

TEXAS CAPITAL BANCSHARES INC/TX

Form 10-Q

April 21, 2011

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  
For the quarterly period ended March 31, 2011**

**Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 001-34657  
TEXAS CAPITAL BANCSHARES, INC.  
(Exact Name of Registrant as Specified in Its Charter)**

**Delaware**  
(State or other jurisdiction of incorporation or organization)

**75-2679109**  
(I.R.S. Employer Identification Number)

**2000 McKinney Avenue, Suite 700, Dallas, Texas,  
U.S.A.**  
(Address of principal executive officers)

**75201**  
(Zip Code)

**214/932-6600**  
(Registrant's telephone number, including area code)

**N/A**

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "large accelerated filer" and "accelerated filer" Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Non-Accelerated Filer   
(Do not check if a smaller reporting company)

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

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

On April 20, 2011, the number of shares set forth below was outstanding with respect to each of the issuer's classes of common stock:

|                                          |            |
|------------------------------------------|------------|
| Common Stock, par value \$0.01 per share | 37,219,649 |
|------------------------------------------|------------|



Texas Capital Bancshares, Inc.  
Form 10-Q  
Quarter Ended March 31, 2011  
Index

Part I. Financial Information

|                                                                                                      |    |
|------------------------------------------------------------------------------------------------------|----|
| <u>Item 1. Financial Statements</u>                                                                  | 3  |
| <u>Consolidated Statements of Income Unaudited</u>                                                   | 3  |
| <u>Consolidated Balance Sheets Unaudited</u>                                                         | 4  |
| <u>Consolidated Statements of Stockholders Equity Unaudited</u>                                      | 5  |
| <u>Consolidated Statements of Cash Flows Unaudited</u>                                               | 6  |
| <u>Notes to Consolidated Financial Statements Unaudited</u>                                          | 7  |
| <u>Financial Summaries Unaudited</u>                                                                 | 21 |
| <br>                                                                                                 |    |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 22 |
| <br>                                                                                                 |    |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>                            | 34 |
| <br>                                                                                                 |    |
| <u>Item 4. Controls and Procedures</u>                                                               | 37 |

Part II. Other Information

|                              |    |
|------------------------------|----|
| <u>Item 1A. Risk Factors</u> | 37 |
| <br>                         |    |
| <u>Item 5. Exhibits</u>      | 38 |
| <br>                         |    |
| <u>Signatures</u>            | 39 |
| <u>EX-31.1</u>               |    |
| <u>EX-31.2</u>               |    |
| <u>EX-32.1</u>               |    |
| <u>EX-32.2</u>               |    |

**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****TEXAS CAPITAL BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF INCOME UNAUDITED**

(In thousands except per share data)

|                                                              | Three months ended March |               |
|--------------------------------------------------------------|--------------------------|---------------|
|                                                              | 2011                     | 31,<br>2010   |
| <b>Interest income</b>                                       |                          |               |
| Interest and fees on loans                                   | \$ 68,040                | \$ 61,569     |
| Securities                                                   | 1,846                    | 2,726         |
| Federal funds sold                                           | 28                       | 9             |
| Deposits in other banks                                      | 197                      | 2             |
| <b>Total interest income</b>                                 | <b>70,111</b>            | <b>64,306</b> |
| <b>Interest expense</b>                                      |                          |               |
| Deposits                                                     | 4,871                    | 7,758         |
| Federal funds purchased                                      | 107                      | 365           |
| Repurchase agreements                                        | 2                        | 4             |
| Other borrowings                                             |                          | 47            |
| Trust preferred subordinated debentures                      | 633                      | 904           |
| <b>Total interest expense</b>                                | <b>5,613</b>             | <b>9,078</b>  |
| <b>Net interest income</b>                                   | <b>64,498</b>            | <b>55,228</b> |
| <b>Provision for credit losses</b>                           | <b>7,500</b>             | <b>13,500</b> |
| <b>Net interest income after provision for credit losses</b> | <b>56,998</b>            | <b>41,728</b> |
| <b>Non-interest income</b>                                   |                          |               |
| Service charges on deposit accounts                          | 1,783                    | 1,483         |
| Trust fee income                                             | 954                      | 954           |
| Bank owned life insurance (BOLI) income                      | 523                      | 471           |
| Brokered loan fees                                           | 2,520                    | 1,904         |
| Equipment rental income                                      | 783                      | 1,344         |
| Other                                                        | 1,121                    | 792           |
| <b>Total non-interest income</b>                             | <b>7,684</b>             | <b>6,948</b>  |
| <b>Non-interest expense</b>                                  |                          |               |
| Salaries and employee benefits                               | 24,172                   | 20,069        |
| Net occupancy expense                                        | 3,310                    | 3,014         |
| Leased equipment depreciation                                | 556                      | 1,059         |
| Marketing                                                    | 2,123                    | 787           |
| Legal and professional                                       | 2,723                    | 1,950         |
| Communications and technology                                | 2,347                    | 1,926         |
| FDIC insurance assessment                                    | 2,511                    | 1,868         |
| Allowance and other carrying costs for OREO                  | 4,030                    | 2,292         |
| Other                                                        | 4,627                    | 4,221         |

Edgar Filing: TEXAS CAPITAL BANCSHARES INC/TX - Form 10-Q

|                                                              |           |          |
|--------------------------------------------------------------|-----------|----------|
| Total non-interest expense                                   | 46,399    | 37,186   |
| <b>Income from continuing operations before income taxes</b> | 18,283    | 11,490   |
| Income tax expense                                           | 6,344     | 3,890    |
| <b>Income from continuing operations</b>                     | 11,939    | 7,600    |
| <b>Loss from discontinued operations (after-tax)</b>         | (60)      | (55)     |
| <b>Net income</b>                                            | \$ 11,879 | \$ 7,545 |
| <br>                                                         |           |          |
| <b>Basic earnings per common share</b>                       |           |          |
| Income from continuing operations                            | \$ 0.32   | \$ 0.21  |
| Net income                                                   | \$ 0.32   | \$ 0.21  |
| <br>                                                         |           |          |
| <b>Diluted earnings per common share</b>                     |           |          |
| Income from continuing operations                            | \$ 0.31   | \$ 0.21  |
| Net income                                                   | \$ 0.31   | \$ 0.21  |

See accompanying notes to consolidated financial statements.

**Table of Contents****TEXAS CAPITAL BANCSHARES, INC.  
CONSOLIDATED BALANCE SHEETS**

(In thousands except per share data)

|                                                             | March 31,<br>2011<br>(Unaudited) | December 31,<br>2010 |
|-------------------------------------------------------------|----------------------------------|----------------------|
| <b>Assets</b>                                               |                                  |                      |
| Cash and due from banks                                     | \$ 213,480                       | \$ 104,866           |
| Federal funds sold                                          | 10,240                           | 75,000               |
| Securities, available-for-sale                              | 171,990                          | 185,424              |
| Loans held for sale                                         | 811,400                          | 1,194,209            |
| Loans held for sale from discontinued operations            | 488                              | 490                  |
| Loans held for investment (net of unearned income)          | 4,711,424                        | 4,711,330            |
| Less: Allowance for loan losses                             | 70,248                           | 71,510               |
| Loans held for investment, net                              | 4,641,176                        | 4,639,820            |
| Premises and equipment, net                                 | 11,652                           | 11,568               |
| Accrued interest receivable and other assets                | 191,706                          | 225,309              |
| Goodwill and intangible assets, net                         | 9,402                            | 9,483                |
| Total assets                                                | \$ 6,061,534                     | \$ 6,446,169         |
| <b>Liabilities and Stockholders Equity</b>                  |                                  |                      |
| Liabilities:                                                |                                  |                      |
| Deposits:                                                   |                                  |                      |
| Non-interest bearing                                        | \$ 1,480,695                     | \$ 1,451,307         |
| Interest bearing                                            | 3,429,358                        | 3,545,146            |
| Interest bearing in foreign branches                        | 311,938                          | 458,948              |
| Total deposits                                              | 5,221,991                        | 5,455,401            |
| Accrued interest payable                                    | 1,662                            | 2,579                |
| Other liabilities                                           | 45,555                           | 48,577               |
| Federal funds purchased                                     | 115,870                          | 283,781              |
| Repurchase agreements                                       | 14,716                           | 10,920               |
| Other borrowings                                            | 3,409                            | 3,186                |
| Trust preferred subordinated debentures                     | 113,406                          | 113,406              |
| Total liabilities                                           | 5,516,609                        | 5,917,850            |
| Stockholders equity:                                        |                                  |                      |
| Preferred stock, \$.01 par value, \$1,000 liquidation value |                                  |                      |
| Authorized shares 10,000,000                                |                                  |                      |
| Issued shares                                               |                                  |                      |
| Common stock, \$.01 par value:                              |                                  |                      |
| Authorized shares 100,000,000                               |                                  |                      |
|                                                             | 372                              | 369                  |

Edgar Filing: TEXAS CAPITAL BANCSHARES INC/TX - Form 10-Q

Issued shares 37,217,346 and 36,957,104 at March 31, 2011 and December 31, 2010)

|                                                                              |              |              |
|------------------------------------------------------------------------------|--------------|--------------|
| Additional paid-in capital                                                   | 341,680      | 336,796      |
| Retained earnings                                                            | 197,686      | 185,807      |
| Treasury stock (shares at cost: 417 at March 31, 2011 and December 31, 2010) | (8)          | (8)          |
| Accumulated other comprehensive income, net of taxes                         | 5,195        | 5,355        |
| Total stockholders' equity                                                   | 544,925      | 528,319      |
| Total liabilities and stockholders' equity                                   | \$ 6,061,534 | \$ 6,446,169 |

See accompanying notes to consolidated financial statements.

4

---



**Table of Contents****TEXAS CAPITAL BANCSHARES, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

(In thousands except share data)

|                                                                                                              | Preferred<br>Stock<br>Shares | Common Stock<br>Shares | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Treasury<br>Stock<br>Shares | Accumulated<br>Other<br>Comprehensive<br>Income,<br>Net of<br>Taxes | Total      |
|--------------------------------------------------------------------------------------------------------------|------------------------------|------------------------|----------------------------------|----------------------|-----------------------------|---------------------------------------------------------------------|------------|
| Balance at<br>December 31,<br>2009                                                                           | \$                           | 35,919,941             | \$ 359                           | \$ 326,224           | \$ 148,620                  | (417) \$ (8) \$ 6,165                                               | \$ 481,360 |
| Comprehensive<br>income:                                                                                     |                              |                        |                                  |                      |                             |                                                                     |            |
| Net income<br>(unaudited)                                                                                    |                              |                        |                                  | 7,545                |                             |                                                                     | 7,545      |
| Change in<br>unrealized gain on<br>available-for-sale<br>securities, net of<br>taxes of \$100<br>(unaudited) |                              |                        |                                  |                      |                             | 185                                                                 | 185        |
| Total<br>comprehensive<br>income (unaudited)                                                                 |                              |                        |                                  |                      |                             |                                                                     | 7,730      |
| Tax expense<br>related to exercise<br>of stock options<br>(unaudited)                                        |                              |                        |                                  | 115                  |                             |                                                                     | 115        |
| Stock-based<br>compensation<br>expense<br>recognized in<br>earnings<br>(unaudited)                           |                              |                        |                                  | 1,572                |                             |                                                                     | 1,572      |
| Issuance of stock<br>related to<br>stock-based awards<br>(unaudited)                                         |                              | 57,068                 | 1                                | 305                  |                             |                                                                     | 306        |
| Issuance of<br>common stock<br>(unaudited)                                                                   |                              | 547,721                | 5                                | 8,908                |                             |                                                                     | 8,913      |
| Balance at<br>March 31, 2010                                                                                 | \$                           | 36,524,730             | \$ 365                           | \$ 337,124           | \$ 156,165                  | (417) \$ (8) \$ 6,350                                               | \$ 499,996 |

(unaudited)

|                                                                                                             |    |            |        |            |            |       |        |          |            |
|-------------------------------------------------------------------------------------------------------------|----|------------|--------|------------|------------|-------|--------|----------|------------|
| Balance at<br>December 31,<br>2010                                                                          | \$ | 36,957,104 | \$ 369 | \$ 336,796 | \$ 185,807 | (417) | \$ (8) | \$ 5,355 | \$ 528,319 |
| Comprehensive<br>income:                                                                                    |    |            |        |            |            |       |        |          |            |
| Net income<br>(unaudited)                                                                                   |    |            |        |            | 11,879     |       |        |          | 11,879     |
| Change in<br>unrealized gain on<br>available-for-sale<br>securities, net of<br>taxes of \$86<br>(unaudited) |    |            |        |            |            |       |        | (160)    | (160)      |
| Total<br>comprehensive<br>income (unaudited)                                                                |    |            |        |            |            |       |        |          | 11,719     |
| Tax expense<br>related to exercise<br>of stock options<br>(unaudited)                                       |    |            |        | 1,160      |            |       |        |          | 1,160      |
| Stock-based<br>compensation<br>expense<br>recognized in<br>earnings<br>(unaudited)                          |    |            |        | 2,134      |            |       |        |          | 2,134      |
| Issuance of stock<br>related to<br>stock-based awards<br>(unaudited)                                        |    | 260,242    | 3      | 1,590      |            |       |        |          | 1,593      |
| Balance at<br>March 31, 2011<br>(unaudited)                                                                 | \$ | 37,217,346 | \$ 372 | \$ 341,680 | \$ 197,686 | (417) | \$ (8) | \$ 5,195 | \$ 544,925 |

See accompanying notes to consolidated financial statements

**Table of Contents****TEXAS CAPITAL BANCSHARES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED**

(In thousands)

|                                                                                   | Three months ended March 31, |             |
|-----------------------------------------------------------------------------------|------------------------------|-------------|
|                                                                                   | 2011                         | 2010        |
| <b>Operating activities</b>                                                       |                              |             |
| Net income from continuing operations                                             | \$ 11,939                    | \$ 7,600    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |             |
| Provision for credit losses                                                       | 7,500                        | 13,500      |
| Depreciation and amortization                                                     | 1,469                        | 1,905       |
| Amortization and accretion on securities                                          | 25                           | 39          |
| Bank owned life insurance (BOLI) income                                           | (523)                        | (471)       |
| Stock-based compensation expense                                                  | 2,134                        | 1,572       |
| Tax benefit from stock option exercises                                           | 1,160                        | 115         |
| Excess tax benefits from stock-based compensation arrangements                    | (3,313)                      | (329)       |
| Originations of loans held for sale                                               | (4,725,151)                  | (3,204,634) |
| Proceeds from sales of loans held for sale                                        | 5,107,959                    | 3,305,702   |
| Loss on sale of assets                                                            | (63)                         | 44          |
| Changes in operating assets and liabilities:                                      |                              |             |
| Accrued interest receivable and other assets                                      | 20,136                       | 13,008      |
| Accrued interest payable and other liabilities                                    | (3,852)                      | (1,584)     |
| Net cash provided by operating activities of continuing operations                | 419,420                      | 136,467     |
| Net cash (used in) operating activities of discontinued operations                | (58)                         | (53)        |
| Net cash provided by operating activities                                         | 419,362                      | 136,414     |
| <b>Investing activities</b>                                                       |                              |             |
| Maturities and calls of available-for-sale securities                             | 1,610                        | 1,515       |
| Principal payments received on available-for-sale securities                      | 11,552                       | 18,650      |
| Net (increase) decrease in loans held for investment                              | (8,855)                      | 3,126       |
| Purchase of premises and equipment, net                                           | (916)                        | (422)       |
| Proceeds from sale of foreclosed assets                                           | 13,497                       | 601         |
| Net cash provided by investing activities of continuing operations                | 16,888                       | 23,470      |
| <b>Financing activities</b>                                                       |                              |             |
| Net increase (decrease) in deposits                                               | (233,410)                    | 289,094     |
| Proceeds from issuance of stock related to stock-based awards                     | 1,593                        | 306         |
| Proceeds from issuance of common stock                                            |                              | 8,913       |
| Net increase (decrease) in other borrowings                                       | 4,019                        | (350,388)   |
| Excess tax benefits from stock-based compensation arrangements                    | 3,313                        | 329         |
| Net (decrease) in federal funds purchased                                         | (167,911)                    | (154,580)   |
| Net cash (used in) financing activities of continuing operations                  | (392,396)                    | (206,326)   |

Edgar Filing: TEXAS CAPITAL BANCSHARES INC/TX - Form 10-Q

|                                                                  |            |           |
|------------------------------------------------------------------|------------|-----------|
| Net increase (decrease) in cash and cash equivalents             | 43,854     | (46,442)  |
| Cash and cash equivalents at beginning of period                 | 179,866    | 125,439   |
| Cash and cash equivalents at end of period                       | \$ 223,720 | \$ 78,997 |
| Supplemental disclosures of cash flow information:               |            |           |
| Cash paid during the period for interest                         | \$ 5,989   | \$ 9,508  |
| Cash paid during the period for income taxes                     | 173        | 299       |
| Non-cash transactions:                                           |            |           |
| Transfers from loans/leases to OREO and other repossessed assets | 926        | 4,151     |
| See accompanying notes to consolidated financial statements.     |            |           |

6

---

**Table of Contents**

**TEXAS CAPITAL BANCSHARES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED**

**(1) OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Operations**

Texas Capital Bancshares, Inc. ( the Company ), a Delaware bank holding company, was incorporated in November 1996 and commenced operations in March 1998. The consolidated financial statements of the Company include the accounts of Texas Capital Bancshares, Inc. and its wholly owned subsidiary, Texas Capital Bank, National Association (the Bank ). The Bank currently provides commercial banking services to its customers primarily in Texas and concentrates on middle market commercial and high net worth customers.

**Basis of Presentation**

The accounting and reporting policies of Texas Capital Bancshares, Inc. conform to accounting principles generally accepted in the United States and to generally accepted practices within the banking industry. Our consolidated financial statements include the accounts of Texas Capital Bancshares, Inc. and its subsidiary, the Bank. Certain prior period balances have been reclassified to conform to the current period presentation.

The consolidated interim financial statements have been prepared without audit. Certain information and footnote disclosures presented in accordance with accounting principles generally accepted in the United States have been condensed or omitted. In the opinion of management, the interim financial statements include all normal and recurring adjustments and the disclosures made are adequate to make interim financial information not misleading. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission ( SEC ). Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with our consolidated financial statements, and notes thereto, for the year ended December 31, 2010, included in our Annual Report on Form 10-K filed with the SEC on February 23, 2011 (the 2010 Form 10-K ). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for possible loan losses, the valuation allowance for other real estate owned ( OREO ), the fair value of stock-based compensation awards, the fair values of financial instruments and the status of contingencies are particularly susceptible to significant change in the near term.

**Accumulated Other Comprehensive Income, Net**

Unrealized gains or losses on our available-for-sale securities (after applicable income tax expense or benefit) are included in accumulated other comprehensive income, net. Accumulated comprehensive income, net for the three months ended March 31, 2011 and 2010 is reported in the accompanying consolidated statements of changes in stockholders equity.

**Fair Values of Financial Instruments**

Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. The fair value estimates of existing on- and off-balance sheet financial instruments do not include the value of anticipated future business or the value of assets and liabilities not considered financial instruments.

**Table of Contents****(2) EARNINGS PER COMMON SHARE**

The following table presents the computation of basic and diluted earnings per share (in thousands except per share data):

|                                                                                                      | Three months ended March 31, |            |
|------------------------------------------------------------------------------------------------------|------------------------------|------------|
|                                                                                                      | 2011                         | 2010       |
| Numerator:                                                                                           |                              |            |
| Net income from continuing operations                                                                | \$ 11,939                    | \$ 7,600   |
| Loss from discontinued operations                                                                    | (60)                         | (55)       |
| Net income                                                                                           | \$ 11,879                    | \$ 7,545   |
| Denominator:                                                                                         |                              |            |
| Denominator for basic earnings per share weighted average shares                                     | 37,090,882                   | 36,191,373 |
| Effect of employee stock options <sup>(1)</sup>                                                      | 957,779                      | 509,935    |
| Effect of warrants to purchase common stock                                                          | 293,018                      | 82,411     |
| Denominator for dilutive earnings per share adjusted weighted average shares and assumed conversions | 38,341,679                   | 36,783,719 |
| Basic earnings per common share from continuing operations                                           | \$ 0.32                      | \$ 0.21    |
| Basic earnings per common share from discontinued operations                                         |                              |            |
| Basic earnings per common share                                                                      | \$ 0.32                      | \$ 0.21    |
| Diluted earnings per share from continuing operations                                                | \$ 0.31                      | \$ 0.21    |
| Diluted earnings per share from discontinued operations                                              |                              |            |
| Diluted earnings per common share                                                                    | \$ 0.31                      | \$ 0.21    |

(1) Stock options, SARs and RSUs outstanding of 116,000 at March 31, 2011 and 1,601,380 at March 31, 2010 have not been included in diluted earnings per share because to do so would have been anti-dilutive for the periods presented.

**(3) SECURITIES**

Securities are identified as either held-to-maturity or available-for-sale based upon various factors, including asset/liability management strategies, liquidity and profitability objectives, and regulatory requirements. Held-to-maturity securities are carried at cost, adjusted for amortization of premiums or accretion of discounts. Available-for-sale securities are securities that may be sold prior to maturity based upon asset/liability management decisions. Securities identified as available-for-sale are carried at fair value. Unrealized gains or losses on available-for-sale securities are recorded as accumulated other comprehensive income in stockholders' equity, net of taxes. Amortization of premiums or accretion of discounts on mortgage-backed securities is periodically adjusted for estimated prepayments. Realized gains and losses and declines in value judged to be other-than-temporary are included in gain (loss) on sale of securities. The cost of securities sold is based on the specific identification method. Our net unrealized gain on the available-for-sale securities portfolio value decreased from a gain of \$8.2 million, which represented 4.65% of the amortized cost at December 31, 2010, to a gain of \$8.0 million, which represented 4.87% of the amortized cost at March 31, 2011.

**Table of Contents**

The following is a summary of securities (in thousands):

|                                        | March 31, 2011    |                              |                               |                            |
|----------------------------------------|-------------------|------------------------------|-------------------------------|----------------------------|
|                                        | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
| Available-for-Sale Securities:         |                   |                              |                               |                            |
| Residential mortgage-backed securities | \$ 115,270        | \$ 6,665                     | \$ (22)                       | \$ 121,913                 |
| Corporate securities                   | 5,000             |                              |                               | 5,000                      |
| Municipals                             | 36,221            | 1,305                        |                               | 37,526                     |
| Equity securities <sup>(1)</sup>       | 7,506             | 45                           |                               | 7,551                      |
|                                        | \$ 163,997        | \$ 8,015                     | \$ (22)                       | \$ 171,990                 |

|                                        | December 31, 2010 |                              |                               |                            |
|----------------------------------------|-------------------|------------------------------|-------------------------------|----------------------------|
|                                        | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
| Available-for-Sale Securities:         |                   |                              |                               |                            |
| Residential mortgage-backed securities | \$ 126,838        | \$ 6,891                     | \$ (5)                        | \$ 133,724                 |
| Corporate securities                   | 5,000             |                              |                               | 5,000                      |
| Municipals                             | 37,841            | 1,244                        |                               | 39,085                     |
| Equity securities <sup>(1)</sup>       | 7,506             | 109                          |                               | 7,615                      |
|                                        | \$ 177,185        | \$ 8,244                     | \$ (5)                        | \$ 185,424                 |

(1) Equity securities consist of Community Reinvestment Act funds.

The amortized cost and estimated fair value of securities are presented below by contractual maturity (in thousands, except percentage data):

|                                                        | March 31, 2011              |                                       |                                          |                       |            |
|--------------------------------------------------------|-----------------------------|---------------------------------------|------------------------------------------|-----------------------|------------|
|                                                        | Less<br>Than<br>One<br>Year | After One<br>Through<br>Five<br>Years | After<br>Five<br>Through<br>Ten<br>Years | After<br>Ten<br>Years | Total      |
| Available-for-sale:                                    |                             |                                       |                                          |                       |            |
| Residential mortgage-backed securities: <sup>(1)</sup> |                             |                                       |                                          |                       |            |
| Amortized cost                                         | \$ 6,968                    | \$ 10,717                             | \$ 45,832                                | \$ 51,753             | \$ 115,270 |
| Estimated fair value                                   | 6,996                       | 11,070                                | 48,802                                   | 55,045                | 121,913    |
| Weighted average yield <sup>(3)</sup>                  | 4.502%                      | 4.351%                                | 4.814%                                   | 4.021%                | 4.396%     |
| Corporate securities:                                  |                             |                                       |                                          |                       |            |
| Amortized cost                                         |                             | 5,000                                 |                                          |                       | 5,000      |

Edgar Filing: TEXAS CAPITAL BANCSHARES INC/TX - Form 10-Q

|                                       |        |        |        |            |
|---------------------------------------|--------|--------|--------|------------|
| Estimated fair value                  |        | 5,000  |        | 5,000      |
| Weighted average yield <sup>(3)</sup> |        | 7.375% |        | 7.375%     |
| Municipals: <sup>(2)</sup>            |        |        |        |            |
| Amortized cost                        | 2,751  | 24,702 | 8,768  | 36,221     |
| Estimated fair value                  | 2,789  | 25,710 | 9,027  | 37,526     |
| Weighted average yield <sup>(3)</sup> | 5.082% | 5.476% | 5.836% | 5.506%     |
| Equity securities:                    |        |        |        |            |
| Amortized cost                        | 7,506  |        |        | 7,506      |
| Estimated fair value                  | 7,551  |        |        | 7,551      |
| Total available-for-sale securities:  |        |        |        |            |
| Amortized cost                        |        |        |        | \$ 163,997 |
| Estimated fair value                  |        |        |        | \$ 171,990 |

- (1) Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.
- (2) Yields have been adjusted to a tax equivalent basis assuming a 35% federal tax rate.
- (3) Yields are calculated based on amortized cost.



**Table of Contents**

Securities with carrying values of approximately \$38.9 million were pledged to secure certain borrowings and deposits at March 31, 2011. Of the pledged securities at March 31, 2011, approximately \$19.2 million were pledged for certain deposits, and approximately \$19.7 million were pledged for repurchase agreements.

The following table discloses, as of March 31, 2011 and December 31, 2010, our investment securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months (in thousands):

March 31, 2011

|                            | Less Than 12 Months |                 | 12 Months or Longer |                 | Total      |                 |
|----------------------------|---------------------|-----------------|---------------------|-----------------|------------|-----------------|
|                            | Fair Value          | Unrealized Loss | Fair Value          | Unrealized Loss | Fair Value | Unrealized Loss |
| Mortgage-backed securities | \$ 3,180            | \$ (22)         | \$                  | \$              | \$ 3,180   | \$ (22)         |
| Corporate securities       |                     |                 |                     |                 |            |                 |
| Municipals                 |                     |                 |                     |                 |            |                 |
|                            | \$ 3,180            | \$ (22)         | \$                  | \$              | \$ 3,180   | \$ (22)         |

December 31, 2010

|                            | Less Than 12 Months |                 | 12 Months or Longer |                 | Total      |                 |
|----------------------------|---------------------|-----------------|---------------------|-----------------|------------|-----------------|
|                            | Fair Value          | Unrealized Loss | Fair Value          | Unrealized Loss | Fair Value | Unrealized Loss |
| Mortgage-backed securities | \$ 3,681            | \$ (5)          | \$                  | \$              | \$ 3,681   | \$ (5)          |
| Corporate securities       |                     |                 |                     |                 |            |                 |
| Municipals                 |                     |                 |                     |                 |            |                 |
|                            | \$ 3,681            | \$ (5)          | \$                  | \$              | \$ 3,681   | \$ (5)          |

At March 31, 2011, we had one investment position in an unrealized loss position. We do not believe these unrealized losses are other than temporary as (1) we do not have the intent to sell any of the securities in the table above; and (2) it is not probable that we will be unable to collect the amounts contractually due. The unrealized losses are interest rate related, and losses have decreased as rates have decreased in 2009 and remained low during 2010 and 2011. We have not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities.

**(4) LOANS AND ALLOWANCE FOR LOAN LOSSES**

At March 31, 2011 and December 31, 2010, loans were as follows (in thousands):

|                                 | March 31,<br>2011 | December 31,<br>2010 |
|---------------------------------|-------------------|----------------------|
| Commercial                      | \$ 2,541,784      | \$ 2,592,924         |
| Construction                    | 349,442           | 270,008              |
| Real estate                     | 1,746,100         | 1,759,758            |
| Consumer                        | 21,590            | 21,470               |
| Leases                          | 80,694            | 95,607               |
| Gross loans held for investment | 4,739,610         | 4,739,767            |

Edgar Filing: TEXAS CAPITAL BANCSHARES INC/TX - Form 10-Q

|                                                   |              |              |
|---------------------------------------------------|--------------|--------------|
| Deferred income (net of direct origination costs) | (28,186)     | (28,437)     |
| Allowance for loan losses                         | (70,248)     | (71,510)     |
| Total loans held for investment, net              | 4,641,176    | 4,639,820    |
| Loans held for sale                               | 811,400      | 1,194,209    |
| Total                                             | \$ 5,452,576 | \$ 5,834,029 |

We continue to lend primarily in Texas. As of March 31, 2011, a substantial majority of the principal amount of the loans held for investment in our portfolio was to businesses and individuals in Texas. This geographic

**Table of Contents**

concentration subjects the loan portfolio to the general economic conditions within this area. The risks created by this concentration have been considered by management in the determination of the adequacy of the allowance for loan losses. Management believes the allowance for loan losses is adequate to cover estimated losses on loans at each balance sheet date.

The reserve for loan losses is comprised of specific reserves for impaired loans and an estimate of losses inherent in the portfolio at the balance sheet date, but not yet identified with specified loans. We regularly evaluate our reserve for loan losses to maintain an adequate level to absorb estimated loan losses inherent in the loan portfolio. Factors contributing to the determination of reserves include the credit worthiness of the borrower, changes in the value of pledged collateral, and general economic conditions. All loan commitments rated substandard or worse and greater than \$500,000 are specifically reviewed for loss potential. For loans deemed to be impaired, a specific allocation is assigned based on the losses expected to be realized from those loans. For purposes of determining the general reserve, the portfolio is segregated by product types to recognize differing risk profiles among categories, and then further segregated by credit grades. Credit grades are assigned to all loans. Each credit grade is assigned a risk factor, or reserve allocation percentage. These risk factors are multiplied by the outstanding principal balance and risk-weighted by product type to calculate the required reserve. A similar process is employed to calculate a reserve assigned to off-balance sheet commitments, specifically unfunded loan commitments and letters of credit, and any needed reserve is recorded in other liabilities. Even though portions of the allowance may be allocated to specific loans, the entire allowance is available for any credit that, in management's judgment, should be charged off.

We have several pass credit grades that are assigned to loans based on varying levels of risk, ranging from credits that are secured by cash or marketable securities, to watch credits which have all the characteristics of an acceptable credit risk but warrant more than the normal level of supervision. Within our criticized/classified credit grades are special mention, substandard, and doubtful. Special mention loans are those that are currently protected by sound worth and paying capacity of the borrower, but that are potentially weak and constitute an additional credit risk. The loan has the potential to deteriorate to a substandard grade due to the existence of financial or administrative deficiencies.

Substandard loans are inadequately protected by sound worth and paying capacity of the borrower and of the collateral pledged. Substandard loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Substandard loans can be accruing or can be on nonaccrual depending on the circumstances of the individual loans. Loans classified as doubtful have all the weaknesses inherent in substandard loans with the added characteristics that the weaknesses make collection or liquidation in full highly questionable and improbable. The possibility of loss is extremely high. All doubtful loans are on nonaccrual.

The reserve allocation percentages assigned to each credit grade have been developed based primarily on an analysis of our historical loss rates. The allocations are adjusted for certain qualitative factors for such things as general economic conditions, changes in credit policies and lending standards. Historical loss rates are adjusted to account for current environmental conditions which we believe are likely to cause loss rates to be higher or lower than past experience. Each quarter we produce an adjustment range for environmental factors unique to us and our market. Changes in the trend and severity of problem loans can cause the estimation of losses to differ from past experience. In addition, the reserve considers the results of reviews performed by independent third party reviewers as reflected in their confirmations of assigned credit grades within the portfolio. The portion of the allowance that is not derived by the allowance allocation percentages compensates for the uncertainty and complexity in estimating loan and lease losses including factors and conditions that may not be fully reflected in the determination and application of the allowance allocation percentages. We evaluate many factors and conditions in determining the unallocated portion of the allowance, including the economic and business conditions affecting key lending areas, credit quality trends and general growth in the portfolio. The allowance is considered adequate and appropriate, given management's assessment of potential losses within the portfolio as of the evaluation date, the significant growth in the loan and lease portfolio, current economic conditions in the Company's market areas and other factors.

The methodology used in the periodic review of reserve adequacy, which is performed at least quarterly, is designed to be dynamic and responsive to changes in portfolio credit quality. The changes are reflected in the general reserve and in specific reserves as the collectability of larger classified loans is evaluated with new information. As our

portfolio has matured, historical loss ratios have been closely monitored, and our reserve adequacy relies primarily on our loss history. Currently, the review of reserve adequacy is performed by executive management and presented to our board of directors for their review, consideration and ratification on a quarterly basis.

**Table of Contents**

The following tables summarize the credit risk profile of our loan portfolio by internally assigned grades and nonaccrual status as of March 31, 2011 and December 31, 2010 (in thousands):

March 31, 2011

|                                 | Commercial   | Construction | Real Estate  | Consumer  | Leases    | Total        |
|---------------------------------|--------------|--------------|--------------|-----------|-----------|--------------|
| Grade:                          |              |              |              |           |           |              |
| Pass                            | \$ 2,414,750 | \$ 316,077   | \$ 1,563,548 | \$ 20,703 | \$ 63,879 | \$ 4,378,957 |
| Special mention                 | 59,076       | 24,286       | 46,974       | 139       | 5,946     | 136,421      |
| Substandard-accruing            | 24,965       | 6,439        | 69,403       | 80        | 6,866     | 107,753      |
| Non-accrual                     | 42,993       | 2,640        | 66,174       | 669       | 4,003     | 116,479      |
| Total loans held for investment | \$ 2,541,784 | \$ 349,442   | \$ 1,746,099 | \$ 21,591 | \$ 80,694 | \$ 4,739,610 |

December 31, 2010

|                                 | Commercial   | Construction | Real Estate  | Consumer  | Leases    | Total        |
|---------------------------------|--------------|--------------|--------------|-----------|-----------|--------------|
| Grade:                          |              |              |              |           |           |              |
| Pass                            | \$ 2,461,769 | \$ 243,843   | \$ 1,549,400 | \$ 20,312 | \$ 78,715 | \$ 4,354,039 |
| Special mention                 | 45,754       | 19,856       | 59,294       | 76        | 1,552     | 126,532      |
| Substandard-accruing            | 42,858       | 6,288        | 88,567       | 376       | 9,017     | 147,106      |
| Non-accrual                     | 42,543       | 21           | 62,497       | 706       | 6,323     | 112,090      |
| Total loans held for investment | \$ 2,592,924 | \$ 270,008   | \$ 1,759,758 | \$ 21,470 | \$ 95,607 | \$ 4,739,767 |

The following table details activity in the reserve for loan losses by portfolio segment for the quarter ended March 31, 2011. Allocation of a portion of the reserve to one category of loans does not preclude its availability to absorb losses in other categories.

| (in thousands)                     | Commercial | Construction | Real Estate | Consumer | Leases   | Unallocated | Total     |
|------------------------------------|------------|--------------|-------------|----------|----------|-------------|-----------|
| Beginning balance                  | \$ 15,918  | \$ 7,336     | \$ 38,049   | \$ 306   | \$ 5,405 | \$ 4,496    | \$ 71,510 |
| Provision for possible loan losses | 99         | (757)        | 6,594       | (42)     | (936)    | 2,732       | 7,690     |
| Charge-offs                        | 1,993      |              | 7,364       | 34       | 532      |             | 9,923     |
| Recoveries                         | 546        | 243          | 31          | 1        | 150      |             | 971       |
| Net charge-offs                    | 1,447      | (243)        | 7,333       | 33       | 382      |             | 8,952     |
| Ending balance                     | \$ 14,570  | \$ 6,822     | \$ 37,310   | \$ 231   | \$ 4,087 | \$ 7,228    | \$ 70,248 |
| Period end amount allocated to:    |            |              |             |          |          |             |           |
|                                    | \$ 5,891   | \$ 425       | \$ 10,980   | \$ 216   | \$ 816   | \$          | \$ 18,328 |

Loans individually  
evaluated for  
impairment  
Loans collectively  
evaluated for  
impairment

|                |          |        |           |        |        |    |           |
|----------------|----------|--------|-----------|--------|--------|----|-----------|
| Ending balance | \$ 5,891 | \$ 425 | \$ 10,980 | \$ 216 | \$ 816 | \$ | \$ 18,328 |
|----------------|----------|--------|-----------|--------|--------|----|-----------|

Activity in the reserve for loan losses during the three months ended March 31, 2010 was as follows (in thousands):

|                                        |           |
|----------------------------------------|-----------|
| Balance at the beginning of the period | \$ 67,931 |
| Provision for loan losses              | 13,054    |
| Net charge-offs:                       |           |
| Loans charged-off                      | 9,331     |
| Recoveries                             | 51        |
| Net charge-offs                        | 9,280     |
| Balance at the end of the period       | \$ 71,705 |

**Table of Contents**

Generally we place loans on non-accrual when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. The table below summarizes our non-accrual loans by type and purpose as of March 31, 2011 (in thousands):

|                         |            |
|-------------------------|------------|
| Commercial              |            |
| Business loans          | \$ 22,992  |
| Energy                  | 20,001     |
| Construction            |            |
| Market risk             | 2,640      |
| Real estate             |            |
| Market risk             | 56,887     |
| Commercial              | 6,733      |
| Secured by 1-4 family   | 2,554      |
| Consumer                | 669        |
| Leases                  | 4,003      |
| Total non-accrual loans | \$ 116,479 |

A loan held for investment is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due (both principal and interest) according to the terms of the loan agreement. The following table details our impaired loans, by portfolio class as of March 31, 2011 (in thousands):

**Table of Contents**

|                                                         | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|---------------------------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| With no related allowance recorded:                     |                        |                                |                      |                                   |                                  |
| Commercial                                              |                        |                                |                      |                                   |                                  |
| Business loans                                          | \$                     | \$                             | \$                   | \$                                | \$                               |
| Energy                                                  |                        |                                |                      |                                   |                                  |
| Other                                                   |                        |                                |                      |                                   |                                  |
| Construction                                            |                        |                                |                      |                                   |                                  |
| Market risk                                             |                        |                                |                      |                                   |                                  |
| Secured by 1-4 family                                   |                        |                                |                      |                                   |                                  |
| Other                                                   |                        |                                |                      |                                   |                                  |
| Real Estate                                             |                        |                                |                      |                                   |                                  |
| Market risk                                             |                        |                                |                      |                                   |                                  |
| Commercial                                              |                        |                                |                      |                                   |                                  |
| Secured by 1-4 family                                   |                        |                                |                      |                                   |                                  |
| Consumer                                                |                        |                                |                      |                                   |                                  |
| Leases                                                  |                        |                                |                      |                                   |                                  |
| Total impaired loans with no related allowance recorded | \$                     | \$                             | \$                   | \$                                | \$                               |
| With an allowance recorded:                             |                        |                                |                      |                                   |                                  |
| Commercial                                              |                        |                                |                      |                                   |                                  |
| Business loans                                          | \$ 22,992              | \$ 28,920                      | \$ 4,891             | \$ 22,692                         | \$                               |
| Energy                                                  | 20,001                 | 20,001                         | 1,000                | 20,001                            |                                  |
| Other                                                   |                        |                                |                      |                                   |                                  |
| Construction                                            |                        |                                |                      |                                   |                                  |
| Market risk                                             | 2,640                  | 2,640                          | 425                  | 2,641                             |                                  |
| Secured by 1-4 family                                   |                        |                                |                      |                                   |                                  |
| Other                                                   |                        |                                |                      |                                   |                                  |
| Real Estate                                             |                        |                                |                      |                                   |                                  |
| Market risk                                             | 56,887                 | 72,011                         | 9,502                | 55,104                            |                                  |
| Commercial                                              | 6,733                  | 6,733                          | 1,179                | 6,606                             |                                  |
| Secured by 1-4 family                                   | 2,554                  | 2,554                          | 299                  | 2,013                             |                                  |
| Consumer                                                | 669                    | 669                            | 216                  | 694                               |                                  |
| Leases                                                  | 4,003                  | 4,003                          | 816                  | 5,550                             |                                  |
| Total impaired loans with an allowance recorded         | \$ 116,479             | \$ 137,531                     | \$ 18,328            | \$ 115,301                        | \$                               |
| Combined:                                               |                        |                                |                      |                                   |                                  |
| Commercial                                              |                        |                                |                      |                                   |                                  |



Edgar Filing: TEXAS CAPITAL BANCSHARES INC/TX - Form 10-Q

|                       |            |            |           |            |    |
|-----------------------|------------|------------|-----------|------------|----|
| Business loans        | \$ 22,992  | \$ 28,920  | \$ 4,891  | \$ 22,692  | \$ |
| Energy                | 20,001     | 20,001     | 1,000     | 20,001     |    |
| Other                 |            |            |           |            |    |
| Construction          |            |            |           |            |    |
| Market risk           | 2,640      | 2,640      | 425       | 2,641      |    |
| Secured by 1-4 family |            |            |           |            |    |
| Other                 |            |            |           |            |    |
| Real Estate           |            |            |           |            |    |
| Market risk           | 56,887     | 72,011     | 9,502     | 55,104     |    |
| Commercial            | 6,733      | 6,733      | 1,179     | 6,606      |    |
| Secured by 1-4 family | 2,554      | 2,554      | 299       | 2,013      |    |
| Consumer              | 669        | 669        | 216       | 694        |    |
| Leases                | 4,003      | 4,003      | 816       | 5,550      |    |
| Total impaired loans  | \$ 116,479 | \$ 137,531 | \$ 18,328 | \$ 115,301 | \$ |

**Table of Contents**

Average impaired loans outstanding during the three months ended March 31, 2011 and 2010 totaled \$115.3 million and \$102.4 million, respectively.

The table below provides an age analysis of our past due loans that are still accruing as of March 31, 2011 (in thousands):

|                                    | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past Due | Greater<br>Than<br>90<br>Days | Total<br>Past<br>Due | Current      | Total        | Greater<br>Than<br>90 Days<br>and<br>Accruing <sup>(1)</sup> |
|------------------------------------|------------------------------|---------------------------|-------------------------------|----------------------|--------------|--------------|--------------------------------------------------------------|
| Commercial                         |                              |                           |                               |                      |              |              |                                                              |
| Business loans                     | \$ 5,323                     | \$ 5,543                  | \$ 2,426                      | \$ 13,292            | \$ 2,045,715 | \$ 2,059,007 | \$ 2,426                                                     |
| Energy                             | 11,279                       | 230                       |                               | 11,509               | 428,275      | 439,784      |                                                              |
| Construction                       |                              |                           |                               |                      |              |              |                                                              |
| Market risk                        |                              |                           |                               |                      | 334,526      | 334,526      |                                                              |
| Secured by 1-4<br>family           |                              |                           |                               |                      | 12,276       | 12,276       |                                                              |
| Real estate                        |                              |                           |                               |                      |              |              |                                                              |
| Market risk                        | 13,707                       |                           | 69                            | 13,776               | 1,285,621    | 1,299,397    | 69                                                           |
| Commercial                         | 1,559                        | 668                       |                               | 2,227                | 296,978      | 299,205      |                                                              |
| Secured by 1-4<br>family           | 7,793                        | 137                       | 34                            | 7,964                | 73,360       | 81,324       | 34                                                           |
| Consumer                           | 267                          | 18                        |                               | 285                  | 20,636       | 20,921       |                                                              |
| Leases                             | 1,423                        | 123                       |                               | 1,546                | 75,145       | 76,691       |                                                              |
| Total loans held for<br>investment | \$ 41,351                    | \$ 6,719                  | \$ 2,529                      | \$ 50,599            | \$ 4,572,532 | \$ 4,623,131 | \$ 2,529                                                     |

(1) Loans past due 90 days and still accruing includes premium finance loans of \$2.4 million. These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

**(5) OREO AND VALUATION ALLOWANCE FOR LOSSES ON OREO**

The table below presents a summary of the activity related to OREO (in thousands):

|                              | Three months ended March<br>31, |           |
|------------------------------|---------------------------------|-----------|
|                              | 2011                            | 2010      |
| Beginning balance            | \$ 42,261                       | \$ 27,264 |
| Additions                    | 926                             | 4,151     |
| Sales                        | (13,695)                        | (601)     |
| Valuation allowance for OREO | (1,921)                         | (1,838)   |
| Direct write-downs           | (1,399)                         | (111)     |
| Ending balance               | \$ 26,172                       | \$ 28,865 |

**(6) FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK**

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit which involve varying degrees of credit risk in excess of the amount recognized in the consolidated balance sheets. The Bank's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the borrower.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination

**Table of Contents**

clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit-worthiness on a case-by-case basis.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

The table below summarizes our financial instruments whose contract amounts represent credit risk at March 31, 2011 (in thousands):

|                              |              |
|------------------------------|--------------|
| Commitments to extend credit | \$ 1,436,490 |
| Standby letters of credit    | 103,075      |

**(7) REGULATORY MATTERS**

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

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

Financial institutions are categorized as well capitalized or adequately capitalized, based on minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the tables below. As shown below, the Bank's capital ratios exceed the regulatory definition of well capitalized as of March 31, 2011 and 2010. As of June 30, 2010, the most recent notification from the OCC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There have been no conditions or events since the notification that management believes have changed the Bank's category. Based upon the information in its most recently filed call report, the Bank continues to meet the capital ratios necessary to be well capitalized under the regulatory framework for prompt corrective action and continues to meet the capital ratios necessary to be well capitalized under the regulatory framework for prompt corrective action.

|                     | March 31, |        |
|---------------------|-----------|--------|
|                     | 2011      | 2010   |
| Risk-based capital: |           |        |
| Tier 1 capital      | 11.21%    | 11.28% |
| Total capital       | 12.46%    | 12.53% |
| Leverage            | 10.29%    | 10.98% |

**(8) STOCK-BASED COMPENSATION**

The fair value of our stock option and stock appreciation right (SAR) grants are estimated at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded

options, and because changes in the subjective input assumptions can materially affect the fair

**Table of Contents**

value estimate, in management's opinion, the existing models do not necessarily provide the best single measure of the fair value of its employee stock options.

Stock-based compensation consists of options issued prior to the adoption of Accounting Standards Codification (ASC) 718, *Compensation - Stock Compensation* (ASC 718), SARs and restricted stock units (RSUs). The SARs and RSUs were granted from 2006 through 2010.

| (in thousands)                               | Three months ended March 31, |          |
|----------------------------------------------|------------------------------|----------|
|                                              | 2011                         | 2010     |
| Stock-based compensation expense recognized: |                              |          |
| Unvested options                             | \$                           | \$ 110   |
| SARs                                         | 506                          | 478      |
| RSUs                                         | 1,628                        | 984      |
| Total compensation expense recognized        | \$ 2,134                     | \$ 1,572 |

|                                                                                   | March 31, 2011 |               |
|-----------------------------------------------------------------------------------|----------------|---------------|
|                                                                                   | Options        | SARs and RSUs |
| Unrecognized compensation expense related to unvested awards                      | \$             | \$ 14,220     |
| Weighted average period over which expense is expected to be recognized, in years |                | 2.22          |

**(9) DISCONTINUED OPERATIONS**

Subsequent to the end of the first quarter of 2007, we and the purchaser of our residential mortgage loan division (RML) agreed to terminate and settle the contractual arrangements related to the sale of the division, which had been completed as of the end of the third quarter of 2006. Historical operating results of RML are reflected as discontinued operations in the financial statements.

During the three months ended March 31, 2011 and 2010, the loss from discontinued operations was \$60,000 and \$55,000, net of taxes, respectively. The 2011 and 2010 losses are primarily related to continuing legal and salary expenses incurred in dealing with the remaining loans and requests from investors related to the repurchase of previously sold loans. We still have approximately \$488,000 in loans held for sale from discontinued operations that are carried at the estimated market value at quarter-end, which is less than the original cost. We plan to sell these loans, but timing and price to be realized cannot be determined at this time due to market conditions. In addition, we continue to address requests from investors related to repurchasing loans previously sold. While the balances as of March 31, 2011 include a liability for exposure to additional contingencies, including risk of having to repurchase loans previously sold, we recognize that market conditions may result in additional exposure to loss and the extension of time necessary to complete the discontinued mortgage operation.

**(10) FAIR VALUE DISCLOSURES**

ASC 820, *Fair Value Measurements and Disclosures* (ASC 820), defines fair value, establishes a framework for measuring fair value under GAAP and enhances disclosures about fair value measurements. Fair value is defined under ASC 820 as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal market for the asset or liability in an orderly transaction between market participants on the measurement date. The adoption of ASC 820 did not have an impact on our financial statements except for the expanded disclosures noted below.

We determine the fair market values of our financial instruments based on the fair value hierarchy. The standard describes three levels of inputs that may be used to measure fair value as provided below.

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets include U.S. Treasuries that are highly liquid and are actively traded in over-the-counter markets.

**Table of Contents**

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets include U.S. government and agency mortgage-backed debt securities, corporate securities, municipal bonds, and Community Reinvestment Act funds. This category includes derivative assets and liabilities where values are based on internal cash flow models supported by market data inputs.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation. This category also includes impaired loans and OREO where collateral values have been based on third party appraisals; however, due to current economic conditions, comparative sales data typically used in appraisals may be unavailable or more subjective due to lack of market activity. Additionally, this category includes certain mortgage loans that were transferred from loans held for sale to loans held for investment at a lower of cost or fair value.

Assets and liabilities measured at fair value at March 31, 2011 are as follows (in thousands):

|                                               | Fair Value Measurements Using |           |         |
|-----------------------------------------------|-------------------------------|-----------|---------|
|                                               | Level 1                       | Level 2   | Level 3 |
| Available for sale securities: <sup>(1)</sup> |                               |           |         |
| Mortgage-backed securities                    | \$                            | \$121,913 | \$      |
| Corporate securities                          |                               | 5,000     |         |
| Municipals                                    |                               | 37,526    |         |
| Other                                         |                               | 7,551     |         |
| Loans <sup>(2) (4)</sup>                      |                               |           | 75,909  |
| OREO <sup>(3) (4)</sup>                       |                               |           | 26,172  |
| Derivative asset <sup>(5)</sup>               |                               | 5,122     |         |
| Derivative liability <sup>(5)</sup>           |                               | (5,122)   |         |

(1) Securities are measured at fair value on a recurring basis, generally monthly.

(2) Includes certain mortgage loans that have been transferred to loans held for investment from loans held for sale at the lower of cost or market. Also, includes impaired loans that have been measured for impairment at the fair value of the loan's collateral.

(3) OREO is transferred from loans to OREO at fair value less selling costs.

(4) Fair value of loans and OREO is measured on a nonrecurring basis, generally annually or more often as warranted by market and economic conditions

(5) Derivative assets and liabilities are measured at fair value on a recurring basis, generally quarterly.

**Level 3 Valuations**

Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. Currently, we measure fair value for certain loans on a nonrecurring basis as described below.



*Loans*

During the three months ended March 31, 2011, certain impaired loans were remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for possible loan losses based upon the fair value of the underlying collateral. The \$75.9 million total above includes impaired loans at March 31, 2011 with a carrying value of \$82.6 million that were reduced by specific valuation allowance allocations totaling \$11.3 million for a total reported fair value of \$71.3 million based on collateral valuations utilizing Level 3 valuation inputs. Fair values were based on third party appraisals; however, based on the current economic conditions, comparative sales data typically used in the appraisals may be unavailable or more subjective due to the lack of real estate market activity. Also included in this total are \$5.5 million in mortgage

**Table of Contents**

warehouse loans that were reduced by specific valuation allowance allocations totaling \$795,000, for a total reported fair value of \$4.7 million. Certain mortgage loans that were transferred from loans held for sale to loans held for investment were valued based on third party broker pricing. As the dollar amount and number of loans being valued is very small, a comprehensive market analysis is not obtained or considered necessary. Instead, we conduct a general polling of one or more mortgage brokers for indications of general market prices for the types of mortgage loans being valued, and we consider values based on recent experience in selling loans of like terms and comparable quality.

**OREO**

Certain foreclosed assets, upon initial recognition, were valued based on third party appraisals. At March 31, 2011, OREO with a carrying value of \$36.6 million was reduced by specific valuation allowance allocations totaling \$10.4 million for a total reported fair value of \$26.2 million based on valuations utilizing Level 3 valuation inputs. Fair values were based on third party appraisals; however, based on the current economic conditions, comparative sales data typically used in the appraisals may be unavailable or more subjective due to the lack of real estate market activity.

**Fair Value of Financial Instruments**

Generally accepted accounting principles require disclosure of fair value information about financial instruments, whether or not recognized on the balance sheet, for which it is practical to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. This disclosure does not and is not intended to represent the fair value of the Company.

A summary of the carrying amounts and estimated fair values of financial instruments is as follows (in thousands):

|                                                  | March 31, 2011  |                      | December 31, 2010 |                      |
|--------------------------------------------------|-----------------|----------------------|-------------------|----------------------|
|                                                  | Carrying Amount | Estimated Fair Value | Carrying Amount   | Estimated Fair Value |
| Cash and cash equivalents                        | \$ 223,720      | \$ 223,720           | \$ 179,866        | \$ 179,866           |
| Securities, available-for-sale                   | 171,990         | 171,990              | 185,424           | 185,424              |
| Loans held for sale                              | 811,400         | 811,400              | 1,194,209         | 1,194,209            |
| Loans held for sale from discontinued operations | 488             | 488                  | 490               | 490                  |
| Loans held for investment, net                   | 4,641,176       | 4,653,368            | 4,639,820         | 4,652,588            |
| Derivative asset                                 | 5,122           | 5,122                | 6,874             | 6,874                |
| Deposits                                         | 5,221,991       | 5,231,602            | 5,455,401         | 5,457,692            |
| Federal funds purchased                          | 115,870         | 115,870              | 283,781           | 283,781              |
| Borrowings                                       | 18,125          | 18,126               | 14,106            | 14,107               |
| Trust preferred subordinated debentures          | 113,406         | 113,406              | 113,406           | 113,406              |
| Derivative liability                             | 5,122           | 5,122                | 6,874             | 6,874                |

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

**Cash and cash equivalents**

The carrying amounts reported in the consolidated balance sheet for cash and cash equivalents approximate their fair value.

**Securities**

The fair value of investment securities is based on prices obtained from independent pricing services which are based on quoted market prices for the same or similar securities.

**Table of Contents**

*Loans, net*

For variable-rate loans that reprice frequently with no significant change in credit risk, fair values are generally based on carrying values. The fair value for all other loans is estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying amount of accrued interest approximates its fair value. The carrying amount of loans held for sale approximates fair value.

*Derivatives*

The estimated fair value of the interest rate swaps are based on internal cash flow models supported by market data inputs.

*Deposits*

The carrying amounts for variable-rate money market accounts approximate their fair value. Fixed-term certificates of deposit fair values are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities.

*Federal funds purchased, other borrowings and trust preferred subordinated debentures*

The carrying value reported in the consolidated balance sheet for federal funds purchased and other borrowings approximates their fair value. The fair value of other borrowings and trust preferred subordinated debentures is estimated using a discounted cash flow calculation that applies interest rates currently being offered on similar borrowings.

*Off-balance sheet instruments*

Fair values for our off-balance sheet instruments which consist of lending commitments and standby letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. Management believes that the fair value of these off-balance sheet instruments is not significant.

**(11) STOCKHOLDERS' EQUITY**

We had comprehensive income of \$11.7 million for the three months ended March 31, 2011 and comprehensive income of \$7.7 million for the three months ended March 31, 2010. Comprehensive income during the three months ended March 31, 2011 included a net after-tax loss of \$160,000 and comprehensive income during the three months ended March 31, 2010 included a net after-tax gain of \$185,000 due to changes in the net unrealized gains/losses on securities available-for-sale.

**(12) NEW ACCOUNTING PRONOUNCEMENTS**

*FASB ASC 310 Receivables* ( ASC 310 ) was amended to enhance disclosures about credit quality of financing receivables and the allowance for credit losses. The amendments require an entity to disclose credit quality information, such as internal risk grades, more detailed nonaccrual and past due information, and modifications of its financing receivables. The disclosures under ASC 310, as amended, were effective for interim and annual reporting periods ending on or after December 15, 2010. This amendment did not have a significant impact on our financial results, but it has significantly expanded the disclosures that we are required to provide.

On April 5, 2011, the FASB issued ASU 2011-02 *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*, which clarifies when creditors should classify loan modifications as troubled debt restructurings. The guidance is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the year. The guidance on measuring the impairment of a receivable restructured in a troubled debt restructuring is effective on a prospective basis. We are currently evaluating the new guidance.

**Table of Contents****QUARTERLY FINANCIAL SUMMARY UNAUDITED**

Consolidated Daily Average Balances, Average Yields and Rates

(In thousands)

|                                                   | For the three months ended<br>March 31, 2011 |                                    |                | For the three months ended<br>March 31, 2010 |                                    |                |
|---------------------------------------------------|----------------------------------------------|------------------------------------|----------------|----------------------------------------------|------------------------------------|----------------|
|                                                   | Average<br>Balance                           | Revenue/<br>Expense <sup>(1)</sup> | Yield/<br>Rate | Average<br>Balance                           | Revenue/<br>Expense <sup>(1)</sup> | Yield/<br>Rate |
| <b>Assets</b>                                     |                                              |                                    |                |                                              |                                    |                |
| Securities taxable                                | \$ 140,007                                   | \$ 1,500                           | 4.35%          | \$ 211,618                                   | \$ 2,341                           | 4.49%          |
| Securities non-taxable <sup>(2)</sup>             | 37,154                                       | 532                                | 5.81%          | 41,654                                       | 592                                | 5.76%          |
| Federal funds sold                                | 44,322                                       | 28                                 | 0.26%          | 7,471                                        | 2                                  | 0.11%          |
| Deposits in other banks                           | 277,228                                      | 197                                | 0.29%          | 12,457                                       | 9                                  | 0.29%          |
| Loans held for sale from continuing<br>operations | 735,682                                      | 8,677                              | 4.78%          | 457,459                                      | 5,490                              | 4.87%          |
| Loans                                             | 4,721,928                                    | 59,363                             | 5.10%          | 4,413,960                                    | 56,079                             | 5.15%          |
| Less reserve for loan losses                      | 70,142                                       |                                    |                | 66,726                                       |                                    |                |
| Loans, net of reserve                             | 5,387,468                                    | 68,040                             | 5.12%          | 4,804,693                                    | 61,569                             | 5.20%          |
| Total earning assets                              | 5,886,179                                    | 70,297                             | 4.84%          | 5,077,893                                    | 64,513                             | 5.15%          |
| Cash and other assets                             | 297,060                                      |                                    |                | 311,128                                      |                                    |                |
| Total assets                                      | \$ 6,183,239                                 |                                    |                | \$ 5,389,021                                 |                                    |                |
| <b>Liabilities and Stockholders Equity</b>        |                                              |                                    |                |                                              |                                    |                |
| Transaction deposits                              | \$ 345,978                                   | \$ 55                              | 0.06%          | \$ 365,205                                   | \$ 264                             | 0.29%          |
| Savings deposits                                  | 2,469,435                                    | 2,371                              | 0.39%          | 1,773,201                                    | 3,524                              | 0.81%          |
| Time deposits                                     | 709,604                                      | 1,921                              | 1.10%          | 840,820                                      | 2,787                              | 1.34%          |
| Deposits in foreign branches                      | 376,570                                      | 524                                | 0.56%          | 353,803                                      | 1,183                              | 1.36%          |
| Total interest bearing deposits                   | 3,901,587                                    | 4,871                              | 0.51%          | 3,333,029                                    | 7,758                              | 0.94%          |
| Other borrowings                                  | 159,450                                      | 109                                | 0.28%          | 461,477                                      | 416                                | 0.37%          |
| Trust preferred subordinated debentures           | 113,406                                      | 633                                | 2.26%          | 113,406                                      | 904                                | 3.23%          |
| Total interest bearing liabilities                | 4,174,443                                    | 5,613                              | 0.55%          | 3,907,912                                    | 9,078                              | 0.94%          |
| Demand deposits                                   | 1,417,734                                    |                                    |                | 956,359                                      |                                    |                |
| Other liabilities                                 | 47,753                                       |                                    |                | 28,643                                       |                                    |                |
| Stockholders equity                               | 543,309                                      |                                    |                | 496,107                                      |                                    |                |
| Total liabilities and stockholders equity         | \$ 6,183,239                                 |                                    |                | \$ 5,389,021                                 |                                    |                |
| Net interest income                               |                                              | \$ 64,684                          |                |                                              | \$ 55,435                          |                |
| Net interest margin                               |                                              |                                    | 4.46%          |                                              |                                    | 4.43%          |

|                                                      |    |     |       |       |     |       |       |
|------------------------------------------------------|----|-----|-------|-------|-----|-------|-------|
| Net interest spread                                  |    |     | 4.29% |       |     | 4.21% |       |
| Additional information from discontinued operations: |    |     |       |       |     |       |       |
| Loans held for sale                                  | \$ | 489 |       | \$    | 585 |       |       |
| Borrowed funds                                       |    | 489 |       |       | 585 |       |       |
| Net interest income                                  |    |     | \$    | 10    |     | \$    | 13    |
| Net interest margin consolidated                     |    |     |       | 4.46% |     |       | 4.43% |

(1) The loan averages include loans on which the accrual of interest has been discontinued and are stated net of unearned income.

(2) Taxable equivalent rates used where applicable.

**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

***Forward-Looking Statements***

Statements and financial analysis contained in this document that are not historical facts are forward looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 (the Act). In addition, certain statements may be contained in our future filings with SEC, in press releases, and in oral and written statements made by or with our approval that are not statements of historical fact and constitute forward-looking statement within the meaning of the Act. Forward looking statements describe our future plans, strategies and expectations and are based on certain assumptions. Words such as believes, anticipates, expects, intends, targeted, continue, remain, will, should, may and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties, many of which are beyond our control that may cause actual results to differ materially from those in such statements. The important factors that could cause actual results to differ materially from the forward looking statements include, but are not limited to, the following:

- (1) Changes in interest rates and the relationship between rate indices, including LIBOR and Fed Funds
- (2) Changes in the levels of loan prepayments, which could affect the value of our loans or investment securities
- (3) Changes in general economic and business conditions in areas or markets where we compete
- (4) Competition from banks and other financial institutions for loans and customer deposits
- (5) The failure of assumptions underlying the establishment of and provisions made to the allowance for credit losses and differences in assumptions utilized by banking regulators which could have retroactive impact
- (6) The loss of senior management or operating personnel and the potential inability to hire qualified personnel at reasonable compensation levels
- (7) Changes in government regulations including changes as a result of the current economic crisis. On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry.

Forward-looking statements speak only as of the date on which such statements are made. We have no obligation to update or revise any forward-looking statements as a result of new information or future events. In light of these assumptions, risks and uncertainties, the events discussed in any forward-looking statements in this quarterly report might not occur.

***Results of Operations***

Except as otherwise noted, all amounts and disclosures throughout this document reflect continuing operations. See Part I, Item 1 herein for a discussion of discontinued operations at Note (9) Discontinued Operations.

***Summary of Performance***

We reported net income of \$11.9 million, or \$0.31 per diluted common share, for the first quarter of 2011 compared to \$7.6 million, or \$0.21 per diluted common share, for the first quarter of 2010. Return on average equity was 8.91% and return on average assets was .78% for the first quarter of 2011, compared to 6.21% and .57%, respectively, for the first quarter of 2010.

Net income increased \$4.3 million, or 57%, for the three months ended March 31, 2011 as compared to the same period in 2010. The \$4.3 million increase during the three months ended March 31, 2011, was primarily

**Table of Contents**

the result of a \$9.3 million increase in net interest income, a \$736,000 increase in non-interest income and a \$6.0 million decrease in the provision for credit losses, offset by a \$9.2 million increase in non-interest expense and a \$2.5 million increase in income tax expense.

Details of the changes in the various components of net income are further discussed below.

**Net Interest Income**

Net interest income was \$64.5 million for the first quarter of 2011, compared to \$55.2 million for the first quarter of 2010. The increase was due to an increase in average earning assets of \$808.3 million as compared to the first quarter of 2010 and an increase in the net interest margin from 4.43% to 4.46%. The increase in average earning assets included a \$308.0 million increase in average loans held for investment and a \$278.2 million increase in loans held for sale, offset by a \$76.1 million decrease in average securities. For the quarter ended March 31, 2011, average net loans and securities represented 93% and 3%, respectively, of average earning assets compared to 95% and 5% in the same quarter of 2010.

Average interest bearing liabilities increased \$266.5 million from the first quarter of 2010, which included a \$568.6 million increase in interest bearing deposits offset by a \$302.0 million decrease in other borrowings. The significant decrease in average other borrowings is a result of the growth in demand deposits and interest bearing deposits, reducing the need for borrowed funds. The average cost of interest bearing deposits and borrowed funds decreased from .94% for the quarter ended March 31, 2010 to .51% for the same period of 2011.

The following table presents the changes (in thousands) in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of earning assets and interest-bearing liabilities and the changes due to changes in the average interest rate on those assets and liabilities.

|                              | Three months ended<br>March 31, 2011/2010 |          |                           |
|------------------------------|-------------------------------------------|----------|---------------------------|
|                              | Change                                    | Volume   | Yield/Rate <sup>(1)</sup> |
| Interest income:             |                                           |          |                           |
| Securities <sup>(2)</sup>    | \$ (901)                                  | \$ (856) | \$ (45)                   |
| Loans held for sale          | 3,187                                     | 3,339    | (152)                     |
| Loans held for investment    | 3,284                                     | 3,913    | (629)                     |
| Federal funds sold           | 26                                        | 10       | 16                        |
| Deposits in other banks      | 188                                       | 191      | (3)                       |
| Total                        | 5,784                                     | 6,597    | (813)                     |
| Interest expense:            |                                           |          |                           |
| Transaction deposits         | (209)                                     | (14)     | (195)                     |
| Savings deposits             | (1,153)                                   | 1,384    | (2,537)                   |
| Time deposits                | (866)                                     | (435)    | (431)                     |
| Deposits in foreign branches | (659)                                     | 76       | (735)                     |
| Borrowed funds               | (578)                                     | (272)    | (306)                     |
| Total                        | (3,465)                                   | 739      | (4,204)                   |
| Net interest income          | \$ 9,249                                  | \$ 5,858 | \$ 3,391                  |

(1) Changes attributable to both volume and yield/rate are allocated to both volume and yield/rate on an equal basis.

(2) Taxable equivalent rates used where applicable.

Net interest margin from continuing operations, the ratio of net interest income to average earning assets from continuing operations, was 4.46% for the first quarter of 2011 compared to 4.43% for the first quarter of 2010. This 3 basis point increase was a result of a decline in the costs of interest bearing liabilities and growth in non-interest bearing deposits and stockholders' equity, as well as improved pricing on loans. Total cost of funding, including demand deposits and stockholders' equity decreased from .68% for the first quarter of 2010 to .37% for the first quarter of 2011. The benefit of the reduction in funding costs was complimented by a 31 basis point increase in yields on earning assets.



**Table of Contents****Non-interest Income**

The components of non-interest income were as follows (in thousands):

|                                         | Three months ended March<br>31, |                 |
|-----------------------------------------|---------------------------------|-----------------|
|                                         | 2011                            | 2010            |
| Service charges on deposit accounts     | \$ 1,783                        | \$ 1,483        |
| Trust fee income                        | 954                             | 954             |
| Bank owned life insurance (BOLI) income | 523                             | 471             |
| Brokered loan fees                      | 2,520                           | 1,904           |
| Equipment rental income                 | 783                             | 1,344           |
| Other                                   | 1,121                           | 792             |
| <b>Total non-interest income</b>        | <b>\$ 7,684</b>                 | <b>\$ 6,948</b> |

Non-interest income increased \$736,000 during the three months ended March 31, 2011 to \$7.7 million compared to \$6.9 million during the same period of 2010. This increase is primarily related to an increase of \$616,000 in brokered loan fees as compared to the same period in 2010, related to an increase in warehouse lending volumes. Service charges increased \$300,000 during the three months ended March 31, 2011 as compared to the same period in 2010 related to an increase in the level of demand deposits. Other non-interest income increased \$329,000 as compared to 2010, also contributed to the year-over-year increase in non-interest income. Offsetting these increases was a \$561,000 decrease in equipment rental income related to a decline in the leased equipment portfolio.

While management expects continued growth in non-interest income, the future rate of growth could be affected by increased competition from nationwide and regional financial institutions. In order to achieve continued growth in non-interest income, we may need to introduce new products or enter into new markets. Any new product introduction or new market entry could place additional demands on capital and managerial resources.

**Non-interest Expense**

The components of non-interest expense were as follows (in thousands):

|                                             | Three months ended March<br>31, |                  |
|---------------------------------------------|---------------------------------|------------------|
|                                             | 2011                            | 2010             |
| Salaries and employee benefits              | \$ 24,172                       | \$ 20,069        |
| Net occupancy expense                       | 3,310                           | 3,014            |
| Leased equipment depreciation               | 556                             | 1,059            |
| Marketing                                   | 2,123                           | 787              |
| Legal and professional                      | 2,723                           | 1,950            |
| Communications and data processing          | 2,347                           | 1,926            |
| FDIC insurance assessment                   | 2,511                           | 1,868            |
| Allowance and other carrying costs for OREO | 4,030                           | 2,292            |
| Other                                       | 4,627                           | 4,221            |
| <b>Total non-interest expense</b>           | <b>\$ 46,399</b>                | <b>\$ 37,186</b> |

Non-interest expense for the first quarter of 2011 increased \$9.2 million, or 25%, to \$46.4 million from \$37.2 million in the first quarter of 2010. The increase is primarily attributable to a \$4.1 million increase in salaries and employee benefits, which was primarily due to general business growth.

Occupancy expense for the three months ended March 31, 2011 increased \$296,000, or 10%, compared to the same quarter in 2010 as a result of general business growth.

Leased equipment depreciation expense for the three months ended March 31, 2011 decreased \$503,000

**Table of Contents**

compared to the same quarter in 2010 as a result of a decline in the leased equipment portfolio.

Marketing expense for the three months ended March 31, 2011 increased \$1.3 million, or 170%, compared to the same quarter in 2010, which was primarily due to general business growth.

Legal and professional expense for the three months ended March 31, 2011 increased \$773,000, or 40%, compared to same quarter in 2010. Our legal and professional expense will continue to fluctuate from quarter to quarter and could increase in the future as we respond to continued regulatory changes and continued credit situations related to the current economic conditions.

FDIC insurance assessment expense increased by \$643,000 from \$1.9 million in 2010 to \$2.5 million due to higher rates and increase in our deposit base. The FDIC assessment rates could continue to increase and will continue to be a factor in our expense growth.

For the three months ended March 31, 2011, allowance and other carrying costs for OREO increased \$1.7 million, to \$4.0 million, \$3.3 million of which related to deteriorating values of assets held in OREO. Of the \$3.3 million valuation expense, \$1.9 million was related to increasing the valuation allowance during the quarter. The remaining \$1.4 million related to direct write-downs of the OREO balance.

**Analysis of Financial Condition****Loan Portfolio**

Total loans net of allowance for loan losses at March 31, 2011 decreased \$381.5 million from December 31, 2010 to \$5.5 billion. Combined commercial, construction, real estate, consumer loans and leases decreased \$157,000. Loans held for sale decreased \$382.8 million from December 31, 2010. We anticipate that overall loan growth during the remainder of 2011 will be less than experienced in prior years as a result of tightened credit standards and reduced demand for credit due to overall economic conditions.

Loans were as follows as of the dates indicated (in thousands):

|                                                   | March 31,<br>2011 | December 31,<br>2010 |
|---------------------------------------------------|-------------------|----------------------|
| Commercial                                        | \$ 2,541,784      | \$ 2,592,924         |
| Construction                                      | 349,442           | 270,008              |
| Real estate                                       | 1,746,100         | 1,759,758            |
| Consumer                                          | 21,590            | 21,470               |
| Leases                                            | 80,694            | 95,607               |
| Gross loans held for investment                   | 4,739,610         | 4,739,767            |
| Deferred income (net of direct origination costs) | (28,186)          | (28,437)             |
| Allowance for loan losses                         | (70,248)          | (71,510)             |
| Total loans held for investment, net              | 4,641,176         | 4,639,820            |
| Loans held for sale                               | 811,400           | 1,194,209            |
| Total                                             | \$ 5,452,576      | \$ 5,834,029         |

We continue to lend primarily in Texas. As of March 31, 2011, a substantial majority of the principal amount of the loans held for investment in our portfolio was to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions in Texas. The risks created by these concentrations have been considered by management in the determination of the adequacy of the allowance for loan losses. Management believes the allowance for loan losses is adequate to cover estimated losses on loans at each balance sheet date.

We originate substantially all of the loans in our portfolio, except participations in residential mortgage loans held for sale, select loan participations and syndications, which are underwritten independently by us prior to purchase and certain USDA and SBA government guaranteed loans that we purchase in the secondary market. We also participate

in syndicated loan relationships, both as a participant and as an agent. As of March 31,

**Table of Contents**

2011, we have \$592.4 million in syndicated loans, \$204.6 million of which we acted as agent. All syndicated loans, whether we act as agent or participant, are underwritten to the same standards as all other loans originated by us. In addition, as of March 31, 2011, \$3.3 million of our syndicated loans were nonperforming.

**Summary of Loan Loss Experience**

The provision for credit losses is a charge to earnings to maintain the reserve for loan losses at a level consistent with management's assessment of the loan portfolio in light of current economic conditions and market trends. We recorded a provision of \$7.5 million during the first quarter of 2011 compared to \$13.5 million in the first quarter of 2010 and \$12.0 million in the fourth quarter of 2010. The amount of reserves and provision required to support the reserve have increased over the last two years as a result of credit deterioration in our loan portfolio driven by negative changes in national and regional economic conditions and the impact of those conditions on the financial condition of borrowers and the values of assets, including real estate assets, pledged as collateral.

The reserve for loan losses is comprised of specific reserves for impaired loans and an estimate of losses inherent in the portfolio at the balance sheet date, but not yet identified with specified loans. We regularly evaluate our reserve for loan losses to maintain an adequate level to absorb estimated loan losses inherent in the loan portfolio. Factors contributing to the determination of reserves include the credit worthiness of the borrower, changes in the value of pledged collateral, and general economic conditions. All loan commitments rated substandard or worse and greater than \$500,000 are specifically reviewed for loss potential. For loans deemed to be impaired, a specific allocation is assigned based on the losses expected to be realized from those loans. For purposes of determining the general reserve, the portfolio is segregated by product types to recognize differing risk profiles among categories, and then further segregated by credit grades. Credit grades are assigned to all loans. Each credit grade is assigned a risk factor, or reserve allocation percentage. These risk factors are multiplied by the outstanding principal balance and risk-weighted by product type to calculate the required reserve. A similar process is employed to calculate a reserve assigned to off-balance sheet commitments, specifically unfunded loan commitments and letters of credit. Even though portions of the allowance may be allocated to specific loans, the entire allowance is available for any credit that, in management's judgment, should be charged off.

The reserve allocation percentages assigned to each credit grade have been developed based primarily on an analysis of our historical loss rates. The allocations are adjusted for certain qualitative factors for such things as general economic conditions, changes in credit policies and lending standards. Changes in the trend and severity of problem loans can cause the estimation of losses to differ from past experience. In addition, the reserve considers the results of reviews performed by independent third party reviewers as reflected in their confirmations of assigned credit grades within the portfolio. The portion of the allowance that is not derived by the allowance allocation percentages compensates for the uncertainty and complexity in estimating loan and lease losses including factors and conditions that may not be fully reflected in the determination and application of the allowance allocation percentages. We evaluate many factors and conditions in determining the unallocated portion of the allowance, including the economic and business conditions affecting key lending areas, credit quality trends and general growth in the portfolio. The allowance is considered adequate and appropriate, given management's assessment of potential losses within the portfolio as of the evaluation date, the significant growth in the loan and lease portfolio, current economic conditions in the Company's market areas and other factors.

The methodology used in the periodic review of reserve adequacy, which is performed at least quarterly, is designed to be dynamic and responsive to changes in portfolio credit quality. The changes are reflected in the general reserve and in specific reserves as the collectability of larger classified loans is evaluated with new information. As our portfolio has matured, historical loss ratios have been closely monitored, and our reserve adequacy relies primarily on our loss history. Currently, the review of reserve adequacy is performed by executive management and presented to our board of directors for their review, consideration and ratification on a quarterly basis.

The combined reserve for credit losses, which includes a liability for losses on unfunded commitments, totaled \$72.0 million at March 31, 2011, \$73.4 million at December 31, 2010 and \$75.1 million at March 31, 2010. The total reserve percentage decreased to 1.53% at March 31, 2011 from 1.56% of loans held for investment at December 31, 2010 and decreased from 1.69% of loans held for investment at March 31, 2010. The total reserve percentage has increased over the past two years as a result of the effects of national and regional



**Table of Contents**

economic conditions on borrowers and values of assets pledged as collateral. These changes in economic conditions have resulted in increases in loans with weakened credit quality and nonperforming loans. The overall reserve for loan losses continues to be driven by the loan loss reserve methodology as described above. At March 31, 2011, we believe the reserve is sufficient to cover all expected losses in the portfolio and has been derived from consistent application of the methodology described above. Should any of the factors considered by management in evaluating the adequacy of the allowance for loan losses change, our estimate of expected losses in the portfolio could also change, which would affect the level of future provisions for loan losses.

**Table of Contents**

Activity in the reserve for loan losses is presented in the following table (in thousands):

|                                                                                     | Three<br>months<br>ended<br>March<br>31,<br>2011 | Three months<br>ended March<br>31,<br>2010 | Year ended<br>December<br>31,<br>2010 |
|-------------------------------------------------------------------------------------|--------------------------------------------------|--------------------------------------------|---------------------------------------|
| Reserve for loan losses:                                                            |                                                  |                                            |                                       |
| Beginning balance                                                                   | \$ 71,510                                        | \$ 67,931                                  | \$ 67,931                             |
| Loans charged-off:                                                                  |                                                  |                                            |                                       |
| Commercial                                                                          | 1,993                                            | 7,551                                      | 27,723                                |
| Real estate construction                                                            |                                                  | 420                                        | 12,438                                |
| Real estate term                                                                    | 7,364                                            | 766                                        | 9,517                                 |
| Consumer                                                                            | 34                                               |                                            | 216                                   |
| Equipment leases                                                                    | 532                                              | 594                                        | 1,555                                 |
| Total charge-offs                                                                   | 9,923                                            | 9,331                                      | 51,449                                |
| Recoveries:                                                                         |                                                  |                                            |                                       |
| Commercial                                                                          | 546                                              | 23                                         | 176                                   |
| Real estate construction                                                            | 243                                              |                                            | 1                                     |
| Real estate term                                                                    | 31                                               | 8                                          | 138                                   |
| Consumer                                                                            | 1                                                |                                            | 4                                     |
| Equipment leases                                                                    | 150                                              | 20                                         | 158                                   |
| Total recoveries                                                                    | 971                                              | 51                                         | 477                                   |
| Net charge-offs                                                                     | 8,952                                            | 9,280                                      | 50,972                                |
| Provision for loan losses                                                           | 7,690                                            | 13,054                                     | 54,551                                |
| Ending balance                                                                      | \$ 70,248                                        | \$ 71,705                                  | \$ 71,510                             |
| Reserve for off-balance sheet credit losses:                                        |                                                  |                                            |                                       |
| Beginning balance                                                                   | \$ 1,897                                         | \$ 2,948                                   | \$ 2,948                              |
| Provision (benefit) for off-balance sheet credit losses                             | (190)                                            | 446                                        | (1,051)                               |
| Ending balance                                                                      | \$ 1,707                                         | \$ 3,394                                   | \$ 1,897                              |
| Total reserve for credit losses                                                     | \$ 71,955                                        | \$ 75,099                                  | \$ 73,407                             |
| Total provision for credit losses                                                   | \$ 7,500                                         | \$ 13,500                                  | \$ 53,500                             |
| Reserve for loan losses to loans held for investment <sup>(2)</sup>                 | 1.49%                                            | 1.61%                                      | 1.52%                                 |
| Net charge-offs to average loans <sup>(1) (2)</sup>                                 | 0.77%                                            | 0.85%                                      | 1.14%                                 |
| Total provision for credit losses to average loans <sup>(2)</sup>                   | 0.64%                                            | 1.24%                                      | 1.20%                                 |
| Recoveries to total charge-offs                                                     | 9.79%                                            | 0.55%                                      | 0.93%                                 |
| Reserve for loan losses as a multiple of net charge-offs                            | 7.8x                                             | 7.7x                                       | 1.4x                                  |
| Reserve for off-balance sheet credit losses to off-balance sheet credit commitments | 0.11%                                            | 0.29%                                      | 0.14%                                 |



|                                                                                 |            |    |         |    |         |
|---------------------------------------------------------------------------------|------------|----|---------|----|---------|
| Combined reserves for credit losses to loans held for investment <sup>(2)</sup> | 1.53%      |    | 1.69%   |    | 1.56%   |
| Non-performing assets:                                                          |            |    |         |    |         |
| Non-accrual loans                                                               | \$ 116,479 | \$ | 115,926 | \$ | 112,090 |
| OREO <sup>(4)</sup>                                                             | 26,172     |    | 28,865  |    | 42,261  |
| Total                                                                           | \$ 142,651 | \$ | 144,791 | \$ | 154,351 |
| Restructured loans                                                              | \$ 22,219  | \$ | 10,700  | \$ | 4,319   |
| Loans past due 90 days and still accruing <sup>(3)</sup>                        | 2,529      |    | 2,390   |    | 6,706   |
| Reserve as a percent of non-performing loans <sup>(2)</sup>                     | .6x        |    | .6x     |    | .6x     |

(1) Interim period ratios are annualized.

(2) Excludes loans held for sale.

(3) At March 31, 2011, December 31, 2010 and March 31, 2010, loans past due 90 days and still accruing includes premium finance loans of \$2.4 million, \$3.3 million and \$2.0 million, respectively. These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

(4) At March 31, 2011, December 31, 2010 and March 31, 2010, OREO balance is net of \$10.4 million, \$12.9 million and \$8.5 million valuation allowance, respectively.

**Table of Contents****Non-performing Assets**

Non-performing assets include non-accrual loans and leases and repossessed assets. The table below summarizes our non-accrual loans by type (in thousands):

|                         | March<br>31,<br>2011 | March 31,<br>2010 | December<br>31,<br>2010 |
|-------------------------|----------------------|-------------------|-------------------------|
| Non-accrual loans       |                      |                   |                         |
| Commercial              | \$ 42,993            | \$ 44,292         | \$ 42,543               |
| Construction            | 2,640                | 19,183            | 21                      |
| Real estate             | 66,174               | 41,271            | 62,497                  |
| Consumer                | 669                  | 535               | 706                     |
| Leases                  | 4,003                | 10,645            | 6,323                   |
| Total non-accrual loans | \$ 116,479           | \$ 115,926        | \$ 112,090              |

The table below summarizes the non-accrual loans as segregated by loan type and type of property securing the credit as of March 31, 2011 (in thousands):

## Non-accrual loans:

## Commercial

Lines of credit secured by the following:

|                                                       |           |
|-------------------------------------------------------|-----------|
| Oil and gas properties                                | \$ 19,980 |
| Various single family residences and notes receivable | 10,063    |
| Assets of the borrowers                               | 8,176     |
| Other                                                 | 4,774     |

|                  |        |
|------------------|--------|
| Total commercial | 42,993 |
|------------------|--------|

## Construction

Secured by:

|                                                     |       |
|-----------------------------------------------------|-------|
| Unimproved land and/or undeveloped residential lots | 2,620 |
| Other                                               | 20    |

|                    |       |
|--------------------|-------|
| Total construction | 2,640 |
|--------------------|-------|

## Real estate

Secured by:

|                                                            |        |
|------------------------------------------------------------|--------|
| Commercial property                                        | 26,236 |
| Unimproved land and/or undeveloped residential lots        | 16,288 |
| Rental properties and multi-family residential real estate | 8,796  |
| Single family residences                                   | 9,878  |
| Other                                                      | 4,976  |

|                   |        |
|-------------------|--------|
| Total real estate | 66,174 |
|-------------------|--------|

|          |     |
|----------|-----|
| Consumer | 669 |
|----------|-----|

|                                                                      |       |
|----------------------------------------------------------------------|-------|
| Leases (commercial leases primarily secured by assets of the lessor) | 4,003 |
|----------------------------------------------------------------------|-------|

|                         |            |
|-------------------------|------------|
| Total non-accrual loans | \$ 116,479 |
|-------------------------|------------|

Generally, we place loans on non-accrual when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectability is questionable, then cash payments are applied to principal. As of March 31, 2011, none of our non-accrual loans were earning on a cash basis.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due (both principal and interest) according to the terms of the original loan agreement. Reserves on impaired loans are measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the underlying collateral.

**Table of Contents**

At March 31, 2011, we had \$2.6 million in loans past due 90 days and still accruing interest. At March 31, 2011, \$2.4 million of the loans past due 90 days and still accruing are premium finance loans. These loans are primarily secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

Restructured loans are loans on which, due to the borrower's financial difficulties, we have granted a concession that we would not otherwise consider. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of the two. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the maturity date at a contractual interest rate lower than the current rate for new debt with similar risk, or a reduction of the face amount of debt, or either forgiveness of either principal or accrued interest. As of March 31, 2011, we have \$22.2 million in loans considered restructured that are not already on nonaccrual. Of the nonaccrual loans at March 31, 2011, \$29.2 million met the criteria for restructured. A loan continues to qualify as restructured until a consistent payment history has been evidenced, generally no less than twelve months. A loan is placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which we have concerns about the borrower's ability to comply with repayment terms because of the borrower's potential financial difficulties. We monitor these loans closely and review their performance on a regular basis. At March 31, 2011 and 2010, we had \$13.8 million and \$46.3 million, respectively, in loans of this type which were not included in either non-accrual or 90 days past due categories.

The table below presents a summary of the activity related to OREO (in thousands):

|                              | Three months ended March<br>31, |           |
|------------------------------|---------------------------------|-----------|
|                              | 2011                            | 2010      |
| Beginning balance            | \$ 42,261                       | \$ 27,264 |
| Additions                    | 926                             | 29,559    |
| Sales                        | (13,695)                        | (6,058)   |
| Valuation allowance for OREO | (1,921)                         | (6,587)   |
| Direct write-downs           | (1,399)                         | (1,917)   |
| Ending balance               | \$ 26,172                       | \$ 42,261 |

The following table summarizes the assets held in OREO at March 31, 2011 (in thousands):

|                                                 |           |
|-------------------------------------------------|-----------|
| Unimproved commercial real estate lots and land | \$ 7,051  |
| Commercial buildings                            | 2,120     |
| Undeveloped land and residential lots           | 11,054    |
| Multifamily lots and land                       | 1,229     |
| Other                                           | 4,718     |
| Total OREO                                      | \$ 26,172 |

When foreclosure occurs, fair value, which is generally based on appraised values, may result in partial charge-off of a loan upon taking property, and so long as property is retained, subsequent reductions in appraised values will result in valuation adjustment taken as non-interest expense. In addition, if the decline in value is believed to be permanent and not just driven by market conditions, a direct write-down to the OREO balance may be taken. We generally pursue sales of OREO when conditions warrant, but we may choose to hold certain properties for a longer term, which can

result in additional exposure related to the appraised values during that holding period. During the three months ended March 31, 2011, we recorded \$3.3 million in valuation expense. Of the \$3.3 million, \$1.9 million related to increases to the valuation allowance, and \$1.4 million related to direct write-downs.

**Table of Contents****Liquidity and Capital Resources**

In general terms, liquidity is a measurement of our ability to meet our cash needs. Our objective in managing our liquidity is to maintain our ability to meet loan commitments, purchase securities or repay deposits and other liabilities in accordance with their terms, without an adverse impact on our current or future earnings. Our liquidity strategy is guided by policies, which are formulated and monitored by our senior management and our Balance Sheet Management Committee ( BSMC ), and which take into account the marketability of assets, the sources and stability of funding and the level of unfunded commitments. We regularly evaluate all of our various funding sources with an emphasis on accessibility, stability, reliability and cost-effectiveness. For the year ended December 31, 2010 and for three months ended March 31, 2011, our principal source of funding has been our customer deposits, supplemented by our short-term and long-term borrowings, primarily from federal funds purchased and Federal Home Loan Bank ( FHLB ) borrowings.

Our liquidity needs have typically been fulfilled through growth in our core customer deposits and supplemented with brokered deposits and borrowings as needed. Our goal is to obtain as much of our funding for loans held for investment and other earnings assets as possible from deposits of these core customers. These deposits are generated principally through development of long-term relationships with customers and stockholders and our retail network, which is mainly through BankDirect. In addition to deposits from our core customers, we also have access to incremental deposits through brokered retail certificates of deposit, or CDs. Since December 31, 2009, growth in customer deposits eliminated the need for use of brokered CDs and none were outstanding at March 31, 2011. In prior periods, brokered CDs were generally of short maturities, 30 to 90 days, and were used to supplement temporary differences in the growth in loans, including growth in specific categories of loans, compared to customer deposits. The following tab summarizes our core customer deposits and brokered deposits (in millions):

|                                                                                                      | March<br>31,<br>2011 | March 31,<br>2010 | December<br>31,<br>2010 |
|------------------------------------------------------------------------------------------------------|----------------------|-------------------|-------------------------|
| Deposits from core customers                                                                         | \$ 5,222.0           | \$ 4,359.2        | \$ 5,455.4              |
| Deposits from core customers as a percent of total deposits                                          | 100.0%               | 98.9%             | 100.0%                  |
| Brokered deposits                                                                                    | \$ 0.0               | \$ 50.6           | \$ 0.0                  |
| Brokered deposits as a percent of total deposits                                                     | 0.0%                 | 1.1%              | 0.0%                    |
| Average deposits from core customers <sup>(1)</sup>                                                  | \$ 5,319.3           | \$ 4,191.5        | \$ 4,982.6              |
| Average deposits from core customers as a percent of total quarterly average deposits <sup>(1)</sup> | 100.0%               | 97.7%             | 99.4%                   |
| Average brokered deposits <sup>(1)</sup>                                                             | \$ 0.0               | \$ 97.9           | \$ 28.6                 |
| Average brokered deposits as a percent of total quarterly average deposits <sup>(1)</sup>            | 0.0%                 | 2.3%              | 0.6%                    |

(1) Annual averages presented for December 31, 2010.

We have access to sources of brokered deposits of not less than an additional \$3.3 billion. Based on the reduction in brokered CDs, customer deposits (total deposits minus brokered CDs) increased by \$862.8 million from March 31, 2010 and decreased \$233.4 million from December 31, 2010.

Additionally, we have borrowing sources available to supplement deposits and meet our funding needs. Such borrowings are generally used to fund our loans held for sale, due to their liquidity, short duration and interest spreads available. These borrowing sources include federal funds purchased from our downstream correspondent bank relationships (which consist of banks that are smaller than our bank) and from our upstream correspondent bank relationships (which consist of banks that are larger than our bank), customer repurchase agreements, treasury, tax and

loan notes, and advances from the FHLB and the Federal Reserve. The following table summarizes our borrowings as of March 31, 2011 (in thousands):

31

---

**Table of Contents**

|                                         |                   |
|-----------------------------------------|-------------------|
| Federal funds purchased                 | \$ 115,870        |
| Customer repurchase agreements          | 14,716            |
| Treasury, tax and loan notes            | 3,328             |
| FHLB borrowings                         | 81                |
| Trust preferred subordinated debentures | 113,406           |
| <b>Total borrowings</b>                 | <b>\$ 247,401</b> |

Maximum outstanding at any month-end during the year \$ 289,207

The following table summarizes our other borrowing capacities in excess of balances outstanding at March 31, 2011 (in thousands):

|                                                            |                     |
|------------------------------------------------------------|---------------------|
| FHLB borrowing capacity relating to loans                  | \$ 897,864          |
| FHLB borrowing capacity relating to securities             | 113,455             |
| <b>Total FHLB borrowing capacity</b>                       | <b>\$ 1,011,319</b> |
| <br>                                                       |                     |
| Unused federal funds lines available from commercial banks | \$ 393,360          |

Our equity capital averaged \$543.3 million for the three months ended March 31, 2011, as compared to \$496.1 million for the same period in 2010. This increase reflects our retention of net earnings during this period. We have not paid any cash dividends on our common stock since we commenced operations and have no plans to do so in the near future.

Our capital ratios remain above the levels required to be well capitalized and have been enhanced with the additional capital raised since 2008 and will allow us to grow organically with the addition of loan and deposit relationships.

**Commitments and Contractual Obligations**

The following table presents significant fixed and determinable contractual obligations to third parties by payment date. Payments for borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts. As of March 31, 2011, our significant fixed and determinable contractual obligations to third parties were as follows (in thousands):

|                                                   | Within One<br>Year | After One<br>but<br>Within<br>Three<br>Years | After Three<br>but<br>Within Five<br>Years | After Five<br>Years | Total       |
|---------------------------------------------------|--------------------|----------------------------------------------|--------------------------------------------|---------------------|-------------|
| Deposits without a stated maturity <sup>(1)</sup> | \$4,277,459        | \$                                           | \$                                         | \$                  | \$4,277,459 |
| Time deposits <sup>(1)</sup>                      | 864,338            | 62,331                                       | 17,076                                     | 787                 | 944,532     |
| Federal funds purchased <sup>(1)</sup>            | 115,870            |                                              |                                            |                     | 115,870     |
| Customer repurchase agreements <sup>(1)</sup>     | 14,716             |                                              |                                            |                     | 14,716      |
| Treasury, tax and loan notes <sup>(1)</sup>       | 3,328              |                                              |                                            |                     | 3,328       |
| FHLB borrowings <sup>(1)</sup>                    |                    |                                              | 81                                         |                     | 81          |



Edgar Filing: TEXAS CAPITAL BANCSHARES INC/TX - Form 10-Q

|                                                           |             |          |          |           |             |
|-----------------------------------------------------------|-------------|----------|----------|-----------|-------------|
| Operating lease obligations <sup>(1)</sup> <sup>(2)</sup> | 8,775       | 17,481   | 16,117   | 43,592    | 85,965      |
| Trust preferred subordinated debentures <sup>(1)</sup>    |             |          |          | 113,406   | 113,406     |
| Total contractual obligations                             | \$5,284,486 | \$79,812 | \$33,274 | \$157,785 | \$5,555,357 |

(1) Excludes interest.

(2) Non-balance sheet item.

SEC guidance requires disclosure of critical accounting policies. The SEC defines critical accounting policies as those that are most important to the presentation of a company's financial condition and results, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

**Table of Contents**

We follow financial accounting and reporting policies that are in accordance with accounting principles generally accepted in the United States. The more significant of these policies are summarized in Note 1 to the consolidated financial statements. Not all these significant accounting policies require management to make difficult, subjective or complex judgments. However, the policy noted below could be deemed to meet the SEC's definition of critical accounting policies.

Management considers the policies related to the allowance for loan losses as the most critical to the financial statement presentation. The total allowance for loan losses includes activity related to allowances calculated in accordance with Accounting Standards Codification (ASC) 310, *Receivables*, and ASC 450, *Contingencies*. The allowance for loan losses is established through a provision for loan losses charged to current earnings. The amount maintained in the allowance reflects management's continuing evaluation of the loan losses inherent in the loan portfolio. The allowance for loan losses is comprised of specific reserves assigned to certain classified loans and general reserves. Factors contributing to the determination of specific reserves include the credit-worthiness of the borrower, and more specifically, changes in the expected future receipt of principal and interest payments and/or in the value of pledged collateral. A reserve is recorded when the carrying amount of the loan exceeds the discounted estimated cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. For purposes of determining the general reserve, the portfolio is segregated by product types in order to recognize differing risk profiles among categories, and then further segregated by credit grades. See Summary of Loan Loss Experience for further discussion of the risk factors considered by management in establishing the allowance for loan losses.

**Table of Contents**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is a broad term for the risk of economic loss due to adverse changes in the fair value of a financial instrument. These changes may be the result of various factors, including interest rates, foreign exchange rates, commodity prices, or equity prices. Additionally, the financial instruments subject to market risk can be classified either as held for trading purposes or held for other than trading.

We are subject to market risk primarily through the effect of changes in interest rates on our portfolio of assets held for purposes other than trading. The effect of other changes, such as foreign exchange rates, commodity prices, and/or equity prices do not pose significant market risk to us.

The responsibility for managing market risk rests with the BSMC, which operates under policy guidelines established by our board of directors. The negative acceptable variation in net interest revenue due to a 200 basis point increase or decrease in interest rates is generally limited by these guidelines to +/- 5%. These guidelines also establish maximum levels for short-term borrowings, short-term assets and public and brokered deposits. They also establish minimum levels for unpledged assets, among other things. Compliance with these guidelines is the ongoing responsibility of the BSMC, with exceptions reported to our board of directors on a quarterly basis.

**Interest Rate Risk Management**

Our interest rate sensitivity is illustrated in the following table. The table reflects rate-sensitive positions as of March 31, 2011, and is not necessarily indicative of positions on other dates. The balances of interest rate sensitive assets and liabilities are presented in the periods in which they next reprice to market rates or mature and are aggregated to show the interest rate sensitivity gap. The mismatch between repricings or maturities within a time period is commonly referred to as the gap for that period. A positive gap (asset sensitive), where interest rate sensitive assets exceed interest rate sensitive liabilities, generally will result in the net interest margin increasing in a rising rate environment and decreasing in a falling rate environment. A negative gap (liability sensitive) will generally have the opposite results on the net interest margin. To reflect anticipated prepayments, certain asset and liability categories are shown in the table using estimated cash flows rather than contractual cash flows. The Company employs interest rate floors in certain variable rate loans to enhance the yield on those loans at times when market interest rates are extraordinarily low. The degree of asset sensitivity, spreads on loans and net interest margin may be reduced until rates increase by an amount sufficient to eliminate the effects of floors. The adverse effect of floors as market rates increase may also be offset by the positive gap, the extent to which rates on deposits and other funding sources lag increasing market rates and changes in composition of funding.

**Table of Contents****Interest Rate Sensitivity Gap Analysis****March 31, 2011**

(In thousands)

|                                                                       | 0-3 mo<br>Balance | 4-12 mo<br>Balance | 1-3 yr<br>Balance | 3+ yr<br>Balance | Total<br>Balance |
|-----------------------------------------------------------------------|-------------------|--------------------|-------------------|------------------|------------------|
| Securities <sup>(1)</sup>                                             | \$ 34,550         | \$ 33,355          | \$ 48,562         | \$ 55,523        | \$ 171,990       |
| Total variable loans                                                  | 4,616,534         | 73,928             | 16,704            | 2,579            | 4,709,745        |
| Total fixed loans                                                     | 355,335           | 205,783            | 191,453           | 89,181           | 841,752          |
| Total loans <sup>(2)</sup>                                            | 4,971,869         | 279,711            | 208,157           | 91,760           | 5,551,497        |
| Total interest sensitive assets                                       | \$ 5,006,419      | \$ 313,066         | \$ 256,719        | \$ 147,283       | \$ 5,723,487     |
| Liabilities:                                                          |                   |                    |                   |                  |                  |
| Interest bearing customer deposits                                    | \$ 3,108,702      | \$                 | \$                | \$               | \$ 3,108,702     |
| CDs & IRAs                                                            | 284,073           | 268,327            | 62,331            | 17,863           | 632,594          |
| Total interest bearing deposits                                       | 3,392,775         | 268,327            | 62,331            | 17,863           | 3,741,296        |
| Repurchase agreements, Federal<br>funds purchased, FHLB<br>borrowings | 133,995           |                    |                   |                  | 133,995          |
| Trust preferred subordinated<br>debentures                            |                   |                    |                   | 113,406          | 113,406          |
| Total borrowings                                                      | 133,995           |                    |                   | 113,406          | 247,401          |
| Total interest sensitive liabilities                                  | \$ 3,526,770      | \$ 268,327         | \$ 62,331         | \$ 131,269       | \$ 3,988,697     |
| GAP                                                                   | \$ 1,479,649      | \$ 44,739          | \$ 194,388        | \$ 16,014        | \$               |
| Cumulative GAP                                                        | 1,479,649         | 1,524,388          | 1,718,776         | 1,734,790        | 1,734,790        |
| Demand deposits                                                       |                   |                    |                   |                  | \$ 1,480,695     |
| Stockholders equity                                                   |                   |                    |                   |                  | 544,925          |
| Total                                                                 |                   |                    |                   |                  | \$ 2,025,620     |

(1) Securities based on fair market value.

(2) Loans include loans held for sale and are stated at gross.

The table above sets forth the balances as of March 31, 2011 for interest bearing assets, interest bearing liabilities, and the total of non-interest bearing deposits and stockholders equity. While a gap interest table is useful in analyzing interest rate sensitivity, an interest rate sensitivity simulation provides a better illustration of the sensitivity of earnings

to changes in interest rates. Earnings are also affected by the effects of changing interest rates on the value of funding derived from demand deposits and stockholders' equity. We perform a sensitivity analysis to identify interest rate risk exposure on net interest income. We quantify and measure interest rate risk exposure using a model to dynamically simulate the effect of changes in net interest income relative to changes in interest rates and account balances over the next twelve months based on three interest rate scenarios. These are a most likely rate scenario and two shock test scenarios.

The most likely rate scenario is based on the consensus forecast of future interest rates published by independent sources. These forecasts incorporate future spot rates and relevant spreads of instruments that are actively traded in the open market. The Federal Reserve's Federal Funds target affects short-term borrowing; the prime lending rate and the LIBOR are the basis for most of our variable-rate loan pricing. The 10-year mortgage rate is also monitored because of its effect on prepayment speeds for mortgage-backed securities. These are our primary interest rate exposures. We are currently not using derivatives to manage our interest rate exposure.

The two shock test scenarios assume a sustained parallel 200 basis point increase or decrease, respectively, in interest rates. As short-term rates continued to fall during 2009 and remain low in 2010, we could not assume interest rate decreases of any amount as the results of the decreasing rates scenario would not be meaningful. We will continue to evaluate these scenarios as interest rates change, until short-term rates rise above 3.0%.

**Table of Contents**

Our interest rate risk exposure model incorporates assumptions regarding the level of interest rate or balance changes on indeterminable maturity deposits (demand deposits, interest bearing transaction accounts and savings accounts) for a given level of market rate changes. These assumptions have been developed through a combination of historical analysis and future expected pricing behavior. Changes in prepayment behavior of mortgage-backed securities, residential and commercial mortgage loans in each rate environment are captured using industry estimates of prepayment speeds for various coupon segments of the portfolio. The impact of planned growth and new business activities is factored into the simulation model. This modeling indicated interest rate sensitivity as follows (in thousands):

|                               |                                                                                                                               |
|-------------------------------|-------------------------------------------------------------------------------------------------------------------------------|
|                               | Anticipated Impact Over the Next<br>Twelve Months<br>as Compared to Most Likely Scenario<br>200 bp Increase<br>March 31, 2011 |
| Change in net interest income | \$ 15,775                                                                                                                     |

The simulations used to manage market risk are based on numerous assumptions regarding the effect of changes in interest rates on the timing and extent of repricing characteristics, future cash flows, and customer behavior. These assumptions are inherently uncertain and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and management strategies, among other factors.

**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

Our management, including our chief executive officer and chief financial officer, have evaluated our disclosure controls and procedures as of March 31, 2011, and concluded that those disclosure controls and procedures are effective. There have been no changes in our internal controls or in other factors known to us that could materially affect these controls subsequent to their evaluation, nor any corrective actions with regard to significant deficiencies and material weaknesses. While we believe that our existing disclosure controls and procedures have been effective to accomplish these objectives, we intend to continue to examine, refine and formalize our disclosure controls and procedures and to monitor ongoing developments in this area.

**PART II OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

There has not been any material change in the risk factors previously disclosed in the Company's 2010 Form 10-K for the fiscal year ended December 31, 2010.

**Table of Contents**

**ITEM 5. EXHIBITS**

(a) Exhibits

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.



**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TEXAS CAPITAL BANCSHARES, INC.

Date: April 21, 2011

/s/ Peter B. Bartholow

Peter B. Bartholow

Chief Financial Officer (Duly authorized  
officer and principal financial officer)

**Table of Contents**

**EXHIBIT INDEX**

Exhibit Number

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.