

TEXAS CAPITAL BANCSHARES INC/TX

Form 10-Q

April 22, 2010

**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, 2010**

**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 21, 2010, 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      36,534,313



Texas Capital Bancshares, Inc.  
Form 10-Q  
Quarter Ended March 31, 2010  
Index

Part I. Financial Information

Item 1. Financial Statements

<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>	18

<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	19
--	----

<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	30
---	----

<u>Item 4. Controls and Procedures</u>	32
--	----

Part II. Other Information

<u>Item 1A. Risk Factors</u>	33
------------------------------	----

<u>Item 5. Exhibits</u>	33
-------------------------	----

<u>Signatures</u>	34
-------------------	----

<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 31	
	2010	2009
<b>Interest income</b>		
Interest and fees on loans	\$ 61,569	\$ 51,912
Securities	2,726	3,851
Federal funds sold	9	15
Deposits in other banks	2	28
<b>Total interest income</b>	<b>64,306</b>	<b>55,806</b>
<b>Interest expense</b>		
Deposits	7,758	11,579
Federal funds purchased	365	618
Repurchase agreements	4	14
Other borrowings	47	1,178
Trust preferred subordinated debentures	904	1,200
<b>Total interest expense</b>	<b>9,078</b>	<b>14,589</b>
<b>Net interest income</b>	<b>55,228</b>	<b>41,217</b>
<b>Provision for credit losses</b>	<b>13,500</b>	<b>8,500</b>
<b>Net interest income after provision for credit losses</b>	<b>41,728</b>	<b>32,717</b>
<b>Non-interest income</b>		
Service charges on deposit accounts	1,483	1,525
Trust fee income	954	884
Bank owned life insurance (BOLI) income	471	274
Brokered loan fees	1,904	2,032
Equipment rental income	1,344	1,456
Other	792	729
<b>Total non-interest income</b>	<b>6,948</b>	<b>6,900</b>
<b>Non-interest expense</b>		
Salaries and employee benefits	20,069	16,219
Net occupancy expense	3,014	2,754
Leased equipment depreciation	1,059	1,123
Marketing	787	555
Legal and professional	1,950	2,251
Communications and data processing	1,016	836
FDIC insurance assessment	1,868	1,547
Allowance and other carrying costs for OREO	2,292	1,200
Other	5,131	3,821

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

Total non-interest expense	37,186	30,306
<b>Income from continuing operations before income taxes</b>	11,490	9,311
Income tax expense	3,890	3,186
<b>Income from continuing operations</b>	7,600	6,125
<b>Loss from discontinued operations (after-tax)</b>	(55)	(95)
<b>Net income</b>	\$ 7,545	\$ 6,030
<b>Basic earnings per common share:</b>		
Income from continuing operations	\$ .21	\$ .17
Net income	\$ .21	\$ .16
<b>Diluted earnings per common share:</b>		
Income from continuing operations	\$ .21	\$ .17
Net income	\$ .21	\$ .16

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, 2010 (Unaudited)	December 31, 2009
<b>Assets</b>		
Cash and due from banks	\$ 70,066	\$ 80,459
Federal funds sold	9,990	44,980
Securities, available-for-sale	246,209	266,128
Loans held for sale	592,436	693,504
Loans held for sale from discontinued operations	583	586
Loans held for investment (net of unearned income)	4,443,456	4,457,293
Less: Allowance for loan losses	71,705	67,931
Loans held for investment, net	4,371,751	4,389,362
Premises and equipment, net	10,773	11,189
Accrued interest receivable and other assets	188,649	202,890
Goodwill and intangible assets, net	9,725	9,806
Total assets	\$ 5,500,182	\$ 5,698,904
<b>Liabilities and Stockholders Equity</b>		
Liabilities:		
Deposits:		
Non-interest bearing	\$ 994,096	\$ 899,492
Interest bearing	3,072,001	2,837,163
Interest bearing in foreign branches	343,722	384,070
Total deposits	4,409,819	4,120,725
Accrued interest payable	2,038	2,468
Other liabilities	22,862	23,916
Federal funds purchased	425,939	580,519
Repurchase agreements	21,874	25,070
Other borrowings	4,248	351,440
Trust preferred subordinated debentures	113,406	113,406
Total liabilities	5,000,186	5,217,544
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		
	365	359

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

Issued shares 36,524,730 and 35,919,941 at March 31, 2010 and December 31, 2009, respectively

Additional paid-in capital	337,124	326,224
Retained earnings	156,165	148,620
Treasury stock (shares at cost: 417 at March 31, 2010 and December 31, 2009)	(8)	(8)
Accumulated other comprehensive income, net of taxes	6,350	6,165
Total stockholders' equity	499,996	481,360
Total liabilities and stockholders' equity	\$ 5,500,182	\$ 5,698,904

See accompanying notes to consolidated financial statements.



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

(In thousands except share data)

	Preferred Stock		Common Stock			Treasury Stock		Accumulated Other Comprehensive Deferred Income, Net of Taxes			Total
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Shares	Amount	Compensation	Taxes	
Balance at December 31, 2008		\$	30,971,189	\$ 310	\$ 255,051	\$ 129,851	(84,691)	\$(581)	\$ 573	\$ 1,869	\$ 387,073
Comprehensive income:											
Net income (unaudited)						6,030					6,030
Change in unrealized gain on available-for-sale securities, net of taxes of \$1,743 (unaudited)										3,237	3,237
Total comprehensive income (unaudited)											9,267
Tax expense related to exercise of stock options (unaudited)					(201)						(201)
Stock-based compensation expense recognized in earnings (unaudited)					1,428						1,428
Deferred compensation (unaudited)							(84,274)	573	(573)		
Issuance of stock related to stock-based awards (unaudited)	75,000	70,836	43,386		205						205
					4,164						75,000

Issuance of preferred stock and related warrant (unaudited)										
Preferred stock dividend and accretion of preferred stock discount (unaudited)		148				(930)				(782)
Balance at March 31, 2009 (unaudited)	75,000	\$ 70,984	31,014,575	\$ 310	\$ 260,647	\$ 134,951	(417)	\$ (8)	\$ 5,106	\$ 471,990
Balance at December 31, 2009		\$	35,919,941	\$ 359	\$ 326,224	\$ 148,620	(417)	\$ (8)	\$ 6,165	\$ 481,360
Comprehensive income:										
Net income (unaudited)						7,545				7,545
Change in unrealized gain on available-for-sale securities, net of taxes of \$100 (unaudited)									185	185
Total comprehensive income (unaudited)										7,730
Tax expense related to exercise of stock options (unaudited)					115					115
Stock-based compensation expense recognized in earnings (unaudited)					1,572					1,572
Issuance of stock related to stock-based awards (unaudited)			57,068	1	305					306

Issuance of common stock (unaudited)		547,721	5	8,908					8,913
Balance at March 31, 2010 (unaudited)	\$	36,524,730	\$ 365	\$ 337,124	\$ 156,165	(417)	\$ (8)	\$ 6,350	\$ 499,996

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	
	2010	2009
<b>Operating activities</b>		
Net income from continuing operations	\$ 7,600	\$ 6,125
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	13,500	8,500
Depreciation and amortization	6,224	2,993
Amortization and accretion on securities	39	65
Bank owned life insurance (BOLI) income	(471)	(274)
Stock-based compensation expense	1,572	1,428
Tax benefit from stock option exercises	115	(201)
Excess tax benefits from stock-based compensation arrangements	329	(82)
Originations of loans held for sale	(3,204,634)	(3,950,363)
Proceeds from sales of loans held for sale	3,305,702	4,019,732
Loss on sale of assets	44	
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	9,748	15,598
Accrued interest payable and other liabilities	(1,584)	(778)
Net cash provided by operating activities of continuing operations	138,184	102,743
Net cash (used in) operating activities of discontinued operations	(53)	(38)
Net cash provided by operating activities	138,131	102,705
<b>Investing activities</b>		
Maturities and calls of available-for-sale securities	1,515	3,500
Principal payments received on available-for-sale securities	18,650	18,268
Net decrease in loans held for investment	3,126	6,016
Purchase of premises and equipment, net	(422)	(819)
Proceeds from sale of foreclosed assets	601	
Net cash provided by investing activities of continuing operations	23,470	26,965
<b>Financing activities</b>		
Net increase (decrease) in deposits	289,094	(322,227)
Proceeds from issuance of stock related to stock-based awards	306	205
Proceeds from issuance of common stock	8,913	
Proceeds from issuance of preferred stock and related warrants		75,000
Dividends paid		(302)
Net decrease in other borrowings	(350,388)	(57,939)
Excess tax benefits from stock-based compensation arrangements	(329)	82
Net increase (decrease) in federal funds purchased	(154,580)	164,115

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

Net cash (used in) financing activities of continuing operations	(206,984)	(141,066)
Net decrease in cash and cash equivalents	(45,383)	(11,396)
Cash and cash equivalents at beginning of period	125,439	82,027
Cash and cash equivalents at end of period	\$ 80,056	\$ 70,631
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	\$ 9,508	\$ 15,038
Cash paid during the period for income taxes	299	20
Non-cash transactions:		
Transfers from loans/leases to OREO and other repossessed assets	4,151	5,614
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 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, 2009, included in our Annual Report on Form 10-K filed with the SEC on February 18, 2010 (the 2009 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 (Loss), 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 (loss), net. Accumulated comprehensive income (loss), net for the three months ended March 31, 2010 and 2009 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	
	2010	2009
Numerator:		
Net income from continuing operations	\$ 7,600	\$ 6,125
Preferred stock dividends		930
Net income from continuing operations available to common shareholders	7,600	5,195
Loss from discontinued operations	(55)	(95)
Net income available to common shareholders	\$ 7,545	\$ 5,100
Denominator:		
Denominator for basic earnings per share-weighted average shares	36,191,373	30,984,434
Effect of employee stock options <sup>(1)</sup>	509,935	88,010
Effect of warrants to purchase common stock	82,411	
Denominator for dilutive earnings per share-adjusted weighted average shares and assumed conversions	36,783,719	31,072,444
Basic earnings per common share from continuing operations	\$ .21	\$ .17
Basic earnings per common share from discontinued operations		(.01)
Basic earnings per common share	\$ .21	\$ .16
Diluted earnings per share from continuing operations	\$ .21	\$ .17
Diluted earnings per share from discontinued operations		(.01)
Diluted earnings per common share	\$ .21	\$ .16

(1) Stock options outstanding of 1,454,080 at March 31, 2010 and 2,716,867 at March 31, 2009 have not been included in diluted earnings per share

because to do so  
would have  
been  
anti-dilutive for  
the periods  
presented. Stock  
options and  
SARs are  
anti-dilutive  
when the  
exercise price is  
higher than the  
average market  
price of our  
common stock.

**(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 (loss) in stockholders' equity, net of taxes. Amortization of premiums or accretion of discounts on mortgage-backed securities is periodically adjusted for estimated prepayments.

Our net unrealized gain on the available-for-sale securities portfolio value increased from a gain of \$9.5 million, which represented 3.70% of the amortized cost at December 31, 2009, to a gain of \$9.8 million, which represented 4.13% of the amortized cost at March 31, 2010.



**Table of Contents**

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

	March 31, 2010			Estimated
	Amortized	Gross	Gross	Fair
	Cost	Unrealized	Unrealized	Value
		Gains	Losses	
Available-for-Sale Securities:				
Residential mortgage-backed securities	\$183,147	\$ 8,030	\$ (17)	\$191,160
Corporate securities	5,000		(291)	4,709
Municipals	40,786	1,899		42,685
Equity securities <sup>(1)</sup>	7,506	149		7,655
	\$236,439	\$10,078	\$(308)	\$246,209

	December 31, 2009			Estimated
	Amortized	Gross	Gross	Fair
	Cost	Unrealized	Unrealized	Value
		Gains	Losses	
Available-for-Sale Securities:				
Residential mortgage-backed securities	\$201,824	\$8,192	\$ (29)	\$209,987
Corporate securities	5,000		(317)	4,683
Municipals	42,314	1,514	(2)	43,826
Equity securities <sup>(1)</sup>	7,506	126		7,632
	\$256,644	\$9,832	\$(348)	\$266,128

(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):

	At March 31, 2010				Total
	Less Than One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	
Available-for-sale:					
Residential mortgage-backed securities: <sup>(1)</sup>					
Amortized cost	18,244	30,684	64,037	70,182	183,147
Estimated fair value	18,464	31,420	67,827	73,449	191,160
Weighted average yield <sup>(3)</sup>	4.221%	4.400%	4.809%	4.399%	4.525%

Corporate securities:				
Amortized cost	5,000			5,000
Estimated fair value	4,709			4,709
Weighted average yield <sup>(3)</sup>	7.375%			7.375%
Municipals: <sup>(2)</sup>				
Amortized cost	3,186	23,103	14,497	40,786
Estimated fair value	3,235	24,258	15,192	42,685
Weighted average yield <sup>(3)</sup>	7.434%	8.255%	8.840%	8.400%
Equity securities:				
Amortized cost	7,506			7,506
Estimated fair value	7,655			7,655
Total available-for-sale securities:				
Amortized cost				\$ 236,439
Estimated fair value				\$ 246,209

(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 \$119.5 million were pledged to secure certain borrowings and deposits at March 31, 2010. Of the pledged securities at March 31, 2010, approximately \$115.1 million were pledged for certain deposits, and approximately \$4.4 million were pledged for repurchase agreements.

The following table discloses, as of March 31, 2010 and March 31, 2009, 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, 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	\$ 192	\$ (1)	\$ 2,305	\$ (16)	\$ 2,497	\$ (17)
Corporate securities			4,709	(291)	4,709	(291)
	\$ 192	\$ (1)	\$ 7,014	\$ (307)	\$ 7,206	\$ (308)

March 31, 2009

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasuries	\$ 24,999	\$ (1)	\$	\$	\$ 24,999	\$ (1)
Mortgage-backed securities	19,170	(108)	3,571	(197)	22,741	(305)
Corporate securities	4,746	(254)			4,746	(254)
Municipals	3,154	(49)			3,154	(49)
	\$ 52,069	\$ (412)	\$ 3,571	\$ (197)	\$ 55,640	\$ (609)

At March 31, 2010, the number of investment positions in this unrealized loss position totals 3. 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 noted are interest rate related, and losses have decreased as rates have decreased in 2009 and remained low during 2010. 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, 2010 and December 31, 2009, loans were as follows (in thousands):

	March 31, 2010	December 31, 2009
Commercial	\$ 2,422,690	\$ 2,457,533
Construction	414,744	669,426
Real estate	1,514,476	1,233,701
Consumer	21,631	25,065
Leases	96,873	99,129
Gross loans held for investment	4,470,414	4,484,854

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

Deferred income (net of direct origination costs)	(26,958)	(27,561)
Allowance for loan losses	(71,705)	(67,931)
Total loans held for investment, net	4,371,751	4,389,362
Loans held for sale	592,436	693,504
Total	\$ 4,964,187	\$ 5,082,866

We continue to lend primarily in Texas. As of March 31, 2010, 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 within this area. The risks created by this concentration have been considered by management in the determination of the adequacy of the

**Table of Contents**

allowance for loan losses. Management believes the allowance for loan losses is adequate to cover estimated losses on loans at each balance sheet date.

**Allowance for Loan Losses**

Activity in the allowance for loan losses was as follows (in thousands):

	Three months ended March 31,	
	2010	2009
Balance at the beginning of the period	\$ 67,931	\$ 45,365
Provision for loan losses	13,054	7,388
Net charge-offs:		
Loans charged-off	9,331	2,636
Recoveries	51	28
Net charge-offs	9,280	2,608
Balance at the end of the period	\$ 71,705	\$ 50,145

The change in the allowance for off-balance sheet credit losses is summarized as follows (in thousands):

	Three months ended March 31,	
	2010	2009
Balance at the beginning of the period	\$ 2,948	\$ 1,470
Provision for off-balance sheet credit losses	446	1,112
Balance at the end of the period	\$ 3,394	\$ 2,582

Reserves on impaired loans were \$22.9 million at March 31, 2010.

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

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

	March 31,	
	2010	2009
Beginning balance	\$ 27,264	\$ 25,904
Additions	4,151	5,614
Sales	(601)	(4,017)
Valuation allowance for OREO	(1,838)	
Direct write-downs	(111)	
Ending balance	\$ 28,865	\$ 27,501

**(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 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.

**Table of Contents**

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.

Financial instruments whose contract amounts represent credit risk (in thousands):

	March 31, 2010
Commitments to extend credit	\$ 1,205,881
Standby letters of credit	65,201

**(7) REGULATORY MATTERS**

The Company and the Bank are subject to various regulatory capital and other 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, 2010, 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 Company's capital ratios exceed the regulatory definition of well capitalized as of March 31, 2010 and 2009. As of June 30, 2009, 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,	
	2010	2009
Risk-based capital:		
Tier 1 capital	11.28%	11.87%
Total capital	12.53%	12.97%
Leverage	10.98%	10.95%

**(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 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 ASC 718, *Compensation - Stock Compensation* ( ASC 718 ), SARs and restricted stock units ( RSUs ). The SARs and RSUs were granted from 2006 through 2010.



**Table of Contents**

(in thousands)	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Stock- based compensation expense recognized:		
Unvested options	\$ 110	\$ 179
SARs	478	395
RSUs	984	854
Total compensation expense recognized	\$ 1,572	\$ 1,428

	March 31, 2010 Options	March 31, 2010 SARs and RSUs
Unrecognized compensation expense related to unvested awards	\$ 109	\$ 13,260
Weighted average period over which expense is expected to be recognized, in years	.75	1.87

**(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, 2010 and March 31, 2009, the loss from discontinued operations was \$55,000 and \$95,000, net of taxes, respectively. The 2010 and 2009 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 \$583,000 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, 2010 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**

Effective January 1, 2008, we adopted Accounting Standards Codification ( ASC ) 820, *Fair Value Measurements and Disclosures* ( ASC 820 ), which 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.
- 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.

**Table of Contents**

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 are 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, 2010 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	\$	\$ 191,160	\$
Corporate securities		4,709	
Municipals		42,685	
Other		7,655	
Loans <sup>(2) (4)</sup>			33,593
OREO <sup>(3) (4)</sup>			28,865
Derivative asset <sup>(5)</sup>		3,452	
Derivative liability <sup>(5)</sup>		(3,452)	

(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, 2010, 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 \$33.6 million total above includes impaired loans at March 31, 2010 with a carrying value of \$35.4 million that were reduced by specific valuation allowance allocations totaling \$7.5 million for a total reported fair value of \$27.9 million 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 \$6.7 million in mortgage warehouse loans that were reduced by specific valuation allowance allocations totaling \$1.0 million, for a total reported fair value of \$5.7 million. Certain mortgage loans that are transferred from loans held for sale to loans held for investment are 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, 2010, OREO with a carrying value of \$37.3 million was reduced by specific valuation allowance allocations totaling \$8.4 million for a total reported fair value of \$28.9 million based on



**Table of Contents**

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, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Cash and cash equivalents	\$ 80,056	\$ 80,056	\$ 125,439	\$ 125,439
Securities, available-for-sale	246,209	246,209	266,128	266,128
Loans held for sale	592,436	592,436	693,504	693,504
Loans held for sale from discontinued operations	583	583	586	586
Loans held for investment, net	4,371,751	4,383,835	4,389,362	4,542,572
Derivative asset	3,452	3,452	1,837	1,837
Deposits	4,409,819	4,410,822	4,120,725	4,121,993
Federal funds purchased	425,939	425,939	580,519	580,519
Borrowings	26,122	25,123	376,510	376,510
Trust preferred subordinated debentures	113,406	113,736	113,406	113,876
Derivative liability	3,452	3,452	1,837	1,837

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.

*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.

**Table of Contents***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**

On January 27, 2010, we announced that we entered into an Equity Distribution Agreement with Morgan Stanley & Co. Incorporated, pursuant to which we may, from time to time, offer and sell shares of our common stock, having aggregate gross sales proceeds of up to \$40,000,000. Sales of the shares are being made by means of brokers transactions on or through the NASDAQ Global Select Market at market prices prevailing at the time of the sale or as otherwise agreed to by the Company and Morgan Stanley. As of March 31, 2010, we have sold 547,721 shares at an average price of \$16.90. Net proceeds of \$8.9 million are being used for general corporate purposes.

We had comprehensive income of \$7.7 million for the three months ended March 31, 2010 and comprehensive income of \$9.3 million for the three months ended March 31, 2009. Comprehensive income during the three months ended March 31, 2010 included a net after-tax gain of \$185,000, and comprehensive income during the three months ended March 31, 2009 included a net after-tax gain of \$3.2 million due to changes in the net unrealized gains/losses on securities available-for-sale.

**(12) NEW ACCOUNTING PRONOUNCEMENTS**

*FASB ASC 105 Generally Accepted Accounting Principles* ( ASC 105 ) establishes the Financial Accounting Standards Board ( FASB ) Accounting Standards Codification (the Codification ) as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative guidance for SEC registrants. All guidance contained in the Codification carries an equal level of authority. All non-grandfathered, non-SEC accounting literature not included in the Codification is superseded and deemed non-authoritative. ASC 105 was adopted on September 15, 2009, and did not have a significant impact on our financial statements.

*FASB ASC 810 Consolidation* ( ASC 810 ) became effective for us on January 1, 2010, and was amended to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. The new authoritative accounting guidance requires additional disclosures about the reporting entity's involvement with variable-interest entities and any significant changes in risk exposure due to that involvement as well as its affect on the entity's financial statements. The new authoritative accounting guidance under ASC 810 was effective January 1, 2010 and did not have a significant impact on our financial statements.

*FASB ASC 860 Transfers and Servicing* ( ASC 860 ) was amended to enhance reporting about transfers of

**Table of Contents**

financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. The new authoritative accounting guidance eliminates the concept of a qualifying special-purpose entity and changes the requirements for derecognizing financial assets. The new authoritative accounting guidance also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The new authoritative accounting guidance under ASC 860 was effective January 1, 2010 and did not have a significant impact on our financial statements.



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

Consolidated Daily Average Balances, Average Yields and Rates

(In thousands)

	For the three months ended March 31, 2010			For the three months ended March 31, 2009		
	Average Balance	Revenue/ Expense <sup>(1)</sup>	Yield/ Rate	Average Balance	Revenue/ Expense <sup>(1)</sup>	Yield/ Rate
<b>Assets</b>						
Securities taxable	\$ 211,618	\$ 2,341	4.49%	\$ 321,802	\$ 3,431	4.32%
Securities non-taxable <sup>(2)</sup>	41,654	592	5.76%	46,055	646	5.69%
Federal funds sold	7,471	9	0.49%	14,923	15	0.41%
Deposits in other banks	12,457	2	0.07%	11,207	28	1.01%
Loans held for sale from continuing operations	457,459	5,490	4.87%	587,401	6,487	4.48%
Loans	4,413,960	56,079	5.15%	4,022,180	45,425	4.58%
Less reserve for loan losses	66,726			46,686		
Loans, net of reserve	4,804,693	61,569	5.20%	4,562,895	51,912	4.61%
Total earning assets	5,077,893	64,513	5.15%	4,956,882	56,032	4.58%
Cash and other assets	311,128			238,723		
Total assets	\$ 5,389,021			\$ 5,195,605		
<b>Liabilities and Stockholders Equity</b>						
Transaction deposits	\$ 365,205	\$ 264	0.29%	\$ 129,850	\$ 44	0.14%
Savings deposits	1,773,201	3,524	0.81%	745,355	1,420	0.77%
Time deposits	840,820	2,787	1.34%	1,277,824	8,066	2.56%
Deposits in foreign branches	353,803	1,183	1.36%	444,549	2,049	1.87%
Total interest bearing deposits	3,333,029	7,758	0.94%	2,597,578	11,579	1.81%
Other borrowings	461,477	416	0.37%	1,367,691	1,810	0.54%
Trust preferred subordinated debentures	113,406	904	3.23%	113,406	1,200	4.29%
Total interest bearing liabilities	3,907,912	9,078	0.94%	4,078,675	14,589	1.45%
Demand deposits	956,359			636,704		
Other liabilities	28,643			23,619		
Stockholders equity	496,107			456,607		
Total liabilities and stockholders equity	\$ 5,389,021			\$ 5,195,605		

Net interest income	\$ 55,435		\$ 41,443	
Net interest margin		4.43%		3.39%
Net interest spread		4.21%		3.13%
<p>(1) The loan averages include loans on which the accrual of interest has been discontinued and are stated net of unearned income.</p>				
<p>(2) Taxable equivalent rates used where applicable.</p>				
<p>Additional information from discontinued operations:</p>				
Loans held for sale	\$ 585		\$ 647	
Borrowed funds	585		647	
Net interest income		\$ 13		\$ 14
Net interest margin consolidated			4.43%	3.39%
		18		

---

**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

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 \$7.6 million for the first quarter of 2010 compared to \$6.1 million for the first quarter of 2009. We reported net income available to common shareholders of \$7.6 million, or \$.21 per diluted common share, for the first quarter of 2010 compared to \$5.2 million, or \$.17 per diluted common share, for the first quarter of 2009. Return on average equity was 6.21% and return on average assets was .57% for the first quarter of 2010, compared to 5.44% and .48%, respectively, for the first quarter of 2009.

Net income and net income available to common shareholders increased \$1.5 million, or 24%, and \$2.4

**Table of Contents**

million, or 46%, respectively, for the three months ended March 31, 2010 compared to the same period in 2009. The increase during the three months ended March 31, 2010 was primarily the result of a \$14.0 million increase in net interest income, offset by a \$5.0 million increase in the provision for loan losses, a \$6.9 million increase in non-interest expense, and a \$1.3 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 \$55.2 million for the first quarter of 2010, compared to \$41.2 million for the first quarter of 2009. The increase was due to an increase in average earning assets of \$121.0 million as compared to the first quarter of 2009. The increase in average earning assets included a \$391.8 million increase in average loans held for investment, offset by a \$129.9 million decrease in loans held for sale and a \$114.6 million decrease in average securities. For the quarter ended March 31, 2010, average net loans and securities represented 95% and 5%, respectively, of average earning assets compared to 92% and 7% in the same quarter of 2009.

Average interest bearing liabilities decreased \$170.7 million from the first quarter of 2009, which included a \$735.5 million increase in interest bearing deposits offset by a \$906.2 million decrease in other borrowings. The significant decrease in average other borrowings is a result of the growth in demand and interest bearing deposits and the reduction in average balances of loans held for sale, reducing the need for borrowed funds. The average cost of interest bearing liabilities decreased from 1.45% for the quarter ended March 31, 2009 to .94% for the same period of 2010.

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 March 31, 2010/2009		
	Change	Change Due To <sup>(1)</sup>	
		Volume	Yield/Rate
Interest income:			
Securities <sup>(2)</sup>	\$ (1,144)	\$ (1,237)	\$ 93
Loans held for sale	(997)	(1,435)	438
Loans held for investment	10,654	4,425	6,229
Federal funds sold	(6)	(7)	1
Deposits in other banks	(26)	3	(29)
<b>Total</b>	<b>8,481</b>	<b>1,749</b>	<b>6,732</b>
Interest expense:			
Transaction deposits	220	80	140
Savings deposits	2,104	1,958	146
Time deposits	(5,279)	(2,758)	(2,521)
Deposits in foreign branches	(866)	(418)	(448)
Borrowed funds	(1,690)	(1,199)	(491)
<b>Total</b>	<b>(5,511)</b>	<b>(2,337)</b>	<b>(3,174)</b>
<b>Net interest income</b>	<b>\$ 13,992</b>	<b>\$ 4,086</b>	<b>\$ 9,906</b>

(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 4.43% for the first quarter of 2010 compared to 3.39% for the first quarter of 2009. This 104 basis point increase was a result of a steep 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 decreased from 1.14% for the first quarter of 2009 to .68% for the first quarter of 2010. The benefit of the reduction in funding costs was complimented by a 57 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	
	2010	2009
Service charges on deposit accounts	\$ 1,483	\$ 1,525
Trust fee income	954	884
Bank owned life insurance (BOLI) income	471	274
Brokered loan fees	1,904	2,032
Equipment rental income	1,344	1,456
Other	792	729
Total non-interest income	\$ 6,948	\$ 6,900

Non-interest income for the first quarter of 2010 remained consistent at \$6.9 million compared to the same quarter of 2009.

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	
	2010	2009
Salaries and employee benefits	\$ 20,069	\$ 16,219
Net occupancy expense	3,014	2,754
Leased equipment depreciation	1,059	1,123
Marketing	787	555
Legal and professional	1,950	2,251
Communications and data processing	1,016	836
FDIC insurance assessment	1,868	1,547
Allowance and other carrying costs for OREO	2,292	1,200
Other	5,131	3,821
Total non-interest expense	\$ 37,186	\$ 30,306

Non-interest expense for the first quarter of 2010 increased \$6.9 million, or 23%, to \$37.2 million from \$30.3 million in the first quarter of 2009. The increase is primarily attributable to a \$3.9 million increase in salaries and employee benefits to \$20.1 million from \$16.2 million, which was primarily due to general business growth.

Occupancy expense for the three months ended March 31, 2010 increased \$260,000, or 9%, compared to the same quarter in 2009 related to general business growth.

Legal and professional expense for the three months ended March 31, 2010 decreased \$301,000, or 13% compared to the same quarter in 2009.

FDIC insurance assessment expense increased by \$321,000 from \$1.5 million in 2009 to \$1.9 million due to overall rate increases. The FDIC assessment rates may continue to increase and will continue to be a factor in our expense growth.

Allowance and other carrying costs for OREO increased \$1.1 million for the three months ended March 31, 2010 related to deteriorating values of assets held in OREO. Of the \$2.3 million expense for the first quarter of 2010, \$1.8 million was related to increasing the valuation allowance during the quarter and \$111,000 related to direct write-downs of OREO balances.

**Table of Contents****Analysis of Financial Condition****Loan Portfolio**

Total loans net of allowance for loan losses at March 31, 2010 decreased \$118.7 million from December 31, 2009 to \$5.1 billion. Commercial loans decreased \$34.8 million and combined real estate and construction loans increased \$26.1 million. Overall end of period decrease in loans held for investment from December 31, 2009 is due to payoffs and seasonal factors. Average loans held for investment increased by \$391.8 in the quarter ended March 31, 2010 as compared to the quarter ended December 31, 2009. Loans held for sale decreased \$101.1 million from December 31, 2009 due to seasonal factors and the impact of rates on sales and refinancing of homes. We anticipate that overall loan growth during the remainder of 2010 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, 2010	December 31, 2009
Commercial	\$ 2,422,690	\$ 2,457,533
Construction	414,744	669,426
Real estate	1,514,476	1,233,701
Consumer	21,631	25,065
Leases	96,873	99,129
Gross loans held for investment	4,470,414	4,484,854
Deferred income (net of direct origination costs)	(26,958)	(27,561)
Allowance for loan losses	(71,705)	(67,931)
Total loans held for investment, net	4,371,751	4,389,362
Loans held for sale	592,436	693,504
Total	\$ 4,964,187	\$ 5,082,866

We continue to lend primarily in Texas. As of March 31, 2010, 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, 2010, we have \$451.0 million in syndicated loans, \$148.5 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, 2010, \$20.3 of our syndicated loans were nonperforming and none are considered potential problem loans.

**Summary of Loan Loss Experience**

During the first quarter of 2010, we recorded net charge-offs in the amount of \$9.3 million, compared to net charge-offs of \$2.6 million for the same period in 2009. For the first quarter of 2010, the ratio of net charge-offs to loans held for investment was .85% compared to .26% for the same period in 2009. The reserve for loan losses, which is available to absorb losses inherent in the loan portfolio, totaled \$71.7 million at March 31, 2010, \$67.9 million at December 31, 2009 and \$50.1 million at March 31, 2009. This represents 1.61%, 1.52% and 1.25% of loans held for investment (net of unearned income) at March 31, 2010, December 31, 2009 and March 31, 2009, respectively.



Including the \$3.4 million of allowance for loss on off-balance sheet

22

---

**Table of Contents**

exposure, the total reserve percentage increased to 1.69% at March 31, 2010 from 1.59% and 1.31% of loans held for investment at December 31, 2009 and March 31, 2009, respectively. The total reserve percentage has increased over the past year as a result of the effects of national and regional economic conditions on borrowers and values of assets pledged as collateral.

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 \$13.5 million during the first quarter of 2010 compared to \$8.5 million in the first quarter of 2009 and \$10.5 million in the fourth quarter of 2009.

The reserve for credit 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 impairment. 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 and anticipated future credit losses. 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**

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

	Three months ended March 31, 2010	Three months ended March 31, 2009	Year ended December 31, 2009
Reserve for loan losses:			
Beginning balance	\$ 67,931	\$ 45,365	\$ 45,365
Loans charged-off:			
Commercial	7,551	1,695	4,000
Real estate construction	420	60	6,508
Real estate term	766	236	4,696
Consumer		419	502
Equipment leases	594	226	4,022
Total charge-offs	9,331	2,636	19,728
Recoveries:			
Commercial	18	21	124
Real estate construction			13
Real estate term	8		53
Consumer			28
Equipment leases	25	7	54
Total recoveries	51	28	272
Net charge-offs	9,280	2,608	19,456
Provision for loan losses	13,054	7,388	42,022
Ending balance	\$ 71,705	\$ 50,145	\$ 67,931
Reserve for off-balance sheet credit losses:			
Beginning balance	\$ 2,948	\$ 1,470	\$ 1,470
Provision for off-balance sheet credit losses	446	1,112	1,478
Ending balance	\$ 3,394	\$ 2,582	\$ 2,948
Total reserve for credit losses	\$ 75,099	\$ 52,727	\$ 70,879
Total provision for credit losses	\$ 13,500	\$ 8,500	\$ 43,500
Reserve for loan losses to loans held for investment <sup>(2)</sup>	1.61%	1.25%	1.52%
Net charge-offs to average loans <sup>(1)(2)</sup>	.85%	.26%	.46%
Total provision for credit losses to average loans <sup>(1)(2)</sup>	1.24%	.86%	1.04%

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

Recoveries to total charge-offs	.55%		1.06%	1.38%
Reserve for loan losses as a multiple of net charge-offs	7.7x		19.2x	3.5x
Reserve for off-balance sheet credit losses to off-balance sheet credit commitments	.29%		.19%	.24%
Combined reserves for credit losses to loans held for investment <sup>(2)</sup>	1.69%		1.31%	1.59%
Non-performing assets: <sup>(4)</sup>				
Non-accrual loans	\$ 115,926	\$	50,683	\$ 95,625
OREO <sup>(5)</sup>	28,865		27,501	27,264
Total	\$ 144,791	\$	78,184	\$ 122,889
Restructured loans	\$ 10,700	\$		\$
Loans past due 90 days and still accruing <sup>(3)</sup>	\$ 2,390	\$	4,637	\$ 6,081
Reserve as a percent of non-performing loans <sup>(2)</sup>	.6x		1.0x	.7x

(1) Interim period ratios are annualized.

(2) Excludes loans held for sale.

(3) At March 31, 2010, December 31, 2009 and March 31, 2009, loans past due 90 days and still accruing includes premium finance loans for \$2.0 million, \$2.4 million and \$1.7 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, 2010, December 31, 2009 and March 31, 2009, non-performing assets include \$2.6 million, \$2.6 million and \$4.0 million, respectively, of mortgage warehouse loans which were transferred to the loans held for investment portfolio at lower of cost or market during the past eighteen months, and some were subsequently moved to OREO.

- (5) At March 31, 2010 and December 31, 2009, OREO balance is net of \$8.5 million and \$6.6 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 31, 2010	March 31, 2009	December 31, 2009
Non-accrual loans:			
Commercial	\$ 44,292	\$ 13,459	\$ 34,021
Construction	49,535	29,493	44,598
Real estate	10,919	3,594	10,189
Consumer	535	86	273
Leases	10,645	4,051	6,544
Total non-accrual loans	\$ 115,926	\$ 50,683	\$ 95,625

At March 31, 2010, our total non-accrual loans were \$115.9 million. Of these, \$44.3 million were characterized as commercial loans. This included a \$6.8 million line of credit secured by single family residences and the borrower's notes receivable, a \$6.5 million auto dealer line of credit secured by vehicle inventory, a \$5.9 million line of credit secured by various single family properties, a \$4.7 million line of credit secured by the assets of the borrower, a \$4.2 million manufacturing loan secured by the assets of the borrower, a \$3.9 million residence rehabilitation loan secured by single family residences, a \$2.5 million loan secured by a first lien security interest in the borrower's accounts receivable and assets, a \$2.4 million loan secured by the borrower's assets and a \$1.7 million loan secured by commercial mortgage securities. Non-accrual loans also included \$49.5 million characterized as construction loans. This included a \$16.4 million commercial real estate lot development loan secured by residential lots, a \$14.3 million commercial real estate loan secured by condominiums, \$5.4 million term loan secured by commercial buildings, a \$4.9 million commercial real estate loan secured by unimproved land, a \$2.8 million line of credit secured by residential lots, a \$2.1 million commercial real estate loan secured by retail property, \$1.3 million in commercial real estate loans secured by single family residences and a \$1.0 million real estate investment loan secured by unimproved lots. Non-accrual loans also included \$10.9 million characterized as real estate loans, \$6.9 of which relates to a real estate loan secured by an apartment building. Also included in this category are \$2.5 million in single family mortgages that were originated in our mortgage warehouse operation. The \$10.6 million characterized as leases is comprised of commercial leases, of which \$6.3 million is secured by heavy duty vehicles, \$1.8 million is secured by the assets of the lessor and \$1.6 million is secured by hospital equipment. Each of these loans and leases were reviewed for impairment and specific reserves were allocated as necessary and included in the allowance for loan losses as of March 31, 2010 to cover any probable loss.

At March 31, 2010, we had \$10.7 million in restructured loans, which consists of one relationship secured by unimproved land. As a result of economic conditions, we have agreed to fund additional money to the borrower and extend the original maturity date.

At March 31, 2010, we had \$2.4 million in loans past due 90 days and still accruing interest. At March 31, 2010, \$2.0 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.

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, 2010, 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.

Restructured loans are loans on which, due to the borrower's financial difficulties, we have granted a

**Table of Contents**

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, either forgiveness of principal or accrued interest. As of March 31, 2010 we have \$10.7 million in loans that were restructured but still accruing. Of the nonaccrual loans at March 31, 2010, \$34.2 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 a year. If a restructured loan is on nonaccrual it can be 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, 2010, we had \$46.3 million in loans of this type which were not included in either non-accrual or 90 days past due categories. The increase in the amount of potential problem loans from March 2009 to March 2010 is consistent with the overall economic deterioration and the increase in nonperforming loans that we have experienced this year.

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

	March 31, 2010	2009
Beginning balance	\$ 27,264	\$ 25,904
Additions	4,151	5,614
Sales	(601)	(4,017)
Valuation allowance for OREO	(1,838)	
Direct write-downs	(111)	
Ending balance	\$ 28,865	\$ 27,501

At March 31, 2010, our other real estate owned totaled \$28.9 million. This included an unimproved commercial real estate lot valued at \$7.5 million and residential real estate lots and undeveloped land valued at \$7.1 million and \$3.1 million, respectively. Also included is a commercial real estate property consisting of single family residences and developed lots valued at \$3.4 million, unimproved commercial real estate lots valued at \$2.9 million and \$1.6 million, an office building valued at \$2.6 million, and commercial real estate property consisting of single family residences and a mix of lots at various levels of completion valued at \$1.2 million.

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, 2010, we recorded \$1.9 million in valuation expense. Of the \$1.9 million, \$1.8 million related to increases to the valuation allowance, and \$111,000 related to direct write-downs.

**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, 2009 and for the three months ended March 31, 2010, our principal source of

**Table of Contents**

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 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. These CDs are generally of short maturities, 30 to 90 days, and are used to supplement temporary differences in the growth in loans, including growth in specific categories of loans, compared to customer deposits. The following table summarizes our core customer deposits and brokered deposits as of March 31, 2010 (in thousands):

	March 31, 2010	March 31, 2009	December 31, 2009
Deposits from core customers	\$ 4,359.2	\$ 2,541.1	\$ 3,902.4
Deposits from core customers as a percent of total deposits	98.9%	84.4%	94.7%
Brokered deposits	\$ 50.6	\$ 469.8	\$ 218.3
Brokered deposits as a percent of total deposits	1.1%	15.6%	5.3%
Average deposits from core customers <sup>(1)</sup>	\$ 4,191.5	\$ 2,546.1	\$ 3,163.8
Average deposits from core customers as a percent of total quarterly average deposits <sup>(1)</sup>	97.7%	78.7%	85.7%
Average brokered deposits <sup>(1)</sup>	\$ 97.9	\$ 688.2	\$ 527.5
Average brokered deposits as a percent of total quarterly average deposits <sup>(1)</sup>	2.3%	21.3%	14.3%

(1) Annual averages presented for December 31, 2009.

We believe the Company has access to sources of brokered deposits of not less than an additional \$3.2 billion. Based on the reduction in brokered CDs, customer deposits (total deposits minus brokered CDs) increased by \$1.8 billion from March 31, 2009 and \$456.8 million from December 31, 2009.

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 (in thousands):

	March 31, 2010
Federal funds purchased	\$ 425,939
Customer repurchase agreements	21,874
Treasury, tax and loan notes	3,148
FHLB borrowings	100

TLGP borrowings	1,000
Trust preferred subordinated debentures	113,406
Total borrowings	\$ 565,467
Maximum outstanding at any month end during the year	\$ 653,665

**Table of Contents**

The following table summarizes our other borrowing capacities in excess of balances outstanding at March 31, 2010 (in thousands):

FHLB borrowing capacity relating to loans	\$ 941,375
FHLB borrowing capacity relating to securities	71,261
<b>Total FHLB borrowing capacity</b>	<b>\$ 1,012,636</b>

Unused federal funds lines available from commercial banks \$ 531,960

In connection with the FDIC's Temporary Liability Guarantee Program ( TLGP ), we had the capacity to issue up to \$1.1 billion in indebtedness which will be guaranteed by the FDIC for a limited period of time to newly issued senior unsecured debt and non-interest bearing deposits. The notes were issued prior to October 31, 2009 and have maturities no later than December 31, 2012. As of March 31, 2010, \$1.0 million of these notes were outstanding.

Our equity capital averaged \$496.1 million for the three months ended March 31, 2010 as compared to \$456.6 million for the same period in 2009. 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.

On January 27, 2010, we announced that we entered into an Equity Distribution Agreement with Morgan Stanley & Co. Incorporated, pursuant to which we may, from time to time, offer and sell shares of our common stock, having aggregate gross sales proceeds of up to \$40,000,000. Sales of the shares are being made by means of brokers transactions on or through the NASDAQ Global Select Market at market prices prevailing at the time of the sale or as otherwise agreed to by the Company and Morgan Stanley. As of March 31, 2010 we have sold 547,721 shares at an average price of \$16.90. Net proceeds of \$8.9 million, are being used for general corporate purposes.

Our capital ratios remain above the levels required to be well capitalized and have been enhanced with the additional capital raised since 2008 through March 31, 2010 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, 2010, our significant fixed and determinable contractual obligations to third parties were as follows (in thousands):

	Within One Year	After One but Within Three Years	After Three but Within Five Years	After Five Years	Total
Deposits without a stated maturity (1)	\$ 3,255,327	\$	\$	\$	\$ 3,255,327
Time deposits (1)	1,116,989	25,715	11,012	776	1,154,492
Federal funds purchased (1)	425,939				425,939
Customer repurchase agreements (1)	21,874				21,874
Treasury, tax and loan notes (1)	3,148				3,148
FHLB borrowings (1)			100		100
TLGP borrowings (1)	1,000				1,000
Operating lease obligations (1) (2)	9,626	15,317	14,505	45,530	84,978
Trust preferred subordinated debentures (1)				113,406	113,406

Total contractual obligations	\$ 4,833,903	\$ 41,032	\$ 25,617	\$ 159,712	\$ 5,060,264
-------------------------------	--------------	-----------	-----------	------------	--------------

(1) Excludes interest.

(2) Non-balance sheet item.

**Table of Contents**

**Critical Accounting Policies**

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.

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, 2010, 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.

**Table of Contents****Interest Rate Sensitivity Gap Analysis****March 31, 2010**

(In thousands)

	0-3 mo Balance	4-12 mo Balance	1-3 yr Balance	3+ yr Balance	Total Balance
Securities <sup>(1)</sup>	\$ 45,614	\$ 63,073	\$ 55,501	\$ 82,021	\$ 246,209
Total variable loans	4,219,740	20,117	14,240		4,254,097
Total fixed loans	317,629	184,754	215,421	91,532	809,336
Total loans <sup>(2)</sup>	4,537,369	204,871	229,661	91,532	5,063,433
Total interest sensitive assets	\$ 4,582,983	\$ 267,944	\$ 285,162	\$ 173,553	\$ 5,309,642
Liabilities:					
Interest bearing customer deposits	\$ 2,604,953	\$	\$	\$	\$ 2,604,953
CDs & IRAs	389,705	332,918	25,715	11,788	760,126
Wholesale deposits	50,644				50,644
Total interest bearing deposits	3,045,302	332,918	25,715	11,788	3,415,723
Repurchase agreements, Federal funds purchased, FHLB borrowings	450,961	1,000		100	452,061
Trust preferred subordinated debentures				113,406	113,406
Total borrowings	450,961	1,000		113,506	565,467
Total interest sensitive liabilities	\$ 3,496,263	\$ 333,918	\$ 25,715	\$ 125,294	\$ 3,981,190
GAP	1,086,720	(65,974)	259,447	48,259	
Cumulative GAP	1,086,720	1,020,746	1,280,193	1,328,452	1,328,452
Demand deposits					\$ 994,096
Stockholders equity					499,996
Total					\$ 1,494,092

(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, 2010 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

**Table of Contents**

meaningful. We will continue to evaluate these scenarios as interest rates change, until short-term rates rise above 3.0%.

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 Twelve Months as Compared to Most Likely Scenario 200 bp Increase March 31, 2010
Change in net interest income	\$ 17,442

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.

**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, 2010, 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.

**Table of Contents**

**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 2009 Form 10-K for the fiscal year ended December 31, 2009.

**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 22, 2010

/s/ Peter B. Bartholow  
Peter B. Bartholow  
Chief Financial Officer  
(Duly authorized officer and principal  
financial officer)  
34

---

**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.