

FIRST FINANCIAL BANKSHARES INC

Form 10-K

February 22, 2013

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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, 2012

Commission file number 0-7674

First Financial Bankshares, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Texas
(State or Other Jurisdiction of

75-0944023
(I.R.S. Employer

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Incorporation or Organization)

Identification No.)

400 Pine Street, Abilene, Texas
(Address of Principal Executive Offices)

79601
(Zip Code)

Registrant's telephone number, including area code: (325) 627-7155
Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of Exchange on Which Registered
Common Stock, par value \$0.01 per share	Nasdaq Global Select Market
Securities registered pursuant to Section 12(g) of the Act:	

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

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, 2012, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's voting and non-voting common stock held by non-affiliates was \$1.03 billion.

As of February 22, 2013, there were 31,502,907 shares of common stock outstanding.

Documents Incorporated by Reference

Certain information called for by Part III is incorporated by reference to the proxy statement for our 2013 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2012.

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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), the Jumpstart Our Business Startups Act, the Consumer Financial Protection Bureau and the capital ratios of proposed rule making pursuant to Basel III;

political instability;

the ability of the Federal government to deal with the slowdown of the national economy and the fiscal cliff;

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;

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;

acquisitions and integration of acquired businesses;

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the possible impairment of goodwill associated with our acquisitions;

consequences of continued bank mergers and acquisitions in our market area, resulting in fewer but much larger and stronger competitors;

expansion of our operations, including branch openings, new product offerings and expansion into new markets;

changes in our compensation and benefit plans; and

acts of God or of war or terrorism.

Such 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 (the Company), is a financial holding company registered under the Bank Holding Company Act of 1956, as amended, or BHCA. As such, we are supervised by the Board of Governors of the Federal Reserve System, or Federal Reserve Board, as well as several other banking 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. Through December 30, 2012, we owned eleven banks, a trust company, a technology operating company, and an insurance agency, all organized and located in Texas. Effective December 30, 2012, we consolidated our eleven bank charters into our Abilene bank charter to reduce certain operating costs and make more efficient our technology and compliance operations. As of December 31, 2012, our subsidiaries are:

First Financial Bank, National Association, Abilene, 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 subsidiaries, we conduct full-service commercial banking business. Our banking centers are located primarily in Central, North Central and West Texas. As of December 31, 2012, we had 55 financial centers across Texas, with eleven locations in Abilene, two locations in Cleburne, two locations in Stephenville, two 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, Waxahachie, Grapevine, Keller, Trophy Club, Boyd, Bridgeport, Decatur, Roby, Trent, Merkel, Clyde, Moran, Albany, Midlothian, Glen Rose, Acton, Odessa, Fort Worth and Huntsville, all in Texas.

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Even though we operate in a growing number of Texas markets, we continue to believe that decisions are best made at the local level. Although we consolidated our eleven bank charters into one charter effective December 30, 2012, we continue to operate as eleven bank regions with local advisory boards of directors, local bank region presidents and local decision-making. We have consolidated many of the backroom operations, such as investment securities, accounting, check processing, technology and employee benefits, which improves our efficiency and frees management of our bank regions to concentrate on serving the banking needs of their local communities. We call this our one bank, eleven regions concept.

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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 25.7 million residents, Texas has more people than any other state except California. The population of Texas grew 23.1% from 2000-2011 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 2000-2011*

Bridgeport and Wise County	22.6%
Fort Worth and Tarrant County	27.9%
Cleburne, Midlothian and Johnson County	20.5%
Granbury and Hood County	25.7%
Weatherford, Willow Park, Aledo and Parker County	33.7%
Stephenville and Erath County	15.9%

* Source: U. S. Census Bureau

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

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

Over the years, we have grown in three ways: by growing 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 \$4.50 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 intend to 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.

When targeting a bank for acquisition, the bank generally needs to be in the type of community that fits our profile, is well managed and profitable. 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 up to \$1.0 billion 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, including advisory boards of directors for our bank regions. We provide resources and policy direction in, among other things, the following areas:

asset and liability management;

investments;

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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, including advisory directors, and their compensation. We also perform, through corporate staff groups or by outsourcing to third parties, internal audits, compliance oversight and loan reviews of our subsidiaries. We provide advice and specialized services for our bank regions related to lending, investing, purchasing, advertising, public relations, and computer services.

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

Services Offered by Our Subsidiaries

Our subsidiary bank is a separate legal entity that operates under the day-to-day management of its board of directors and officers. Our eleven bank regions operating under this subsidiary bank each have separate advisory boards that make recommendations and provide assistance to bank regional management in the operations of their respective region. Each of our bank regions provides general commercial banking services, which include accepting and holding checking, savings and time deposits, making loans, automated teller machines, drive-in and night deposit services, safe deposit facilities, remote deposit capture, internet banking, mobile banking, payroll cards, transmitting funds, and performing other customary commercial banking services. We also conduct full service trust activities through First Financial Trust & Asset Management Company, National Association. Through our trust company, we offer personal trust services, which include the administration of estates,

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testamentary trusts, revocable and irrevocable trusts and agency accounts. We also administer all types of retirement and employee benefit accounts, which include 401(k) profit sharing plans and IRAs. In addition, we provide securities brokerage services through arrangements with an unrelated third party in our Abilene, San Angelo and Weatherford bank regions.

Competition

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

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

Employees

Including all of our subsidiaries, we employed approximately 1,000 full-time equivalent employees at December 31, 2012. 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 FDIC. The following information describes particular laws and regulatory provisions relating to financial holding companies and banks. This discussion is qualified in its entirety by reference to the particular laws and regulatory provisions. A change in any of these laws or regulations may have a material effect on our business and the business of our subsidiaries.

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.

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Mergers and Acquisitions

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

Under the BHCA, the Company must obtain the prior approval of the Federal Reserve Board, or acting under delegated authority, the Federal Reserve Bank of Dallas before (1) acquiring direct or indirect ownership or control of any class of voting securities of any bank or bank holding company if, after the acquisition, the Company would directly or indirectly own or control 5% or more of the class; (2) acquiring all of substantially all of the assets of another bank or bank holding company; or (3) merging or consolidating with another bank holding company.

The Change in Bank Control Act of 1978, as amended, or the CIBCA, and the related regulations of the Federal Reserve Board require any person or groups of persons acting in concert (except for companies required to make application under the BHCA), to file a written notice with the Federal Reserve Board before the person or group acquires control of the Company. The CIBCA defines control as the direct or indirect power to vote 25% or more of any class of voting securities or to direct the management or policies of a bank holding company or an insured bank. A rebuttable presumption of control arises under the CIBCA where a person or group controls 10% or more, but less than 25%, of a class of the voting stock of a company or insured bank which is a reporting company under the Securities Exchange Act of 1934, as amended, such as the Company, or such ownership interest is greater than the ownership interest held by any other person or group.

Banks

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

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

First Financial Bank, National Association, Abilene, Texas;

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

First Technology Services, Inc.

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.

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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). Prior to December 30, 2012, the Banking

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Department regulated, supervised and regularly examined 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 were non-member banks of the Federal Reserve, and as such their federal regulator was the FDIC and were subject to most of the federal laws described below.

Deposit Insurance

Our subsidiary bank 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. The unlimited coverage for interest bearing accounts was not renewed and expired on December 31, 2012.

Our subsidiary bank must pay assessments to the FDIC under a risk-based assessment system for this federal deposit insurance protection. FDIC-insured depository institutions that are members of the Bank Insurance Fund pay insurance premiums at rates based on their risk classification. Institutions assigned to higher risk classifications (i.e., institutions that pose a greater risk of loss to the 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, 2012, the assessment rate for our subsidiary bank was at the lowest level risk-based premium available which was 5.00% of the assessment base per annum. During 2012 and prior to December 30, 2012 when we consolidated our bank charters, three of our bank subsidiaries paid higher than the 5.00% premium, the highest being 6.11% at First Financial Bank, Hereford. 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 depositor 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 was expensed based on 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

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solely bank deposits at an institution. This base assessment change necessitated that the FDIC adjust the assessment rates to ensure that the revenue collected under the new assessment system, will approximately equal that under the existing assessment system.

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

The 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 subsidiaries pay or paid dividends.

National banks are 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). Prior to December 30, 2012, First Financial Bank, Hereford and First Financial Bank, Huntsville, as Texas state banking associations, could not pay a dividend reducing its capital and surplus without the prior approval of the Banking Department. In addition, the FDIC had the right to prohibit the payment of dividends by a state, non-member bank where the payment was deemed to be an unsafe or unsound banking practice.

Our subsidiaries paid aggregate dividends of approximately \$58.4 million in 2012 and approximately \$47.4 million in 2011. Under the dividend restrictions discussed above, as of December 31, 2012, our subsidiaries could have declared in the aggregate additional dividends of approximately \$60.0 million from retained net profits, without obtaining regulatory approvals.

To pay dividends, we and our subsidiaries 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 subsidiaries. These laws regulate covered transactions between insured depository institutions and their subsidiaries, on the one hand, and their nondepository affiliates, on the other hand. The Dodd-Frank Act expanded the definition of affiliate to make any investment fund, including a mutual fund, for which a depository institution or its affiliates serve as investment advisor an affiliate of the depository institution. Covered transactions include a loan or extension of

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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 subsidiaries conduct transactions internally among us, we are required to do so at arm's length.

Loans to Directors, Executive Officers and Principal Shareholders

The authority of our subsidiary bank to extend credit to our directors, executive officers and principal shareholders, including their immediate family members 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 bank may make to directors and other insiders, and specified approval procedures must be followed in making loans that exceed certain amounts. In addition, all loans our subsidiary bank 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 bank;

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

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

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

Capital

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

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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, 2012, our capital ratios were as follows: (1) Tier 1 Capital to Risk-Weighted Assets Ratio, 17.43%; (2) Total Capital to Risk-Weighted Assets Ratio, 18.68%; and (3) Tier 1 Capital Leverage Ratio, 10.60%.

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.

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. The various regulatory agencies, including the OCC, have adopted substantially similar regulations that define the five categories identified by FDICIA, using the total risk based capital, Tier 1 risk based capital and Tier 1 leverage ratios as relevant capital measures. Under current regulations, our subsidiary bank was well capitalized as of December 31, 2012.

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.

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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 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. Prior to December 30, 2012, our two Texas-chartered banks exceeded the minimum ratios applied to them.

Our Support of Our Subsidiaries

Under Federal Reserve Board policy, we are expected to commit resources to act as a source of strength to support each of our subsidiaries. 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 subsidiaries would be subordinate in right of payment to deposits and to other indebtedness of our subsidiaries. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and be subject to a priority of payment.

Under the 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 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.

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Community Reinvestment Act of 1977

The Community Reinvestment Act of 1977, or CRA, subjects a bank to regulatory assessment to determine if the institution meets the credit needs of its entire community, including low- and moderate-income neighborhoods served by the bank, and to take that determination into account in its evaluation of any application made by such bank for, among other things, approval of the acquisition or establishment of a branch or other 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. Prior to our consolidation of our bank charters and effective as of December 30, 2012, we believe our subsidiary banks had 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

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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.

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Consumer Laws and Regulations

We are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the following list is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, The Fair and Accurate Credit Transactions Act, The Real Estate Settlement Procedures Act and the Fair Housing Act, among others. These laws and regulations, among other things, prohibit discrimination on the basis of race, gender or other designated characteristics and mandate various disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. These and other laws also limit finance charges or other fees or charges earned in our activities. We must comply with the applicable provisions of these consumer protection laws and regulations as part of our ongoing customer relations.

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.

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Enforcement Powers of Federal Banking Agencies

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

Regulatory Reform and Legislation

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. Department of the 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 have affected or could 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 has examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act 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 Tier 1 common equity and Tier 1 capital ratio requirements will be phased in incrementally between January 1, 2013 and January 1, 2015; the deductions from common equity made in calculating Tier 1 common equity will be phased in incrementally over a four-year period commencing on January 1, 2014; and the capital conservation buffer will be phased in incrementally between January 1, 2016 and January 1, 2019. The Basel Committee also announced that a countercyclical buffer of 0% to 2.5% of common equity or other fully loss-absorbing capital will be implemented according to national circumstances as an extension of the conservation buffer.

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On June 7, 2012, the U.S. banking agencies requested comment on the three proposed rules that, taken together, would establish an integrated regulatory capital framework implementing the Basel III regulatory capital reforms in the United States. As proposed, the U.S. implementation of Basel III would lead to significantly higher capital requirements and more restrictive leverage and liquidity ratios than those currently in place. Once adopted, these new capital requirements would be phased in over time. Additionally, the U.S. implementation of Basel III contemplates that, for banking organizations with less than \$15 billion in assets, the ability to treat trust preferred securities as Tier 1 capital would be phased out over a ten-year period. Comments to the proposed rules were requested by September 7, 2012 in order to begin the gradual integration of the proposed rules on January 1, 2013. U.S. banking agencies have delayed implementation of the proposed rules as they continue weighing views expressed during the comment period. The ultimate impact of the U.S. implementation of the new capital and liquidity standards on the Company and the Bank is currently being reviewed. At this point we cannot determine the ultimate effect that any final regulations, if enacted, would have upon our earnings or financial position. In addition, important questions remain as to how the numerous capital and liquidity mandates of the Dodd-Frank Act will be integrated with the requirements of Basel III.

Available Information

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any document we file at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. Our SEC filings are also available to the public at the SEC's web site at <http://www.sec.gov>. Our web site is <http://www.ffin.com>. You may also obtain copies of our annual, quarterly and special reports, proxy statements and certain other information filed with the SEC, as well as amendments thereto, free of charge from our web site. These documents are posted to our web site after we have filed them with the SEC. Our corporate governance guidelines, including our code of conduct applicable to all our employees, officers and directors, as well as the charters of our audit and nominating committees, are available at www.ffin.com. The foregoing information is also available in print to any shareholder who requests it. Except as explicitly provided, information on any web site is not incorporated into this Form 10-K or our other securities filings and is not a part of them.

ITEM 1A. RISK FACTORS

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

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.

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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.

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

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

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

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

Our network of bank regions is concentrated in Texas, primarily in the 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.

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

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

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

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

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.

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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.

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.

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

From time to time, customers could make claims and take legal action pertaining to our performance of our fiduciary responsibilities. Whether customer claims and legal action related to our performance of our fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to us, they may result in significant financial liability and/or adversely affect our market perception of our products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Our business is subject to significant government regulation.

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

The Dodd-Frank Act, enacted in July 2010, instituted major changes to the banking and financial institutions regulatory regimes in light of the recent performance of and government intervention in the financial services sector. Other changes to 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.

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.

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We are subject to interest rate risk.

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

Although we have implemented strategies which we believe reduce the potential effects of adverse changes in interest rates on our results of operations, these strategies may not always be successful. In addition, any substantial and prolonged increase in market interest rates could reduce our customers' desire to borrow money from us or adversely affect their ability to repay their outstanding loans by increasing their credit costs since most of our loans have adjustable interest rates that reset periodically. Any of these events could adversely affect our results of operations, financial condition and liquidity.

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 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 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.

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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 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, 2012, we had \$72.0 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;

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

changes in government regulations, including tax laws.

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

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal office is located in the First Financial Bank Building at 400 Pine Street in downtown Abilene, Texas. We lease two spaces in a building owned by First Financial Bank, National Association, Abilene totaling approximately 4,500 square feet. Our subsidiaries collectively own 46 banking facilities, some of which are detached drive-ins, and also lease eight banking facilities and 15 ATM locations. Our management considers all our existing locations to be well-suited for conducting the business of banking. We believe our existing facilities are adequate to meet our requirements and our subsidiaries' requirements for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

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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, 2013, we had approximately 1,250 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, 2007 to December 31, 2012). The performance graph assumes \$100 invested in our common stock at its closing price on December 31, 2007, 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.

<i>Index</i>	<i>Period Ending</i>					
	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12
First Financial Bankshares, Inc.	100.00	150.92	152.42	148.01	149.28	179.12
Russell 3000	100.00	62.69	80.46	94.08	95.05	110.65
SNL Bank \$1B-\$5B	100.00	82.94	59.45	67.39	61.46	75.78

Source : SNL Financial LC, Charlottesville, VA

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The selected financial data presented below as of and for the years ended December 31, 2012, 2011, 2010, 2009, and 2008, have been derived from our audited consolidated financial statements. The selected financial data should be read in conjunction with Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and accompanying notes presented elsewhere in this Form 10-K. The results of operations presented below are not necessarily indicative of the results of operations that may be achieved in the future. Management's Discussion and Analysis of Financial Condition and Results of Operations incorporates information required to be disclosed by the SEC's Industry Guide 3, Statistical Disclosure by Bank Holding Companies.

	Year Ended December 31,				
	2012	2011	2010	2009	2008
	(dollars in thousands, except per share data)				
Summary Income Statement Information:					
Interest income	\$ 159,796	\$ 160,021	\$ 149,699	\$ 146,445	\$ 159,154
Interest expense	5,112	8,024	13,528	17,274	35,259
Net interest income	154,684	151,997	136,171	129,171	123,895
Provision for loan losses	3,484	6,626	8,962	11,419	7,957
Noninterest income	57,209	51,438	49,478	48,598	49,453
Noninterest expense	109,049	104,624	98,256	94,000	91,587
Earnings before income taxes and extraordinary item	99,360	92,185	78,431	72,350	73,804
Income tax expense	25,135	23,816	20,068	18,553	20,640
Net earnings before extraordinary item	74,225	68,369	58,363	53,797	53,164
Extraordinary item			1,296		
Net earnings	\$ 74,225	\$ 68,369	\$ 59,659	\$ 53,797	\$ 53,164
Per Share Data:					
Earnings per share, basic before extraordinary item	\$ 2.36	\$ 2.17	\$ 1.87	\$ 1.72	\$ 1.71
Earnings per share, assuming dilution before extraordinary item	2.36	2.17	1.87	1.72	1.70
Earnings per share, basic	2.36	2.17	1.91	1.72	1.71
Earnings per share, assuming dilution	2.36	2.17	1.91	1.72	1.70
Cash dividends declared	0.99	0.95	0.91	0.91	0.89
Book value at period-end	17.68	16.16	14.06	13.31	11.82
Earnings performance ratios:					
Return on average assets	1.75%	1.78%	1.75%	1.72%	1.74%
Return on average equity	13.85	14.44	13.74	13.63	15.27
Summary Balance Sheet Data (Period-end):					
Securities	\$ 1,820,096	\$ 1,844,998	\$ 1,546,242	\$ 1,285,377	\$ 1,318,406
Loans	2,088,623	1,786,544	1,690,346	1,514,369	1,566,143
Total assets	4,502,012	4,120,531	3,776,367	3,279,456	3,212,385
Deposits	3,632,584	3,334,798	3,113,301	2,684,757	2,582,753
Total liabilities	3,945,049	3,611,994	3,334,679	2,863,754	2,843,603
Total shareholders' equity	556,963	508,537	441,688	415,702	368,782
Asset quality ratios:					
Allowance for loan losses/period-end loans	1.67%	1.92%	1.84%	1.82%	1.37%
Nonperforming assets/period-end loans plus foreclosed assets	1.22	1.64	1.53	1.46	0.80
Net charge offs/average loans	0.15	0.20	0.35	0.36	0.25
Capital ratios:					
Average shareholders' equity/average assets	12.65%	12.30%	12.76%	12.63%	11.37%
Leverage ratio (1)	10.60	10.33	10.28	10.69	9.68
Tier 1 risk-based capital (2)	17.43	17.49	17.01	17.73	15.89

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Total risk-based capital (3)	18.68	18.74	18.26	18.99	17.04
Dividend payout ratio	41.99	43.57	47.58	52.63	52.41

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

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

Introduction

As a 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 bank subsidiary. 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.

The following discussion and analysis of the major elements of our consolidated balance sheets as of December 31, 2012 and 2011, and consolidated statements of earnings for the years 2010 through 2012 should be read in conjunction with our consolidated financial statements, accompanying notes, and selected financial data presented elsewhere in this Form 10-K.

Critical Accounting Policies

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

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

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

Consolidation of Bank Charters

Effective December 30, 2012, the Company consolidated its eleven bank charters into one charter. Regulatory, compliance and technology complexities and the opportunity for cost savings was the reason for making this change. We expect to operate the prior eleven bank charters as regions with local management decisions with recommendations from the bank regions' advisory board to benefit the customers and communities it serves as we do currently.

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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 2012 were \$74.2 million, an increase of \$5.9 million, or 8.57%, over net earnings for 2011 of \$68.4 million. Net earnings for 2010 were \$59.7 million. The increases in net earnings for 2012 over 2011 and 2011 over 2010 were primarily attributable to growth in net interest income and noninterest 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 in 2011.

On a basic net earnings per share basis, net earnings were \$2.36 for 2012 as compared to \$2.17 for 2011 and \$1.91 for 2010. Basic earnings per share before the extraordinary item were \$2.36 for 2012 as compared to \$2.17 for 2011 and \$1.87 for 2010. The return on average assets was 1.75% for 2012 as compared to 1.78% for 2011 and 1.75% for 2010. The return on average equity was 13.85% for 2012 as compared to 14.44% for 2011 and 13.74% for 2010. 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 \$169.3 million in 2012 as compared to \$164.8 million in 2011 and \$147.1 million in 2010. The increase in 2012 compared to 2011 was largely attributable to an increase in the volume of earning assets. Average earning assets were \$3.95 billion in 2012, as compared to \$3.57 billion in 2011 and \$3.14 billion in 2010. Average earning assets increased \$380.4 million in 2012 with increases in all categories of earning assets, except for short-term investments. The yield on earning assets decreased 43 basis points in 2012, whereas the rate paid on interest-bearing liabilities decreased 14 basis points. The increase in 2011 compared to 2010 also resulted from an increase in the volume of earnings assets and from the decrease in the rates paid on interest-bearing liabilities.

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

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

	2012 Compared to 2011			2011 Compared to 2010		
	Change Attributable to Volume	Rate	Total Change	Change Attributable to Volume	Rate	Total Change
Short-term investments	\$ (369)	\$ (97)	\$ (466)	\$ (76)	\$ (245)	\$ (321)
Taxable investment securities	1,451	(7,854)	(6,403)	6,680	(5,186)	1,494
Tax-exempt investment securities (1)	11,259	(6,185)	5,074	5,805	(835)	4,970
Loans (1) (2)	11,342	(7,985)	3,357	10,439	(4,309)	6,130
Interest income	23,683	(22,121)	1,562	22,848	(10,575)	12,273
Interest-bearing deposits	323	(3,268)	(2,945)	1,467	(6,716)	(5,249)
Short-term borrowings	65	(31)	34	63	(318)	(255)
Interest expense	388	(3,299)	(2,911)	1,530	(7,034)	(5,504)
Net interest income	\$ 23,295	\$ (18,822)	\$ 4,473	\$ 21,318	\$ (3,541)	\$ 17,777

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

(2) Non-accrual loans are included in loans.

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 2010 through 2012. The net interest margin in 2012 was 4.28%, a decrease of 34 basis points from 2011 and a decrease of 6 basis points from 2010. The decrease in our net interest margin in 2012 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 2010 to 2012. 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 2015 as announced by the Federal Reserve which will continue to place pressure on our interest margin.

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

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

	Average Balance	2012 Income/ Expense	Yield/ Rate	Average Balance	2011 Income/ Expense	Yield/ Rate	Average Balance	2010 Income/ Expense	Yield/ Rate
Assets									
Short-term investments									
(1)	\$ 134,588	\$ 754	0.61%	\$ 181,068	\$ 1,221	0.69%	\$ 189,041	\$ 1,541	0.82%
Taxable investment securities (2)	1,144,763	31,318	2.74	1,102,356	37,721	3.42	930,731	36,227	3.89
Tax-exempt investment securities (2)(3)	762,754	39,049	5.12	572,895	33,975	5.93	477,357	29,005	6.08
Loans (3)(4)	1,909,890	103,312	5.41	1,715,266	99,955	5.83	1,543,537	93,825	6.08
Total earning assets	3,951,995	174,433	4.41	3,571,585	172,872	4.84	3,140,666	160,598	5.11
Cash and due from banks	120,477			113,423			107,791		
Bank premises and equipment, net	80,315			72,381			66,714		
Other assets	47,891			51,870			52,965		
Goodwill and other intangible assets, net	72,041			72,312			63,691	\$32,286	
Cost of sales	(23,345)	(20,987)							
Gross profit	12,170	11,299							
Selling, research and administrative expense	(11,481)	(10,676)							
Gain on sale of property, plant and equipment	17	447							
Pension curtailment gain	794	-							
Operating income	1,500	1,070							
Interest expense	(141)	(64)							
Interest income	19	2							
Foreign currency gain (loss)	218	(39)							
Income before income tax	1,596	969							
Income tax provision	(401)	(257)							
Net income	\$1,195	\$712							
Basic earnings per share	\$.36	\$.22							
Fully diluted earnings per share	\$.35	\$.21							
Weighted average shares used in									

computation of
earnings per share:

Basic	3,329	3,303
Diluted	3,380	3,337

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

Sevcon, Inc. and Subsidiaries

For the Years ended September 30, 2012 and 2011

(in thousands of dollars)

	2012	2011
Net income	\$ 1,195	\$ 712
Foreign currency translation adjustment	(53)	(125)
Pension liability adjustment, net of tax	(2,362)	642
Comprehensive (loss) income	\$ (1,220)	\$ 1,229

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Sevcon, Inc. and Subsidiaries

For the Years ended September 30, 2012 and 2011

(in thousands of dollars except number of shares data)

Common Stock \$.10 par value						
	Number of Shares	Common Stock	Premium paid in on common stock	Retained Earnings	Accumulated other comprehensive loss	Total stockholders equity
Balance September, 30 2010	3,340,322	\$ 334	\$ 5,132	\$ 7,755	\$ (7,125)	\$ 6,096
Net income				712		712
Currency translation adjustment					(125)	(125)
Issuance of restricted stock	20,000	2	(2)			-
Stock-based compensation, net of tax			165			165
Pension liability adjustment, net of tax provision of \$91					642	642
Balance September 30, 2011	3,360,322	\$ 336	\$ 5,295	\$ 8,467	\$ (6,608)	\$ 7,490
Net income				1,195		1,195
Currency translation adjustment					(53)	(53)
Issuance of restricted stock	125,200	13	(13)			-
Retirement of shares	(10,216)	(1)	(68)			(69)
Stock-based compensation, net of tax			278			278
Pension liability adjustment, net of tax benefit of \$711					(2,362)	(2,362)
Balance September 30, 2012	3,475,306	\$ 348	\$ 5,492	\$ 9,662	\$ (9,023)	\$ 6,479

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
Sevcon, Inc. and Subsidiaries

For the Years ended September 30, 2012 and 2011
(in thousands of dollars)

	2012	2011
Cash flow from operating activities:		
Net income	\$ 1,195	\$ 712
Adjustments to reconcile net income to net cash generated from (used by) operating activities:		
Depreciation	598	654
Gain on sale of property, plant and equipment	(17)	(447)
Stock-based compensation	242	186
Pension contributions less than pension expense	50	220
Pension curtailment gain	(794)	-
Deferred tax charge	313	99
Increase (decrease) in cash resulting from changes in operating assets and liabilities:		
Receivables	93	(745)
Inventories	1,285	(2,541)
Prepaid expenses and other current assets	(182)	(135)
Accounts payable	(700)	74
Accrued expenses	(310)	640
Accrued and deferred taxes on income	(267)	36
Net cash generated from (used by) operating activities	1,506	(1,247)
Cash flow (used by) generated from investing activities:		
Acquisition of property, plant and equipment	(426)	(635)
Proceeds of sale of fixed assets	20	1,278
Net cash (used by) generated from investing activities	(406)	643
Cash flow (used by) generated from financing activities:		
Repayment of long term debt	(39)	(38)
Repurchase of common stock	(69)	-
Proceeds of long term debt	-	1,700
Net cash (used by) generated from financing activities	(108)	1,662
Effect of exchange rate changes on cash	34	(64)
Net increase in cash	1,026	994
Beginning balance - cash and cash equivalents	1,797	803
Ending balance - cash and cash equivalents	\$ 2,823	\$ 1,797
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$ 360	\$ 77
Cash paid for interest	\$ 120	\$ 62

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Sevcon, Inc. and Subsidiaries

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of presentation

Sevcon, Inc. is a Delaware corporation organized on December 22, 1987 to carry on the electronic controls business previously performed by Tech/Ops. Through wholly-owned subsidiaries located in the United States, England, France, South Korea and Japan, the Company designs and sells, under the Sevcon name, microprocessor based controls for zero emission and hybrid electric vehicles. The controls are used to vary the speed and movement of vehicles, to integrate specialized functions and to prolong the shift life of vehicles' power source. The Company's customers are manufacturers of on-road, off-road and industrial vehicles including automobiles, motorcycles, buses, fork lift trucks, aerial lifts, mining vehicles, airport ground support vehicles, utility vehicles, sweepers and other battery powered vehicles. Through another subsidiary located in Wales, Sevcon manufactures special metalized film capacitors that are used as components in the power electronics, signaling and audio equipment markets.

The accompanying consolidated financial statements include the accounts of Sevcon, Inc. (Sevcon), Sevcon USA, Inc., Sevcon Limited and subsidiary, Sevcon SAS, Sevcon Asia Limited and Sevcon Japan KK. All material intercompany transactions have been eliminated. Certain prior year amounts have been reclassified to conform to the current year presentation.

B. Revenue recognition

Revenue from the sales of products is recognized at the time title and risks and rewards of ownership pass to the customer (either when the products reach the free-on-board shipping point or destination depending on the contractual terms), there is persuasive evidence of an arrangement, the sales price is fixed and determinable and collection is reasonably assured. Shipping, handling, purchasing, receiving, inspecting, warehousing, and other costs of distribution are presented in cost of sales in the consolidated statements of operations. The Company classifies amounts charged to its customers for shipping and handling in net sales in its consolidated income statement. The Company's only post-shipment obligation relates to warranty in the normal course of business for which ongoing reserves, which management believes to be adequate, are maintained. The movement in warranty reserves was as follows:

(in thousands of dollars)

	2012	2011
Warranty reserves at beginning of year	89	96
Decrease in beginning balance for warranty obligations settled during the year	(38)	(37)
Other changes to pre-existing warranties	(8)	(25)
Foreign currency translation adjustment	1	(1)
Net increase in warranty reserves for products sold during the year	45	56
Warranty reserves at end of year	\$89	\$89

The Company recognizes revenue in certain circumstances before delivery has occurred (commonly referred to as bill and hold transactions). In such circumstances, among other things, risk of ownership has passed to the buyer, the buyer has made a written fixed commitment to purchase the finished goods, the buyer has requested the finished goods be held for future delivery as scheduled and designated by them, and no additional performance obligations exist by the Company. For these transactions, the finished goods are segregated from inventory and normal billing and credit terms are granted.

Infrequently the Company enters into fixed-price non-recurring engineering contracts. Revenue from these contracts is recognized in accordance with the percentage-of-completion method of accounting.

C. Research and development

The cost of research and development programs is charged against income as incurred and amounted to approximately \$3,545,000 in 2012 and \$3,069,000 in 2011, net of U.K. government grants received. This expense is included in selling, research and administrative expense in the accompanying consolidated income statements. Research and development expense, net of grants received, was 10% of sales in both 2012 and 2011.

Over the past three years, the Company received awards of research and development grants by the Technology Strategy Board, a public body established by the U.K. government to stimulate technology-enabled innovation. In one of the awards, the Company is one of a consortium of organizations including Jaguar Landrover, GKN and Newcastle University in the U.K. participating in projects to research and design ultra-efficient systems for electric and hybrid vehicles. The Company recorded grant income from this Technology Strategy Board project of \$191,000 in 2012 associated with research and development expense of \$416,000. In 2011, the Company was awarded a research and development grant by the Technology Strategy Board to lead a collaborative project with Cummins Generator Technologies and Newcastle University in the U.K. to develop an innovative electric drive system for electric vehicles using advanced switched reluctance motor technology. The Company recorded grant income from this Technology Strategy Board project of \$9,000 in 2012 associated with research and development expense of \$25,000. The Company did not record any grant income or incur any research and development expense in respect of either of these Technology Strategy Board grants in 2011. The grant income in 2012 was recorded as a reduction of research and development expense.

The Company was awarded research and development grants in 2010 by One North East, the Regional Development Agency responsible for the support of business in the North East of England, to accelerate the development of two new products. These two projects were completed in March 2011 as required by the grant awards. The Company recorded grant income of \$600,000 in 2011 associated with research and development expense of \$1,714,000 in 2011 on these two projects. The grant income was recorded as a reduction of research and development expense. The Company did not record any grant income or incur any research and development expense in respect of either of these grants in 2012. The grant income is subject to audit through 2016 and may be subject to adjustment if it is determined that the costs incurred did not meet the specifications of the grant award.

D. Depreciation and maintenance

Property, plant and equipment are depreciated on a straight-line basis over their estimated useful lives, which are primarily fifty years for buildings, seven years for equipment and four years for computer equipment and software. Maintenance and repairs are charged to expense and renewals and betterments are capitalized.

E. Stock based compensation plans

The Company's 1996 Equity Incentive Plan (the "Equity Plan") provides for the granting of stock options, restricted stock and other equity-based awards to officers, key employees, consultants and non-employee directors of the Company.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The Company has not granted stock options since 2003.

Since 2004 the Company has granted restricted stock to certain officers, key employees and non-employee directors in exchange for services provided to the Company over the vesting period of the stock. The vesting period of the

restricted stock (i.e. when the restrictions lapse) is normally five years in respect of officers and key employees and one year in respect of non-employee directors. For officers and key employees, the Company recognizes compensation expense in respect of restricted stock grants on a straight line basis over the vesting period of the restricted stock based on the closing stock price on the grant date and an expected forfeiture rate of awards of 4%. For non-employee directors, the Company recognizes compensation expense in respect of restricted stock grants on a straight line basis over the vesting period of the restricted stock based on the closing stock price on the grant date.

F. Income taxes

The Company uses the liability method of accounting for income taxes. Under the liability method, deferred tax assets and liabilities reflect the impact of temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured under enacted tax laws. A valuation allowance is required to offset any net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax asset will not be realized.

Sevcon, Inc. files tax returns in the respective countries in which it operates. The financial statements reflect the current and deferred tax consequences of all events recognized in the financial statements or tax returns. We account for income tax uncertainties according to guidance on the recognition, de-recognition and measurement of potential tax benefits associated with tax positions. We recognize interest and penalties relating to income tax matters as a component of income tax expense. See Note 4.

G. Inventories

Inventories are valued at the lower of cost or market. Inventory costs include materials, direct labor and overhead, and are relieved from inventory on a first-in, first-out basis. The Company's reported financial condition includes a provision for estimated slow-moving and obsolete inventory that is based on a comparison of inventory levels with forecast future demand. Such demand is estimated based on many factors, including management judgments, relating to each customer's business and to economic conditions. The Company reviews in detail all significant inventory items with holdings in excess of estimated normal requirements. It also considers the likely impact of changing technology. It makes an estimate of the provision for slow moving and obsolete stock on an item-by-item basis based on a combination of likely usage based on forecast customer demand, potential sale or scrap value and possible alternative use. This provision represents the difference between original cost and market value at the end of the financial period. In cases where there is no estimated future use for the inventory item and there is no estimated scrap or resale value, a 100% provision is recorded. Where the Company estimates that only part of the total holding of an inventory item will not be used, or there is an estimated scrap, resale or alternate use value, then a proportionate provision is recorded. Once an item has been written down, it is not subsequently revalued upwards. The reserve for slow moving and obsolete inventories at September 30, 2012 was \$659,000 or 9% of gross inventory. At September 30, 2011 the reserve was \$437,000, or 6% of gross inventory.

Inventories were comprised of:

(in thousands of dollars)

	2012	2011
Raw materials	\$2,391	\$1,281
Work-in-process	76	99
Finished goods	3,879	6,098
	\$6,346	\$7,478

H. Accounts receivable

In the normal course of business, the Company provides credit to customers, performs credit evaluations of these customers, monitors payment performance, and maintains reserves for potential credit losses in the allowance for

doubtful accounts which, when realized, have historically been within the range of the Company's reserves.

I. Translation of foreign currencies

Sevcon, Inc. translates the assets and liabilities of its foreign subsidiaries at the current rate of exchange, and income statement accounts at the average exchange rates in effect during the period. Gains or losses from foreign currency translation are credited or charged to the cumulative translation adjustment included in the statement of comprehensive (loss) income and as a component of accumulated other comprehensive loss in stockholders' equity in the consolidated balance sheets. Foreign currency transaction gains and losses are shown in the consolidated income statements.

J. Derivative instruments and hedging

The Company sells to customers throughout the industrialized world. In the controls segment the majority of the Company's product is produced in three separate plants in Poland, Mexico and China. Approximately 49% of the Company's sales are made in U.S. Dollars, 18% are made in British Pounds and 33% are made in Euros. Approximately 25% of the Company's cost of sales is incurred in British Pounds and 61% is incurred in Euros. This results in the Company's sales and margins being exposed to fluctuations due to the change in the exchange rates of U.S. Dollar, the British Pound and the Euro.

The Company had no foreign currency derivative financial instruments during the years ended September 30, 2012 and 2011.

K. Cash equivalents and short-term investments

The Company considers all highly liquid investments with a maturity of 90 days or less to be cash equivalents. Highly liquid investments with maturities greater than 90 days and less than one year are classified as short-term investments.

Such investments are generally money market funds, bank certificates of deposit, U.S. Treasury bills and short-term bank deposits in Europe.

L. Earnings per share

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the year. The computation of diluted earnings per share is similar to the computation of basic earnings per share, except that the denominator is increased for the assumed exercise of dilutive options and other potentially dilutive securities using the treasury stock method unless the effect is anti-dilutive.

Basic and diluted net incomes per common share for the two years ended September 30, 2012 are calculated as follows:

(in thousands except per share data)

	2012	2011
Net income	\$ 1,195	\$ 712
Weighted average shares outstanding	3,329	3,303
Basic income per share	\$.36	\$.22
Common stock equivalents	51	34
Average common and common equivalent shares outstanding	3,380	3,337
Diluted income per share	\$.35	\$.21

M. Use of estimates in the preparation of financial statements

The presentation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of income and expenses during the reporting periods. The most significant estimates and assumptions made by management include bad debt, inventory and warranty reserves, goodwill impairment assessment, pension plan assumptions and income tax assumptions. Operating results in the future could vary from the amounts derived from management's estimates and assumptions.

N. Fair value measurements

The FASB has issued authoritative guidance, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This guidance does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. In accordance with this guidance, financial assets and liabilities have been categorized, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy as set forth below. If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

The three levels of the hierarchy are defined as follows:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 - Observable inputs other than quoted prices included in Level 1. Level 2 inputs include quoted prices for identical assets or liabilities in non-active markets, quoted prices for similar assets or liabilities in active markets and inputs other than quoted prices that are observable for substantially the full term of the asset or liability. The Company currently does not have any Level 2 financial assets or liabilities.

Level 3 - Unobservable inputs reflecting management's own assumptions about the input used in pricing the asset or liability. The Company currently does not have any Level 3 financial assets or liabilities.

At September 30, 2012, the fair value measurements affect only the Company's consideration of pension plan assets as disclosed in Note 7, Employee Benefit Plans.

O. Fair value of financial instruments

The Company's financial instruments consist mainly of cash and cash equivalents, short-term investments, accounts receivable and accounts payable. The carrying amount of these financial instruments as of September 30, 2012 approximates fair value due to the short-term nature of these instruments. The fair value of the Company's long term debt at September 30, 2012 approximated \$1,774,000 (the carrying value on the consolidated balance sheet at September 30, 2012) based on recent financial market pricing. The long term debt represented a level 2 liability in accordance with the fair value hierarchy outlined above.

P. Goodwill

The amount by which the cost of purchased businesses included in the accompanying financial statements exceeded the fair value of net assets at the date of acquisition has been recorded as "goodwill".

In accordance with FASB accounting guidance regarding goodwill and other intangible assets, the Company performs an assessment of goodwill impairment annually or more frequently if events or changes in circumstances indicate that the value has been impaired. The Company has designated September 30 as the date it performs the annual review of goodwill impairment. Goodwill impairment testing is performed at the segment (or "reporting unit") level.

In evaluating goodwill for impairment, the reporting unit's fair value was first compared to its carrying value. The fair value of the reporting unit was estimated by considering (1) market capitalization, (2) market multiple and recent transaction values of similar companies and (3) projected discounted future cash flows, if reasonably estimable. Key assumptions in the estimation of projected discounted future cash flows include the use of an appropriate discount rate, estimated future cash flows and estimated run rates of sales, gross profit and operating expenses. In estimating future cash flows, the Company incorporates expected growth rates, as well as other factors into its revenue and expense forecasts. If the reporting unit's fair value exceeds its carrying value, no further testing is required. If, however, the reporting unit's carrying value exceeds its fair value, the amount of the impairment charge is determined, if any. An impairment charge is recognized if the carrying value of the reporting unit's goodwill exceeds its implied fair value. At each of September 30, 2012 and 2011, there was \$1,435,000 of goodwill on the balance sheet of the Company which related wholly to one business segment, the controls segment, and the estimated fair value of the reporting unit significantly exceeded its carrying value under each method of calculation performed.

Q. New Accounting Pronouncements

In May 2011, the FASB issued authoritative guidance in respect of the accounting guidance for fair value measurement and disclosure. The Accounting Standards Update ("ASU") is, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). Among other things, the guidance expands the disclosure requirements around fair value measurements categorized in Level 3 of the fair value hierarchy and requires disclosure of the level in the fair value hierarchy of items that are not measured at fair value in the statement of financial position but whose fair value must be disclosed. It also clarifies and expands upon existing requirements for measurement of the fair value of financial assets and liabilities as well as instruments classified in shareholders' equity. The guidance is effective for interim and annual periods beginning after December 15, 2011. The adoption of this accounting pronouncement did not have a material impact on our financial statements.

In June 2011, the FASB issued authoritative guidance for the presentation of comprehensive income. The ASU is, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. Under the amended guidance, a company may present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In either case, a company is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. For public companies, the amendment is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and shall be applied retrospectively. The implementation of this accounting pronouncement did not have a material impact on our financial statements.

On September 15, 2011, the FASB issued authoritative guidance in respect of the simplification of the testing of goodwill impairment. The ASU is, Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment. This ASU gives an entity the option in its annual goodwill impairment test to first assess revised qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. In certain cases this will allow an entity to forego the existing two-step goodwill impairment test. This guidance is applicable for fiscal years beginning after December 15, 2011. The implementation of this accounting pronouncement did not have a material impact on our financial statements.

R. Employee Benefit Plans

Sevcon, Inc. recognizes its pension plans' over-funded or under-funded status in its balance sheets and recognizes the change in a plan's funded status in comprehensive income in the year which the changes occur.

(2) CAPITAL STOCK

Sevcon, Inc. has two classes of authorized capital stock, preferred and common. There are authorized 1,000,000 shares of preferred stock, \$.10 par value and 8,000,000 shares of common stock, \$.10 par value.

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(3) STOCK-BASED COMPENSATION PLANS

Under the Company's 1996 Equity Incentive Plan there were 122,800 shares reserved and available for grant at September 30, 2012. There were 238,000 shares reserved and available for grant at September 30, 2011. There were no options exercised in 2012 or in 2011.

Recipients of grants or options must execute a standard form of non-competition agreement. The plan provides for the grant of Restricted Stock, Restricted Stock Units, Options, and Stock Appreciation Rights ("SAR"s). SARs may be awarded either separately, or in relation to options granted, and for the grant of bonus shares. Options granted are exercisable at a price not less than fair market value on the date of grant.

Option transactions under the plans for the two years ended September 30, 2012 were as follows:

	Shares under option	Weighted average exercise price	Weighted average remaining contractual life (years)	Aggregate Intrinsic value
Outstanding at September 30, 2010	46,000	\$5.62	2 years	\$25,400
Exercised in 2011	-	\$-	-	-
Cancelled in 2011	-	\$-	-	-
Outstanding at September 30, 2011	46,000	\$5.62	1 year	\$65,500
Exercisable at September 30, 2011	41,000	\$5.75	1 year	\$56,700
Exercised in 2012	-	\$-	-	-
Cancelled in 2012	(10,000)	\$9.60	-	-
Outstanding at September 30, 2012	36,000	\$4.51	0.6 years	\$11,800
Exercisable at September 30, 2012	33,500	\$4.51	0.6 years	\$11,100

The aggregate intrinsic value included in the table above represents the difference between the exercise price of the options and the market price of the Company's common stock for the options that had exercise prices that were lower than the \$4.75 market price of the Company's common stock at September 30, 2012.

Details of options outstanding at September 30, 2012 were as follows:

Price range	Shares under option	Weighted average remaining contractual life
\$ 4.37 - \$ 6.56	36,000	0.6 years

In December 2011, the Company granted 110,000 shares of restricted stock to seven employees, which will vest in five equal annual installments so long as the employee is then employed by the Company or as determined by the Compensation Committee. The estimated fair value of the stock on the date of grant was \$561,000 based on the fair market value of stock on the date of issue. Compensation expense is being charged to income on a straight line basis over five years. The charge to income for these restricted stock grants in 2012 was \$84,000 and the subsequent charge will be approximately \$28,000 on a quarterly basis.

In January 2012, the Company granted 15,200 shares of restricted stock to eight non-employee directors, which will vest on the day before the 2013 annual meeting providing that the grantee remains a director of the Company, or as otherwise determined by the Compensation Committee. The aggregate fair value of the stock measured on the date of grant was \$80,000, based on the closing sale price of the stock on the date of grant. Compensation expense is being charged to income on a straight line basis over the twelve month period during which the forfeiture conditions lapse.

The charge to income for these restricted stock grants in 2012 was \$53,000 and the subsequent charge will be approximately \$20,000 on a quarterly basis.

For the purposes of calculating average issued shares for basic earnings per share these shares are only considered to be outstanding when the forfeiture conditions lapse and the shares vest.

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Restricted stock transactions under the plans for the two years ended September 30, 2012 were as follows:
(in thousands of shares)

	2012	2011
Beginning Balance – Non-vested	50.0	60.0
Granted to employees – 5 year vesting	110.0	-
Granted to non-employee directors – 1 year vesting	15.2	20.0
Vested	(31.0)	(30.0)
Forfeited	-	-
Ending Balance – Non-vested	144.2	50.0
Weighted-average fair value for shares granted during the year	\$ 5.69	\$ 8.75
Weighted-average fair value for shares vested during the year	\$ 7.10	\$ 3.56
Weighted-average fair value for ending balance - non-vested	\$ 5.22	\$ 5.21

As of September 30, 2012, there was \$531,000 of compensation expense related to non-vested awards not yet recognized, which is expected to be recognized over a weighted average period of 3.9 years.

Stock-based compensation expense was \$242,000 and \$186,000 for the years ended September 30, 2012 and 2011, respectively.

(4) INCOME TAXES

The domestic and foreign components of income before income taxes are as follows:
(in thousands of dollars)

	2012	2011
Domestic	\$220	\$(250)
Foreign	1,376	1,219
	\$1,596	\$969

The components of the provision for income taxes and deferred taxes for the years ended September 30, 2012 and 2011 are as follows:
(in thousands of dollars)

	2012	
	Current	Deferred
Federal	\$23	\$53
Domestic	\$14	\$66
Foreign	51	194
	\$88	\$313

	2011	
	Current	Deferred
Federal	\$-	\$(222)
Domestic	\$17	\$(60)
Foreign	141	381
	\$158	\$99

The provision (benefit) for income taxes in each period differs from that which would be computed by applying the statutory U.S. Federal income tax rate to the income before income taxes. The following is a summary of the major items affecting the provision:

(in thousands of dollars)

	2012		2011	
Statutory Federal income tax rate	34	%	34	%
Computed tax provision at statutory rate	\$532		\$322	
Increases (decreases) resulting from:				
Foreign tax rate differentials	(118))	(82))
State taxes net of federal tax benefit	54		8	
Change in deferred tax valuation allowance	-		(177))
Foreign research incentives	(322))	(230))
U.K. rate change	225		370	
Other	30		46	
Income tax provision in the consolidated income statements	\$401		\$257	

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will either expire before the Company is able to realize the benefit, or that future deductibility is uncertain. The significant items comprising the domestic and foreign deferred tax accounts at September 30, 2012 and 2011 are as follows:

	2012				
	Domestic current	Domestic long-term	Foreign current	Foreign long-term	Total
Assets:					
Pension accruals	\$ -	\$ 439	\$ -	\$ 2,147	\$ 2,586
Inventory basis differences	54	-	-	-	54
Warranty reserves	19	-	-	-	19
Foreign tax credit carry forwards	-	277	-	-	277
Accrued compensation expense	14	-	-	58	72
Net operating losses	308	-	627	-	935
Other (net)	-	252	4	-	256
	395	968	631	2,205	4,199
Liabilities:					
Property basis differences	-	33	-	(44)	(11)
Net asset	395	1,001	631	2,161	4,188
Valuation allowance	-	(159)	-	-	(159)
Net deferred tax asset	\$ 395	\$ 842	\$ 631	\$ 2,161	\$ 4,029

2011

	Domestic current	Domestic long-term	Foreign current	Foreign long-term	Total
Assets:					
Pension accruals	\$ -	\$ 449	\$ -	\$ 1,668	\$ 2,117
Inventory basis differences	49	-	-	-	49
Warranty reserves	19	-	-	-	19
Foreign tax credit carry forwards	-	275	-	-	275
Accrued compensation expense	33	-	-	-	33
Net operating losses	130	239	522	-	891
Other (net)	1	241	56	51	349
	232	1,204	578	1,719	3,733
Liabilities:					
Property basis differences	-	31	-	(98)	(67)
Net asset	232	1,235	578	1,621	3,666
Valuation allowance	-	(157)	-	-	(157)
Net deferred tax asset	\$ 232	\$ 1,078	\$ 578	\$ 1,621	\$ 3,509

The valuation allowance at September 30, 2012 relates to the realizability of foreign tax credit carryforwards in the U.S. In assessing the continuing need for a valuation allowance the Company has assessed the available means of recovering its deferred tax assets, including the ability to carryback net operating losses, the existence of reversing temporary differences, the availability of tax planning strategies, and available sources of future taxable income, including a revised estimate of future sources of pre-tax income.

The Company has generated domestic federal and state net operating losses of \$813,000 which will expire in 2028 and 2013, respectively. The Company has generated foreign net operating losses of approximately \$2,531,000 which have an indefinite carry forward period.

At September 30, 2012, the Company has not provided United States income taxes or foreign withholding taxes on unremitted

foreign earnings of approximately \$11.0 million, as those amounts are considered indefinitely invested in light of the Company's substantial non-U.S. operations. Due to the complexities of the U.S. tax law, including the effect of U.S. foreign tax credits, it is not practicable to estimate the amount of tax that might be payable on these earnings in the event they no longer are indefinitely reinvested.

Uncertain tax positions

Effective October 1, 2007, the Company adopted FASB authoritative guidance regarding the recognition and measurement of all tax positions taken or to be taken by the Company and its subsidiaries. The adoption of this guidance followed a review by the Company of all potential uncertain tax positions. As a consequence of that review, it was concluded that no provision was required in respect of the adoption of this guidance and consequently the Company has not recorded a liability for uncertain tax positions and the Company has recorded no cumulative effect to retained earnings pursuant to the adoption of this guidance. The Company's tax returns are open to audit from 2009 and forward.

(5) ACCRUED EXPENSES

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The analysis of accrued expenses at September 30, 2012 and 2011 showing separately any items in excess of 5% of total current liabilities was as follows:

	(in thousands of dollars)	
	2012	2011
Accrued compensation and related costs	\$1,021	\$1,090
Other accrued expenses	782	1,016
	\$1,803	\$2,106

(6) COMMITMENTS AND CONTINGENCIES

Sevcon, Inc. is involved in various legal proceedings in the ordinary course of business but believes that it is remote that the outcome will be material to operations.

The Company maintains a directors' retirement plan which provides for certain retirement benefits to non-employee directors. Effective January 1997 the plan was frozen and no further benefits are being accrued. While the cost of the plan has been fully charged to expense, the plan is not separately funded. The estimated maximum liability which has been recorded based on the cost of buying deferred annuities at September 30, 2012 was \$173,000.

Minimum rental commitments under all non-cancelable leases are as follows for the years ended September 30: 2013 - \$188,000; 2014 - \$95,000; 2015 - \$95,000; 2016 - \$87,000; 2017 - \$87,000 and \$3,096,000 thereafter. Net rentals of certain land, buildings and equipment charged to expense were \$241,000 in 2012 and \$243,000 in 2011.

The U.K. subsidiaries of the Company have given to a bank a security interest in certain leasehold and freehold property assets as security for overdraft facilities of \$1,452,000. There were no amounts outstanding on the overdraft facilities at September 30, 2012 or 2011. The obligations under a secured revolving credit facility entered into in 2011 by the U.S. subsidiary of the Company, are guaranteed by the Company and are secured by all of the assets and a pledge of all of the capital stock, of Sevcon USA, Inc. As at September 30, 2012 and 2011 there was \$1,700,000 outstanding under the revolving credit facility.

(7) EMPLOYEE BENEFIT PLANS

Sevcon, Inc. has defined contribution plans covering the majority of its U.S. and U.K. employees in the controls business. There is also a small defined contribution plan covering senior managers in the capacitor business. The Company has frozen U.K. and U.S. defined benefit plans for which no future benefits are being earned by employees. The Company uses a September 30 measurement date for its defined benefit pension plans.

The following table sets forth the estimated funded status of these frozen defined benefit plans and the amounts recognized by Sevcon, Inc.:

	(in thousands of dollars)	
	2012	2011
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 23,191	\$ 23,637
Service cost	263	331
Interest cost	1,263	1,268
Plan participants contributions	211	198
Actuarial loss (gain)	3,639	(202)
Prior service credit	-	(1,133)
Gains on curtailments	(907)	-
Benefits paid	(325)	(689)
Foreign currency exchange rate changes	810	(219)
Benefit obligation at end of year	28,145	23,191
Change in plan assets:		
Fair value of plan assets at beginning of year	15,557	15,434
Return on plan assets	1,295	233
Employer contributions	626	545
Plan participants contributions	211	198
Benefits paid	(325)	(689)

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Foreign currency exchange rate changes	517	(164)
Fair value of plan assets at end of year	17,881	15,557
Funded status	(10,264)	(7,634)
Liability for pension benefits recorded in the balance sheet	\$ (10,264)	\$ (7,634)

The funded status of the Company's defined benefit pension plans deteriorated from a deficit of \$7,634,000 at September 30, 2011 to a deficit of \$10,264,000 at September 30, 2012. The increase in the deficit of \$2,630,000 was due to several factors. The most significant factor was an actuarial loss of \$3,639,000 of which \$3,360,000 related to the Company's U.K. defined benefit plan and \$279,000 related to the Company's U.S. defined benefit plan. The actuarial losses were largely the result of a reduction in the discount rate of the U.K. pension plan from 5.45% at September 30, 2011 to 4.70% at September 30, 2012 and a reduction in the discount rate of the U.S. pension plan from 4.55% at September 30, 2011 to 4.00% at September 30, 2012. The increase in the pension liability deficit was partially offset by a curtailment gain of \$907,000 arising from the freezing of the U.K. defined benefit plan at September 30, 2012.

Amounts recognized in the balance sheets consist of:

(in thousands of dollars)

	2012	2011
Non current liabilities	10,264	\$7,634

Amounts recognized in other comprehensive loss consist of:

(in thousands of dollars)

	2012	2011
Actuarial loss, net of \$706,000 tax benefit (2011: net of \$188,000 tax benefit)	\$(2,344)	\$(194)
Prior service (loss) gain, net of \$5,000 tax benefit (2011: net of \$279,000 tax provision)	(18)	836
	\$(2,362)	\$642

The Sevcon, Inc. net pension cost included the following components:

(in thousands of dollars)

	2012	2011
Components of net periodic benefit cost:		
Service cost	\$ 263	\$ 331
Interest cost	1,263	1,268
Expected return on plan assets	(1,158)	(1,126)
Amortization of prior service gain	(24)	(18)
Amortization of net actuarial loss	332	310
Net periodic benefit cost	\$ 676	\$ 765
Net cost of defined contribution plans	\$ 160	\$ 77

The weighted average assumptions used to determine plan obligations and net periodic benefit cost for the years ended September 30, 2012 and 2011 were as set out below:

	2012		2011	
Plan obligations:				
Discount rate	4.61	%	5.34	%
Rate of compensation increase	0.0	%	2.79	%
Net periodic benefit cost:				
Discount rate	4.61	%	5.34	%

Expected long term return on plan assets	6.67	%	7.26	%
Rate of compensation increase	0.0	%	2.79	%

The changes in these assumptions reflect actuarial advice and changing market conditions and experience. There is no compensation increase assumed in 2013 and in future years as both the U.K. and the U.S. defined benefit pension plans have been frozen and therefore there will be no future benefits earned by employees under these benefit arrangements.

The Company's investment strategy is to build an efficient, well-diversified portfolio based on a long-term strategic outlook of the investment markets. The investment markets outlook utilizes both historical-based and forward-looking return forecasts to establish future return expectations for various asset classes. These return expectations are used to develop a core asset allocation based on the specific needs of the plan. The core asset allocation utilizes multiple investment managers to maximize the plan's return while minimizing risk.

The assumed rate of return on plan assets represents an estimate of long-term returns on an investment portfolio consisting of a mixture of equities, fixed income and alternative investments. In determining the expected return on plan assets, the Company considers long-term rates of return on the asset classes (historically and forecasted) in which the Company expects the pension funds to be invested.

At September 30, 2012, the assets of the U.S. plan were invested 88% in mutual funds and 12% in cash and cash equivalents. The U.S. plan had a deficit of \$930,000, or 29% of the total U.S. benefit obligation, as at September 30, 2012. The Company has committed to future annual contributions to the defined benefit plan to pay down this deficit within the next seven years. The Company established a 401(k) defined contribution plan for current and future U.S. employees effective October 1, 2010.

At September 30, 2012, the assets of the U.K. plan were invested 79% in equity securities, 10% in U.K. government bonds, 10% in U.K. corporate bonds and 1% in cash and cash equivalents. The U.K. plan was frozen effective September 30, 2012 and in consequence there will be no future accrual earned by U.K. employees under this defined benefit arrangement. The U.K. plan had a deficit of \$9,334,000, or 38% of the total U.K. benefit obligation, as at September 30, 2012. The Company has committed to future annual contributions to the defined benefit plan to pay down this deficit within the next ten years. The Company has established a defined contribution pension plan for current and future U.K. employees effective October 1, 2012.

As a result of the September 30, 2012 amendment to freeze future pension benefits in the U.K pension plan, the Company recognized a pre-tax pension curtailment gain of \$794,000 which was credited to operating income in the fourth quarter of 2012. This curtailment gain represents the unamortized prior service credit from a 2011 plan amendment to change the inflation index for deferred pension plan members from the Retail Prices Index to the Consumer Prices Index.

The overall expected long-term rate of return on plan assets has been based on the expected returns on equities, bonds and real estate based broadly on the current and proposed future asset allocation.

The table below presents information about our plan assets measured and recorded at fair value as of September 30, 2012, and indicates the fair value hierarchy of the inputs utilized by the Company to determine the fair values (see Fair value measurements in Note 1).

(in thousands of dollars)

	Level 1* (Quoted prices in active markets)	Level 2** (Significant observable inputs)	Level 3*** (Unobservable inputs)
Mutual Funds			

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Standard Life Pension Global Absolute Returns Strategies Fund	6,148	-	-
Standard Life UK Indexed Linked Fund	1,576	-	-
Standard Life Long Corporate Bond Fund	1,581	-	-
CF Ruffer Absolute Return Fund	6,168	-	-
U.S. Mutual Funds	2,060	-	-
U.S. Exchange Traded Funds	185	-	-
Other Types of Investments			
Cash	163	-	-
Total	17,881	-	-

*Level 1 investments represent mutual funds for which a quoted market price is available on an active market. These investments primarily hold stocks or bonds, or a combination of stocks and bonds.

** The Company currently does not have any Level 2 pension plan financial assets.

*** The Company currently does not have any Level 3 pension plan financial assets.

The following estimated benefit payments, which reflect future service, as appropriate, are expected to be paid:

(in thousands of dollars)

2013	\$ 390
2014	535
2015	689
2016	757
2017	765
2018 – 2022	4,252

In 2013 it is estimated that the Company will make contributions to the U.K. and U.S. defined benefit pension plans of \$510,000. Actual payment obligations with respect to the pension plan liability come due over an extended period of time and will depend on changes in the assumptions described above.

(8) SEGMENT INFORMATION

The Company has two reportable segments: electronic controls and capacitors. The electronic controls segment produces microprocessor based control systems for zero emission and hybrid electric vehicles. The capacitor segment produces special metalized film capacitors for sale to electronic equipment manufacturers. Each segment has its own management team, manufacturing facilities and sales force.

The accounting policies of the segments are the same as those described in Note 1. Intersegment sales are accounted for at current market prices. The Company evaluates the performance of each segment principally based on operating income. The Company does not allocate income taxes, interest income and expense or foreign currency translation gains and losses to segments. Information concerning operations of these businesses is as follows:

(in thousands of dollars)

	2012			
	Controls	Capacitors	Corporate	Total
Sales to external customers	\$ 33,825	\$ 1,690	\$ -	\$ 35,515
Inter-segment revenues	-	19	-	19
Operating income (loss)	1,584	(86)	2	1,500
Depreciation	507	89	2	598
Identifiable assets	21,855	1,270	436	23,561

Capital expenditures	340	86	-	426
			2011	
	Controls	Capacitors	Corporate	Total
Sales to external customers	\$ 30,039	\$ 2,247	\$ -	\$ 32,286
Inter-segment revenues	-	26	-	26
Operating income (loss)	1,232	392	(555)	1,070
Depreciation	574	78	2	654
Identifiable assets	21,382	1,291	274	22,947
Capital expenditures	571	64	-	635

The Company has businesses located in the United States, the United Kingdom, France, Korea and Japan. The analysis of revenues set out below is by the location of the business selling the products rather than by destination of the products.

(in thousands of dollars)

	2012	2011
Sales:-		
U.S. sales	\$ 15,516	\$ 15,178
Foreign sales:		
United Kingdom	10,137	8,787
France	9,862	8,321
Total Foreign	19,999	17,108
Total sales	\$ 35,515	\$ 32,286
Long-lived assets:		
U.S.A.	\$ 2,342	\$ 2,617
Foreign:		
United Kingdom	4,192	3,744
France	76	75
Korea and Japan	2	3
Total Foreign	4,270	3,822
Total	\$ 6,612	\$ 6,439

In the controls business segment the revenues were derived from the following products and services:

(in thousands of dollars)

	2012	2011
Electronic controls for zero emission and hybrid electric vehicles	\$ 25,199	\$ 22,394
Accessory and aftermarket products and services	8,626	7,645
Total controls segment revenues	\$ 33,825	\$ 30,039

The business located in the United States services customers in North and South America. The business located in France services customers in France, Spain, Portugal, Belgium, Germany, Netherlands and North Africa. The businesses located in Korea and Japan support customers in Asia, however, sales to these customers are made from the United Kingdom. The businesses located in the United Kingdom service customers in the rest of the world, principally Europe and the Far East.

In 2012 Sevcon, Inc.'s largest customer, Renault Spain, accounted for 10% of sales and, at September 30, 2012 0% of receivables. In 2011 the largest customer accounted for 9% of sales and, at September 30, 2011, 7% of receivables.

(9) DEBT

At September 30, 2012 the Company had \$117,000 outstanding under a U.K. bank loan entered into in April 2010, with a fixed interest rate of 6.8%. The loan, which was entered into by the U.K. metalized film capacitor subsidiary to purchase an item of capital equipment, is denominated in British Pounds. The loan agreement provides for equal monthly installments comprising interest and principal for a five year period commencing in May 2010. Of the total amount outstanding at September 30, 2012, \$43,000 is shown in the current liabilities section of the accompanying consolidated balance sheet under current debt, representing the principal element of the loan installments in the year ending September 30, 2013. Included in other long term liabilities at September 30, 2012, is \$74,000 which represents the principal element of the loan installments for the years 2013 and 2015. The fair market value of the debt at September 30, 2012 was \$117,000.

On June 15, 2011, the Company's wholly owned subsidiary, Sevcon USA, Inc., entered into a \$3,500,000 secured revolving credit facility with RBS Citizens, National Association for working capital and general corporate purposes. The loan and security agreement will expire on June 14, 2014 when all outstanding principal and unpaid interest will be due and payable in full. The facility may be paid before maturity in whole or in part at the option of Sevcon USA, Inc., without penalty or premium. Interest on the loan is payable monthly, and in 2012, was calculated at a margin over LIBOR. Upon entering into the revolving credit facility, Sevcon USA, Inc. drew down \$1,700,000, which was the total amount outstanding at September 30, 2012. This \$1,700,000 is shown in the accompanying consolidated balance sheet under long-term debt. The carrying value of the debt approximated to fair value based on current interest rates.

In July 2012, the Company's U.K. bank renewed the overdraft facilities of the Company's U.K. controls and capacitor subsidiaries. The Company's U.K. controls and capacitor subsidiaries each have multi-currency overdraft facilities which together total \$1,452,000 and which are secured against real estate owned by those companies. In common with bank overdrafts in Europe, the renewal of the facilities is for a twelve month period although in line with normal practice in Europe, they can be withdrawn on demand by the bank. The facilities were unused at September 30, 2012.

Annual principal payments on long term debt at September 30, 2012 are as follows:

(in thousands of dollars)

2013	\$43
2014	1,746

2015	28
Total	1,817

(10) SUBSEQUENT EVENTS

In preparing these consolidated financial statements, the Company has evaluated, for the potential recognition or disclosure, events or transactions subsequent to the end of the fiscal year and through the date these financial statements were available to be issued. No material subsequent events were identified that require recognition or disclosure in these financial statements.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Sevcon, Inc.:

We have audited the accompanying consolidated balance sheets of Sevcon, Inc. and subsidiaries as of September 30, 2012 and 2011, and the related consolidated statements of income, comprehensive (loss) income, stockholders' equity, and cash flows for the years then ended. Our audits also included the financial statement schedule of Sevcon, Inc. and subsidiaries listed in Item 15(a). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule 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. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sevcon, Inc. and subsidiaries as of September 30, 2012 and 2011, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ McGladrey LLP
McGladrey LLP

Boston, Massachusetts
December 20, 2012

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

None.

ITEM 9A CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company's principal executive officer and principal financial officer, after evaluating the effectiveness of the Company's "disclosure controls and procedures" (as defined in Securities Exchange Act of 1934 Rule 13a-15(e)), have concluded that, as of September 30, 2012, the disclosure controls and procedures were effective.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) of the Exchange Act as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel, 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 and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our 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. 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.

Our management assessed the effectiveness of our internal control over financial reporting as of September 30, 2012 using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on this assessment and those criteria, our management concluded that, as of September 30, 2012, our internal control over financial reporting was effective.

Changes in Internal Control over Financial Reporting

Our principal executive officer and principal financial officer have identified no change in our internal control over financial reporting that occurred during the fourth quarter of 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B OTHER INFORMATION

None.

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PART III

ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The requisite information regarding the Company's directors, executive officers and audit committee members is incorporated by reference from the discussion responsive thereto under the captions "Proposal 1: Election of Directors," "Corporate Governance" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's Proxy Statement for the 2013 Annual Meeting of Stockholders.

We have adopted a Code of Ethics for Senior Officers that applies to our chief executive officer, chief financial officer, principal accounting officer and controllers. We have also adopted a Code of Conduct and Ethics that applies to all of our employees, including, but not limited to, our chief executive officer, chief financial officer, principal accounting officer, and controllers. A copy of either Code is available without charge upon request from the Chief Financial Officer at Sevcon, Inc., 155 Northboro Road, Southborough, MA 01772. If we make any substantive amendments to the Code of Ethics for Senior Officers or grant any waiver from a provision of such Code, or if we make any substantive amendment to a provision of the Code of Conduct that applies to our chief executive officer, chief financial officer, principal accounting officer or controllers, or if we grant any waiver from a provision of such Code for any such persons, we will disclose the nature of such amendment or waiver in a report on Form 8-K.

EXECUTIVE OFFICERS OF THE REGISTRANT

Name of Officer	Age	Position
Matthew Boyle	50	President & Chief Executive Officer
Paul N. Farquhar	50	Vice President, Treasurer & Chief Financial Officer

There are no family relationships between any director or executive officer and any other director or executive officer of the Company.

All officers serve until the next annual meeting and until their successors are elected and qualified. Mr. Boyle has been President and Chief Executive Officer since 1997 and was Vice President and Chief Operating Officer of the Company from 1996 to 1997. Mr. Farquhar became Chief Financial Officer in January 2008, having served as Principal Accounting Officer since April 2007.

ITEM 11 EXECUTIVE COMPENSATION

This information is incorporated by reference from the information under the captions "Director Compensation," and "Executive Compensation" in the Company's Proxy Statement for the 2013 Annual Meeting of Stockholders.

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

The requisite information concerning security ownership and related stockholder matters is incorporated by reference from the information responsive thereto under the captions "Beneficial Ownership of Common Stock", and "Proposal 1: Election of Directors" in the Company's Proxy Statement for the 2013 Annual Meeting of Stockholders.

The following table sets out the status of shares authorized for issuance under equity compensation plans at September 30, 2012:

Plan Category	Number of securities to be issued upon exercise of outstanding options warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) at end of year
	(a)	(b)	(c)
Equity compensation plans approved by security holders:			
1996 Equity Incentive Plan	31,000	\$ 4.37	122,800
1998 Director Stock Option Plan	5,000	\$ 5.40	-
Sub Total	36,000	\$ 4.51	122,800
Equity compensation plans not approved by - security holders		-	-
Total	36,000	\$ 4.51	122,800

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

This information is incorporated by reference from the information responsive thereto under the captions “Transactions with Related Persons” and “Director Independence” in the Company’s Proxy Statement for the 2013 Annual Meeting of Stockholders.

ITEM 14 PRINCIPAL ACCOUNTING FEES AND SERVICES

This information is incorporated by reference from the discussion responsive thereto under the caption “Proposal 2: Ratification of the Selection of the Company’s Independent Registered Public Accounting Firm for the Fiscal Year Ending September 30, 2013” in the Company’s Proxy Statement for the 2013 Annual Meeting of Stockholders.

PART IV

ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Financial statements and schedule

The financial statements and financial statement schedule are filed as part of this Annual Report on Form 10-K.

(b) Exhibits

The exhibits filed as part of this Annual Report on Form 10-K are listed on the Exhibit Index below.

INDEX TO EXHIBITS

- * (3)(a) Restated Certificate of Incorporation of the registrant (incorporated by reference to Exhibit 3.2 to Current Report on Form 8-K filed on June 7, 2011).
- * (3)(b) Amended and Restated By-laws of the registrant (incorporated by reference to Exhibit 3.3 to Current Report on Form 8-K filed on June 7, 2011).
- * (10)(a) Sevcon, Inc. 1996 Equity Incentive Plan and amendment thereto (incorporated by reference to 2004 Proxy Statement filed on December 29, 2003 and Exhibit 10.1 to Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, respectively).
- * (10)(b) Form of Option for 1996 Equity Incentive Plan (incorporated by reference to Exhibit (10) (b) to Annual Report for the year ended September 30, 2002).
- * (10)(c) Form of Restricted Stock Agreement for employees for 1996 Equity Incentive Plan (incorporated by reference to Exhibit (10) (c) to Annual Report for the year ended September 30, 2004).
- * (10)(d) Form of Indemnification Agreement dated January 4, 1988 between the registrant and each of its directors (incorporated by reference to Exhibit (10) (e) to Annual Report for the year ended September 30, 1994).
- * (10)(e) Directors' Retirement Plan (incorporated by reference to Exhibit (10) (b) to Annual Report for the year ended September 30, 1990).
- * (10)(f) Board resolution terminating Directors' Retirement Plan (incorporated by reference to Exhibit (10) (e) to Annual Report for the year ended September 30, 1997).
- * (10)(g) Sevcon, Inc. 1998 Director Stock Option Plan (incorporated by reference to Exhibit 10 to Quarterly Report on Form 10-Q for the quarter ended March 31, 1998).
- * (10)(h) Service Agreement dated as of July 1, 2010, between Mathew Boyle and Sevcon Limited (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed on July 6, 2010).
- * (10)(i) Noncompetition/Nonsolicitation Agreement dated as of July 1, 2010, between Matthew Boyle and Sevcon, Inc. (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed on July 6, 2010).
- * (10)(j) Service Agreement dated as of July 1, 2010, between Paul N. Farquhar and Sevcon Limited (incorporated by reference to Exhibit 10.3 to Current Report on Form 8-K filed on July 6, 2010).
- * (10)(k) Noncompetition/Nonsolicitation Agreement dated as of July 1, 2010, between Paul N. Farquhar and Sevcon, Inc. (incorporated by reference to Exhibit 10.4 to Current Report on Form 8-K filed on July 6, 2010).
- (10)(l) Summary of Director and Executive Officer Non-Plan Compensation (filed herewith).
- * (10)(m) Loan and Security Agreement by and between Sevcon USA, Inc. and RBS Citizens, National
- * (10)(n) Association, dated June 15, 2011 (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed on June 21, 2011).

Unlimited Guaranty by Sevcon, Inc. in favor of RBS Citizens, National Association, dated June 15, 2011 (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed on June 21, 2011).

- (21) Subsidiaries of the registrant (filed herewith).
- (23) Consent of McGladrey LLP (filed herewith).
- (31.1) Certification of Principal Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- (31.2) Certification of Principal Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002. (filed herewith).
- (32.1) Certification of Principal Executive Officer and Principal Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 101 The following materials formatted in eXtensible Business Reporting Language (XBRL):
(i) Consolidated Income Statements, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Comprehensive (Loss) Income, (iv) Consolidated Statements of Stockholders' Equity, (v) Consolidated Statements of Cash Flows and (vi) Notes to Consolidated Financial Statements. These materials are furnished and not "filed" herewith.

*Indicates exhibit previously filed and incorporated by reference. Exhibits filed with periodic reports were filed under File No. 1-9789.

Executive Compensation Plans and Arrangements:

Exhibits (10) (a) - (l) are management contracts or compensatory plans or arrangements in which the executive officers or directors of the registrant participate.

A copy of these exhibits may be obtained on the SEC's EDGAR database (at www.sec.gov) or will be furnished without charge to any stockholder upon written request to Sevcon, Inc., attention Paul N. Farquhar, Treasurer, 155 Northboro Road, Southborough MA 01772, Telephone: (581) 281-5510.

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.

SEVCON, INC.

By /s/ Matthew Boyle December 20, 2012
Matthew Boyle
President and Chief
Executive Officer

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:

SIGNATURE	TITLE	DATE
/s/ Matthew Boyle	President, Chief Executive	December 20, 2012
Matthew Boyle	Officer and Director (Principal Executive Officer)	
/s/ Paul N. Farquhar	Vice President, Chief Financial Officer and Treasurer	December 20, 2012
Paul N. Farquhar	(Principal Accounting Officer)	
/s/ Maarten D. Hemsley	Director	December 20, 2012
Maarten D. Hemsley		
/s/ Paul B. Rosenberg	Director	December 20, 2012
Paul B. Rosenberg		
/s/ Marvin G. Schorr	Director	December 20, 2012
Marvin G. Schorr		
/s/ Bernard F. Start	Director	December 20, 2012

Bernard F. Start

/s/ David R. A. Steadman	Director	December 20, 2012
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David R. A. Steadman

/s/ Paul O. Stump	Director	December 20, 2012
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Paul O. Stump

/s/ Frederick.A.Wang	Director	December 20, 2012
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Frederick. A. Wang

/s/ William J. Ketelhut	Director	December 20, 2012
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William J. Ketelhut

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SCHEDULE II
SEVCON, INC. AND SUBSIDIARIES

Reserves for the years ended September 30, 2012 and 2011

(in thousands of dollars)

	2012	2011
Allowance for doubtful accounts		
Balance at beginning of year	49	53
Additions charged to costs and expenses	25	15
Deductions from reserves:		
Accounts collected	(3)	-
Reduction in reserve	-	(1)
Write off of uncollectible accounts	(39)	(18)
Balance at end of year	32	49

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