assumed:	
Deposits	343,583
Subordinated debt	13,125
Other liabilities	1,651
Total liabilities assumed	358,359
Fair value of net identifiable assets acquired	15,726
Goodwill resulting from acquisition	$ 43,922

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Goodwill recorded in the acquisition was accounted for in accordance with the authoritative business combination guidance. Accordingly, goodwill will not be amortized, but will be tested for impairment annually. The goodwill recorded is not deductible for federal income tax purposes.

The subordinated debt of $13,125,000 was paid off August 3, 2015, subsequent to closing.

The fair value of total loans acquired was $248,380,000 at acquisition compared to contractual amounts of $252,458,000. The fair value of purchased credit impaired loans at acquisition was $1,398,000 compared to contractual amounts of $1,704,000. Additional purchased credit impaired loan disclosures were omitted due to immateriality. All other acquired loans were considered performing loans.

First Bank, N.A. had branches in Conroe, Magnolia, Tomball, Willis, Cut and Shoot and Huntsville, all located north of Houston, Texas. In February 2016, the Company closed First Bank s Huntsville location and consolidated the branch with the Company s existing Huntsville location.

On April 8, 2015, the Company announced that it had entered into an asset purchase agreement with 4Trust Mortgage, Inc. for a cash purchase price of $1,900,000. The asset purchase was finalized on June 1, 2015. The total asset purchase price exceeded the estimated fair value of assets purchased by approximately $1,750,000 and the Company recorded such excess as goodwill.