

FIRST FINANCIAL BANKSHARES INC  
Form 10-K  
February 22, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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

For the fiscal year ended December 31, 2011

Commission file number 0-7674

**First Financial Bankshares, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

|   |   |
|---|---|
| Texas<br>(State or Other Jurisdiction of<br>Incorporation or Organization)  | 75-0944023<br>(I.R.S. Employer<br>Identification No.) |
| 400 Pine Street, Abilene, Texas<br>(Address of Principal Executive Offices) | 79601<br>(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

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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, 2011, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of voting and non-voting common stock held by non-affiliates was \$1.03 billion.

As of February 22, 2012, there were 31,466,644 shares of Common Stock outstanding.

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**Documents Incorporated by Reference**

Certain information called for by Part III is incorporated by reference to the proxy statement for our 2012 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2011.

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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 our 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 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 ) and Basel III;

political instability;

the ability of the Federal government to deal with the national economic slowdown and the effect of stimulus packages enacted by Congress as well as future stimulus packages, if any;

competition from other financial institutions and financial holding companies;

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;

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;

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inflation, interest rate, market and monetary fluctuations;

changes in consumer spending, borrowing and savings habits;

continued high levels of FDIC insurance assessments, including the possibility of additional special assessments;

our ability to attract deposits;

changes in our liquidity position;

changes in the reliability of our vendors, internal control system or information systems;

our ability to attract and retain qualified employees;

the possible impairment of goodwill associated with our acquisitions;

consequences of bank continued 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;

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changes in compensation and benefit plans;

acquisitions and integration of acquired businesses; and

acts of God or of war or terrorism.

Such 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.

**PART I**

**ITEM 1. BUSINESS**

**General**

First Financial Bankshares, Inc., a Texas corporation, is a financial holding company registered under the Bank Holding Company Act of 1956, or BHCA. As such, we are supervised by the Board of Governors of the Federal Reserve System, or Federal Reserve Board, as well as several other state and federal 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. We own eleven banks, a trust company, a technology operating company, and an insurance agency, all organized and located in Texas. As of February 22, 2012, these subsidiaries are:

First Financial Bank, National Association, Abilene, Texas;

First Financial Bank, Hereford, Texas;

First Financial Bank, National Association, Sweetwater, Texas;

First Financial Bank, National Association, Eastland, Texas;

First Financial Bank, National Association, Cleburne, Texas;

First Financial Bank, National Association, Stephenville, Texas;

First Financial Bank, National Association, San Angelo, Texas;

First Financial Bank, National Association, Weatherford, Texas;

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First Financial Bank, National Association, Southlake, Texas;

First Financial Bank, National Association, Mineral Wells, Texas;

First Financial Bank, Huntsville, Texas;

First Technology Services, Inc., Abilene, Texas;

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

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

Through our subsidiary banks, we conduct a full-service commercial banking business. Our service centers are located primarily in Central, North Central and West Texas. Including the branches and locations of all our subsidiaries, as of December 31, 2011, we had 52 financial centers across Texas, with ten locations in Abilene, two locations in Cleburne, two locations in Stephenville, three locations in Granbury, two locations in San Angelo, three locations in Weatherford, and one location each in Mineral Wells, Hereford, Sweetwater, Eastland, Ranger, Rising Star, Cisco, Southlake, Aledo, Willow Park, Brock, Alvarado, Burleson, Crowley, Keller, Trophy



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Club, Boyd, Bridgeport, Decatur, Roby, Trent, Merkel, Clyde, Moran, Albany, Midlothian, Glen Rose, Odessa, Fort Worth and Huntsville, 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. Accordingly, each of our eleven separately chartered banks operates with local boards of directors, local bank presidents and local decision-making. However, we have consolidated many of the backroom operations, such as investment securities, accounting, check processing, technology and employee benefits, which improves each of our subsidiary bank's efficiency and frees management of our subsidiary banks to concentrate on serving the banking needs of their local communities. We call this our "one bank, eleven charters" concept.

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 25.2 million residents, Texas has more people than any other state except California. The population of Texas grew 20.6 percent from 2000-2010 according to the U.S. Census Bureau. Many of the communities in which we operate are growing faster than the statewide average, as shown below:

Population Growth 2000-2010\*

|   |       |                                    |       |
|---|-------|------------------------------------|-------|
| Bridgeport and Wise County              | 21.2% | Weatherford, Willow Park and Aledo | 32.1% |
| Fort Worth/Tarrant County               | 25.1% | Granbury and Hood County           | 24.5% |
| Cleburne, Midlothian and Johnson County | 19.9% | Stephenville and Erath County      | 14.8% |

\*Source: U. S. Census Bureau

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

We have also largely foregone the larger metropolitan areas of Texas. We believe our community approach way of 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 three ways: by growing our banks internally, by opening new branch locations and by acquisition of other banks. Since 1997, we have completed eleven bank acquisitions increasing total assets from \$1.57 billion to \$4.12 billion. We have also established a trust and asset management company and a technology services company, both of which operate as subsidiaries of First Financial Bankshares, Inc. Looking ahead, we will continue to grow locally 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 would like to acquire, working with brokers and the FDIC.

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When targeting a bank for acquisition, the bank generally needs to be in the type of community that fits our profile. We like 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 and 20 corridors in Texas. We might also consider the acquisition of banks in East Texas or the Texas Hill Country area. Banks in the \$100 million to \$500 million asset size fit our sweet spot for acquisition, but we will 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 existing Company.

We also own First Financial Investments, Inc. (which is dormant). During 2011, we merged First Financial Bankshares of Delaware, Inc. and First Financial Investments of Delaware, Inc. into First Financial Bankshares, Inc.

Information on our revenues, profits and losses and total assets appears in the discussion of our Results of Operations contained in Item 7 hereof.

### **First Financial Bankshares, Inc.**

We provide management and technical resources and policy direction to our subsidiaries, which enable them to improve or expand their banking 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, with substantial authority in making decisions concerning their own loan decisions, interest rates, service charges and marketing. 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;

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, dividend policies, and appointment of officers and 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 banks related to lending, investing, purchasing, advertising, public relations, and computer services.

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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 subsidiary banks, utilization of available lines of credit and future debt or equity offerings.

### **Services Offered by Our Subsidiary Banks**

Each of our subsidiary banks is a separate legal entity that operates under the day-to-day management of its own board of directors and officers. Each of our subsidiary banks 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. Through our trust company, we administer all types of retirement and employee benefit accounts, which include 401(k) profit sharing plans and IRAs. We also offer personal trust services, which include the administration of estates, testamentary trusts, revocable and irrevocable trusts and agency accounts. In addition, First Financial Bank, National Association, Abilene, First Financial Bank, National Association, San Angelo and First Financial Bank, National Association, Weatherford provide securities brokerage services through arrangements with an unrelated third party.

### **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 our banks 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 subsidiary banks 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 our subsidiary banks 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 of which 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 subsidiary banks we may make loans to 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 directors, officers and their affiliates are also subject to numerous restrictions under federal and state banking laws, which we describe in greater detail below.

### **Employees**

With our subsidiary banks, we employed approximately 980 full-time equivalent employees at December 31, 2011. 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 of the Federal Deposit Insurance Corporation, or 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 subsidiary banks.

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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 affiliation 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, make merchant banking investments, 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.).

### *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.

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*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. The OCC supervises, regulates and regularly examines:

First Financial Bank, National Association, Abilene;

First Financial Bank, National Association, Sweetwater;

First Financial Bank, National Association, Cleburne;

First Financial Bank, National Association, Eastland;

First Financial Bank, National Association, San Angelo;

First Financial Bank, National Association, Weatherford;

First Financial Bank, National Association, Southlake;

First Financial Bank, National Association, Stephenville;

First Financial Bank, National Association, Mineral Wells;

First Financial Trust & Asset Management Company, National Association; and

First Technology Services, Inc.

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.

*State Banks.* Banks that are organized as state banks under Texas law are subject to regulation and examination by the Texas Department of Banking (the Banking Department). The Banking Department regulates, supervises and regularly examines our two subsidiary state banks, First Financial Bank, Hereford and First Financial Bank, Huntsville. The Banking Department's supervision and regulation of banks is primarily designed to protect the interests of depositors. Texas law:

restricts the nature and amount of loans that may be made and the interest that may be charged, and

restricts investments and other activities.

State banks are also subject to regulation by either the FDIC or the Federal Reserve Board. First Financial Bank, Hereford and First Financial Bank, Huntsville are non-member banks of the Federal Reserve, and as such their federal regulator is the FDIC and are subject to most of the federal laws described below.

#### *Deposit Insurance*

Each of our subsidiary banks is a member of the FDIC. The FDIC provides deposit insurance protection that covers all deposit accounts in FDIC-insured depository institutions. Until October 2008, the protection generally did not exceed \$100,000 per depositor. Beginning in October 2008, the amount of protection was increased to \$250,000, under the Temporary Liquidity Guarantee Program (TLGP) of the Emergency Economic Stabilization Act of 2008. This increased protection to \$250,000 was initially available only through December 31, 2009 but the Dodd-Frank Act made this \$250,000 protection permanent. The new regulations were also expanded whereby the protection for non interest bearing deposits was unlimited at institutions participating in the TLGP. This unlimited coverage for these non interest bearing accounts was also initially only available through December 31, 2009 but was extended by the Dodd-Frank Act until December 31, 2012. Non interest bearing deposits initially also included, by definition, certain Interest on Lawyers Trust Accounts (IOLTA) and Negotiable Order of Withdrawal accounts (NOW Accounts) with a maximum capped interest rate. Effective January 1, 2011 through December 31, 2012, the definition of non interest bearing was changed to no longer include NOW accounts.

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Our subsidiary banks 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 deposit insurance fund) 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. In addition, the FDIC can impose shortages in special assessments to cover the Deposit Insurance Fund (DIF). As of December 31, 2011, the assessment rate for each of our subsidiary banks was at the lowest level risk-based premium available which was 5.00 percent of the assessment base per annum (with the exception of First Financial Bank, N.A., Southlake whose rate was 6.58 percent, First Financial Bank, N.A., Weatherford whose rate was 5.86 percent and First Financial Bank, N.A., Cleburne whose rate was 6.89 percent). The assessment base was broadened by the Dodd-Frank Act to be defined as average consolidated total assets less average tangible equity. The FDIC also announced in 2009 the requirement of 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 Company's prepayment amount totaled \$11.6 million in the aggregate and is being expensed over a three year period ending December 31, 2012 based on future quarterly assessment calculations.

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. The Dodd-Frank Act also eliminated the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. Under the Restoration Plan, the FDIC did not institute the uniform three-basis point increase in assessment rates scheduled to take place on January 1, 2011 and maintained the current schedule of assessment rates for all depository institutions. At least semi-annually, the FDIC will update its loss and income projections for the DIF and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking, if required. 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.

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-receiver, 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 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. 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 subsidiary banks pay dividends.



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Each of our national bank subsidiaries 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. 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). First Financial Bank, Hereford and First Financial Bank, Huntsville, as Texas state banking associations, may not pay a dividend reducing its capital and surplus without the prior approval of the Banking Department. In addition, the FDIC has the right to prohibit the payment of dividends by a state, non-member bank where the payment is deemed to be an unsafe or unsound banking practice.

Our subsidiaries paid aggregate dividends of approximately \$47.4 million in 2011 and approximately \$41.1 million in 2010. Under the dividend restrictions discussed above, as of December 31, 2011, our subsidiary banks could have declared in the aggregate additional dividends of approximately \$59.8 million from retained net profits, without obtaining regulatory approvals.

To pay dividends, we and our subsidiary banks 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 regulatory authorities 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. 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. No undercapitalized institution may pay a dividend.

### *Affiliate Transactions*

The Federal Reserve Act, the 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 depository 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 include 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 nondepository 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 nondepository 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 subsidiary banks conduct transactions internally among us, we are required to do so at arm's length.

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### *Loans to Directors, Executive Officers and Principal Shareholders*

The authority of our subsidiary banks to extend credit to our directors, executive officers and principal shareholders, including their immediate family members and 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 banks 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 banks make 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 prevailing at the time for comparable transactions with persons not affiliated with us or the subsidiary banks;

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

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

Furthermore, each 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*

*Bank Holding Companies and Financial Holding Companies.* The Federal Reserve Board has adopted risk-based capital guidelines for bank holding companies and financial holding companies. The ratio of total capital to risk weighted assets (including certain off-balance-sheet activities, such as standby letters of credit) must be a minimum of eight percent. At least half of the total capital is to be composed of common shareholders' equity, minority interests in the equity accounts of consolidated subsidiaries and a limited amount of perpetual preferred stock, less goodwill, which is collectively referred to as Tier 1 Capital. The remainder of total capital may consist of subordinated debt, other preferred stock and a limited amount of loan loss reserves.

In addition, the Federal Reserve Board has established minimum leverage ratio guidelines for bank holding companies and financial holding companies. Bank holding companies and financial holding companies that meet certain specified criteria, including having the highest regulatory rating, must maintain a minimum Tier 1 Capital leverage ratio (Tier 1 Capital to average assets for the current quarter, less goodwill) of three percent. Bank holding companies and financial holding companies that do not have the highest regulatory rating will generally be required to maintain a higher Tier 1 Capital leverage ratio of three percent plus an additional cushion of 100 to 200 basis points. The guidelines also provide that bank holding companies and financial holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions. Such strong capital positions must be kept substantially above the minimum supervisory levels without significant reliance on intangible assets (e.g., goodwill and core deposit intangibles). As of December 31, 2011, our capital ratios were as follows: (1) Tier 1 Capital to Risk-Weighted Assets Ratio, 17.49%; (2) Total Capital to Risk-Weighted Assets Ratio, 18.74%; and (3) Tier 1 Capital Leverage Ratio, 10.33%.

The Dodd-Frank Act requires the Federal Reserve Board to apply consolidated capital requirements to bank holding companies and financial holding companies that are no less stringent than those currently applied to depository institutions. Under these standards, trust preferred securities will be excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by a bank holding company with less than \$15 billion in assets. The Dodd-Frank Act additionally requires capital requirements to be countercyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness.

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*Banks.* The Federal Deposit Insurance Corporation Improvement Act of 1991, or FDICIA, established five capital tiers with respect to depository institutions: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. A depository institution's capital tier will depend upon where its capital levels are in relation to various relevant capital measures, including (1) risk-based capital measures, (2) a leverage ratio capital measure and (3) certain other factors. Regulations establishing the specific capital tiers provide that a well-capitalized institution will have a total risk-based capital ratio of ten percent or greater, a Tier 1 risk-based capital ratio of six percent or greater, and a Tier 1 leverage ratio of five percent or greater, and not be subject to any written regulatory enforcement agreement, order, capital directive or prompt corrective action derivative. For an institution to be adequately capitalized, it will have a total risk-based capital ratio of eight percent or greater, a Tier 1 risk-based capital ratio of four percent or greater, and a Tier 1 leverage ratio of four percent or greater (in some cases three percent). For an institution to be undercapitalized, it will have a total risk-based capital ratio that is less than eight percent, a Tier 1 risk-based capital ratio less than four percent or a Tier 1 leverage ratio less than four percent (or a leverage ratio less than three percent if the institution's composite rating is 1 in its most recent report of examination, subject to appropriate federal banking agency guidelines). For an institution to be significantly undercapitalized, it will have a total risk-based capital ratio less than six percent, a Tier 1 risk-based capital ratio less than three percent, or a Tier 1 leverage ratio less than three percent. For an institution to be critically undercapitalized, it will have a ratio of tangible equity to total assets equal to or less than two percent. FDICIA requires federal banking agencies to take prompt corrective action against depository institutions that do not meet minimum capital requirements. Under current regulations, all of our subsidiary banks were well capitalized as of December 31, 2011.

The Dodd-Frank Act requires the FDIC to establish minimum leverage and risk-based capital requirements to apply to insured depository institutions. The Dodd-Frank Act additionally requires capital requirements to be countercyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness.

FDICIA generally prohibits a depository institution from making any capital distribution (including payment of a dividend) or paying any management fee to its holding company if the depository institution would thereafter be undercapitalized. An undercapitalized institution must develop a capital restoration plan and its parent holding company must guarantee that institution's compliance with such plan. The liability of the parent holding company under any such guarantee is limited to the lesser of five percent of the institution's assets at the time it became undercapitalized or the amount needed to bring the institution into compliance with all capital standards. Furthermore, in the event of the bankruptcy of the parent holding company, such guarantee would take priority over the parent's general unsecured creditors. If a depository institution fails to submit an acceptable capital restoration plan, it shall be treated as if it is significantly undercapitalized. Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. Critically undercapitalized institutions are subject to the appointment of a receiver or conservator. Finally, FDICIA requires the various regulatory agencies to set forth certain standards that do not relate to capital. Such standards relate to the safety and soundness of operations and management and to asset quality and executive compensation, and permit regulatory action against a financial institution that does not meet such standards.

If an insured bank fails to meet its capital guidelines, it may be subject to a variety of other enforcement remedies, including a prohibition on the taking of brokered deposits and the termination of deposit insurance by the FDIC. Bank regulators continue to indicate their desire to raise capital requirements beyond their current levels.

In addition to FDICIA capital standards, Texas-chartered banks must also comply with the capital requirements imposed by the Banking Department. Neither the Texas Finance Code nor its regulations specify any minimum capital-to-assets ratio that must be maintained by a Texas-chartered bank. Instead, the Banking

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Department determines the appropriate ratio on a bank by bank basis, considering factors such as the nature of a bank's business, its total revenue, and the bank's total assets. As of December 31, 2011, our two Texas-chartered banks exceeded the minimum ratios applied to them.

### *Our Support of Our Subsidiary Banks*

Under Federal Reserve Board policy, we are expected to commit resources to act as a source of strength to support each of our subsidiary banks. This support may be required at times when, absent such Federal Reserve Board policy, we would not otherwise be required to provide it. This policy was codified by the Dodd-Frank Act. In addition, any loans we make to our subsidiary banks would be subordinate in right of payment to deposits and to other indebtedness of our banks. 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 National Bank Act, if the capital stock of a national bank is impaired by losses or otherwise, the OCC is authorized to require the bank's shareholders to pay the deficiency on a pro-rata basis. If any shareholder refuses to pay the pro-rata assessment after three months notice, then the bank's board of directors must sell an appropriate amount of the shareholder's stock at a public auction to make up the deficiency. To the extent necessary, if a deficiency in capital still exists and the bank refuses to go into liquidation, then a receiver may be appointed to wind down the bank's affairs. Additionally, 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 banking subsidiaries may be assessed for the FDIC's loss.

### *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 opts 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.

Both the OCC and Banking Department accept 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

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made by such bank for, among other things, approval of the acquisition or establishment of a branch or other deposit 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 banks have taken significant actions to comply with the CRA, and each has received ratings ranging from satisfactory to outstanding 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, IRS rules and other regulations, we are required to monitor and report unusual or suspicious account activity as well as transactions involving the transfer or withdrawal of amounts in excess of prescribed limits. 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 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.

*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

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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.

### *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.

### *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

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finances 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*

The U. S. and global economies have experienced and are experiencing significant stress and disruptions in the financial sector. Dramatic slowdowns in the housing industry with falling home prices and increasing foreclosures and unemployment have created strains on financial institutions, including government-sponsored entities and investment banks. As a result, many financial institutions sought and continue to seek additional capital, merge or seek mergers with larger and stronger institutions and, in some cases, failed.

In response to the financial crisis affecting the banking and financial markets, in October 2008, the Emergency Economic Stabilization Act of 2008 (the EESA) was signed into law. Pursuant to the EESA, the U.S. Treasury (the Treasury) was authorized to purchase equity stakes in U. S. financial institutions. Under this program, known as the Troubled Asset Relief Program Capital Purchase Program (the TARP Capital Purchase Program), the Treasury made \$250 billion of capital available to U.S. financial institutions through the purchase of preferred stock or subordinated debentures by the Treasury. In conjunction with the purchase of preferred stock from publicly-held financial institutions, the Treasury received warrants to purchase common stock with an aggregate market price equal to 15% of the total amount of the preferred investment. Participating financial institutions were required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the TARP Capital Purchase Program and were restricted from increasing dividends to common shareholders or repurchasing common stock for three years without the consent of the Treasury. The Company made a decision to not participate in the TARP Capital Purchase Program due to its capital and liquidity positions.

### *Dodd-Frank Wall Street Reform and Consumer Protection Act*

On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act is intended to effect a fundamental restructuring of federal banking regulation. Among other things, the Dodd-Frank Act creates 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. The Dodd-Frank Act additionally creates a new independent federal regulator to administer federal consumer protection laws. The Dodd-Frank Act is expected to have a significant impact on our business operations as its provisions take effect. In addition to those provisions discussed above, among the provisions that are likely to affect us are the following:

Payment of Interest on Business Checking Accounts. Effective one year from the date of enactment, the Dodd-Frank Act eliminated the federal statutory prohibition against the payment of interest on business checking accounts.

Corporate Governance. 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.



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Prohibition Against Charter Conversions of Troubled Institutions. Effective one year after enactment, the Dodd-Frank Act prohibits a depository institution from converting from a state to federal charter or vice versa while it is the subject of a cease and desist order or other formal enforcement action or a memorandum of understanding with respect to a significant supervisory matter unless the appropriate federal banking agency gives notice of the conversion to the federal or state authority that issued the enforcement action and that agency does not object within 30 days. The notice must include a plan to address the significant supervisory matter. The converting institution must also file a copy of the conversion application with its current federal regulator which must notify the resulting federal regulator of any ongoing supervisory or investigative proceedings that are likely to result in an enforcement action and provide access to all supervisory and investigative information relating hereto.

Limits on Derivatives. Effective 18 months after enactment, the Dodd-Frank Act prohibits state-chartered banks from engaging in derivatives transactions unless the loans to one borrower limits of the state in which the bank is chartered takes into consideration credit exposure to derivatives transactions. For this purpose, derivative transaction includes 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 commodities securities, currencies, interest or other rates, indices or other assets.

Debit Card Interchange Fees. Effective July 21, 2011, the Dodd-Frank Act requires 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 \$0.24 per 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.

Consumer Financial Protection Bureau. The Dodd-Frank Act creates 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 will have examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Smaller institutions will be subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB will have authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower's ability to repay. In addition, the Dodd-Frank Act will allow borrowers to raise certain defenses to foreclosure if they receive any loan other than a qualified mortgage as defined by the CFPB. 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 state attorneys general to enforce compliance with both the state and federal laws and regulations.

Basel Committee. On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee, announced agreement on the calibration and phase-in arrangements for a strengthened set of capital requirements, known as Basel III. Basel III increases the minimum Tier 1 common equity ratio to 4.5%, net of regulatory deductions, and introduces a capital conservation buffer of an additional 2.5% of common equity to risk-weighted assets, raising the target minimum common equity ratio to 7%. This capital conservation buffer also increases the minimum Tier 1 capital ratio from 6% to 8.5% and the minimum total capital ratio from 8% to 10.5%. In addition, Basel III introduces a countercyclical capital buffer of up to 2.5% of common equity or other fully loss absorbing capital for periods of excess credit growth. Basel III also introduces a non-risk adjusted Tier 1 leverage ratio of 3%, based on a measure of total exposure rather than total assets, and new liquidity standards. The Basel III capital and liquidity standards will be phased in over a multi-year period.

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The final package of Basel III reforms was submitted to the Seoul G20 Leaders Summit in November 2010 for endorsement by G20 leaders, and then will be subject to individual adoption by member nations, including the United States. The Federal Reserve will likely implement changes to the capital adequacy standards applicable to the Company and our subsidiary banks in light of Basel III.

### *Available Information*

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy any document we file at the Securities and Exchange Commission's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the public reference room. Our SEC filings are also available to the public at the Securities and Exchange Commission'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](http://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.

*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;

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.

*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 collectibility of our loan

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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, federal and state 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.

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

Our network of subsidiary banks is concentrated in Texas, primarily in the Western and North Central regions of the state. Most of our customers and revenue are derived from this area. The economy of this region is focused on agriculture (including farming and ranching), commercial and industrial, medical, education, wind energy, manufacturing, service, oil and gas production, and real estate. 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 this part of Texas. Any significant decline in one or more segments of the local economy could adversely affect our business, revenue, operations and properties.

*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 portfolios include 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 continue to see negative economic conditions 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.

*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

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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.

*Recent developments in the mortgage market may affect our ability to originate loans and the profitability of loans in our mortgage pipeline.*

During the past several years, the real estate housing market throughout the United States has softened resulting in an industry-wide increase in borrowers unable to make their mortgage payments and increased foreclosure rates. Lenders in certain sections of the housing and mortgage markets were forced to close or limit their operations or seek additional capital. In response, financial institutions have tightened their underwriting standards, limiting the availability of sources of credit and liquidity. If the housing/real estate market continues to have problems in the future, there could be a prolonged decrease in the demand for our loans in the secondary market, adversely affecting our earnings.

*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.

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

We may need to raise additional capital/liquidity in the future to provide us with sufficient capital resources and liquidity to meet our commitments and business needs, particularly if our asset quality or earnings were to deteriorate significantly. Our ability to raise additional capital/liquidity, 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/liquidity, including depositors, other financial institution borrowings, repurchase agreements and borrowings from the discount window of the Federal Reserve. Any occurrence that may limit our access to the capital/liquidity markets, such as a decline in the confidence of other financial institutions, depositors or counterparties participating in the capital markets, may adversely affect our costs and our ability to raise capital/liquidity. An inability to raise additional capital/liquidity on acceptable terms when needed could have a materially adverse effect on our financial condition, results of operations and liquidity.

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*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 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.

*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

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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 statutes, 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.

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.*

In the past several years, the FDIC has significantly increased premiums charged for FDIC deposit insurance protection. We have historically paid the lowest premium rate available due to our sound financial position. In 2009, a special assessment (\$1.4 million for the Company) was paid by the Company. Should bank failures continue to occur, FDIC premiums could remain high or 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 Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the

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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.

*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 subsidiaries may pay to First Financial Bankshares, Inc. In the event our bank subsidiaries are unable to pay dividends to First Financial Bankshares, Inc., First Financial Bankshares, Inc. may not be able to service debt or pay dividends on the Company's common stock. The inability to receive dividends from our bank 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.

*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. From time to time, we may also seek to raise capital through selling additional common stock. 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 operational and financial results are affected by our ability to successfully integrate our acquisitions.*

Acquisitions of financial institutions involve operational risks and uncertainties and acquired companies may have unforeseen liabilities, exposure to asset quality problems, key employee and customer retention problems and other problems that could negatively affect our organization. We may not be able to successfully integrate the operations, management, products and services of the entities that we acquire nor eliminate redundancies. The integration process may also require significant time and attention from our management that



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they would otherwise direct at servicing existing business and developing new business. Our failure to successfully integrate the entities we acquire into our existing operations may increase our operating costs significantly and adversely affect our business and earnings.

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

As of December 31, 2011, we had \$72.1 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 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 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 agreement 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.

*The Company may not be able to attract and retain skilled people.*

The Company's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by the Company can be intense and the Company may not be able to hire people or to retain them. The unexpected loss of services of one or more of the Corporation's key personnel could have a material adverse impact on the Company's business because of their skills, knowledge of the Company's market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

*The Company's stock price can be volatile.*

Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you 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;

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.

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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 operations results.

*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.

*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. 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.

*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.

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### **ITEM 2. PROPERTIES**

Our principal office is located in the First Financial Bank Building at 400 Pine Street in downtown Abilene, Texas. We lease two spaces in a building owned by First Financial Bank, National Association, Abilene totaling approximately 4,500 square feet. Our subsidiary banks collectively own 41 banking facilities, some of which are detached drive-ins, and also lease eleven banking facilities and 14 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 subsidiary banks' requirements for the foreseeable future.

### **ITEM 3. LEGAL PROCEEDINGS**

From time to time we and our subsidiary banks 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 subsidiary banks 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, 2012, we had approximately 1,300 shareholders of record.

#### **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 .

**Table of Contents****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 \$1 billion to \$5 billion in total assets, for a five-year period (December 31, 2006 to December 31, 2011). The performance graph assumes \$100 invested in our common stock at its closing price on December 31, 2006, 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 represents 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.***

| <i>Index</i>                     | <i>Period Ending</i> |                 |                 |                 |                 |                 |
|----------------------------------|----------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                                  | <b>12/31/06</b>      | <b>12/31/07</b> | <b>12/31/08</b> | <b>12/31/09</b> | <b>12/31/10</b> | <b>12/31/11</b> |
| First Financial Bankshares, Inc. | 100.00               | 92.88           | 140.17          | 141.56          | 137.47          | 138.65          |
| Russell 3000                     | 100.00               | 105.14          | 65.92           | 84.60           | 98.92           | 99.93           |
| SNL Bank \$1B-\$5B               | 100.00               | 72.84           | 60.42           | 43.31           | 49.09           | 44.77           |

Source: SNL Financial LC, Charlottesville, VA

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[www.snl.com](http://www.snl.com)

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA**

The selected financial data presented below as of and for the years ended December 31, 2011, 2010, 2009, 2008, and 2007, 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 Securities and Exchange Commission's Industry Guide 3, Statistical Disclosure by Bank Holding Companies.

|   | Year Ended December 31,                       |              |              |              |              |
|---|---|--------------|--------------|--------------|--------------|
|   | 2011  | 2010         | 2009         | 2008         | 2007         |
|   | (dollars in thousands, except per share data) |              |              |              |              |
| <b>Summary Income Statement Information:</b>                    |   |              |              |              |              |
| Interest income   | \$ 160,021                                    | \$ 149,699   | \$ 146,445   | \$ 159,154   | \$ 169,369   |
| Interest expense  | 8,024   | 13,528       | 17,274       | 35,259       | 58,557       |
| Net interest income   | 151,997                                       | 136,171      | 129,171      | 123,895      | 110,812      |
| Provision for loan losses                                       | 6,626   | 8,962        | 11,419       | 7,957        | 2,331        |
| Noninterest income  | 51,438  | 49,478       | 48,598       | 49,453       | 48,273       |
| Noninterest expense   | 104,624                                       | 98,256       | 94,000       | 91,587       | 86,827       |
| Earnings before income taxes and extraordinary item             | 92,185  | 78,431       | 72,350       | 73,804       | 69,927       |
| Income tax expense  | 23,816  | 20,068       | 18,553       | 20,640       | 20,437       |
| Net earnings before extraordinary item                          | 68,369  | 58,363       | 53,797       | 53,164       | 49,490       |
| Extraordinary item  |   | 1,296        |              |              |              |
| Net earnings  | \$ 68,369                                     | \$ 59,659    | \$ 53,797    | \$ 53,164    | \$ 49,490    |
| <b>Per Share Data:</b>  |   |              |              |              |              |
| Earnings per share, basic before extraordinary item             | \$ 2.17                                       | \$ 1.87      | \$ 1.72      | \$ 1.71      | \$ 1.59      |
| Earnings per share, assuming dilution before extraordinary item | 2.17  | 1.87         | 1.72         | 1.70         | 1.59         |
| Earnings per share, basic                                       | 2.17  | 1.91         | 1.72         | 1.71         | 1.59         |
| Earnings per share, assuming dilution                           | 2.17  | 1.91         | 1.72         | 1.70         | 1.59         |
| Cash dividends declared   | 0.95  | 0.91         | 0.91         | 0.89         | 0.84         |
| Book value at period-end  | 16.16   | 14.06        | 13.31        | 11.82        | 10.77        |
| <b>Earnings performance ratios:</b>                             |   |              |              |              |              |
| Return on average assets  | 1.78%   | 1.75%        | 1.72%        | 1.74%        | 1.72%        |
| Return on average equity  | 14.44   | 13.74        | 13.63        | 15.27        | 15.87        |
| <b>Summary Balance Sheet Data (Period-end):</b>                 |   |              |              |              |              |
| Securities  | \$ 1,844,998                                  | \$ 1,546,242 | \$ 1,285,377 | \$ 1,318,406 | \$ 1,128,493 |
| Loans   | 1,786,544                                     | 1,690,346    | 1,514,369    | 1,566,143    | 1,528,020    |
| Total assets  | 4,120,531                                     | 3,776,367    | 3,279,456    | 3,212,385    | 3,070,309    |
| Deposits  | 3,334,798                                     | 3,113,301    | 2,684,757    | 2,582,753    | 2,546,083    |
| Total liabilities   | 3,611,994                                     | 3,334,679    | 2,863,754    | 2,843,603    | 2,734,814    |
| Total shareholders' equity                                      | 508,537                                       | 441,688      | 415,702      | 368,782      | 335,495      |
| <b>Asset quality ratios:</b>                                    |   |              |              |              |              |
| Allowance for loan losses/period-end loans                      | 1.92%   | 1.84%        | 1.82%        | 1.37%        | 1.14%        |
| Nonperforming assets/period-end loans plus foreclosed assets    | 1.64  | 1.53         | 1.46         | 0.80         | 0.31         |
| Net charge offs/average loans                                   | 0.20  | 0.35         | 0.36         | 0.25         | 0.07         |
| <b>Capital ratios:</b>  |   |              |              |              |              |
| Average shareholders' equity/average assets                     | 12.30%  | 12.76%       | 12.63%       | 11.37%       | 10.84%       |

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|                               |       |       |       |       |       |
|-------------------------------|-------|-------|-------|-------|-------|
| Leverage ratio (1)            | 10.33 | 10.28 | 10.69 | 9.68  | 9.23  |
| Tier 1 risk-based capital (2) | 17.49 | 17.01 | 17.73 | 15.89 | 14.65 |
| Total risk-based capital (3)  | 18.74 | 18.26 | 18.99 | 17.04 | 15.62 |
| Dividend payout ratio         | 43.57 | 47.58 | 52.63 | 52.41 | 52.86 |

- (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.

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- (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.

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

**Introduction**

As a multi-bank financial holding company, we generate most of our revenue from interest on loans and investments, trust fees, and service charges on deposits. Our primary source of funding for our loans and investments are deposits held by our subsidiary banks. Our largest expenses are interest on these deposits and salaries and related employee benefits. We usually 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.

You should read the following discussion and analysis of the major elements of our consolidated balance sheets as of December 31, 2011 and 2010, and consolidated statements of earnings for the years 2009 through 2011 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 the selection of certain accounting policies, generally accepted accounting principles 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.

The following discussion addresses (1) our allowance for loan losses and its provision for loan losses and (2) our valuation of securities, which we deem to be our most critical accounting policies. 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.

*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 collectibility of the principal is unlikely.

The allowance is an amount management believes is appropriate to absorb estimated inherent losses on existing loans that are deemed uncollectible based upon management's review and evaluation of the loan



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portfolio. The allowance for loan losses is comprised of three elements: (i) specific reserves determined in accordance with current authoritative accounting guidance based on probable losses on specific classified loans; (ii) general reserve determined in accordance with current authoritative accounting guidance that consider historical loss rates; and (iii) qualitative reserves determined in accordance with current authoritative accounting guidance 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 general reserve, the loan portfolio, less cash secured loans, government guaranteed loans and classified loans, is multiplied by the Company's historical loss rate. The Company's methodology is constructed so that specific allocations are increased in accordance with deterioration in credit quality and a corresponding increase in risk of loss. In addition, the Company adjusts our allowance for qualitative factors such as current local economic conditions and trends, including unemployment, lending staff, policies and procedures, credit concentrations, trends and severity of problem loans and trends in volume and terms of loans. This additional allocation based on qualitative factors serves to compensate for additional areas of uncertainty 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 further downturn in the economy and employment could result in increased levels of nonperforming assets and charge-offs, increased loan loss provisions and reductions in income. Additionally as an integral part of their examination process, bank regulatory agencies periodically review our allowance for loan losses. The bank regulatory agencies could require the recognition of additions to the loan loss allowance based on their judgment of information available to them at the time of their examination of subsidiary banks.

Accrual of interest is discontinued on a loan and payments 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. 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, it is probable we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. If a loan is impaired, a specific valuation allowance is allocated, if necessary. 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 uncollectible.

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 are measured based on the present value of expected future cash flows or the loan's observable market price. At December 31, 2011 and 2010, 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

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of principal, or a longer term to maturity. To date, these troubled debt restructurings have been such that, after considering economic and business conditions and collection efforts, the collection of interest is doubtful and therefore the loan has been placed on non-accrual. Each of these loans is evaluated for impairment and a specific reserve is recorded based on probable losses, taking into consideration the related collateral and modified loan terms and cash flow. As of December 31, 2011, all of the Company's troubled debt restructured loans are included in the non-accrual totals.

### *Valuation of 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 estimated fair value, with all unrealized gains and unrealized losses judged to be temporary, net of deferred income taxes, excluded from earnings and reported as a separate component of shareholders' equity. 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 estimated fair value with unrealized gains and losses included in earnings.

Fair value 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 and yield curves. Fair values for our 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 market 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 costs, 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.

The Company utilizes independent third party pricing services to value its investment securities. The Company reviews the prices supplied by the independent pricing services as well as the underlying pricing methodologies for reasonableness and to ensure such prices are aligned with traditional pricing matrices. The Company's investment portfolio consists of traditional investments, substantially all in U. S. Treasury securities, obligations of U. S. government sponsored-enterprises and agencies, mortgage pass-through securities, corporate bonds and general obligation or revenue based municipal bonds. Pricing for such securities is relatively straight forward and generally not difficult to obtain. The Company validates quarterly, on a sample basis, prices supplied by the independent pricing service by comparison to prices obtained from other third party sources.

### **Acquisition**

On November 1, 2010, an agreement and plan of merger with Sam Houston Financial Corp., the parent company of The First State Bank, Huntsville, Texas, was completed. Pursuant to the agreement, we paid \$22.0 million in cash and our common stock, for all of the outstanding shares of Sam Houston Financial Corp.

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At closing, Sam Houston Financial Corp. was merged into First Financial Bankshares of Delaware, Inc. and The First State Bank became a wholly owned bank subsidiary. The total purchase price exceeded estimated fair value of tangible net assets acquired by approximately \$10.0 million, of which approximately \$228 thousand was assigned to an identifiable intangible asset with the balance recorded by the Company as goodwill. The identifiable intangible asset represents the future benefit associated with the acquisition of the core deposits and is being amortized over seven years, utilizing a method that approximates the expected attrition of the deposits.

The primary purpose of the acquisition was to expand the Company's market share along Interstate Highway 45 in Central Texas. Factors that contributed to a purchase price resulting in goodwill include Huntsville's historic record of earnings and its geographic location. The results of operations from this acquisition are included in the consolidated earnings of the Company commencing November 1, 2010.

### **Stock Split**

On April 26, 2011, the Company's Board of Directors declared a three-for-two stock split in the form of a 50% stock dividend effective for shareholders of record on May 16, 2011 that was distributed on June 1, 2011. 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, 2011.

### **Results of Operations**

*Performance Summary.* Net earnings for 2011 were \$68.4 million, an increase of \$8.7 million, or 14.6%, over net earnings for 2010 of \$59.7 million. Net earnings for 2009 were \$53.8 million. The increases in net earnings for 2011 over 2010 and 2010 over 2009 were primarily attributable to growth in net interest income.

Net earnings for 2010 included income from an extraordinary item totaling \$1.3 million, after related income taxes, related to the expropriation of a portion of our real property. The Texas Department of Transportation (TXDOT) expropriated a portion of real property at our Southlake bank location to expand highway access. TXDOT paid \$2.2 million for land and damages to our existing property resulting in a net gain of \$2.0 million before income taxes. As a result, our current location's accessibility significantly deteriorated and we constructed a new bank location in Southlake and sold the existing location.

On a basic net earnings per share basis, net earnings were \$2.17 for 2011 as compared to \$1.91 for 2010 and \$1.72 for 2009. Basic earnings per share before the extraordinary item were \$2.17 for 2011 as compared to \$1.87 for 2010 and \$1.72 for 2009. The return on average assets was 1.78% for 2011 as compared to 1.75% for 2010 and 1.72% for 2009. The return on average equity was 14.44% for 2011 as compared to 13.74% for 2010 and 13.63% for 2009. All the 2010 amounts include the extraordinary item.

*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 \$164.8 million in 2011 as compared to \$147.1 million in 2010 and \$139.0 million in 2009. The increase in 2011 compared to 2010 was largely attributable to an increase in the volume of earning assets. Average earning assets were \$3.572 billion in 2011, as compared to \$3.141 billion in 2010 and \$2.895 billion in 2009. Average earning assets increased \$430.9 million in 2011 with increases in all categories of earning assets, except for short-term investments. The yield on earning assets decreased 27 basis points in 2011, whereas the rate paid on interest-bearing liabilities decreased 30 basis points. The increase in 2010 compared to 2009 also resulted from an increase in the volume of earnings assets and from the decrease in the rates paid on interest bearing liabilities. The 2010 increase in average earning assets was attributable primarily to an increase in tax-exempt investment securities. Table 1 allocates the change in tax-equivalent net interest income between the amount of change attributable to volume and to rate.

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

|                                      | 2011 Compared to 2010            |            |                 | 2010 Compared to 2009            |          |                 |
|--------------------------------------|----------------------------------|------------|-----------------|----------------------------------|----------|-----------------|
|                                      | Change Attributable to<br>Volume | Rate       | Total<br>Change | Change Attributable to<br>Volume | Rate     | Total<br>Change |
| Short-term investments               | \$ (76)                          | \$ (245)   | \$ (321)        | \$ 680                           | \$ 447   | \$ 1,127        |
| Taxable investment securities (1)    | 6,680                            | (5,186)    | 1,494           | 2,394                            | (3,282)  | (888)           |
| Tax-exempt investment securities (2) | 5,805                            | (835)      | 4,970           | 2,707                            | (653)    | 2,054           |
| Loans (2)                            | 10,439                           | (4,309)    | 6,130           | 2,988                            | (960)    | 2,028           |
| Interest income                      | 22,848                           | (10,575)   | 12,273          | 8,769                            | (4,448)  | 4,321           |
| Interest-bearing deposits            | 1,467                            | (6,716)    | (5,249)         | 1,800                            | (5,203)  | (3,403)         |
| Short-term borrowings                | 63                               | (318)      | (255)           | (47)                             | (296)    | (343)           |
| Interest expense                     | 1,530                            | (7,034)    | (5,504)         | 1,753                            | (5,499)  | (3,746)         |
| Net interest income                  | \$ 21,318                        | \$ (3,541) | \$ 17,777       | \$ 7,016                         | \$ 1,051 | \$ 8,067        |

(1) Trading securities are included in taxable investment securities.

(2) Computed on a tax-equivalent basis assuming a marginal tax rate of 35%.

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 2009 through 2011. The net interest margin in 2011 was 4.62%, a decrease of 6 basis points from 2010 and a decrease of 18 basis points from 2009. The decrease in our net interest margin in 2011 was largely the result of the extended period of historically low levels of short-term interest rates. The Federal funds rates remained at zero to 0.25% during 2009 to 2011. 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. We expect interest rates to remain at the current low levels until 2014 as recently announced by the Federal Reserve which will place pressure on our interest margin.

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

|   | Average<br>Balance  | 2011<br>Income/<br>Expense | Yield/<br>Rate | Average<br>Balance  | 2010<br>Income/<br>Expense | Yield/<br>Rate | Average<br>Balance  | 2009<br>Income/<br>Expense | Yield/<br>Rate |
|---|---------------------|----------------------------|----------------|---------------------|----------------------------|----------------|---------------------|----------------------------|----------------|
| <b>Assets</b>                                     |                     |                            |                |                     |                            |                |                     |                            |                |
| Short-term investments                            | \$ 181,068          | \$ 1,221                   | 0.69%          | \$ 189,041          | \$ 1,541                   | 0.82%          | \$ 91,755           | \$ 415                     | 0.45%          |
| Taxable investment securities (1)(2)              | 1,102,356           | 37,721                     | 3.42           | 930,731             | 36,227                     | 3.89           | 874,330             | 37,115                     | 4.24           |
| Tax-exempt investment securities (2)(3)           | 572,895             | 33,975                     | 5.93           | 477,357             | 29,005                     | 6.08           | 433,780             | 26,950                     | 6.21           |
| Loans (3)(4)                                      | 1,715,266           | 99,955                     | 5.83           | 1,543,537           | 93,825                     | 6.08           | 1,494,876           | 91,797                     | 6.14           |
| <b>Total earning assets</b>                       | <b>3,571,585</b>    | <b>172,872</b>             | <b>4.84</b>    | <b>3,140,666</b>    | <b>160,598</b>             | <b>5.11</b>    | <b>2,894,741</b>    | <b>156,277</b>             | <b>5.40</b>    |
| Cash and due from banks                           | 113,423             |                            |                | 107,791             |                            |                | 88,651              |                            |                |
| Bank premises and equipment, net                  | 72,381              |                            |                | 66,714              |                            |                | 64,541              |                            |                |
| Other assets                                      | 51,870              |                            |                | 52,965              |                            |                | 37,774              |                            |                |
| Goodwill and other intangible assets, net         | 72,312              |                            |                | 63,691              |                            |                | 63,567              |                            |                |
| Allowance for loan losses                         | (33,244)            |                            |                | (29,553)            |                            |                | (23,722)            |                            |                |
| <b>Total assets</b>                               | <b>\$ 3,848,327</b> |                            |                | <b>\$ 3,402,274</b> |                            |                | <b>\$ 3,125,552</b> |                            |                |
| <b>Liabilities and Shareholders' Equity</b>       |                     |                            |                |                     |                            |                |                     |                            |                |
| Interest-bearing deposits                         | 2,165,750           | 7,822                      | 0.36%          | \$ 1,947,120        | \$ 13,071                  | 0.67%          | \$ 1,755,275        | \$ 16,474                  | 0.94%          |
| Short-term borrowings                             | 196,230             | 202                        | 0.10           | 172,536             | 457                        | 0.26           | 183,228             | 800                        | 0.44           |
| <b>Total interest-bearing liabilities</b>         | <b>\$ 2,361,980</b> | <b>8,024</b>               | <b>0.34</b>    | <b>\$ 2,119,656</b> | <b>\$ 13,528</b>           | <b>0.64</b>    | <b>1,938,503</b>    | <b>17,274</b>              | <b>0.89</b>    |
| Noninterest-bearing deposits                      | 973,588             |                            |                | 811,464             |                            |                | 758,112             |                            |                |
| Other liabilities                                 | 39,354              |                            |                | 37,002              |                            |                | 34,125              |                            |                |
| <b>Total liabilities</b>                          | <b>3,374,922</b>    |                            |                | <b>2,968,122</b>    |                            |                | <b>2,730,740</b>    |                            |                |
| Shareholders' equity                              | 473,405             |                            |                | 434,152             |                            |                | 394,812             |                            |                |
| <b>Total liabilities and shareholders' equity</b> | <b>\$ 3,848,327</b> |                            |                | <b>\$ 3,402,274</b> |                            |                | <b>\$ 3,125,552</b> |                            |                |
| <b>Net interest income</b>                        |                     | <b>\$ 164,848</b>          |                |                     | <b>\$ 147,070</b>          |                |                     | <b>\$ 139,003</b>          |                |
| <b>Rate Analysis:</b>                             |                     |                            |                |                     |                            |                |                     |                            |                |
| Interest income/earning assets                    |                     |                            | 4.84%          |                     |                            | 5.11%          |                     |                            | 5.40%          |
| Interest expense/earning assets                   |                     |                            | 0.22           |                     |                            | 0.43           |                     |                            | 0.60           |
| Net yield on earning assets                       |                     |                            | 4.62%          |                     |                            | 4.68%          |                     |                            | 4.80%          |

(1) Trading securities are included in taxable investment securities.

(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 2011 was \$51.4 million, an increase of \$2.0 million, or 4.0%, as compared to 2010. Increases in certain categories of noninterest income included (1) ATM, interchange and credit card fees of \$2.3 million principally as a result of increased use of debit cards, (2) trust fees of \$1.9 million, (3) net gains on sales of assets of \$945 thousand, (4) real estate mortgage operations of \$131 thousand and (4) net gain on securities transactions of \$129 thousand. Under the Dodd-Frank Act, the Federal Reserve was



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authorized to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers. While the proposed changes relate only to banks with assets greater than \$10 billion, concern exists that the proposed regulation will also impact our Company. The increase in trust fees was primarily due to an increase in the market value of the equity investments under management over the prior year. The fair value of our trust assets, which are not reflected in our consolidated balance sheet, totaled \$2.431 billion at December 31, 2011 compared to \$2.290 billion at December 31, 2010. Included in net gains on sales of bank assets were gains totaling \$1.0 million on sales of former bank facilities in Cleburne and Southlake and a loss of \$85 thousand on the write down of a parcel of land owned by a bank subsidiary. The increases in income from real estate mortgage operations reflected a higher level of refinancing activity due to the favorable interest rate environment and additional resources devoted to expanding the Company's mortgage loan operations.

These increases in noninterest income were offset by a \$2.4 million decrease in service charges on deposit accounts, and net losses on sales of foreclosed assets of \$1.8 million over amounts recorded in 2010. The decrease in service charges on deposit accounts was primarily due to a reduction in customer use of overdraft services and changes in overdraft regulations. Beginning in the third quarter of 2010, a new rule issued by the Federal Reserve Board prohibits financial institutions from charging consumers fees for paying overdrafts on automated teller machine and debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those types of transactions. Consumers must be provided a notice that explains the financial institution's overdraft services, including the fees associated with the service, and the consumer's choices. We continue to monitor the impact of these new regulations and other related developments on our service charge revenue.

Noninterest income for 2010 was \$49.5 million, an increase of \$880 thousand, or 1.8%, as compared to 2009. The increase is primarily attributable to increases in (1) ATM, interchange and credit card fees of \$1.7 million principally as a result of increased use of debit cards, (2) trust fees of \$1.7 million, (3) the net gain on sale of foreclosed assets of \$1.0 million and (4) real estate mortgage fees of \$903 thousand. Under the Dodd-Frank Act, the Federal Reserve was authorized to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers. While the proposed changes relate only to banks with assets greater than \$10 billion, concern exists that the proposed regulation will also impact our Company. The increase in trust fees reflects higher oil and gas prices and an increase in the market value of the equity investments under management over the prior year. The fair value of our trust assets, which are not reflected in our consolidated balance sheet, totaled \$2.290 billion at December 31, 2010 compared to \$2.102 billion at December 31, 2009. The increases in real estate mortgage fees reflected a higher level of refinancing activity due to the favorable interest rate environment and additional resources devoted to expanding the Company's mortgage loan operations.

These increases in noninterest income in 2010 were partially offset by (1) a \$1.9 million decrease in service charges on deposit accounts, (2) a decrease in the net gain on investment securities transactions of \$1.5 million and (3) a decrease of \$983 thousand in the gain on sale of student loans. The decrease in service charges on deposit accounts was primarily due to a reduction in customer use of overdraft services and changes in overdraft regulations. Beginning in the third quarter of 2010, a new rule issued by the Federal Reserve Board prohibits financial institutions from charging consumers fees for paying overdrafts on automated teller machine and debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those types of transactions. Consumers must be provided a notice that explains the financial institution's overdraft services, including the fees associated with the service, and the consumer's choices. In 2009, we recorded a gain of \$983 thousand on the sale of student loans. The Company suspended its student loan origination activities in 2009 as a result of changes mandated by the Department of Education.

**Table of Contents****Table 3 Noninterest Income (in thousands):**

|   | 2011             | Increase<br>(Decrease) | 2010             | Increase<br>(Decrease) | 2009             |
|---|------------------|------------------------|------------------|------------------------|------------------|
| Trust fees  | \$ 12,671        | \$ 1,862               | \$ 10,809        | \$ 1,726               | \$ 9,083         |
| Service charges on deposit accounts               | 17,689           | (2,415)                | 20,104           | (1,852)                | 21,956           |
| ATM, interchange and credit card fees             | 13,587           | 2,311                  | 11,276           | 1,730                  | 9,546            |
| Real estate mortgage operations                   | 3,943            | 131                    | 3,812            | 903                    | 2,909            |
| Net gain on sale of available-for-sale securities | 492              | 129                    | 363              | (1,488)                | 1,851            |
| Net gain on sale of student loans                 |                  |                        |                  | (983)                  | 983              |
| Net gain (loss) on sale of foreclosed assets      | (1,315)          | (1,772)                | 457              | 1,005                  | (548)            |
| Other:  |                  |                        |                  |                        |                  |
| Check printing fees                               | 209              | (40)                   | 249              | (185)                  | 434              |
| Safe deposit rental fees                          | 453              | 5                      | 448              | 2                      | 446              |
| Exchange fees                                     | 103              | (1)                    | 104              | 13                     | 91               |
| Credit life and debt protection fees              | 246              | 51                     | 195              | (7)                    | 202              |
| Brokerage commissions                             | 226              | (47)                   | 273              | (23)                   | 296              |
| Interest on loan recoveries                       | 598              | 159                    | 439              | 146                    | 293              |
| Gain on sales of assets                           | 897              | 945                    | (48)             | (37)                   | (11)             |
| Miscellaneous income                              | 1,639            | 642                    | 997              | (70)                   | 1,067            |
| <b>Total other</b>                                | <b>4,371</b>     | <b>1,714</b>           | <b>2,657</b>     | <b>(161)</b>           | <b>2,818</b>     |
| <b>Total Noninterest Income</b>                   | <b>\$ 51,438</b> | <b>\$ 1,960</b>        | <b>\$ 49,478</b> | <b>\$ 880</b>          | <b>\$ 48,598</b> |

*Noninterest Expense.* Total noninterest expense for 2011 was \$104.6 million, an increase of \$6.4 million, or 6.5%, as compared to 2010. Noninterest expense for 2010 amounted to \$98.3 million, an increase of \$4.3 million, or 4.5%, as compared to 2009. An important measure in determining whether a banking company 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 2011 was 48.37% compared to 49.49% for 2010, and 50.11% for 2009. The 2010 ratio includes the extraordinary item.

Included in noninterest expense in 2010 were certain costs related to the acquisition of Sam Houston Financial Corp. and its wholly owned subsidiary, First Financial Bank, Huntsville, Texas (formerly The First State Bank, Huntsville, Texas). These acquisition-related costs included \$239 thousand in data processing expenses, \$151 thousand in legal fees and \$60 thousand in other related acquisition costs. The acquisition was consummated on November 1, 2010.

Salaries and employee benefits for 2011 totaled \$56.3 million, an increase of \$3.6 million, or 6.9%, as compared to 2010. The principal causes of this increase were increases in salaries and related payroll taxes and profit sharing expense. The increase in salaries and payroll taxes were largely the result of annual merit increases. Also contributing to these increases were the salaries and employee benefits expenses included in our operations beginning November 1, 2010 related to our Huntsville acquisition.

All other categories of noninterest expense for 2011 totaled \$48.4 million, an increase of \$2.8 million, or 6.0%, as compared to 2010. The increase in noninterest expense was largely the result of increases in ATM, interchange and credit card expenses of \$1.1 million, net occupancy expense of \$420 thousand, equipment expense of \$324 thousand, professional and service fees of \$393 thousand and advertising of \$522 thousand. The increase in ATM, interchange and credit card expenses was largely the result of increased use of debit cards discussed above. The increases in net occupancy and equipment expenses were partly the result of our Huntsville acquisition (discussed above). The increase in advertising expense resulted from our new marketing campaign. The increase in professional and service fees was largely the result of technology conversion and other expenses



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related to the Huntsville acquisitions and volume-related increases in expenses related to internet and mobile banking products. Partially offsetting these increases were a reduction in FDIC insurance premiums of \$1.4 million and reduction in several other categories of noninterest expense. The decrease in FDIC insurance premiums resulted from changes in the insurance assessment base and rates under the Dodd-Frank Act.

Salaries and employee benefits for 2010 totaled \$52.6 million, an increase of \$3.2 million, or 6.4%, as compared to 2009. The primary causes of this increase were an increase in profit sharing expense, overall pay increases and an increase in employee medical expenses offset by a reduction in pension expense.

All other categories of noninterest expense for 2010 totaled \$45.6 million, an increase of \$1.1 million, or 2.5%, as compared to 2009. The increase in noninterest expense was largely the result of increases in ATM expense of \$579 thousand, other real estate expense of \$529 thousand, advertising of \$341 thousand and acquisition-related expenses (discussed above). The increase in ATM expense was largely the result of increased use of debit cards discussed above. The increase in other real estate expenses was the result of a higher volume of foreclosed real estate. The increase in advertising expense reflected marketing efforts to capitalize on our being recognized in January 2010 as the best-performing bank in the nation in the \$3 billion-plus category by *Bank Director Magazine*. Partially offsetting these increases were a reduction in FDIC insurance premiums of \$893 thousand and reduction in several other categories of noninterest expense.

**Table 4 Noninterest Expense (in thousands):**

|   | 2011      | Increase<br>(Decrease) | 2010      | Increase<br>(Decrease) | 2009      |
|---|-----------|------------------------|-----------|------------------------|-----------|
| Salaries                                  | \$ 42,667 | \$ 3,119               | \$ 39,548 | \$ 887                 | \$ 38,661 |
| Medical                                   | 3,647     | (149)                  | 3,796     | 369                    | 3,427     |
| Profit sharing                            | 4,688     | 389                    | 4,299     | 1,939                  | 2,360     |
| Pension                                   | 354       | (129)                  | 483       | (255)                  | 738       |
| 401(k) match expense                      | 1,305     | 85                     | 1,220     | 42                     | 1,178     |
| Payroll taxes                             | 3,168     | 260                    | 2,908     | 100                    | 2,808     |
| Stock option expense                      | 427       | 40                     | 387       | 73                     | 314       |
| Total salaries and employee benefits      | 56,256    | 3,615                  | 52,641    | 3,155                  | 49,486    |
| Net occupancy expense                     | 6,862     | 420                    | 6,442     | 149                    | 6,293     |
| Equipment expense                         | 7,800     | 324                    | 7,476     | (267)                  | 7,743     |
| Printing, stationery and supplies         | 1,831     | 114                    | 1,717     | (175)                  | 1,892     |
| FDIC insurance premiums                   | 2,646     | (1,354)                | 4,000     | (893)                  | 4,893     |
| ATM, interchange and credit card expenses | 4,918     | 1,139                  | 3,779     | 579                    | 3,200     |
| Professional and service fees             | 3,232     | 393                    | 2,839     | 296                    | 2,543     |
| Amortization of intangible assets         | 402       | (207)                  | 609       | (242)                  | 851       |
| Other:                                    |           |                        |           |                        |           |
| Data processing fees                      | 497       | (197)                  | 694       | 274                    | 420       |
| Postage                                   | 1,381     | (53)                   | 1,434     | (55)                   | 1,489     |
| Advertising                               | 2,102     | 522                    | 1,580     | 341                    | 1,239     |
| Correspondent bank service charges        | 804       | 37                     | 767       | (265)                  | 1,032     |
| Telephone                                 | 1,485     | 113                    | 1,372     | 16                     | 1,356     |
| Public relations and business development | 1,715     | 175                    | 1,540     | 214                    | 1,326     |
| Directors fees                            | 756       | 3                      | 753       | 51                     | 702       |
| Audit and accounting fees                 | 1,346     | 169                    | 1,177     | (43)                   | 1,220     |
| Legal fees                                | 792       | (29)                   | 821       | 269                    | 552       |
| Regulatory exam fees                      | 949       | 77                     | 872       | 24                     | 848       |
| Travel                                    | 695       | 27                     | 668       | 142                    | 526       |
| Courier expense                           | 658       | 74                     | 584       | 26                     | 558       |
| Operational and other losses              | 1,064     | 28                     | 1,036     | 60                     | 976       |
| Other real estate                         | 1,045     | (72)                   | 1,117     | 529                    | 588       |
| Other miscellaneous expense               | 5,388     | 1,050                  | 4,338     | 71                     | 4,267     |

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|                           |            |          |           |          |           |
|---------------------------|------------|----------|-----------|----------|-----------|
| Total other               | 20,677     | 1,924    | 18,753    | 1,654    | 17,099    |
| Total Noninterest Expense | \$ 104,624 | \$ 6,368 | \$ 98,256 | \$ 4,256 | \$ 94,000 |

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*Income Taxes.* Income tax expense was \$23.8 million for 2011 as compared to \$20.1 million for 2010 (\$20.8 million including the extraordinary item) and \$18.6 million for 2009. Our effective tax rates on pretax income were 25.8%, 25.6% (25.8% including the extraordinary item), and 25.6%, respectively, for the years 2011, 2010 and 2009. 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 Texas state taxes.

**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 banks. Real estate loans represent loans primarily for new home construction and owner-occupied commercial real estate. The structure of loans in the real estate mortgage classification generally provides repricing intervals to minimize the interest rate risk inherent in long-term fixed rate loans. As of December 31, 2011, total loans held for investment were \$1.776 billion, an increase of \$98.7 million, as compared to December 31, 2010. As compared to year-end 2010, real estate loans increased \$61.7 million, commercial, financial and agricultural loans increased \$14.8 million, and consumer loans increased \$22.3 million. Loans averaged \$1.72 billion during 2011, an increase of \$171.7 million over the 2010 average balances.

**Table 5 Composition of Loans (in thousands):**

|  | 2011                | 2010                | December 31,<br>2009 | 2008                | 2007                |
|--|---------------------|---------------------|----------------------|---------------------|---------------------|
| Commercial, financial and agricultural | \$ 539,547          | \$ 524,757          | \$ 508,431           | \$ 485,707          | \$ 493,478          |
| Real estate construction               | 80,881              | 91,815              | 77,711               | 158,000             | 196,250             |
| Real estate mortgage                   | 943,139             | 870,551             | 752,735              | 678,788             | 626,146             |
| Consumer, net of unearned income       | 212,348             | 190,064             | 175,492              | 243,648             | 212,146             |
| <b>Total loans held for investment</b> | <b>\$ 1,775,915</b> | <b>\$ 1,677,187</b> | <b>\$ 1,514,369</b>  | <b>\$ 1,566,143</b> | <b>\$ 1,528,020</b> |

Our real estate loans represent approximately 57.7% of our loan portfolio and are comprised of (i) commercial real estate loans (30.6%), generally owner occupied, (ii) 1-4 family residence loans (39.1%), (iii) residential development and construction loans (5.3%), which includes our custom and speculation home construction loans, (iv) commercial development and construction loans (4.2%) and (v) other (20.8%).

Loans held for sale totaled \$10.6 million and \$13.2 million at December 31, 2011 and 2010, respectively, in which the carrying amounts approximate market.

**Table 6 Maturity Distribution and Interest Sensitivity of Loans at December 31, 2011 (in thousands):**

The following tables summarize maturity and repricing information for the commercial, financial, and agricultural and the real estate-construction portion of our loan portfolio as of December 31, 2011:

|   | One Year<br>or less | After One<br>Year<br>Through<br>Five Years | After Five<br>Years | Total             |
|---|---------------------|--|---------------------|-------------------|
| Commercial, financial, and agricultural | \$ 242,137          | \$ 173,735                                 | \$ 123,675          | \$ 539,547        |
| Real estate construction                | 33,824              | 28,333                                     | 18,724              | 80,881            |
|   | <b>\$ 275,961</b>   | <b>\$ 202,068</b>                          | <b>\$ 142,399</b>   | <b>\$ 620,428</b> |

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|  |                                 |
|--|---------------------------------|
|  | Maturities<br>After One<br>Year |
| Loans with fixed interest rates                  | \$ 261,791                      |
| Loans with floating or adjustable interest rates | 82,676                          |
|  | \$ 344,467                      |

*Asset Quality.* Loan portfolios of each of our subsidiary banks are subject to periodic reviews by our centralized independent loan review group as well as periodic examinations by state and federal bank regulatory agencies. Loans are placed on nonaccrual status when, in the judgment of management, the collectibility of principal or interest under the original terms becomes doubtful. Nonaccrual, past due 90 days still accruing and restructured loans plus foreclosed assets, were \$29.5 million at December 31, 2011, as compared to \$26.0 million at December 31, 2010 and \$22.1 million at December 31, 2009. As a percent of loans and foreclosed assets, these assets were 1.64% at December 31, 2011, as compared to 1.53% at December 31, 2010 and 1.46% at December 31, 2009. As a percent of total assets, these assets were 0.72% at December 31, 2011, as compared to 0.69% at December 31, 2010 and 0.67% at December 31, 2009. The higher level of these assets in 2011 was a result of the continued slower national and Texas economy. We believe the level of these assets to be manageable and are not aware of any material classified credit not properly disclosed as nonperforming at December 31, 2011. The increased dollar amount of nonperforming assets compared to a year ago is a result of ongoing weakness in real estate markets and the overall general economy.

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

|   | 2011      | 2010      | At December 31,<br>2009 | 2008      | 2007     |
|---|-----------|-----------|-------------------------|-----------|----------|
| Nonaccrual loans                                  | \$ 19,975 | \$ 15,445 | \$ 18,540               | \$ 9,893  | \$ 3,189 |
| Loans still accruing and past due 90 days or more | 96        | 2,196     | 15                      | 36        | 36       |
| Restructured loans                                |           |           |                         |           |          |
| Nonperforming loans                               | 20,071    | 17,641    | 18,555                  | 9,929     | 3,225    |
| Foreclosed assets                                 | 9,464     | 8,309     | 3,533                   | 2,602     | 1,506    |
| Total nonperforming assets                        | \$ 29,535 | \$ 25,950 | \$ 22,088               | \$ 12,531 | \$ 4,731 |
| As a % of loans and foreclosed assets             | 1.64%     | 1.53%     | 1.46%                   | 0.80%     | 0.31%    |
| As a % of total assets                            | 0.72      | 0.69      | 0.67                    | 0.39      | 0.15     |

We record interest payments received on nonaccrual loans as reductions of principal. Prior to the loans being placed on nonaccrual, we recognized interest income on the December 31, 2011 impaired loans above of approximately \$697,000 during the year ended December 31, 2011. If interest on these impaired loans had been recognized on a full accrual basis during the year ended December 31, 2011, such income would have approximated \$1,533,000.

From time to time, the Company modifies its loan agreement with customers. 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 characteristics. Modifications to loan terms may include a lower interest rate, a reduction of principal, or a longer term to maturity. To date, these troubled debt restructurings have been such that, after considering economic and business conditions and collections efforts, the collection of interest is doubtful and therefore the loan has been placed on non-accrual. As a result, as of December 31, 2011, all of the Company's troubled debt restructured loans are included in the non-accrual totals.

*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



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based on our review and evaluation of the loan portfolio. For a discussion of our methodology, see **Critical Accounting Policies** **Allowance for Loan Losses** earlier in this section. The provision for loan losses was \$6.6 million for 2011 as compared to \$9.0 million for 2010 and \$11.4 million for 2009. The continued provision for loan losses in 2011 reflects the growth in loans and higher levels of nonperforming assets. As a percent of average loans, net loan charge-offs were 0.20% during 2011, 0.35% during 2010 and 0.36% during 2009. The allowance for loan losses as a percent of loans was 1.92% as of December 31, 2011, as compared to 1.84% as of December 31, 2010. Included in Tables 8 and 9 are further analysis of our allowance for loan losses.

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. The current downturn in the economy or lower employment could result in increased levels of nonaccrual, past due 90 days still accruing and restructured loans and 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 subsidiary banks.

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

|  | 2011         | 2010         | 2009         | 2008         | 2007         |
|--|--------------|--------------|--------------|--------------|--------------|
| Balance at January 1,  | \$ 31,106    | \$ 27,612    | \$ 21,529    | \$ 17,462    | \$ 16,201    |
| Charge-offs:   |              |              |              |              |              |
| Commercial, financial and agricultural   | 735          | 2,711        | 1,188        | 1,937        | 1,056        |
| Real estate  | 3,682        | 2,231        | 3,072        | 1,696        |              |
| Consumer   | 907          | 1,505        | 1,950        | 1,082        | 742          |
| Total charge-offs  | 5,324        | 6,447        | 6,210        | 4,715        | 1,798        |
| Recoveries:  |              |              |              |              |              |
| Commercial, financial and agricultural   | 643          | 290          | 190          | 342          | 341          |
| Real estate  | 874          | 238          | 122          | 133          | 5            |
| Consumer   | 390          | 451          | 562          | 350          | 376          |
| All other  |              |              |              |              | 6            |
| Total recoveries   | 1,907        | 979          | 874          | 825          | 728          |
| Net charge-offs  | 3,417        | 5,468        | 5,336        | 3,890        | 1,070        |
| Provision for loan losses  | 6,626        | 8,962        | 11,419       | 7,957        | 2,331        |
| Balance at December 31,  | \$ 34,315    | \$ 31,106    | \$ 27,612    | \$ 21,529    | \$ 17,462    |
| Loans at year-end  | \$ 1,786,544 | \$ 1,690,346 | \$ 1,514,369 | \$ 1,566,143 | \$ 1,528,020 |
| Average loans  | 1,715,266    | 1,543,537    | 1,494,876    | 1,537,027    | 1,427,922    |
| Net charge-offs/average loans  | 0.20%        | 0.35%        | 0.36%        | 0.25%        | 0.07%        |
| Allowance for loan losses/year-end loans   | 1.92         | 1.84         | 1.82         | 1.37         | 1.14         |
| Allowance for loan losses/nonaccrual, past due 90 days still accruing and restructured loans | 171.00       | 176.33       | 148.81       | 216.83       | 541.49       |

The ratio of our allowance to nonaccrual, past due 90 days still accruing and restructured loans has generally trended downward since 2007, as the economic conditions began to worsen. Although the ratio has declined substantially from prior years when net charge-offs and nonperforming asset levels were historically low, management believes the allowance for loan losses is adequate at December 31, 2011 in spite of these trends.

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

|              | 2011<br>Allocation<br>Amount | 2010<br>Allocation<br>Amount | 2009<br>Allocation<br>Amount | 2008<br>Allocation<br>Amount | 2007<br>Allocation<br>Amount |
|--------------|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Commercial   | \$ 9,664                     | \$ 7,745                     | \$ 8,840                     | \$ 7,290                     | \$ 6,393                     |
| Agricultural | 1,482                        | 2,299                        | 1,489                        | 1,397                        | 1,393                        |
| Real estate  | 21,533                       | 19,101                       | 16,378                       | 11,572                       | 8,004                        |
| Consumer     | 1,636                        | 1,961                        | 905                          | 1,270                        | 1,672                        |
| Total        | \$ 34,315                    | \$ 31,106                    | \$ 27,612                    | \$ 21,529                    | \$ 17,462                    |

**Percent of Loans in Each Category of Total Loans:**

|                                  | 2011   | 2010   | 2009   | 2008   | 2007   |
|----------------------------------|--------|--------|--------|--------|--------|
| Commercial                       | 26.37% | 26.17% | 28.73% | 26.02% | 26.52% |
| Agricultural                     | 4.02   | 4.87   | 4.84   | 4.99   | 5.78   |
| Real estate                      | 57.66  | 57.71  | 54.84  | 53.43  | 53.82  |
| Consumer, net of unearned income | 11.95  | 11.25  | 11.59  | 15.56  | 13.88  |

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 \$5.7 million as of December 31, 2011.

*Interest-Bearing Deposits in Banks.* The Company had interest-bearing deposits in banks of \$165.8 million, \$243.8 million, and \$167.3 million at December 31, 2011, 2010, and 2009, respectively. At December 31, 2011, our interest-bearing deposits in banks included \$96.6 million maintained at the Federal Reserve Bank of Dallas, \$61.2 million invested in FDIC-insured certificates of deposit at unaffiliated banks, \$5.5 million invested in money market accounts at an unaffiliated regional bank, and \$2.5 million on deposit with the Federal Home Loan Bank of Dallas. The average balance of interest-bearing deposits in banks was \$176.6 million, \$185.8 million and \$58.2 million in 2011, 2010 and 2009, respectively. The average yield on interest-bearing deposits in banks was 0.69%, 0.83% and 0.59% in 2011, 2010 and 2009, respectively. The Company increased its investment in interest-bearing deposits in banks in 2010 primarily by investing funds in (i) FDIC-insured certificate of deposits at unaffiliated banks, (ii) money market account at an unaffiliated bank and (iii) the Federal Reserve Bank of Dallas for better interest rates and less interest rate risk. The continued high level in our interest-bearing deposits in banks is the result of several factors including cash flows from maturing investment securities, growth in deposits and fluctuating deposits from large depository customers.

*Trading Securities.* As of December 31, 2011 and 2010, the Company did not hold trading securities, but did hold such securities during 2009. The trading securities portfolio was a government securities money market fund comprised primarily of U.S. government agency securities and repurchase agreements collateralized by U.S. government agency securities. The trading securities were carried at estimated fair value with unrealized gains and losses included in earnings. The average balance on trading securities in 2009 was \$33.6 million and the average yield was 0.45%. The Company purchased trading securities in 2009 to improve its yield and to diversify its Federal Funds sold portfolio. However, due to significantly lower interest rates, the Company deployed these funds in other assets, with higher yields.

*Available-for-Sale and Held-to-Maturity Securities.* At December 31, 2011, securities with a fair value of \$1.841 billion were classified as securities available-for-sale and securities with an amortized cost of \$3.6 million were classified as securities held-to-maturity. As compared to December 31, 2010, the available-for-sale

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portfolio at December 31, 2011, reflected (1) a decrease of \$169 thousand in U. S. Treasury securities; (2) a decrease of \$17.9 million in obligations of U.S. government sponsored-enterprises and agencies; (3) an increase of \$154.8 million in obligations of states and political subdivisions; (4) an increase of \$70.6 million in corporate bonds and other; and (5) an increase of \$96.9 million in mortgage-backed securities. As compared to December 31, 2009, the available-for-sale portfolio at December 31, 2010, reflected (1) an increase of \$15.5 million in U. S. Treasury securities; (2) an increase of \$7.2 million in obligations of U.S. government sponsored-enterprises and agencies; (3) an increase of \$94.3 million in obligations of states and political subdivisions; (4) a decrease of \$18.1 million in corporate bonds and other; and (5) an increase of \$168.2 million in mortgage-backed securities. Securities-available-for-sale included fair value adjustments of \$83.9 million, \$40.2 million and \$55.9 million at December 31, 2011, 2010, and 2009, respectively. We did not hold any collateralized mortgage obligations or structured notes as of December 31, 2011 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, 2011 and 2010.

**Table 10 Maturities and Yields of Available-for-Sale and Held-to-Maturity Securities Held at December 31, 2011 (in thousands, except percentages):**

|  | One Year or Less |              | After One Year Through Five Years |              | Maturing After Five Years Through Ten Years |              | After Ten Years |          | Total           |              |
|--|------------------|--------------|-----------------------------------|--------------|---|--------------|-----------------|----------|-----------------|--------------|
|  | Amount           | Yield        | Amount                            | Yield        | Amount                                      | Yield        | Amount          | Yield    | Amount          | Yield        |
| <b>Held-to-Maturity:</b>                         |                  |              |                                   |              |   |              |                 |          |                 |              |
| Obligations of states and political subdivisions | \$ 2,798         | 7.75%        | \$ 389                            | 7.75%        | \$  | %            | \$              | %        | \$ 3,187        | 7.75%        |
| Mortgage-backed securities                       | 3                | 5.62         | 334                               | 2.96         | 85  | 2.13         |                 |          | 422             | 3.24         |
| <b>Total</b>                                     | <b>\$ 2,801</b>  | <b>7.74%</b> | <b>\$ 723</b>                     | <b>4.86%</b> | <b>\$ 85</b>                                | <b>2.13%</b> | <b>\$</b>       | <b>%</b> | <b>\$ 3,609</b> | <b>7.22%</b> |

|   | One Year or Less  |              | After One Year Through Five Years |              | Maturing After Five Years Through Ten Years |              | After Ten Years  |              | Total               |              |
|---|-------------------|--------------|-----------------------------------|--------------|---|--------------|------------------|--------------|---------------------|--------------|
|   | Amount            | Yield        | Amount                            | Yield        | Amount                                      | Yield        | Amount           | Yield        | Amount              | Yield        |
| <b>Available-for-Sale:</b>  |                   |              |                                   |              |   |              |                  |              |                     |              |
| U. S. Treasury securities   | \$ 9,066          | 1.29%        | \$ 6,281                          | 1.76%        | \$  | %            | \$               | %            | \$ 15,347           | 1.48%        |
| Obligations of U.S. government sponsored-enterprises and agencies | 92,541            | 3.01         | 162,906                           | 2.22         | 5,899                                       | 1.51         |                  |              | 261,346             | 2.48         |
| Obligations of states and political subdivisions                  | 33,650            | 5.69         | 212,028                           | 5.24         | 430,012                                     | 6.25         | 28,981           | 7.32         | 704,671             | 5.94         |
| Corporate bonds and other securities                              | 15,575            | 3.79         | 62,955                            | 2.93         | 52,944                                      | 3.02         |                  |              | 131,474             | 3.17         |
| Mortgage-backed securities  | 46,948            | 5.37         | 524,370                           | 3.25         | 157,200                                     | 3.30         | 33               | 1.63         | 728,551             | 3.39         |
| <b>Total</b>  | <b>\$ 197,780</b> | <b>4.07%</b> | <b>\$ 968,540</b>                 | <b>3.99%</b> | <b>\$ 646,055</b>                           | <b>5.21%</b> | <b>\$ 29,014</b> | <b>7.31%</b> | <b>\$ 1,841,389</b> | <b>4.18%</b> |



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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, 2011, the investment portfolio had an overall tax equivalent yield of 4.18%, a weighted average life of 4.01 years and modified duration of 3.53 years.

*Deposits.* Deposits held by subsidiary banks represent our primary source of funding. Total deposits were \$3.335 billion as of December 31, 2011, as compared to \$3.113 billion as of December 31, 2010 and \$2.685 billion as of December 31, 2009. 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):**

|                                    | 2011            |              | 2010            |              | 2009            |              |
|------------------------------------|-----------------|--------------|-----------------|--------------|-----------------|--------------|
|                                    | Average Balance | Average Rate | Average Balance | Average Rate | Average Balance | Average Rate |
| Noninterest-bearing deposits       | \$ 973,588      |              | \$ 811,464      |              | \$ 758,112      |              |
| Interest-bearing deposits          |                 |              |                 |              |                 |              |
| Interest-bearing checking          | 801,816         | 0.13%        | 679,816         | 0.25%        | 604,731         | 0.33%        |
| Savings and money market accounts  | 577,519         | 0.16         | 470,925         | 0.28         | 443,509         | 0.43         |
| Time deposits under \$100,000      | 352,865         | 0.70         | 348,464         | 1.25         | 360,364         | 1.69         |
| Time deposits of \$100,000 or more | 433,550         | 0.78         | 447,915         | 1.26         | 346,671         | 1.86         |
| Total interest-bearing deposits    | 2,165,750       | 0.36%        | 1,947,120       | 0.67%        | 1,755,275       | 0.94%        |
| Total average deposits             | \$ 3,139,338    |              | \$ 2,758,584    |              | \$ 2,513,387    |              |

|  | As of December 31,<br>2011 |
|--|----------------------------|
| Three months or less                     | \$ 159,949                 |
| Over three through six months            | 115,099                    |
| Over six through twelve months           | 126,009                    |
| Over twelve months                       | 32,756                     |
| Total time deposits of \$100,000 or more | \$ 433,813                 |

*Short-Term Borrowings.* Included in short-term borrowings were federal funds purchased and securities sold under repurchase agreements of \$207.8 million, \$178.4 million and \$146.1 million at December 31, 2011, 2010, and 2009, respectively. Securities sold under repurchase agreements are generally with significant customers of the Company that require short-term liquidity for their funds. The average balances of federal funds purchased and securities sold under repurchase agreements were \$196.2 million, \$172.5 million and \$183.2 million in 2011, 2010 and 2009 respectively. The average rates paid on federal funds purchased and securities sold under repurchase agreements were 0.10%, 0.26% and 0.44% in 2011, 2010 and 2009, respectively. The weighted average rate on federal funds purchased and securities sold under repurchase agreements was 0.10%, 0.10% and 0.40% at December 31, 2011, 2010 and 2009, respectively. The highest amount of federal funds purchased and securities sold under repurchase agreements at any month end during 2011, 2010 and 2009 was \$215.8 million, \$244.7 million and \$244.2 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.



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Total shareholders' equity was \$508.5 million, or 12.34% of total assets, at December 31, 2011, as compared to \$441.7 million, or 11.7% of total assets, at December 31, 2010. During 2011, total shareholders' equity averaged \$473.4 million, or 12.30% of average assets, as compared to \$434.1 million, or 12.8% of average assets, during 2010 and \$394.8 million, or 12.6% of average assets, during 2009.

Banking regulators measure capital adequacy by means of the risk-based capital ratios and leverage ratio. The risk-based capital rules provide for the weighting of assets and off-balance-sheet commitments and contingencies according to prescribed risk categories ranging from 0% to 100%. 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. Regulatory minimums for total risk-based, Tier 1 risk-based and leverage ratios are 8.00%, 4.00% and 3.00%, respectively. As of December 31, 2011, our total risk-based, Tier 1 risk-based and leverage capital ratios were 18.74%, 17.49% and 10.33%, respectively, as compared to total risk-based, Tier 1 risk-based and leverage capital ratios of 18.26%, 17.01% and 10.28% as of December 31, 2010. We believe by all measurements our capital ratios remain well above regulatory minimums.

*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.

Each of our subsidiary banks has an asset liability management committee that monitors interest rate risk and compliance with investment policies; there is also a holding company-wide committee that monitors the aggregate company's interest rate risk and compliance with investment policies. The Company and each subsidiary bank utilize 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 12 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 12 months. These simulations incorporate assumptions regarding balance sheet growth and mix, pricing and the repricing and maturity characteristics of the existing and projected balance sheet.

As of December 31, 2011, the model simulations projected that 100 and 200 basis point increases in interest rates would result in positive variances in net interest income of 0.53% and 1.05%, respectively, relative to the base case over the next 12 months, while decreases in interest rates of 50 basis points would result in a negative variance in a net interest income of 2.35% relative to the base case over the next 12 months. The likelihood of a decrease in interest rates beyond 50 basis points as of December 31, 2011 is considered remote given current interest rate levels. Our model simulations also indicated that if interest rates remain unchanged, our net interest income for 2012 would decrease by 1.99% compared to 2011. Such a decrease would be largely attributable reinvesting proceeds from investment security maturities and pay downs at current market interest rates. 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 of 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 reprice 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.

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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 committees oversee and monitor 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 banks. Other sources of funds include our ability to borrow from short-term sources, such as purchasing federal funds from correspondents and sales of securities under agreements to repurchase, which amounted to \$207.8 million at December 31, 2011, and an unfunded \$25.0 million line of credit established with The Frost National Bank, a nonaffiliated bank which matures on June 30, 2013. First Financial Bank, N. A., Abilene also has federal funds purchased lines of credit with two non-affiliated banks totaling \$80.0 million. Six of our subsidiary banks have available lines of credit with the Federal Home Loan Bank of Dallas totaling \$217.2 million secured by portions of their loan portfolios and certain investment securities. At December 31, 2011, \$69.4 million in letters of credit issued by the Federal Home Loan Bank of Dallas were outstanding under these lines of credit. These letters of credit were pledged as collateral for public funds held by subsidiary banks.

The Company renewed its loan agreement, effective June 30, 2011, with The Frost National Bank. Under the loan agreement, as renewed and amended, the Company is permitted to draw up to \$25.0 million on a revolving line of credit. Prior to June 30, 2013, interest is paid quarterly at the Wall Street Journal Prime Rate and the line of credit matures June 30, 2013. If a balance exists at June 30, 2013, the principal balance converts to a term facility payable quarterly over five years and interest is paid quarterly at the election of the Company 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, the Company must satisfy certain financial covenants during the term of the loan agreement, including, without limitation, covenants that require the Company to maintain certain capital, tangible net worth, loan loss reserve, non-performing asset and cash flow coverage ratio. 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 consolidated net income in a range of 37% (low) in 1995 to 53% (high) in 2003 and 2006. Management believes the Company was in compliance with the financial and operational covenants at December 31, 2011. There was no outstanding balance under the line of credit as of December 31, 2011 or 2010.

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

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 \$52.1 million at December 31, 2011, available dividends from subsidiary banks which totaled \$59.8 million at December 31, 2011, utilization of available lines of credit, and future debt

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or equity offerings are expected to be the source of funding for these potential acquisitions or expansions. Existing cash resources at our subsidiary banks may also be used as a source of funding for these potential acquisitions or expansions.

**Table 12 Contractual Obligations as of December 31, 2011 (in thousands):**

|                                      | Total Amounts     | Payment Due by Period |                  |                  | Over 5 years    |
|--------------------------------------|-------------------|-----------------------|------------------|------------------|-----------------|
|                                      |                   | Less than 1 year      | 2 - 3 years      | 4 - 5 years      |                 |
| Deposits with stated maturity dates  | \$ 752,298        | \$ 680,500            | \$ 61,087        | \$ 10,702        | \$ 9            |
| Pension obligation                   | 15,867            | 1,310                 | 2,837            | 3,021            | 8,699           |
| Operating leases                     | 2,700             | 714                   | 1,058            | 741              | 187             |
| Outsourcing service contracts        | 918               | 918                   |                  |                  |                 |
| <b>Total Contractual Obligations</b> | <b>\$ 771,783</b> | <b>\$ 683,442</b>     | <b>\$ 64,982</b> | <b>\$ 14,464</b> | <b>\$ 8,895</b> |

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 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 our 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.

**Table 13 Commitments as of December 31, 2011 (in thousands):**

|                                       | Total Notional Amounts Committed | Payment Due by Period |                  |                 | Over 5 years     |
|---------------------------------------|----------------------------------|-----------------------|------------------|-----------------|------------------|
|                                       |                                  | Less than 1 year      | 2 - 3 years      | 4 - 5 years     |                  |
| Unfunded lines of credit              | \$ 449,100                       | \$ 439,309            | \$ 2,845         | \$ 1,444        | \$ 5,502         |
| Unfunded commitments to extend credit | 67,115                           | 29,423                | 4,179            | 2,361           | 31,152           |
| Standby letters of credit             | 20,533                           | 16,776                | 3,757            |                 |                  |
| <b>Total Commercial Commitments</b>   | <b>\$ 536,748</b>                | <b>\$ 485,508</b>     | <b>\$ 10,781</b> | <b>\$ 3,805</b> | <b>\$ 36,654</b> |

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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 subsidiary banks. 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 subsidiary banks. At December 31, 2011, approximately \$59.8 million was available for the payment of intercompany dividends by the subsidiaries without the prior approval of regulatory agencies. Our subsidiaries paid aggregate dividends of \$47.4 million in 2011 and \$41.1 million in 2010.

*Dividends.* Our long-term dividend policy is to pay cash dividends to our shareholders of between 40% and 55% 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 The Frost National Bank to dividend no greater than 55% of net income, as defined in such loan agreement. The cash dividend payout ratios have amounted to 43.6%, 47.6% and 52.6% of net earnings, respectively, in 2011, 2010 and 2009. Given our current capital position and projected earnings and asset growth rates, we do not anticipate any significant change in our current dividend policy.

Our two state bank subsidiaries, which are members of the Federal Reserve System, and each national banking association are required by federal law to obtain the prior approval of the Federal Reserve Board and the OCC, respectively, 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).

To pay dividends, we and our subsidiary banks 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 Board, 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 Board, 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**

Our management considers interest rate risk to be a significant market risk for us. 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 begin on page F-1.

**Table of Contents****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 fiscal 2011 and 2010. 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.

|   | 2011   |                 |                 |                 |
|---|--|-----------------|-----------------|-----------------|
|   | 4 <sup>th</sup>                                  | 3 <sup>rd</sup> | 2 <sup>nd</sup> | 1 <sup>st</sup> |
|   | (dollars in thousands, except per share amounts) |                 |                 |                 |
| <b>Summary Income Statement Information:</b>        |  |                 |                 |                 |
| Interest income                                     | \$ 39,888  | \$ 40,164       | \$ 40,241       | \$ 39,727       |
| Interest expense                                    | 1,704  | 1,854           | 2,065           | 2,400           |
| Net interest income                                 | 38,184   | 38,310          | 38,176          | 37,327          |
| Provision for loan losses                           | 1,221  | 1,354           | 1,924           | 2,127           |
| Net interest income after provision for loan losses | 36,963   | 36,956          | 36,252          | 35,200          |
| Noninterest income                                  | 12,628   | 13,844          | 11,852          | 12,623          |
| Net gain on securities transactions                 | 164  | 67              | 42              | 219             |
| Noninterest expense                                 | 26,257   | 26,320          | 25,888          | 26,161          |
| Earnings before income taxes                        | 23,498   | 24,547          | 22,258          | 21,881          |
| Income tax expense                                  | 6,032  | 6,460           | 5,738           | 5,586           |
| Net earnings  | \$ 17,466  | \$ 18,087       | \$ 16,520       | \$ 16,295       |
| <b>Per Share Data:</b>                              |  |                 |                 |                 |
| Earnings per share, basic                           | \$ 0.56  | \$ 0.58         | \$ 0.53         | \$ 0.52         |
| Earnings per share, assuming dilution               | 0.55   | 0.57            | 0.52            | 0.52            |
| Cash dividends declared                             | 0.24   | 0.24            | 0.24            | 0.23            |
| Book value at period-end                            | 16.16  | 15.87           | 15.19           | 14.51           |
| <b>Common stock sales price:</b>                    |  |                 |                 |                 |
| High  | \$ 34.19   | \$ 34.90        | \$ 37.16        | \$ 35.55        |
| Low   | 25.01  | 24.56           | 32.16           | 32.00           |
| Close   | 33.43  | 26.16           | 34.45           | 34.25           |

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|   | 2010      |           |           |           |
|---|-----------|-----------|-----------|-----------|
|   | 4th       | 3rd       | 2nd       | 1st       |
| <b>Summary Income Statement Information:</b>                    |           |           |           |           |
| Interest income   | \$ 39,041 | \$ 37,259 | \$ 37,054 | \$ 36,345 |
| Interest expense  | 2,887     | 3,345     | 3,596     | 3,699     |
| Net interest income   | 36,154    | 33,914    | 33,458    | 32,646    |
| Provision for loan losses                                       | 1,992     | 1,988     | 2,973     | 2,010     |
| Net interest income after provision for loan losses             | 34,162    | 31,926    | 30,485    | 30,636    |
| Noninterest income  | 12,586    | 12,919    | 12,498    | 11,109    |
| Net gain on securities transactions                             | 284       | 7         | 72        | 1         |
| Noninterest expense   | 26,261    | 24,706    | 23,951    | 23,338    |
| Earnings before income taxes and extraordinary item             | 20,771    | 20,146    | 19,104    | 18,408    |
| Income tax expense  | 5,256     | 5,213     | 4,906     | 4,691     |
| Net earnings before extraordinary item                          | 15,515    | 14,933    | 14,198    | 13,717    |
| Extraordinary item  |           | 1,296     |           |           |
|   | \$ 15,515 | \$ 16,229 | \$ 14,198 | \$ 13,717 |
| <b>Per Share Data:</b>  |           |           |           |           |
| Earnings per share, basic before extraordinary item             | \$ 0.49   | \$ 0.48   | \$ 0.45   | \$ 0.44   |
| Earnings per share, assuming dilution before extraordinary item | 0.49      | 0.48      | 0.45      | 0.44      |
| Earnings per share, basic                                       | 0.49      | 0.52      | 0.45      | 0.44      |
| Earnings per share, assuming dilution                           | 0.49      | 0.52      | 0.45      | 0.44      |
| Cash dividends declared   | 0.23      | 0.23      | 0.23      | 0.23      |
| Book value at period-end  | 14.06     | 14.42     | 13.78     | 13.55     |
| <b>Common stock sales price:</b>                                |           |           |           |           |
| High  | \$ 35.31  | \$ 33.89  | \$ 36.63  | \$ 36.68  |
| Low   | 30.67     | 29.03     | 32.06     | 33.34     |
| Close   | 34.17     | 31.33     | 32.06     | 34.37     |

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**  
None.

**ITEM 9A. CONTROLS AND PROCEDURES**

As of December 31, 2011, 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 pursuant to Securities Exchange Act Rule 15d-15. Our management, including the principal executive officer and 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.



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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 under Rule 13a-14(c) and Rule 15d-14(c) of the Securities Exchange Act of 1934 are effective at the reasonable assurance level as of December 31, 2011.

Subsequent to our evaluation, there were no significant changes in internal controls over financial reporting or other factors that have materially affected, or is reasonably likely to materially affect, these internal controls.

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**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, 2011. 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 (COSO) in *Internal Control - Integrated Framework*. Based on our assessment we believe that, as of December 31, 2011, the Company's internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f), is effective based on those criteria.

First Financial Bankshares, Inc. and subsidiaries' independent auditors have issued an audit report, dated February 22, 2012, on the effectiveness of the Company's internal control over financial reporting as of December 31, 2011.

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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 First Financial Bankshares, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (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, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2011 consolidated financial statements of First Financial Bankshares, Inc. and subsidiaries and our report dated February 22, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas

February 22, 2012

**Table of Contents****ITEM 9B. OTHER INFORMATION**

None.

**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 2012 annual meeting of shareholders.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by Item 11 is hereby incorporated by reference from our proxy statement for our 2012 annual meeting of shareholders.

**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 2012 annual meeting of shareholders. The following chart gives aggregate information under our equity compensation plans as of December 31, 2011.

|  | Number of Securities<br>To be Issued<br>Upon<br>Exercise of<br>Outstanding Options,<br>Warrants and<br>Rights | Weighted Average<br>Exercise Price<br>of<br>Outstanding Options,<br>Warrants and<br>Rights | Number of Securities<br>Remaining<br>Available<br>For Future<br>Issuance<br>Under Equity<br>Compensation<br>Plans<br>(Excluding Securities<br>Reflected in<br>Far Left<br>Column) |
|--|---|--|---|
| Equity compensation plans approved by security holders     | 481,024   | \$ 29.11   | 605,905   |
| Equity compensation plans not approved by security holders |   |  |   |
| <b>Total</b>   | <b>481,024</b>  | <b>\$ 29.11</b>  | <b>605,905</b>  |

The remainder of the information required by Item 12 is incorporated by reference from our proxy statement for our 2012 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 2012 annual meeting of shareholders.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by Item 14 is hereby incorporated by reference from our proxy statement for our 2012 annual meeting of shareholders.

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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, 2011 and 2010

Consolidated Statements of Earnings for the years ended December 31, 2011, 2010 and 2009

Consolidated Statements of Comprehensive Earnings for the years ended December 31, 2011, 2010 and 2009

Consolidated Statements of Shareholders' Equity for the years ended December 31, 2011, 2010 and 2009

Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009

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.

**Table of Contents****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 22, 2012

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     |  | February 22,<br>2012 |
| F. Scott Dueser         | Chairman of the Board, Director,<br>President, and Chief Executive Officer<br>(Principal Executive Officer)                  |                      |
| /s/ J. BRUCE HILDEBRAND |  | February 22,<br>2012 |
| J. Bruce Hildebrand     | Executive Vice President and Chief<br>Financial Officer<br>(Principal Financial Officer and Principal<br>Accounting Officer) |                      |
| /s/ STEVEN L. BEAL      |  | February 22,<br>2012 |
| Steven L. Beal          | Director   |                      |
| /s/ TUCKER S. BRIDWELL  |  | February 22,<br>2012 |
| Tucker S. Bridwell      | Director   |                      |
| /s/ JOSEPH E. CANON     |  | February 22,<br>2012 |
| Joseph E. Canon         | Director   |                      |
| /s/ DAVID COPELAND      |  | February 22,<br>2012 |
| David Copeland          | Director   |                      |





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| <b>Name</b>                              | <b>Title</b> | <b>Date</b>          |
|--|--------------|----------------------|
| /s/MURRAY EDWARDS<br>Murray Edwards      | Director     | February 22,<br>2012 |
| /s/RONALD GIDDIENS<br>Ronald Giddiens    | Director     | February 22,<br>2012 |
| /s/ KADE L. MATTHEWS<br>Kade L. Matthews | Director     | February 22,<br>2012 |
| /s/ DIAN GRAVES STAI<br>Dian Graves Stai | Director     | February 22,<br>2012 |
| /s/ JOHNNY TROTTER<br>Johnny Trotter     | Director     | February 22,<br>2012 |

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Exhibits Index

The following exhibits are filed as part of this report:

- 3.1 Amended and Restated Certificate of Formation (incorporated by reference from Exhibit 3.1 of the Registrant's Form 10-Q Quarterly Report filed May 4, 2011).
- 3.2 Amended and Restated Bylaws, and all amendments thereto, of the Registrant (incorporated by reference from Exhibit 3.2 of the Registrant's Form 8-K Annual Report 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 Executive Recognition Plan (incorporated by reference from Exhibit 10.1 of the Registrant's Form 8-K Report filed July 1, 2010).
- 10.2 1992 Incentive Stock Option Plan (incorporated by reference from Exhibit 10.2 of the Registrant's Form 10-Q Quarterly Report filed May 4, 2010).
- 10.3 2002 Incentive Stock Option Plan (incorporated by reference from Exhibit 10.3 of Registrant's Form 10-Q Quarterly Report filed May 4, 2010).
- 10.4 Loan agreement dated December 31, 2004, between First Financial Bankshares, Inc. and The Frost National Bank (incorporated by reference from Exhibit 10.4 of the Registrant's Form 10-Q Quarterly Report filed May 4, 2010).
- 10.5 First Amendment to Loan Agreement, dated December 28, 2005, between First Financial Bankshares, Inc. and The Frost National Bank (incorporated by reference from Exhibit 10.2 of the Registrant's Form 10-Q Quarterly Report filed August 2, 2011).
- 10.6 Second Amendment to Loan Agreement, dated December 31, 2006, between First Financial Bankshares, Inc. and The Frost National Bank (incorporated by reference from Exhibit 10.3 of the Registrant's Form 8-K filed January 3, 2007).
- 10.7 Third Amendment to Loan Agreement, dated December 31, 2007, between First Financial Bankshares, Inc. and The Frost National Bank (incorporated by reference from Exhibit 10.4 of the Registrant's Form 8-K filed January 2, 2008).
- 10.8 Fourth Amendment to Loan Agreement, dated July 24, 2008, between First Financial Bankshares, Inc. and The Frost National Bank (incorporated by reference from Exhibit 10.10 of the Registrant's Form 10-Q Quarterly Report filed July 25, 2008).
- 10.9 Fifth Amendment to Loan Agreement, dated December 19, 2008, between First Financial Bankshares, Inc. and The Frost National Bank (incorporated by reference from Exhibit 10.6 of the Registrant's Form 8-K filed December 23, 2008).
- 10.10 Sixth Amendment to Loan Agreement, dated June 16, 2009, between First Financial Bankshares, Inc. and The Frost National Bank (incorporated by reference from Exhibit 10-7 of the Registrant's Form 8-K filed June 30, 2009).
- 10.11 Seventh Amendment to Loan Agreement, dated December 30, 2009, between First Financial Bankshares, Inc. and The Frost National Bank (incorporated by reference from Exhibit 10.8 of the Registrant's Form 8-K filed December 31, 2009).
- 10.12 Eighth Amendment to Loan Agreement, dated June 30, 2011, between First Financial Bankshares, Inc. and The Frost National Bank (incorporated by reference from Exhibit 10.9 of the Registrant's Form 8-K filed June 30, 2011).

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|         |  |
|---------|--|
| 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

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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, 2011 and 2010, 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, 2011. 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, 2011 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, 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, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 22, 2012, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas

February 22, 2012

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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

December 31, 2011 and 2010

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

|  | 2011         | 2010         |
|--|--------------|--------------|
| <b>ASSETS</b>  |              |              |
| CASH AND DUE FROM BANKS  | \$ 146,239   | \$ 124,177   |
| FEDERAL FUNDS SOLD   |              |              |
| INTEREST-BEARING DEPOSITS IN BANKS   | 104,597      | 140,090      |
| Total cash and cash equivalents  | 250,836      | 264,267      |
| INTEREST-BEARING TIME DEPOSITS IN BANKS  | 61,175       | 103,686      |
| SECURITIES AVAILABLE-FOR-SALE, at fair value   | 1,841,389    | 1,537,178    |
| SECURITIES HELD-TO-MATURITY (fair value of \$3,655 in 2011 and \$9,240 in 2010)  | 3,609        | 9,064        |
| <b>LOANS:</b>  |              |              |
| Held for investment  | 1,775,915    | 1,677,187    |
| Less allowance for loan losses   | (34,315)     | (31,106)     |
| Net loans held for investment  | 1,741,600    | 1,646,081    |
| Held for sale  | 10,629       | 13,159       |
| Net loans  | 1,752,229    | 1,659,240    |
| BANK PREMISES AND EQUIPMENT, net   | 76,483       | 70,162       |
| INTANGIBLE ASSETS  | 72,122       | 72,524       |
| OTHER ASSETS   | 62,688       | 60,246       |
| Total assets   | \$ 4,120,531 | \$ 3,776,367 |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |              |              |
| NONINTEREST-BEARING DEPOSITS   | \$ 1,101,576 | \$ 959,473   |
| INTEREST-BEARING DEPOSITS  | 2,233,222    | 2,153,828    |
| Total deposits   | 3,334,798    | 3,113,301    |
| DIVIDENDS PAYABLE  | 7,550        | 7,120        |
| SHORT-TERM BORROWINGS  | 207,756      | 178,356      |
| OTHER LIABILITIES  | 61,890       | 35,902       |
| Total liabilities  | 3,611,994    | 3,334,679    |
| <b>COMMITMENTS AND CONTINGENCIES</b>   |              |              |
| <b>SHAREHOLDERS EQUITY:</b>  |              |              |
| Common stock, \$0.01 par value; authorized 40,000,000 shares; 31,459,635 and 20,942,141 issued at December 31, 2011 and 2010, respectively | 314          | 209          |
| Capital surplus  | 276,127      | 274,629      |
| Retained earnings  | 184,871      | 146,397      |
| Treasury stock (shares at cost: 258,235 and 166,329 at December 31, 2011 and 2010, respectively)   | (4,597)      | (4,207)      |
| Deferred Compensation  | 4,597        | 4,207        |
| Accumulated other comprehensive earnings   | 47,225       | 20,453       |

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|  |              |              |
|--|--------------|--------------|
| Total shareholders' equity                 | 508,537      | 441,688      |
| Total liabilities and shareholders' equity | \$ 4,120,531 | \$ 3,776,367 |

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 Earnings

Years Ended December 31, 2011, 2010 and 2009

(Dollars in thousands, except per share amounts)

|   | 2011           | 2010           | 2009           |
|---|----------------|----------------|----------------|
| <b>INTEREST INCOME:</b>   |                |                |                |
| Interest and fees on loans  | \$ 98,767      | \$ 92,715      | \$ 90,932      |
| Interest on investment securities:                                    |                |                |                |
| Taxable   | 37,721         | 36,227         | 36,964         |
| Exempt from federal income tax  | 22,312         | 19,216         | 17,983         |
| Interest on federal funds sold and interest-bearing deposits in banks | 1,221          | 1,541          | 415            |
| Interest on trading securities  |                |                | 151            |
| <b>Total interest income</b>  | <b>160,021</b> | <b>149,699</b> | <b>146,445</b> |
| <b>INTEREST EXPENSE:</b>  |                |                |                |
| Interest on deposits  | 7,822          | 13,071         | 16,474         |
| Other   | 202            | 457            | 800            |
| <b>Total interest expense</b>   | <b>8,024</b>   | <b>13,528</b>  | <b>17,274</b>  |
| <b>Net interest income</b>  | <b>151,997</b> | <b>136,171</b> | <b>129,171</b> |
| <b>PROVISION FOR LOAN LOSSES</b>                                      | <b>6,626</b>   | <b>8,962</b>   | <b>11,419</b>  |
| <b>Net interest income after provision for loan losses</b>            | <b>145,371</b> | <b>127,209</b> | <b>117,752</b> |
| <b>NONINTEREST INCOME:</b>  |                |                |                |
| Trust fees  | 12,671         | 10,809         | 9,083          |
| Service charges on deposit accounts                                   | 17,689         | 20,104         | 21,956         |
| ATM and credit card fees  | 13,587         | 11,276         | 9,546          |
| Real estate mortgage operations                                       | 3,943          | 3,812          | 2,909          |
| Net gain on sale of available-for-sale securities                     | 492            | 363            | 1,851          |
| Net gain on sale of student loans                                     |                |                | 983            |
| Net gain (loss) on sale of foreclosed assets                          | (1,315)        | 457            | (548)          |
| Other   | 4,371          | 2,657          | 2,818          |
| <b>Total noninterest income</b>                                       | <b>51,438</b>  | <b>49,478</b>  | <b>48,598</b>  |
| <b>NONINTEREST EXPENSE:</b>   |                |                |                |
| Salaries and employee benefits  | 56,256         | 52,641         | 49,486         |
| Net occupancy expense   | 6,862          | 6,442          | 6,293          |
| Equipment expense   | 7,800          | 7,476          | 7,743          |
| FDIC insurance premiums   | 2,646          | 4,000          | 4,893          |
| ATM, interchange and credit card expenses                             | 4,918          | 3,779          | 3,200          |
| Professional and service fees   | 3,232          | 2,839          | 2,543          |
| Printing, stationery and supplies                                     | 1,831          | 1,717          | 1,892          |
| Amortization of intangible assets                                     | 402            | 609            | 851            |
| Other expenses  | 20,677         | 18,753         | 17,099         |

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|  |                  |                  |                  |
|--|------------------|------------------|------------------|
| Total noninterest expense  | 104,624          | 98,256           | 94,000           |
| <b>EARNINGS BEFORE INCOME TAXES AND EXTRAORDINARY ITEM</b>                 | <b>92,185</b>    | <b>78,431</b>    | <b>72,350</b>    |
| INCOME TAX EXPENSE   | 23,816           | 20,068           | 18,553           |
| <b>NET EARNINGS BEFORE EXTRAORDINARY ITEM</b>                              | <b>68,369</b>    | <b>58,363</b>    | <b>53,797</b>    |
| EXTRAORDINARY ITEM EXPROPRIATION OF LAND, NET OF INCOME TAXES OF \$697     |                  | 1,296            |                  |
| <b>NET EARNINGS</b>  | <b>\$ 68,369</b> | <b>\$ 59,659</b> | <b>\$ 53,797</b> |
| NET EARNINGS PER SHARE, BASIC BEFORE EXTRAORDINARY ITEM                    | \$ 2.17          | \$ 1.87          | \$ 1.72          |
| <b>NET EARNINGS PER SHARE, ASSUMING DILUTION BEFORE EXTRAORDINARY ITEM</b> | <b>\$ 2.17</b>   | <b>\$ 1.87</b>   | <b>\$ 1.72</b>   |
| NET EARNINGS PER SHARE, BASIC  | \$ 2.17          | \$ 1.91          | \$ 1.72          |
| <b>NET EARNINGS PER SHARE, ASSUMING DILUTION</b>                           | <b>\$ 2.17</b>   | <b>\$ 1.91</b>   | <b>\$ 1.72</b>   |

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, 2011, 2010 and 2009

(Dollars in thousands)

|   | 2011      | 2010      | 2009      |
|---|-----------|-----------|-----------|
| NET EARNINGS  | \$ 68,369 | \$ 59,659 | \$ 53,797 |
| OTHER ITEMS OF COMPREHENSIVE EARNINGS:  |           |           |           |
| Change in unrealized gain (loss) on investment securities available-for-sale, before income tax                     | 44,279    | (15,332)  | 32,006    |
| Reclassification adjustment for realized gains on investment securities included in net earnings, before income tax | (492)     | (363)     | (1,851)   |
| Minimum liability pension adjustment, before income tax   | (2,599)   | (650)     | 963       |
| Total other items of comprehensive earnings   | 41,188    | (16,345)  | 31,118    |
| Income tax benefit (expense) related to:  |           |           |           |
| Investment securities   | (15,325)  | 5,493     | (10,554)  |
| Minimum liability pension adjustment  | 909       | 227       | (337)     |
|   | (14,416)  | 5,720     | (10,891)  |
| COMPREHENSIVE EARNINGS  | \$ 95,141 | \$ 49,034 | \$ 74,024 |

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, 2011, 2010 and 2009

(Dollars in thousands, except per share amounts)

|   | Common Stock |        | Capital    | Retained   | Treasury  | Deferred     | Accumulated | Total        |            |
|---|--------------|--------|------------|------------|-----------|--------------|-------------|--------------|------------|
|   | Shares       | Amount | Surplus    | Earnings   | Stock     | Compensation | Other       | Shareholders |            |
|   |              |        |            |            | Shares    | Amounts      | Earnings    | Equity       |            |
|   |              |        |            |            |           |              | (Losses)    |              |            |
| BALANCE, December 31, 2008  | 20,799,198   | \$ 208 | \$ 268,087 | \$ 89,637  | (158,811) | \$ (3,500)   | \$ 3,500    | \$ 10,850    | \$ 368,782 |
| Net earnings  |              |        |            | 53,797     |           |              |             |              | 53,797     |
| Stock option exercises  | 27,233       |        | 682        |            |           |              |             |              | 682        |
| Cash dividends declared, \$0.91 per share   |              |        |            | (28,311)   |           |              |             |              | (28,311)   |
| Minimum liability pension adjustment, net of related income taxes                                     |              |        |            |            |           |              | 626         |              | 626        |
| Change in unrealized gain on investment in securities available-for-sale, net of related income taxes |              |        |            |            |           |              | 19,601      |              | 19,601     |
| Additional tax benefit related to directors deferred compensation plan                                |              |        | 211        |            |           |              |             |              | 211        |
| Shares purchased in connection with directors' deferred compensation plan, net                        |              |        |            |            | (4,025)   | (333)        | 333         |              |            |
| Stock option expense  |              |        | 314        |            |           |              |             |              | 314        |
| BALANCE, December 31, 2009  | 20,826,431   | \$ 208 | \$ 269,294 | \$ 115,123 | (162,836) | \$ (3,833)   | \$ 3,833    | \$ 31,077    | \$ 415,702 |
| Net earnings  |              |        |            | 59,659     |           |              |             |              | 59,659     |
| Stock issued in acquisition of Sam Houston Financial Corp.  | 85,306       | 1      | 4,031      |            |           |              |             |              | 4,032      |
| Stock option exercises  | 30,404       |        | 789        |            |           |              |             |              | 789        |
| Cash dividends declared, \$0.91 per share   |              |        |            | (28,385)   |           |              |             |              | (28,385)   |
| Minimum liability pension adjustment, net of related income taxes                                     |              |        |            |            |           |              | (423)       |              | (423)      |
| Change in unrealized gain on investment in securities available-for-sale, net of related income taxes |              |        |            |            |           |              | (10,201)    |              | (10,201)   |
| Additional tax benefit related to directors deferred compensation plan                                |              |        | 128        |            |           |              |             |              | 128        |
| Shares purchased in connection with directors' deferred compensation plan, net                        |              |        |            |            | (3,493)   | (374)        | 374         |              |            |
| Stock option expense  |              |        | 387        |            |           |              |             |              | 387        |
| BALANCE, December 31, 2010  | 20,942,141   | \$ 209 | \$ 274,629 | \$ 146,397 | (166,329) | \$ (4,207)   | \$ 4,207    | \$ 20,453    | \$ 441,688 |
| Net earnings  |              |        |            | 68,369     |           |              |             |              | 68,369     |
| Stock option exercises  | 36,317       |        | 950        |            |           |              |             |              | 950        |
| Cash dividends declared, \$0.95 per share   |              |        |            | (29,790)   |           |              |             |              | (29,790)   |
| Minimum liability pension adjustment, net of related income taxes                                     |              |        |            |            |           |              | (1,690)     |              | (1,690)    |
| Change in unrealized gain on investment in securities available-for-sale, net of related income taxes |              |        |            |            |           |              | 28,462      |              | 28,462     |
| Additional tax benefit related to directors deferred compensation plan                                |              |        | 121        |            |           |              |             |              | 121        |
| Shares purchased in connection with directors' deferred compensation plan, net                        |              |        |            |            | (8,760)   | (390)        | 390         |              |            |
| Stock option expense  |              |        | 427        |            |           |              |             |              | 427        |
|   | 10,481,177   | 105    |            | (105)      | (83,146)  |              |             |              |            |

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Three-for-two stock split in the form of a  
50% stock dividend

|                            |            |        |            |            |           |            |          |           |            |
|----------------------------|------------|--------|------------|------------|-----------|------------|----------|-----------|------------|
| BALANCE, December 31, 2011 | 31,459,635 | \$ 314 | \$ 276,127 | \$ 184,871 | (258,235) | \$ (4,597) | \$ 4,597 | \$ 47,225 | \$ 508,537 |
|----------------------------|------------|--------|------------|------------|-----------|------------|----------|-----------|------------|

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, 2011, 2010 and 2009

(Dollars in Thousands)

|   | 2011             | 2010             | 2009            |
|---|------------------|------------------|-----------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                  |                  |                 |
| Net earnings  | \$ 68,369        | \$ 59,659        | \$ 53,797       |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                  |                  |                 |
| Depreciation and amortization   | 7,352            | 7,102            | 7,746           |
| Provision for loan losses   | 6,626            | 8,962            | 11,419          |
| Securities premium amortization (discount accretion), net                           | 8,251            | 4,460            | 1,636           |
| Gain on sale of assets, net   | (80)             | (2,765)          | (2,275)         |
| Deferred federal income tax expense (benefit)                                       | 2,005            | 1,089            | (221)           |
| Trading security activity, net  |                  |                  | 55,991          |
| Change in loans held for sale   | 2,531            | (8,837)          | 50,444          |
| Change in other assets  | (1,075)          | 4,573            | (6,597)         |
| Change in other liabilities   | 1,132            | (2,415)          | (425)           |
| <b>Total adjustments</b>  | <b>26,742</b>    | <b>12,169</b>    | <b>117,718</b>  |
| <b>Net cash provided by operating activities</b>                                    | <b>95,111</b>    | <b>71,828</b>    | <b>171,515</b>  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                  |                  |                 |
| Cash paid for acquisition of bank, less cash acquired                               |                  | (2,463)          |                 |
| Net decrease (increase) in interest-bearing time deposits in banks                  | 42,511           | (47,063)         | (54,445)        |
| Activity in available-for-sale securities:  |                  |                  |                 |
| Sales   | 22,970           | 28,039           | 50,063          |
| Maturities  | 1,886,632        | 1,812,241        | 182,214         |
| Purchases   | (2,171,404)      | (2,068,639)      | (233,876)       |
| Activity in held-to-maturity securities maturities                                  | 5,458            | 6,216            | 8,227           |
| Net increase in loans   | (108,152)        | (82,823)         | (8,344)         |
| Purchases of bank premises and equipment and computer software                      | (14,777)         | (11,240)         | (6,481)         |
| Proceeds from sale of other assets  | 5,732            | 9,924            | 4,455           |
| <b>Net cash used in investing activities</b>  | <b>(331,030)</b> | <b>(355,808)</b> | <b>(58,187)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                  |                  |                 |
| Net increase in noninterest-bearing deposits  | 142,103          | 99,387           | 39,246          |
| Net increase in interest-bearing deposits   | 79,394           | 179,237          | 62,758          |
| Net increase (decrease) in short-term borrowings                                    | 29,400           | 32,262           | (89,504)        |
| Common stock transactions:  |                  |                  |                 |
| Proceeds of stock issuances   | 950              | 789              | 682             |
| Dividends paid  | (29,359)         | (28,346)         | (28,302)        |
| <b>Net cash provided by (used in) financing activities</b>                          | <b>222,488</b>   | <b>283,329</b>   | <b>(15,120)</b> |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                         | <b>(13,431)</b>  | <b>(651)</b>     | <b>98,208</b>   |
| CASH AND CASH EQUIVALENTS, beginning of year  | 264,267          | 264,918          | 166,710         |

|  |            |            |            |
|--|------------|------------|------------|
| CASH AND CASH EQUIVALENTS, end of year | \$ 250,836 | \$ 264,267 | \$ 264,918 |
|--|------------|------------|------------|

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, 2011, 2010 and 2009

**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 eleven banks located in Texas as of December 31, 2011. Those subsidiary banks are First Financial Bank, National Association, Abilene; First Financial Bank, Hereford; First Financial Bank, National Association, Sweetwater; First Financial Bank, National Association, Eastland; First Financial Bank, National Association, Cleburne; First Financial Bank, National Association, Stephenville; First Financial Bank, National Association, San Angelo; First Financial Bank, National Association, Weatherford; First Financial Bank, National Association, Southlake; First Financial Bank, National Association, Mineral Wells and First Financial Bank, Huntsville. Each subsidiary 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., First Financial Investments, Inc. and First Technology Services, Inc. During 2011, First Financial Bankshares of Delaware, Inc and First Financial Investments of Delaware, Inc. were merged into the Company.

A summary of significant accounting policies of Bankshares and 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. generally accepted accounting principles 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. generally accepted accounting principles 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.

**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. Certain reclassifications have been made to 2009 and 2010 financial statements to conform to the 2011 presentation.

**Stock Split**

On April 26, 2011, the Company's Board of Directors declared a three-for-two stock split in the form of a 50% stock dividend effective for shareholders of record on May 16, 2011 that was distributed on June 1, 2011. 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, 2011.

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**Stock Repurchase**

On October 26, 2011, the Company's Board of Directors authorized the repurchase of up to 750,000 shares of its common stock through September 30, 2014. 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. Through December 31, 2011, no shares have been repurchased under this authorization.

**Investment Securities**

Management classifies debt and equity securities as trading, available-for-sale, or held-to-maturity based on its intent. Securities classified as trading are recorded at estimated fair value with unrealized gains and losses included in earnings. 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 trading or held-to-maturity are classified as available-for-sale and recorded at estimated fair value. Available-for-sale unrealized gains and unrealized losses judged to be temporary, net of deferred income taxes, are excluded from earnings and reported as a separate component of shareholders equity.

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 market 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 unrealized losses judged other than temporary are included in gain (loss) on sale of available-for-sale securities and a new cost basis is established. 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 costs, 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.

Estimated fair values 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 and yield curves. Fair values 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 using a range of fair value estimates in the market place as a result of the illiquid market specific to the type of security.

**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 collectibility of the principal is unlikely.

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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 a regular basis and makes changes as appropriate. Management receives frequent reports related to loan originations, quality, concentrations, delinquencies, non-performing 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 geography.

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. Agricultural loans are primarily made based 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 the 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, through central, north and west 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.

The Company utilizes methodical credit standards and analysis to supplement its policies and procedures in underwriting consumer loans. 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 minimizes the Company's risk.

The allowance is an amount management believes is appropriate to absorb estimated inherent losses on existing loans that are deemed uncollectible based upon management's review and evaluation of the loan portfolio. The allowance for loan losses is comprised of three elements: (i) specific reserves determined in accordance with current authoritative accounting guidance based on probable losses on specific classified loans; (ii) general reserve determined in accordance with current authoritative accounting guidance that consider historical loss rates; and (iii) qualitative reserves determined in accordance with current authoritative accounting guidance 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 general reserve, the loan portfolio, less cash secured loans, government guaranteed portions of loans and classified loans, is multiplied by the Company's historical loss rate. The Company's methodology is constructed



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so that specific allocations are increased in accordance with deterioration in credit quality and a corresponding increase in risk of loss. In addition, we adjust our allowance for qualitative factors such as current local economic conditions and trends, including unemployment, lending staff, policies and procedures, credit concentrations, trends and severity of problem loans and trends in volume and terms of loans. This additional allocation based on qualitative factors compensates for additional areas of uncertainty 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 further downturn in the economy and employment could result in increased levels of nonperforming assets and charge-offs, increased loan loss provisions and reductions in income. Additionally bank regulatory agencies periodically review our allowance for loan losses and could require additions to the loan loss allowance based on their judgment of information available to them at the time of their examination of subsidiary banks.

Accrual of loan interest is discontinued 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. 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, facts and circumstances are evaluated in making charge-off decisions.

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

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 are measured based on the present value of expected future cash flows or the loan's observable market price. At December 31, 2011 and 2010, 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. To date, these troubled debt restructurings have been such that, after considering economic and business conditions and collection efforts, the collection of interest is doubtful and therefore the loan has been placed on non-accrual. Each of these loans is evaluated for impairment and a specific reserve is recorded based on probable losses, taking into consideration the related collateral and modified loan terms and cash flow. As of December 31, 2011, all of the Company's troubled debt restructured loans are included in the non-accrual totals.

The Company originates mortgage loans primarily 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

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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. Prior to 2010, the Company also originated student loans for sale to the Department of Education or another financial institution. These student loans were guaranteed by an agency of the U. S. Government. During 2009, the Company suspended its student loan origination activities as a result of changes mandated by the Department of Education. There were no outstanding balances of student loans at December 31, 2011 or 2010.

Loans acquired, including loans acquired in a business combination, that have 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 are initially recorded at fair value with no valuation allowance. The difference between the undiscounted 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. Contractually required payments for interest and principal that exceed the undiscounted 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 are recognized as impairment. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition.

**Other Real Estate**

Other real estate 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 and intangible assets with indefinite lives are not amortized, but rather tested annually for impairment as of June 30 each year and totaled \$71.9 million at both December 31, 2011 and 2010. There was no impairment recorded for the years ended December 31, 2011, 2010 and 2009.

The carrying amount of goodwill arising from acquisitions that qualify as an asset purchase for federal income tax purposes was approximately \$49.6 million at both December 31, 2011 and 2010, and is deductible for federal income tax purposes.

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**Securities Sold Under Agreements To Repurchase**

Securities sold under agreements to repurchase, which are classified as short-term 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 subsidiaries meet the aggregation criteria of the current authoritative accounting guidance since each of its community banks offers similar products and services, operates in a similar manner, has similar customers and reports to the same regulatory authority, and therefore operates 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 include 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 gains on the Company's available-for-sale securities (after applicable income tax expense) totaling \$54,566,000 and \$26,107,000 at December 31, 2011 and 2010, respectively, and the minimum pension liability totaled (after applicable income tax benefit) totaling \$7,343,000 and \$5,654,000 at December 31, 2011 and 2010, respectively, are included in accumulated other comprehensive income.

**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 \$427,000, \$387,000 and \$314,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

**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 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 is reflected by application of the treasury stock



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method, whereby the proceeds from the exercised options are assumed to be used to purchase common stock at the average market price during the period. The following table reconciles the computation of basic EPS to dilutive EPS:

|   | Net<br>Earnings<br>(in thousands) | Weighted<br>Average<br>Shares | Per Share<br>Amount |
|---|-----------------------------------|-------------------------------|---------------------|
| For the year ended December 31, 2011      |                                   |                               |                     |
| Net earnings per share, basic             | \$ 68,369                         | 31,443,712                    | \$ 2.17             |
| Effect of stock options                   |                                   | 18,252                        |                     |
| Net earnings per share, assuming dilution | \$ 68,369                         | 31,461,964                    | \$ 2.17             |
| For the year ended December 31, 2010:     |                                   |                               |                     |
| Net earnings per share, basic             | \$ 59,659                         | 31,291,486                    | \$ 1.91             |
| Effect of stock options                   |                                   | 28,077                        |                     |
| Net earnings per share, assuming dilution | \$ 59,659                         | 31,319,563                    | \$ 1.91             |
| For the year ended December 31, 2009:     |                                   |                               |                     |
| Net earnings per share, basic             | \$ 53,797                         | 31,220,385                    | \$ 1.72             |
| Effect of stock options                   |                                   | 35,800                        |                     |
| Net earnings per share, assuming dilution | \$ 53,797                         | 31,256,185                    | \$ 1.72             |

**Recently Issued Authoritative Accounting Guidance**

In 2010, the FASB issued authoritative guidance expanding disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. The new guidance further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) disclosures should be provided about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. The disclosures related to the gross presentation of purchases, sales, issuances and settlements of assets and liabilities included in Level 3 of the fair value hierarchy became effective January 1, 2011. The remaining disclosure requirements and clarifications made by the new guidance became effective in 2010.

In 2010, the FASB issued authoritative guidance that requires enhanced disclosures about loans including credit risk exposures and the allowance for loan losses. While some of the required disclosures are already included in the management discussion and analysis section of our interim and annual filings, the new guidance requires inclusion of such analyses in the notes to the financial statements. Included in the new guidance are a roll forward of the allowance for loan losses as well as credit quality information, impaired loan, nonaccrual and past due information. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for loan losses, and class of loans. The period-end information became effective in 2010 and the activity-related information became effective in 2011.

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In 2010, the FASB issued authoritative guidance that modified Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform

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Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist such as if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This new authoritative guidance became effective for the Company in 2011 and did not have a significant impact on the Company's financial statements.

In 2011, the FASB issued authoritative guidance to provide additional guidance and clarification in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The new guidance includes examples illustrating whether a restructuring constitutes a troubled debt restructuring. The authoritative guidance became effective for the Company in 2011 and did not have a significant impact on the Company's financial statements.

In 2011, the FASB amended its authoritative guidance to require that all changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, the authoritative guidance requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. The new guidance will be effective in 2012, although certain provisions in the guidance have been deferred to allow the FASB time to redeliberate. The new guidance is not expected to have a significant impact on the Company's financial statements.

In 2011, the FASB amended its authoritative guidance related to goodwill impairment to give entities the option to first assess quantitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. The new guidance is effective for annual and interim impairment tests in 2012, and is not expected to have a significant impact on the Company's financial statements.

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

Interest-bearing time deposits with banks totaled \$61.2 million and \$103.7 million at December 31, 2011 and 2010, respectively, and have original maturities generally ranging from one to two years. Of these amounts, \$51.8 million and \$70.4 million, respectively, are time deposits with balances greater than \$100,000 at December 31, 2011 and 2010.

As of December 31, 2011 and 2010, the Company did not hold trading securities but did hold such securities during 2009. The trading securities portfolio was a government securities money market fund comprised primarily of U.S. government agency securities and repurchase agreements collateralized by U.S. government agency securities. The trading securities were carried at estimated fair value with unrealized gains and losses included in earnings. The Company began investing in trading securities in 2008 to improve its yield on daily funds and to lower its exposure on Federal funds. However, due to significantly lower interest rates, the Company deployed these funds in other assets, which yielded a higher rate.

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A summary of the Company's available-for-sale and held-to-maturity securities as of December 31, 2011 and 2010 are as follows (in thousands):

|  | December 31, 2011       |                                      |                                       |                         |
|--|-------------------------|--------------------------------------|---------------------------------------|-------------------------|
|  | Amortized<br>Cost Basis | Gross<br>Unrealized<br>Holding Gains | Gross<br>Unrealized<br>Holding Losses | Estimated<br>Fair Value |
| <b>Securities available-for-sale:</b>                                |                         |                                      |                                       |                         |
| U. S. Treasury securities  | \$ 15,143               | \$ 204                               | \$                                    | \$ 15,347               |
| Obligations of U.S. government<br>sponsored-enterprises and agencies | 255,548                 | 5,802                                | (4)                                   | 261,346                 |
| Obligations of state and political subdivisions                      | 655,957                 | 48,812                               | (98)                                  | 704,671                 |
| Corporate bonds and other  | 127,514                 | 4,215                                | (255)                                 | 131,474                 |
| Mortgage-backed securities   | 703,280                 | 25,360                               | (89)                                  | 728,551                 |
| <b>Total securities available-for-sale</b>                           | <b>\$ 1,757,442</b>     | <b>\$ 84,393</b>                     | <b>\$ (446)</b>                       | <b>\$ 1,841,389</b>     |
| <b>Securities held-to-maturity:</b>                                  |                         |                                      |                                       |                         |
| Obligations of state and political subdivisions                      | \$ 3,187                | \$ 30                                | \$                                    | \$ 3,217                |
| Mortgage-backed securities   | 422                     | 16                                   |                                       | 438                     |
| <b>Total debt securities held-to-maturity</b>                        | <b>\$ 3,609</b>         | <b>\$ 46</b>                         | <b>\$</b>                             | <b>\$ 3,655</b>         |



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|  | December 31, 2010       |                                      |                                       |                         |
|--|-------------------------|--------------------------------------|---------------------------------------|-------------------------|
|  | Amortized<br>Cost Basis | Gross<br>Unrealized<br>Holding Gains | Gross<br>Unrealized<br>Holding Losses | Estimated<br>Fair Value |
| <b>Securities available-for-sale:</b>                                |                         |                                      |                                       |                         |
| U. S. Treasury Securities  | \$ 15,253               | \$ 263                               | \$                                    | \$ 15,516               |
| Obligations of U.S. government<br>sponsored-enterprises and agencies | 270,706                 | 8,542                                |                                       | 279,248                 |
| Obligations of state and political subdivisions                      | 543,074                 | 12,695                               | (5,861)                               | 549,908                 |
| Corporate bonds and other  | 56,710                  | 4,118                                |                                       | 60,828                  |
| Mortgage-backed securities   | 611,275                 | 22,283                               | (1,880)                               | 631,678                 |
| <b>Total securities available-for-sale</b>                           | <b>\$ 1,497,018</b>     | <b>\$ 47,901</b>                     | <b>\$ (7,741)</b>                     | <b>\$ 1,537,178</b>     |
| <b>Securities held-to-maturity:</b>                                  |                         |                                      |                                       |                         |
| Obligations of state and political subdivisions                      | \$ 8,549                | \$ 160                               | \$                                    | \$ 8,709                |
| Mortgage-backed securities   | 515                     | 16                                   |                                       | 531                     |
| <b>Total debt securities held-to-maturity</b>                        | <b>\$ 9,064</b>         | <b>\$ 176</b>                        | <b>\$</b>                             | <b>\$ 9,240</b>         |

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, 2011, were computed by using scheduled amortization of balances and historical prepayment rates. At December 31, 2011 and 2010, the Company did not hold any CMOs that entail higher risks than standard mortgage-backed securities.

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The amortized cost and estimated fair value of debt securities at December 31, 2011, by contractual and expected maturity, are shown below (in thousands):

|  | Available-for-Sale      |                         | Held-to-Maturity           |                         |
|--|-------------------------|-------------------------|----------------------------|-------------------------|
|  | Amortized<br>Cost Basis | Estimated<br>Fair Value | Amortized<br>Cost<br>Basis | Estimated<br>Fair Value |
| Due within one year                    | \$ 148,485              | \$ 150,832              | \$ 2,798                   | \$ 2,813                |
| Due after one year through five years  | 427,520                 | 444,170                 | 389                        | 404                     |
| Due after five years through ten years | 451,213                 | 488,855                 |                            |                         |
| Due after ten years                    | 26,944                  | 28,981                  |                            |                         |
| Mortgage-backed securities             | 703,280                 | 728,551                 | 422                        | 438                     |
| Total                                  | \$ 1,757,442            | \$ 1,841,389            | \$ 3,609                   | \$ 3,655                |

The following table discloses, as of December 31, 2011 and 2010, 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         |                    |
|--|---------------------|--------------------|---------------------|--------------------|---------------|--------------------|
|  | Fair<br>Value       | Unrealized<br>Loss | Fair<br>Value       | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
| December 31, 2011  |                     |                    |                     |                    |               |                    |
| Obligations of U. S. government sponsored-enterprises and agencies | \$ 3,114            | \$ 4               | \$                  | \$                 | \$ 3,114      | \$ 4               |
| Obligations of state and political subdivisions                    | 9,595               | 98                 |                     |                    | 9,595         | 98                 |
| Mortgage-backed securities   | 13,722              | 89                 |                     |                    | 13,722        | 89                 |
| Corporate bonds and other  | 17,533              | 255                |                     |                    | 17,533        | 255                |
| Total  | \$ 43,964           | \$ 446             | \$                  | \$                 | \$ 43,964     | \$ 446             |

|   | Less than 12 Months |                    | 12 Months or Longer |                    | Total         |                    |
|---|---------------------|--------------------|---------------------|--------------------|---------------|--------------------|
|   | Fair<br>Value       | Unrealized<br>Loss | Fair<br>Value       | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
| December 31, 2010                               |                     |                    |                     |                    |               |                    |
| Obligations of state and political subdivisions | \$ 164,437          | \$ 5,665           | \$ 2,070            | \$ 196             | \$ 166,507    | \$ 5,861           |
| Mortgage-backed securities                      | 110,591             | 1,880              |                     |                    | 110,591       | 1,880              |
| Total   | \$ 275,028          | \$ 7,545           | \$ 2,070            | \$ 196             | \$ 277,098    | \$ 7,741           |

The number of investment positions in this unrealized loss position totaled 32 at December 31, 2011. 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

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related due to the level of interest rates at December 31, 2011 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.

Securities, carried at approximately \$829,074,000 and \$763,412,000 at December 31, 2011 and 2010, respectively, were pledged as collateral for public or trust fund deposits and for other purposes required or permitted by law.

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During 2011, 2010, and 2009, sales of investment securities that were classified as available-for-sale totaled approximately \$22,970,000, \$28,039,000, and \$50,063,000 respectively. Gross realized gains from 2011, 2010, and 2009, securities sales were approximately \$505,000, \$363,000, and \$1,851,000, respectively. Gross realized losses from 2011 securities sales were approximately \$13,000. There were no losses on securities sales in 2010 or 2009. The specific identification method was used to determine cost in computing the realized gains and losses.

**3. LOANS AND ALLOWANCE FOR LOAN LOSSES:**

Major classifications of loans are as follows (in thousands):

|  | December 31,        |                     |
|--|---------------------|---------------------|
|  | 2011                | 2010                |
| Commercial                             | \$ 468,224          | \$ 442,377          |
| Agricultural                           | 71,323              | 82,380              |
| Real estate                            | 1,024,020           | 962,366             |
| Consumer                               | 212,348             | 190,064             |
| <b>Total loans held for investment</b> | <b>\$ 1,775,915</b> | <b>\$ 1,677,187</b> |

Loans held for sale totaled \$10.6 million and \$13.2 million at December 31, 2011 and 2010, respectively, in which the carrying amounts approximate market.

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

|   | December 31,     |                  |
|---|------------------|------------------|
|   | 2011             | 2010             |
| Non-accrual loans                                 | \$ 19,975        | \$ 15,445        |
| Loans still accruing and past due 90 days or more | 96               | 2,196            |
| Restructured loans*                               |                  |                  |
| <b>Total</b>                                      | <b>\$ 20,071</b> | <b>\$ 17,641</b> |

\* Restructured loans whose interest collection, after considering economic and business conditions and collection efforts, is doubtful are included in non-accrual loans.

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

|  | December 31, 2011   |                     | December 31, 2010   |                     |
|--|---------------------|---------------------|---------------------|---------------------|
|  | Recorded Investment | Valuation Allowance | Recorded Investment | Valuation Allowance |

|           |          |           |          |
|-----------|----------|-----------|----------|
| \$ 19,975 | \$ 5,953 | \$ 15,445 | \$ 3,152 |
|-----------|----------|-----------|----------|

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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

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The average recorded investment in impaired loans for the years ended December 31, 2011, 2010, and 2009 was approximately \$22,348,000, \$17,242,000, and \$11,239,000 respectively. The Company had approximately \$29,535,000, and \$25,950,000 in nonaccrual, past due 90 days still accruing, restructured loans and foreclosed assets at December 31, 2011 and 2010, respectively. Non-accrual loans totaled \$20.0 million and \$15.4 million, respectively, of this amount and consisted of (in thousands):

|              | December 31,     |                  |
|--------------|------------------|------------------|
|              | 2011             | 2010             |
| Commercial   | \$ 3,450         | \$ 1,403         |
| Agricultural | 145              | 3,030            |
| Real Estate  | 16,193           | 10,675           |
| Consumer     | 187              | 337              |
| <b>Total</b> | <b>\$ 19,975</b> | <b>\$ 15,445</b> |

No additional funds are committed to be advanced in connection with impaired loans.

The Company's impaired loans and related allowance as of December 31, 2011 and 2010 is summarized in the following table (in thousands). No interest income was recognized on impaired loans subsequent to their classification as impaired.

|                   | Unpaid<br>Contractual<br>Principal<br>Balance | Recorded<br>Investment<br>With No<br>Allowance | Recorded<br>Investment<br>With<br>Allowance | Total<br>Recorded<br>Investment | Related<br>Allowance | Average<br>Recorded<br>Investment |
|-------------------|---|--|---|---------------------------------|----------------------|-----------------------------------|
| December 31, 2011 |   |  |   |                                 |                      |                                   |
| Commercial        | \$ 3,856                                      | \$   | \$ 3,450                                    | \$ 3,450                        | \$ 2,092             | \$ 3,801                          |
| Agricultural      | 199   | 3  | 142   | 145                             | 79                   | 246                               |
| Real Estate       | 19,305  | 1,786  | 14,407                                      | 16,193                          | 3,708                | 18,068                            |
| Consumer          | 227   | 29   | 158   | 187                             | 74                   | 233                               |
| <b>Total</b>      | <b>\$ 23,587</b>                              | <b>\$ 1,818</b>                                | <b>\$ 18,157</b>                            | <b>\$ 19,975</b>                | <b>\$ 5,953</b>      | <b>\$ 22,348</b>                  |

|                   | Unpaid<br>Contractual<br>Principal<br>Balance | Recorded<br>Investment<br>With No<br>Allowance | Recorded<br>Investment<br>With<br>Allowance | Total<br>Recorded<br>Investment | Related<br>Allowance | Average<br>Recorded<br>Investment |
|-------------------|---|--|---|---------------------------------|----------------------|-----------------------------------|
| December 31, 2010 |   |  |   |                                 |                      |                                   |
| Commercial        | \$ 1,625                                      | \$ 434   | \$ 969                                      | \$ 1,403                        | \$ 471               | \$ 1,622                          |
| Agricultural      | 3,048   | 405  | 2,625                                       | 3,030                           | 695                  | 3,922                             |
| Real Estate       | 12,518  | 1,224  | 9,451                                       | 10,675                          | 1,881                | 11,276                            |
| Consumer          | 449   | 81   | 256   | 337                             | 105                  | 422                               |
| <b>Total</b>      | <b>\$ 17,640</b>                              | <b>\$ 2,144</b>                                | <b>\$ 13,301</b>                            | <b>\$ 15,445</b>                | <b>\$ 3,152</b>      | <b>\$ 17,242</b>                  |

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Interest payments received on impaired loans are recorded as interest income unless collections of the remaining recorded investment are doubtful, at which time payments received are recorded as reductions of principal. The Company recognized interest income on impaired loans of approximately \$1,137,000, \$425,000 and \$691,000 during the years ended December 31, 2011, 2010, and 2009, respectively.

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

The classifications 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

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portfolio. Ratings are adjusted to reflect the degree of risk and loss that is felt to be inherent in each credit as of each monthly 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.

Credit 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 nonaccrual.

At December 31, 2011 and 2010, the following summarizes the Company's internal ratings of its loans (in thousands):

|                   | Pass                | Special<br>Mention | Substandard      | Doubtful      | Total               |
|-------------------|---------------------|--------------------|------------------|---------------|---------------------|
| December 31, 2011 |                     |                    |                  |               |                     |
| Commercial        | \$ 446,247          | \$ 9,227           | \$ 12,748        | \$ 2          | \$ 468,224          |
| Agricultural      | 68,208              | 347                | 2,755            | 13            | 71,323              |
| Real Estate       | 962,932             | 20,922             | 40,068           | 98            | 1,024,020           |
| Consumer          | 211,215             | 302                | 820              | 11            | 212,348             |
| <b>Total</b>      | <b>\$ 1,688,602</b> | <b>\$ 30,798</b>   | <b>\$ 56,391</b> | <b>\$ 124</b> | <b>\$ 1,775,915</b> |

|                   | Pass                | Special<br>Mention | Substandard      | Doubtful      | Total               |
|-------------------|---------------------|--------------------|------------------|---------------|---------------------|
| December 31, 2010 |                     |                    |                  |               |                     |
| Commercial        | \$ 414,436          | \$ 11,505          | \$ 16,346        | \$ 90         | \$ 442,377          |
| Agricultural      | 72,124              | 1,094              | 9,144            | 18            | 82,380              |
| Real Estate       | 899,532             | 15,721             | 47,036           | 77            | 962,366             |
| Consumer          | 188,325             | 197                | 1,510            | 32            | 190,064             |
| <b>Total</b>      | <b>\$ 1,574,417</b> | <b>\$ 28,517</b>   | <b>\$ 74,036</b> | <b>\$ 217</b> | <b>\$ 1,677,187</b> |

At December 31, 2011 and 2010, the Company's past due loans are as follows (in thousands):



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| December 31, 2011 | 15-59<br>Days<br>Past<br>Due* | 60-89<br>Days<br>Past<br>Due | Greater<br>Than 90<br>Days | Total<br>Past<br>Due | Total<br>Current    | Total<br>Loans      | Total 90<br>Days Past<br>Due Still<br>Accruing |
|-------------------|-------------------------------|------------------------------|----------------------------|----------------------|---------------------|---------------------|--|
| Commercial        | \$ 1,574                      | \$ 430                       | \$                         | \$ 2,004             | \$ 466,220          | \$ 468,224          | \$   |
| Agricultural      | 300                           | 60                           |                            | 360                  | 70,963              | 71,323              |  |
| Real Estate       | 10,215                        | 547                          | 988                        | 11,750               | 1,012,270           | 1,024,020           | 62   |
| Consumer          | 1,396                         | 128                          | 47                         | 1,571                | 210,777             | 212,348             | 34   |
| <b>Total</b>      | <b>\$ 13,485</b>              | <b>\$ 1,165</b>              | <b>\$ 1,035</b>            | <b>\$ 15,685</b>     | <b>\$ 1,760,230</b> | <b>\$ 1,775,915</b> | <b>\$ 96</b>                                   |

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|                   | 15-59<br>Days<br>Past<br>Due* | 60-89<br>Days<br>Past<br>Due | Greater<br>Than 90<br>Days | Total<br>Past<br>Due | Total<br>Current    | Total Loans         | Total 90<br>Days Past<br>Due Still<br>Accruing |
|-------------------|-------------------------------|------------------------------|----------------------------|----------------------|---------------------|---------------------|--|
| December 31, 2010 |                               |                              |                            |                      |                     |                     |  |
| Commercial        | \$ 2,138                      | \$ 241                       | \$ 713                     | \$ 3,092             | \$ 439,285          | \$ 442,377          | \$ 20  |
| Agricultural      | 371                           |                              |                            | 371                  | 82,009              | 82,380              |  |
| Real Estate       | 6,638                         | 1,569                        | 3,792                      | 11,999               | 950,367             | 962,366             | 2,169  |
| Consumer          | 1,048                         | 180                          | 25                         | 1,253                | 188,811             | 190,064             | 7  |
| <b>Total</b>      | <b>\$ 10,195</b>              | <b>\$ 1,990</b>              | <b>\$ 4,530</b>            | <b>\$ 16,715</b>     | <b>\$ 1,660,472</b> | <b>\$ 1,677,187</b> | <b>\$ 2,196</b>                                |

\* 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.

The allowance for loan losses as of December 31, 2011 and 2010, is presented below (in thousands). Management has evaluated the appropriateness of the allowance for loan losses by estimating the losses in various categories of the loan portfolio which are identified below:

|  | 2011             | 2010             |
|--|------------------|------------------|
| Allowance for loan losses provided for:  |                  |                  |
| Loans specifically evaluated as impaired | \$ 5,953         | \$ 3,152         |
| Remaining portfolio                      | 28,362           | 27,954           |
| <b>Total allowance for loan losses</b>   | <b>\$ 34,315</b> | <b>\$ 31,106</b> |

The following table details the allowance for loan loss at December 31, 2011 and 2010 by portfolio segment (in thousands). 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, 2011                           | Commercial      | Agricultural    | Real<br>Estate   | Consumer        | Total            |
|---|-----------------|-----------------|------------------|-----------------|------------------|
| Loans individually evaluated for impairment | \$ 4,647        | \$ 758          | \$ 8,310         | \$ 282          | \$ 13,997        |
| Loan collectively evaluated for impairment  | 5,017           | 724             | 13,223           | 1,354           | 20,318           |
| <b>Total</b>                                | <b>\$ 9,664</b> | <b>\$ 1,482</b> | <b>\$ 21,533</b> | <b>\$ 1,636</b> | <b>\$ 34,315</b> |

| December 31, 2010                           | Commercial | Agricultural | Real<br>Estate | Consumer | Total     |
|---|------------|--------------|----------------|----------|-----------|
| Loans individually evaluated for impairment | \$ 3,718   | \$ 1,548     | \$ 6,829       | \$ 445   | \$ 12,540 |

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|  |                 |                 |                  |                 |                  |
|--|-----------------|-----------------|------------------|-----------------|------------------|
| Loan collectively evaluated for impairment | 4,027           | 751             | 12,272           | 1,516           | 18,566           |
| <b>Total</b>                               | <b>\$ 7,745</b> | <b>\$ 2,299</b> | <b>\$ 19,101</b> | <b>\$ 1,961</b> | <b>\$ 31,106</b> |

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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

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Changes in the allowance for loan losses are summarized as follows (in thousands):

|                              | 2011      | December 31,<br>2010 | 2009      |
|------------------------------|-----------|----------------------|-----------|
| Balance at beginning of year | \$ 31,106 | \$ 27,612            | \$ 21,529 |
| Add:                         |           |                      |           |
| Provision for loan losses    | 6,626     | 8,962                | 11,419    |
| Loan recoveries              | 1,907     | 979                  | 874       |
| Deduct:                      |           |                      |           |
| Loan charge-offs             | (5,324)   | (6,447)              | (6,210)   |
| Balance at end of year       | \$ 34,315 | \$ 31,106            | \$ 27,612 |

For the year ended December 31, 2011 the changes are presented by classification (in thousands):

|                           | Commercial | Agricultural | Real Estate | Consumer | Total     |
|---------------------------|------------|--------------|-------------|----------|-----------|
| Beginning balance         | \$ 7,745   | \$ 2,299     | \$ 19,101   | \$ 1,961 | \$ 31,106 |
| Provision for loan losses | 1,949      | (755)        | 5,240       | 192      | 6,626     |
| Recoveries                | 610        | 33           | 874         | 390      | 1,907     |
| Charge-offs               | (640)      | (95)         | (3,682)     | (907)    | (5,324)   |
| Ending balance            | \$ 9,664   | \$ 1,482     | \$ 21,533   | \$ 1,636 | \$ 34,315 |

The Company's recorded investment in loans as of December 31, 2011 related to the balance in the allowance for loan losses on the basis of the Company's impairment methodology was as follows (in thousands):

| December 31, 2011                           | Commercial | Agricultural | Real Estate  | Consumer   | Total        |
|---|------------|--------------|--------------|------------|--------------|
| Loans individually evaluated for impairment | \$ 21,977  | \$ 3,115     | \$ 61,088    | \$ 1,133   | \$ 87,313    |
| Loan collectively evaluated for impairment  | 446,247    | 68,208       | 962,932      | 211,215    | 1,688,602    |
| Total                                       | \$ 468,224 | \$ 71,323    | \$ 1,024,020 | \$ 212,348 | \$ 1,775,915 |

| December 31, 2010                           | Commercial | Agricultural | Real Estate | Consumer   | Total        |
|---|------------|--------------|-------------|------------|--------------|
| Loans individually evaluated for impairment | \$ 27,941  | \$ 10,256    | \$ 62,834   | \$ 1,739   | \$ 102,770   |
| Loan collectively evaluated for impairment  | 414,436    | 72,124       | 899,532     | 188,325    | 1,574,417    |
| Total                                       | \$ 442,377 | \$ 82,380    | \$ 962,366  | \$ 190,064 | \$ 1,677,187 |

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The Company's loans that were modified in the year ended December 31, 2011 and considered a troubled debt restructuring are as follows (dollars in thousands):

|              | Number    | Pre-Modification<br>Recorded Investment | Post-<br>Modification<br>Recorded<br>Investment |
|--------------|-----------|---|---|
| Commercial   | 8         | \$ 2,467                                | \$ 2,467  |
| Agricultural | 4         | 2,566                                   | 2,566   |
| Real Estate  | 9         | 2,292                                   | 2,292   |
| Consumer     |           |   |   |
| <b>Total</b> | <b>21</b> | <b>\$ 7,325</b>                         | <b>\$ 7,325</b>                                 |

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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

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The balances below provide information as to how the loans were modified as troubled debt restructured loans during the year ended December 31, 2011.

|              | Adjusted<br>Interest<br>Rate | Extended<br>Maturity | Combined<br>Rate and<br>Maturity |
|--------------|------------------------------|----------------------|----------------------------------|
| Commercial   | \$ 2,350                     | \$ 118               | \$                               |
| Agricultural |                              | 2,566                |                                  |
| Real Estate  | 492                          | 1,468                | 331                              |
| Consumer     |                              |                      |                                  |
| <b>Total</b> | <b>\$ 2,842</b>              | <b>\$ 4,152</b>      | <b>\$ 331</b>                    |

There were no loans modified as a troubled debt restructured loan within the previous 12 months and for which there was a payment default during the year ended December 30, 2011. A default for purposes of this disclosure is a troubled debt restructured loan in which the borrower is 90 days past due or results in the foreclosure and repossession of the applicable collateral.

As of December 31, 2011, 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, 2011 (determined as of each respective year-end) follows (in thousands):

|                              | Beginning<br>Balance | Additional<br>Loans | Payments  | Ending<br>Balance |
|------------------------------|----------------------|---------------------|-----------|-------------------|
| Year ended December 31, 2011 | \$ 30,905            | \$ 70,928           | \$ 59,285 | \$ 42,548         |

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.

Certain of our subsidiary banks have established lines of credit with the Federal Home Loan Bank of Dallas to provide liquidity and meet pledging requirements for those customers eligible to have securities pledged to secure certain uninsured deposits. At December 31, 2011, approximately \$721.4 million in loans held by these subsidiaries were subject to blanket liens as security for letters of credit issued under these lines of credit. At December 31, 2011, \$69.4 million in letters of credit issued by the Federal Home Loan Bank of Dallas were outstanding under these lines of credit. These letters of credit were pledged as collateral for public funds held by subsidiary banks.

**4. BANK PREMISES AND EQUIPMENT:**

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

| Useful Life | December 31,<br>2011 | 2010 |
|-------------|----------------------|------|
|-------------|----------------------|------|

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|   |                                       |           |           |
|---|---------------------------------------|-----------|-----------|
| Land  |                                       | \$ 17,542 | \$ 17,900 |
| Buildings                                       | 20 to 40 years                        | 76,822    | 69,429    |
| Furniture and equipment                         | 3 to 10 years                         | 42,844    | 39,723    |
| Leasehold improvements                          | Lesser of lease term or 5 to 15 years | 3,991     | 4,035     |
|   |                                       | 141,199   | 131,087   |
| Less- accumulated depreciation and amortization |                                       | (64,716)  | (60,925)  |
|   |                                       | \$ 76,483 | \$ 70,162 |

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Depreciation expense for the years ended December 31, 2011, 2010 and 2009 amounted to \$5,875,000, \$5,604,000, and \$6,029,000, 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 \$1,646,000, \$1,687,000 and \$1,647,000, for the years ended December 31, 2011, 2010, and 2009, respectively.

**5. DEPOSITS**

Time deposits of \$100,000 or more totaled approximately \$433,813,000 and \$480,847,000 at December 31, 2011 and 2010, respectively.

At December 31, 2011, the scheduled maturities of time deposits (in thousands) were, as follows:

|                          |            |
|--------------------------|------------|
| Year ending December 31, |            |
| 2012                     | \$ 680,500 |
| 2013                     | 53,997     |
| 2014                     | 7,090      |
| 2015                     | 5,766      |
| 2016                     | 4,936      |
| Thereafter               | 9          |
|                          | \$ 752,298 |

Deposits received from related parties at December 31, 2011 and 2010 totaled \$93,267,000 and \$121,552,000, respectively.

**6. LINE OF CREDIT**

The Company renewed its loan agreement, effective June 30, 2011, with The Frost National Bank. Under the loan agreement, as renewed and amended, the Company is permitted to draw up to \$25.0 million on a revolving line of credit. Prior to June 30, 2013, interest is paid quarterly at Wall Street Journal Prime and the line of credit matures June 30, 2013. If a balance exists at June 30, 2013, the principal balance converts to a term facility payable quarterly over five years and interest is paid quarterly at the election of the Company at Wall Street Journal Prime plus 50 basis points or LIBOR plus 250 basis points. The line of credit is unsecured. Among other provisions in the credit agreement, the Company must satisfy certain financial covenants during the term of the loan agreement, including, without limitation, covenants that require the Company to maintain certain capital, tangible net worth, loan loss reserve, non-performing asset and cash flow coverage ratio. In addition, the credit agreement contains certain operational covenants, that 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. Management believes the Company was in compliance with the financial and operational covenants at December 31, 2011. There was no outstanding balance under the line of credit as of December 31, 2011 or 2010.



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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

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**7. INCOME TAXES:**

The Company files a consolidated federal income tax return. Income tax expense is comprised of the following:

|   | Year Ended December 31, |           |           |
|---|-------------------------|-----------|-----------|
|   | 2011                    | 2010      | 2009      |
| Current federal income tax                    | \$ 21,727               | \$ 19,625 | \$ 18,689 |
| Current state income tax                      | 84                      | 51        | 85        |
| Deferred federal income tax expense (benefit) | 2,005                   | 1,089     | (221)     |
| Income tax expense                            | \$ 23,816               | \$ 20,765 | \$ 18,553 |

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 |       |       |
|--|---------------------------------|-------|-------|
|  | 2011                            | 2010  | 2009  |
| Statutory federal income tax rate  | 35.0%                           | 35.0% | 35.0% |
| Reductions in tax rate resulting from interest income exempt from federal income tax | (9.3)                           | (9.2) | (9.5) |
| Effect of state income tax   | 0.1                             | 0.1   | 0.1   |
| ESOP tax credit  | (0.3)                           | (0.3) | (0.4) |
| Other  | 0.3                             | 0.2   | 0.4   |
| Effective income tax rate  | 25.8%                           | 25.8% | 25.6% |

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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

December 31, 2011, 2010 and 2009

The approximate effects of each type of difference that gave rise to the Company's deferred tax assets and liabilities at December 31, 2011 and 2010 are as follows:

|   | 2011               | 2010               |
|---|--------------------|--------------------|
| <b>Deferred tax assets:</b>   |                    |                    |
| Tax basis of loans in excess of financial statement basis   | \$ 12,231          | \$ 11,199          |
| Minimum liability in defined benefit plan   | 3,954              | 3,044              |
| Recognized for financial reporting purposes but not for tax purposes:                               |                    |                    |
| Deferred compensation   | 1,807              | 1,621              |
| Write-downs and adjustments to other real estate owned and repossessed assets                       | 538                | 155                |
| Other deferred tax assets   | 306                | 201                |
| <b>Total deferred tax assets</b>  | <b>18,836</b>      | <b>16,220</b>      |
| <b>Deferred tax liabilities:</b>  |                    |                    |
| Financial statement basis of fixed assets in excess of tax basis                                    | 5,204              | 3,154              |
| Intangible asset amortization deductible for tax purposes, but not for financial reporting purposes | 7,761              | 6,583              |
| Recognized for financial reporting purposes but not for tax purposes:                               |                    |                    |
| Accretion on investment securities  | 2,129              | 2,082              |
| Pension plan contributions  | 1,668              | 1,267              |
| Net unrealized gain on investment securities Available-for-sale                                     | 29,383             | 14,057             |
| Other deferred tax liabilities  | 433                | 398                |
| <b>Total deferred tax liabilities</b>   | <b>46,578</b>      | <b>27,541</b>      |
| <b>Net deferred tax asset (liability)</b>   | <b>\$ (27,742)</b> | <b>\$ (11,321)</b> |

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 2008 or Texas state tax examinations by tax authorities for years before 2010.

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8. **EXTRAORDINARY ITEM:**

In the third quarter of 2010, the Company recorded income from an extraordinary item in the amount of \$1.3 million, after income taxes, related to the expropriation of a portion of our real property. The Texas Department of Transportation (TXDOT) expropriated a portion of our real property at our Southlake bank location to expand highway access. TXDOT paid \$2.2 million for land and damages to our existing property resulting in a net gain of \$2.0 million before income taxes. As a result, our prior location's accessibility significantly deteriorated and we constructed a new bank location in Southlake. We sold the prior Southlake location in August 2011.

9. **FAIR VALUE DISCLOSURES:**

The accounting authoritative 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 accounting authoritative 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 accounting 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 trading and available for sale 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. Securities are considered to be measured with Level 1 inputs at the time of purchase and for 30 days following. After 30 days, the majority of securities are transferred to Level 2 as they are considered to be measured with Level 2 inputs, with the exception of U. S. Treasury securities and any other security for which there remain Level 1 inputs. Transfers are recognized on the actual date of transfer.

There were no transfers between Level 2 and Level 3 during the year ended December 31, 2011.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of December 31, 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (dollars in thousands):

|  | Level 1<br>Inputs | Level 2<br>Inputs   | Level 3<br>Inputs | Total Fair<br>Value |
|--|-------------------|---------------------|-------------------|---------------------|
| <b>Available for sale investment securities:</b>                   |                   |                     |                   |                     |
| U. S. Treasury securities  | \$ 15,347         | \$                  | \$                | \$ 15,347           |
| Obligations of U. S. government sponsored-enterprises and agencies |                   | 261,346             |                   | 261,346             |
| Obligations of state and political subdivisions                    | 46,207            | 658,464             |                   | 704,671             |
| Corporate bonds  | 1,593             | 126,076             |                   | 127,669             |
| Mortgage-backed securities   | 18,206            | 710,345             |                   | 728,551             |
| Other securities   | 3,805             |                     |                   | 3,805               |
| <b>Total</b>   | <b>\$ 85,158</b>  | <b>\$ 1,756,231</b> | <b>\$</b>         | <b>\$ 1,841,389</b> |

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, 2011:

**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 or Level 3 input based on the discounting of the collateral. At December 31, 2011, impaired loans with a carrying value of \$20.0 million were reduced by specific valuation allowance totaling \$6.0 million resulting in a net fair value of \$14.0 million, based on Level 3 inputs.



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**Loans Held for Sale** Loans held for sale are reported at the lower of cost or fair value. In determining whether the fair value of loans held for sale is less than cost when quoted market prices are not available, the Company considers investor commitments/contracts. These loans are considered Level 2 of the fair value hierarchy. At December 31, 2011, the Company's mortgage loans held for sale were recorded at cost as fair value exceeded 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 nonrecurring basis during the year ended December 31, 2011 and 2010 include other real estate owned which, subsequent to their initial transfer to other real estate owned from loans, were remeasured 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. 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 remeasured subsequent to their initial transfer to other real estate owned from loans and reported at fair value (dollars in thousands):

|  | Year Ended<br>December 31, |               |
|--|----------------------------|---------------|
|  | 2011                       | 2010          |
| Carrying value of other real estate owned prior to remeasurement       | \$ 7,064                   | \$ 1,076      |
| Write-downs included in gain (loss) on sale of other real estate owned | (1,522)                    | (153)         |
| <b>Fair value</b>  | <b>\$ 5,542</b>            | <b>\$ 923</b> |

At December 31, 2011 and 2010, other real estate owned totaled \$9.2 million and \$8.3 million, 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, as defined. 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 which 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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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. Financial instrument liabilities with no stated maturities have an estimated fair value equal to both the amount payable on demand and the carrying value. Changes in assumptions or estimation methodologies may have a material effect on these estimated fair values.

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 accounting guidance at December 31, 2011 and 2010, were as follows (in thousands):

|   | 2011           |                      | 2010           |                      |
|---|----------------|----------------------|----------------|----------------------|
|   | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Cash and due from banks                 | \$ 146,239     | \$ 146,239           | \$ 124,177     | \$ 124,177           |
| Federal funds sold                      |                |                      |                |                      |
| Interest-bearing deposits in banks      | 104,597        | 104,597              | 140,090        | 140,090              |
| Interest-bearing time deposits in banks | 61,175         | 61,175               | 103,686        | 103,686              |
| Available for sale securities           | 1,841,389      | 1,841,389            | 1,537,178      | 1,537,178            |
| Held to maturity securities             | 3,609          | 3,655                | 9,064          | 9,240                |
| Loans                                   | 1,752,229      | 1,757,732            | 1,659,240      | 1,659,444            |
| Accrued interest receivable             | 22,446         | 22,446               | 21,006         | 21,006               |
| Deposits with stated maturities         | 752,298        | 754,186              | 837,615        | 840,234              |
| Deposits with no stated maturities      | 2,582,500      | 2,582,500            | 2,275,686      | 2,275,686            |
| Short-term borrowings                   | 207,756        | 207,756              | 178,356        | 178,356              |
| Accrued interest payable                | 594            | 594                  | 1,234          | 1,234                |

**10. 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 the resolution of these matters will have no 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, 2011, future minimum lease commitments were: 2012 \$714,000; 2013 \$633,000; 2014 \$425,000; 2015 \$400,000; 2016 \$341,000 and thereafter \$187,000.

**11. FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK:**

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include unfunded lines of credit, commitments to extend credit 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.



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The Company's exposure to credit loss in the event of nonperformance by the other party 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. The Company generally uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

|  | Contract or<br>Notional Amount<br>at December 31, 2011 |
|--|--|
| Financial instruments whose contract amounts represent credit risk (in thousands): |  |
| Unfunded lines of credit   | \$ 449,100   |
| Unfunded commitments to extend credit  | 67,115   |
| Standby letters of credit  | 20,533   |
|  | \$ 536,748   |

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. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant, and equipment, livestock, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Company 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.

The Company has no other significant off-balance sheet arrangements or transactions that would expose the Company to liability that is not reflected in the consolidated financial statements.

**12. CONCENTRATION OF CREDIT RISK:**

The Company grants commercial, retail, agriculture and residential real estate loans to customers primarily in North Central 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 this local economic sector. In addition, the Company holds mortgage related securities which are backed by GNMA, FNMA or FHLMC or are collateralized by securities backed by these agencies.

**13. PENSION AND PROFIT SHARING PLANS:**

The Company's defined benefit pension plan was frozen effective January 1, 2004 whereby no additional years of service accrue to participants, unless the pension plan is reinstated at a future date. The pension plan covered substantially all of the Company's employees. The benefits 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 freezing



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the pension plan, we did not expect contributions or pension expense to be significant in future years. However, as a result of the Pension Protection Act of 2006, the Company will be required to contribute amounts in future years to fund any shortfalls. The Company evaluated the provisions of the Act as well as Internal Revenue Service's funding standards to develop a preliminary plan for funding in future years. The Company made a contribution totaling \$1.5 million and \$1.0 million in 2011 and 2010, respectively, and is continuing to evaluate future funding amounts.

Using an actuarial measurement date of December 31, 2011 and 2010, respectively, benefit obligation activity and fair value of plan assets for the years ended December 31, 2011 and 2010, and a statement of the funded status as of December 31, 2011 and 2010, are as follows (in thousands):

|  | 2011           | 2010           |
|--|----------------|----------------|
| <b>Reconciliation of benefit obligations:</b>  |                |                |
| Benefit obligation at January 1  | \$ 22,263      | \$ 20,671      |
| Interest cost on projected benefit obligation  | 1,139          | 1,159          |
| Actuarial loss (gain)  | 2,320          | 1,445          |
| Benefits paid  | (1,114)        | (1,012)        |
| <br>Benefit obligation at December 31  | <br>24,608     | <br>22,263     |
| <b>Reconciliation of fair value of plan assets:</b>  |                |                |
| Fair value of plan assets at January 1   | \$ 17,184      | \$ 15,726      |
| Actual return on plan assets   | 506            | 1,470          |
| Employer contributions   | 1,500          | 1,000          |
| Benefits paid  | (1,114)        | (1,012)        |
| Fair value of plan assets at December 31   | 18,076         | 17,184         |
| <br>Funded status  | <br>\$ (6,532) | <br>\$ (5,079) |
| <b>Reconciliation of funded status to accrued pension liability:</b>                                     |                |                |
| Funded status at December 31   | \$ (6,532)     | \$ (5,079)     |
| Unrecognized loss from past experience different than that assumed and effects of changes in assumptions | 11,620         | 9,021          |
| Additional minimum liability recorded  | (11,620)       | (9,021)        |
| <br>Accrued pension liability  | <br>\$ (6,532) | <br>\$ (5,079) |

Current authoritative accounting guidance requires an employer to recognize the overfunded or underfunded status of defined benefit post-retirement benefit plans as an asset or a liability in its balance sheet. The funded status is measured as the difference between plan assets at fair value and the benefit obligation. An employer is also required to measure the funded status of a plan as of the date of its year-end statement of financial position with changes in the funded status recognized through comprehensive income. Current authoritative accounting guidance also requires certain disclosures regarding the effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of gains or losses.



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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

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Net periodic pension cost for the years ended December 31, 2011, 2010, and 2009, included (in thousands):

|  | Year Ended December 31, |               |               |
|--|-------------------------|---------------|---------------|
|  | 2011                    | 2010          | 2009          |
| Service cost benefits earned during the period | \$                      | \$            | \$            |
| Interest cost on projected benefit obligation  | 1,139                   | 1,159         | 1,169         |
| Expected return on plan assets                 | (1,220)                 | (1,092)       | (915)         |
| Amortization of unrecognized net loss          | 434                     | 416           | 484           |
| <b>Net periodic pension cost</b>               | <b>\$ 353</b>           | <b>\$ 483</b> | <b>\$ 738</b> |

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:

|   | 2011  | 2010  | 2009  |
|---|-------|-------|-------|
| Weighted average discount rate              | 4.65% | 5.25% | 5.75% |
| Expected long-term rate of return on assets | 6.75% | 6.75% | 7.25% |

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 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 major type of plan assets in the pension plan and the targeted allocation percentage as of December 31, 2011 and 2010 is as follows:

|                      | December 31, 2011<br>Allocation | December 31, 2010<br>Allocation | Targeted<br>Allocation |
|----------------------|---------------------------------|---------------------------------|------------------------|
| Equity securities    | 82%                             | 84%                             | 75%                    |
| Debt securities      | 16%                             | 15%                             | 25%                    |
| Cash and equivalents | 2%                              | 1%                              |                        |

The range and weighted average final maturities of debt securities held in the pension plan as of December 31, 2011 are 1 1/2 to 9 1/2 years and approximately 5.79 years, respectively. Assets held in the pension are considered either Level 1 consisting of the publicly traded common stocks and publically traded mutual funds or Level 2 consisting of agency and corporate debt securities. There were no Level 3 securities. See note 9 for a discussion of the fair value hierarchy. The breakdown by level is as follows (in thousands):

|   | Level 1<br>Inputs | Level 2<br>Inputs | Level 3<br>Inputs | Total Fair<br>Value |
|---|-------------------|-------------------|-------------------|---------------------|
| Money market fund                               | \$ 294            | \$                | \$                | \$ 294              |
| U. S. Treasury securities                       | 209               |                   |                   | 209                 |
| Obligations of state and political subdivisions |                   | 698               |                   | 698                 |

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|                                   |                  |                 |           |                  |
|-----------------------------------|------------------|-----------------|-----------|------------------|
| Corporate bonds                   |                  | 1,213           |           | 1,213            |
| Mortgage-backed securities        |                  | 786             |           | 786              |
| Corporate stocks and mutual funds | 14,876           |                 |           | 14,876           |
| <b>Total</b>                      | <b>\$ 15,379</b> | <b>\$ 2,697</b> | <b>\$</b> | <b>\$ 18,076</b> |

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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, |          |
|--------------------------|----------|
| 2012                     | \$ 1,310 |
| 2013                     | 1,390    |
| 2014                     | 1,447    |
| 2015                     | 1,492    |
| 2016                     | 1,529    |
| 2017 to 2021             | 8,699    |

As of December 31, 2011 and 2010, the pension plan's assets included Company common stock valued at approximately \$1,030,000 and \$1,053,000, 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 \$4,688,000, \$4,299,000, and \$2,360,000 in 2011, 2010 and 2009, respectively, and are included in salaries and employee benefits in the accompanying consolidated statements of earnings. As of December 31, 2011 and 2010, the profit sharing plan's assets included Company common stock valued at approximately \$25,715,000 and \$26,803,000, 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 2011, 2010 and 2009 was \$1,305,000, \$1,220,000 and \$1,178,000, 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.

**14. DIVIDENDS FROM SUBSIDIARIES:**

At December 31, 2011, approximately \$59.8 million was available for the declaration of dividends by the Company's subsidiary banks without the prior approval of regulatory agencies.

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FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

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15. REGULATORY MATTERS:

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and each of its subsidiaries to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes as of December 31, 2011 and 2010, that Company and each of its subsidiaries meet all capital adequacy requirements to which they are subject.

As of December 31, 2011 and 2010, the most recent notification from each respective subsidiary's primary regulator categorized each of the Company's subsidiaries as well-capitalized. To be categorized as well-capitalized, the subsidiaries must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table.

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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

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There are no conditions or events since that notification that management believes have changed the institutions' categories. Bankshares' and its significant subsidiaries' actual capital amounts and ratios are presented in the table below (in thousands):

|   | Actual<br>Amount | Ratio | For Capital<br>Adequacy Purposes:<br>Amount | Ratio           | To Be Well<br>Capitalized Under<br>Prompt Corrective<br>Action Provisions:<br>Amount | Ratio            |
|---|------------------|-------|---|-----------------|--|------------------|
| <b>As of December 31, 2011:</b>                 |                  |       |   |                 |  |                  |
| <i>Total Capital (to Risk-Weighted Assets):</i> |                  |       |   |                 |  |                  |
| Consolidated                                    | \$ 426,532       | 19%   | <sup>3</sup> \$ 182,050                     | <sup>3</sup> 8% | N/A  |                  |
| First Financial Bank Abilene                    | \$ 110,120       | 15%   | <sup>3</sup> \$ 56,943                      | <sup>3</sup> 8% | <sup>3</sup> \$71,179  | <sup>3</sup> 10% |
| First Financial Bank San Angelo                 | \$ 38,744        | 18%   | <sup>3</sup> \$ 16,988                      | <sup>3</sup> 8% | <sup>3</sup> \$21,235  | <sup>3</sup> 10% |
| First Financial Bank Weatherford                | \$ 33,975        | 16%   | <sup>3</sup> \$16,894                       | <sup>3</sup> 8% | <sup>3</sup> \$21,117  | <sup>3</sup> 10% |
| First Financial Bank Stephenville               | \$ 33,062        | 14%   | <sup>3</sup> \$18,488                       | <sup>3</sup> 8% | <sup>3</sup> \$23,109  | <sup>3</sup> 10% |
| First Financial Bank Southlake                  | \$ 31,753        | 15%   | <sup>3</sup> \$ 16,570                      | <sup>3</sup> 8% | <sup>3</sup> \$20,713  | <sup>3</sup> 10% |
| <i>Tier1 Capital (to Risk-Weighted Assets):</i> |                  |       |   |                 |  |                  |
| Consolidated                                    | \$ 397,916       | 17%   | <sup>3</sup> \$ 91,025                      | <sup>3</sup> 4% | N/A  |                  |
| First Financial Bank Abilene                    | \$ 103,002       | 14%   | <sup>3</sup> \$ 28,472                      | <sup>3</sup> 4% | <sup>3</sup> \$42,707  | <sup>3</sup> 6%  |
| First Financial Bank San Angelo                 | \$ 36,237        | 17%   | <sup>3</sup> \$ 8,494                       | <sup>3</sup> 4% | <sup>3</sup> \$12,741  | <sup>3</sup> 6%  |
| First Financial Bank Weatherford                | \$ 31,309        | 15%   | <sup>3</sup> \$ 8,447                       | <sup>3</sup> 4% | <sup>3</sup> \$12,670  | <sup>3</sup> 6%  |
| First Financial Bank Stephenville               | \$ 30,143        | 13%   | <sup>3</sup> \$ 9,244                       | <sup>3</sup> 4% | <sup>3</sup> \$13,866  | <sup>3</sup> 6%  |
| First Financial Bank Southlake                  | \$ 29,126        | 14%   | <sup>3</sup> \$ 8,285                       | <sup>3</sup> 4% | <sup>3</sup> \$12,428  | <sup>3</sup> 6%  |
| <i>Tier1 Capital (to Average Assets):</i>       |                  |       |   |                 |  |                  |
| Consolidated                                    | \$ 397,916       | 10%   | <sup>3</sup> \$115,610                      | <sup>3</sup> 3% | N/A  |                  |
| First Financial Bank Abilene                    | \$ 103,002       | 8%    | <sup>3</sup> \$38,902                       | <sup>3</sup> 3% | <sup>3</sup> \$64,837  | <sup>3</sup> 5%  |
| First Financial Bank San Angelo                 | \$ 36,237        | 9%    | <sup>3</sup> \$ 11,679                      | <sup>3</sup> 3% | <sup>3</sup> \$19,465  | <sup>3</sup> 5%  |
| First Financial Bank Weatherford                | \$ 31,309        | 8%    | <sup>3</sup> \$ 11,126                      | <sup>3</sup> 3% | <sup>3</sup> \$18,544  | <sup>3</sup> 5%  |
| First Financial Bank Stephenville               | \$ 30,143        | 9%    | <sup>3</sup> \$ 10,148                      | <sup>3</sup> 3% | <sup>3</sup> \$16,914  | <sup>3</sup> 5%  |
| First Financial Bank Southlake                  | \$ 29,126        | 9%    | <sup>3</sup> \$ 9,225                       | <sup>3</sup> 3% | <sup>3</sup> \$15,375  | <sup>3</sup> 5%  |

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|   | Actual     |       | For Capital        |       | To Be Well         |                   |
|---|------------|-------|--------------------|-------|--------------------|-------------------|
|   | Amount     | Ratio | Adequacy Purposes: | Ratio | Capitalized Under  | Prompt Corrective |
|   |            |       | Amount             |       | Action Provisions: | Ratio             |
| <b>As of December 31, 2010:</b>                 |            |       |                    |       |                    |                   |
| <i>Total Capital (to Risk-Weighted Assets):</i> |            |       |                    |       |                    |                   |
| Consolidated                                    | \$ 382,427 | 18%   | ³\$ 167,526        | ³ 8%  | N/A                |                   |
| First Financial Bank Abilene                    | \$ 101,175 | 16%   | ³\$ 51,559         | ³ 8%  | ³\$64,449          | ³ 10%             |
| First Financial Bank San Angelo                 | \$ 37,547  | 19%   | ³\$ 15,832         | ³ 8%  | ³\$19,789          | ³ 10%             |
| First Financial Bank Weatherford                | \$ 32,133  | 16%   | ³\$ 15,680         | ³ 8%  | ³\$19,600          | ³ 10%             |
| First Financial Bank Stephenville               | \$ 30,845  | 15%   | ³\$ 16,059         | ³ 8%  | ³\$20,074          | ³ 10%             |
| First Financial Bank Southlake                  | \$ 29,825  | 16%   | ³\$ 14,504         | ³ 8%  | ³\$18,130          | ³ 10%             |
| <i>Tier1 Capital (to Risk-Weighted Assets):</i> |            |       |                    |       |                    |                   |
| Consolidated                                    | \$ 356,152 | 17%   | ³\$ 83,763         | ³ 4%  | N/A                |                   |
| First Financial Bank Abilene                    | \$ 94,437  | 15%   | ³\$ 25,780         | ³ 4%  | ³\$38,670          | ³ 6%              |
| First Financial Bank San Angelo                 | \$ 35,201  | 18%   | ³\$ 7,916          | ³ 4%  | ³\$11,874          | ³ 6%              |
| First Financial Bank Weatherford                | \$ 29,656  | 15%   | ³\$ 7,840          | ³ 4%  | ³\$11,760          | ³ 6%              |
| First Financial Bank Stephenville               | \$ 28,312  | 14%   | ³\$ 8,029          | ³ 4%  | ³\$12,044          | ³ 6%              |
| First Financial Bank Southlake                  | \$ 27,529  | 15%   | ³\$ 7,252          | ³ 4%  | ³\$10,878          | ³ 6%              |
| <i>Tier1 Capital (to Average Assets):</i>       |            |       |                    |       |                    |                   |
| Consolidated                                    | \$ 356,152 | 10%   | ³\$ 103,946        | ³ 3%  | N/A                |                   |
| First Financial Bank Abilene                    | \$ 94,437  | 8%    | ³\$ 34,551         | ³ 3%  | ³\$57,585          | ³ 5%              |
| First Financial Bank San Angelo                 | \$ 35,201  | 10%   | ³\$ 10,765         | ³ 3%  | ³\$17,941          | ³ 5%              |
| First Financial Bank Weatherford                | \$ 29,656  | 8%    | ³\$ 10,483         | ³ 3%  | ³\$17,472          | ³ 5%              |
| First Financial Bank Stephenville               | \$ 28,312  | 9%    | ³\$ 9,546          | ³ 3%  | ³\$15,910          | ³ 5%              |
| First Financial Bank Southlake                  | \$ 27,529  | 10%   | ³\$ 8,117          | ³ 3%  | ³\$13,528          | ³ 5%              |

In connection with the First Financial Trust & Asset Management Company, N.A.'s (the Trust Company) application to obtain our trust charter, the Trust Company is required to maintain tangible net assets of \$2.0 million at all times. As of December 31, 2011, our Trust Company had tangible net assets totaling \$4.4 million.

Certain subsidiary banks may be required at times to maintain reserve balances with the Federal Reserve Bank. No such reserves were required at December 31, 2011. At December 31, 2010, such required reserve balances totaled approximately \$756,000.

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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

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**16. STOCK OPTION PLAN:**

The Company has an incentive stock plan to provide for the granting of options to senior management of the Company at prices not less than market at the date of grant. At December 31, 2011, the Company had allocated 1,087,000 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, 2011 is presented in the table and narrative below:

|                                | Shares  | Weighted-Average<br>Ex. Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (Years) | Aggregate Intrinsic<br>Value (\$000) |
|--------------------------------|---------|-------------------------------|--|--------------------------------------|
| Outstanding, beginning of year | 380,457 | \$ 27.11                      |  |                                      |
| Granted                        | 154,100 | 31.45                         |  |                                      |
| Exercised                      | 46,903  | 20.25                         |  |                                      |
| Cancelled                      | 6,630   | 31.41                         |  |                                      |
| Outstanding, end of year       | 481,024 | \$ 29.11                      | \$ 6.79  | \$ 14,002                            |
| Exercisable at end of year     | 176,414 | \$ 24.79                      | \$ 4.21  | \$ 4,373                             |

The options outstanding at December 31, 2011, had exercise prices ranging between \$15.40 and \$33.55. 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, 2011:

| Exercise Price | Remaining   |              | Number Vested |
|----------------|-------------|--------------|---------------|
|                | Number      | Contracted   |               |
|                | Outstanding | Life (Years) |               |
| \$15.40        | 21,532      | 1.4          | 21,532        |
| \$22.05        | 70,502      | 3.1          | 70,502        |
| \$27.32        | 98,060      | 5.1          | 55,250        |
| \$33.55        | 136,830     | 7.4          | 29,130        |
| \$31.45        | 154,100     | 9.8          |               |

The fair value of the options granted in 2011 and 2009 was estimated using the Black-Scholes options pricing model with the following weighted-average assumptions: risk-free interest rate of 1.34% and 3.24%; expected dividend yield of 2.88% and 2.66%; expected life of 5.93 and 5.79 years; and expected volatility of 26.92% and 41.64%, respectively.

The weighted-average grant-date fair value of options granted during the year ended December 31, 2011 and 2009 was \$5.94 and \$11.33. There were no grants during 2010. The total intrinsic value of options exercised during the years ended December 31, 2011, 2010, and 2009, was

\$619,000, \$778,000, and \$1,351,000, respectively.

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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

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As of December 31, 2011, there was \$1,543,000 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 2.31 years. The total fair value of shares vested during the years ended December 31, 2011, 2010, and 2009 was \$369,000, \$213,000 and \$371,000 respectively.

The aggregate intrinsic value of vested stock options at December 31, 2011 totaled \$1,525,000.

**17. CONDENSED FINANCIAL INFORMATION PARENT COMPANY:****Condensed Balance Sheets-December 31, 2011 and 2010**

|   | 2011       | 2010       |
|---|------------|------------|
| <b><u>ASSETS</u></b>                                  |            |            |
| Cash in subsidiary bank                               | \$ 16,800  | \$ 13,341  |
| Cash in unaffiliated banks                            | 2          | 5          |
| Interest-bearing deposits in unaffiliated bank        | 5,026      | 5,014      |
| Interest-bearing deposits in subsidiary banks         | 28,192     | 13,545     |
| Total cash and cash equivalents                       | 50,020     | 31,905     |
| Interest-bearing time deposits in unaffiliated banks  | 2,118      | 4,278      |
| Securities available-for-sale, at fair value          | 17,729     | 13,497     |
| Investment in and advances to subsidiaries, at equity | 446,320    | 399,087    |
| Intangible assets                                     | 723        | 723        |
| Other assets  | 2,009      | 746        |
| Total assets  | \$ 518,919 | \$ 450,236 |
| <b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>    |            |            |
| Total liabilities                                     | \$ 10,382  | \$ 8,548   |
| Shareholders' equity:                                 |            |            |
| Common stock  | 315        | 209        |
| Capital surplus                                       | 276,126    | 274,629    |
| Retained earnings                                     | 184,871    | 146,397    |
| Treasury shares                                       | (4,597)    | (4,207)    |
| Deferred compensation                                 | 4,597      | 4,207      |
| Accumulated other comprehensive earnings              | 47,225     | 20,453     |
| Total shareholders' equity                            | 508,537    | 441,688    |
| Total liabilities and shareholders' equity            | \$ 518,919 | \$ 450,236 |

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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

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## Condensed Statements of Earnings-

For the Years Ended December 31, 2011, 2009 and 2009

|   | 2011      | 2010      | 2009      |
|---|-----------|-----------|-----------|
| <b>Income:</b>  |           |           |           |
| Cash dividends from subsidiaries                      | \$ 47,350 | \$ 41,050 | \$ 37,750 |
| Excess of earnings over dividends of subsidiary banks | 22,722    | 20,149    | 17,362    |
| Other income  | 2,435     | 1,991     | 1,812     |
|   | 72,507    | 63,190    | 56,924    |
| <b>Expenses:</b>                                      |           |           |           |
| Salaries and employee benefits                        | 3,493     | 2,833     | 2,492     |
| Other operating expenses                              | 2,199     | 2,068     | 1,896     |
|   | 5,692     | 4,901     | 4,388     |
| Earnings before income taxes                          | 66,815    | 58,289    | 52,536    |
| Income tax benefit                                    | 1,554     | 1,370     | 1,261     |
| Net earnings  | \$ 68,369 | \$ 59,659 | \$ 53,797 |

## Condensed Statements of Cash Flows-

For the Years Ended December 31, 2011, 2010, and 2009

|   | 2011      | 2010      | 2009      |
|---|-----------|-----------|-----------|
| <b>Cash flows from operating activities:</b>  |           |           |           |
| Net earnings  | \$ 68,369 | \$ 59,659 | \$ 53,797 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |           |           |           |
| Excess of earnings over dividends of subsidiary banks                               | (22,722)  | (20,149)  | (17,362)  |
| Depreciation and amortization, net  | 187       | 171       | 114       |
| Decrease in other assets  | 396       | 10        | 203       |
| Increase (decrease) in liabilities  | 774       | (29)      | 640       |
| Net cash provided by operating activities   | 47,004    | 39,662    | 37,392    |
| <b>Cash flows from investing activities:</b>  |           |           |           |
| Acquisition of bank   |           | (18,200)  |           |
| Net decrease (increase) in interest-bearing time deposits in unaffiliated banks     | 2,160     | (198)     | (4,080)   |
| Purchase of available for sale securities   | (5,756)   | (5,649)   |           |

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|   |           |           |           |
|---|-----------|-----------|-----------|
| Maturities of available for securities  | 2,500     | 2,500     |           |
| Purchases of bank premises and equipment  | (204)     | (59)      | (14)      |
| Repayment from (of advances related to) investment in and advances to subsidiaries, net | 820       | (200)     | 345       |
| Net cash used in investing activities   | (480)     | (21,806)  | (3,749)   |
| Cash flows from financing activities:   |           |           |           |
| Proceeds of stock issuances   | 950       | 790       | 682       |
| Cash dividends paid   | (29,359)  | (28,346)  | (28,302)  |
| Net cash used in financing activities   | (28,409)  | (27,556)  | (27,620)  |
| Net increase (decrease) in cash and cash equivalents                                    | 18,115    | (9,700)   | 6,023     |
| Cash and cash equivalents, beginning of year  | 31,905    | 41,605    | 35,582    |
| Cash and cash equivalents, end of year  | \$ 50,020 | \$ 31,905 | \$ 41,605 |

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In connection with the Company's Federal Housing Administration (FHA) mortgage loan originations, the parent company has executed a corporate guarantee agreement in which the parent company guarantees the ongoing FHA net worth and liquidity compliance of First Financial Bank, N.A., Abilene and First Financial Bank, N.A., San Angelo.

**18. CASH FLOW INFORMATION:**

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

|  | Year Ended December 31, |           |           |
|--|-------------------------|-----------|-----------|
|  | 2011                    | 2010      | 2009      |
| <b>Supplemental cash flow information:</b>                     |                         |           |           |
| Interest paid  | \$ 8,664                | \$ 13,802 | \$ 18,046 |
| Federal income taxes paid                                      | 18,942                  | 18,844    | 18,690    |
| <b>Schedule of noncash investing and financing activities:</b> |                         |           |           |
| Assets acquired through foreclosure                            | 6,013                   | 11,017    | 5,321     |
| Investment securities purchased but not settled                | 21,325                  | 14,945    |           |

**19. ACQUISITION**

On November 1, 2010, the agreement and plan of merger with Sam Houston Financial Corp., the parent company of The First State Bank, Huntsville, Texas was completed. Pursuant to the agreement, we paid \$22.0 million, for all of the outstanding shares of Sam Houston Financial Corp.

At closing, Sam Houston Financial Corp. was merged into First Financial Bankshares of Delaware, Inc. and The First State Bank became a wholly owned bank subsidiary. The total purchase price exceeded the estimated fair value of tangible net assets acquired by approximately \$10.0 million, of which approximately \$228 thousand was assigned to an identifiable intangible asset with the balance recorded by the Company as goodwill. The identifiable intangible asset represents the future benefit associated with the acquisition of the core deposits and is being amortized over seven years, utilizing a method that approximates the expected attrition of the deposits.

The primary purpose of the acquisition was to expand the Company's market share along Interstate Highway 45 in Central Texas. Factors that contributed to a purchase price resulting in goodwill include Huntsville's historic record of earnings and its geographic location. The results of operations from this acquisition are included in the consolidated earnings of the Company commencing November 1, 2010.



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## FIRST FINANCIAL BANKSHARES, INC. AND SUBSIDIARIES

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The following is a condensed balance sheet disclosing the preliminary estimated fair value amounts assigned to the major asset and liability categories at the acquisition date.

| <b>ASSETS</b>                                 |                |
|---|----------------|
| Cash and cash equivalents                     | \$ 15,523      |
| Investment in securities                      | 43,569         |
| Loans, net                                    | 100,804        |
| Goodwill                                      | 9,752          |
| Identifiable intangible asset                 | 228            |
| Other assets                                  | 4,108          |
| <br>Total assets                              | <br>\$ 173,984 |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>    |                |
| Deposits                                      | \$ 149,921     |
| Other liabilities                             | 2,046          |
| Shareholders equity                           | 22,017         |
| <br>Total liabilities and shareholders equity | <br>\$ 173,984 |

Goodwill recorded in the acquisition of Huntsville 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 and identifiable intangible asset recorded are expected to be deductible for federal income tax purposes.

Cash flow information relative to the acquisition of Huntsville is as follows:

|   |                |
|---|----------------|
| Fair value of assets acquired   | \$ 173,984     |
| Cash and common stock paid for the capital stock of Sam Houston Financial Corp. | 22,017         |
| <br>Liabilities assumed   | <br>\$ 151,967 |

We believe the proforma impact of this acquisition to the Company's financial statements is not significant.