

TEXAS CAPITAL BANCSHARES INC/TX

Form 10-Q

October 23, 2009

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**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 September 30, 2009**

**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 0-30533  
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 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 <input type="checkbox"/>	Accelerated Filer <input checked="" type="checkbox"/>	Non-Accelerated Filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller Reporting Company <input type="checkbox"/>
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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 October 21, 2009, 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	35,804,668
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Texas Capital Bancshares, Inc.  
Form 10-Q  
Quarter Ended September 30, 2009  
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**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 September 30		Nine months ended September 30	
	2009	2008	2009	2008
<b>Interest income</b>				
Interest and fees on loans	\$58,959	\$57,909	\$167,326	\$176,195
Securities	3,226	4,281	10,621	13,691
Federal funds sold	5	40	29	141
Deposits in other banks	7	10	40	30
Total interest income	62,197	62,240	178,016	190,057
<b>Interest expense</b>				
Deposits	8,916	18,338	29,264	56,777
Federal funds purchased	586	2,273	1,944	7,186
Repurchase agreements	14	86	42	462
Other borrowings	125	1,791	1,873	7,770
Trust preferred subordinated debentures	990	1,486	3,308	4,837
Total interest expense	10,631	23,974	36,431	77,032
<b>Net interest income</b>	51,566	38,266	141,585	113,025
<b>Provision for loan losses</b>	13,500	4,000	33,000	15,750
<b>Net interest income after provision for loan losses</b>	38,066	34,266	108,585	97,275
<b>Non-interest income</b>				
Service charges on deposit accounts	1,658	1,161	4,797	3,566
Trust fee income	1,000	1,234	2,836	3,656
Bank owned life insurance (BOLI) income	418	299	1,115	925
Brokered loan fees	2,120	1,024	6,822	2,168
Equipment rental income	1,291	1,487	4,200	4,513
Other	646	(320)	1,679	1,692
Total non-interest income	7,133	4,885	21,449	16,520
<b>Non-interest expense</b>				
Salaries and employee benefits	19,569	16,039	53,788	46,750
Net occupancy expense	3,164	2,300	9,305	7,097
Leased equipment depreciation	1,050	1,153	3,288	3,525
Marketing	705	521	1,915	1,847
Legal and professional	3,274	2,358	8,816	6,829
Communications and data processing	935	858	2,750	2,482
FDIC insurance assessment	1,452	432	6,492	1,154
Allowance and other carrying costs for OREO	2,390	239	3,968	668

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Other	4,528	3,775	12,424	10,856
Total non-interest expense	37,067	27,675	102,746	81,208
<b>Income from continuing operations before income taxes</b>	8,132	11,476	27,288	32,587
Income tax expense	2,779	3,911	9,328	11,192
<b>Income from continuing operations</b>	5,353	7,565	17,960	21,395
<b>Loss from discontinued operations (after-tax)</b>	(41)	(252)	(180)	(516)
<b>Net income</b>	5,312	7,313	17,780	20,879
Preferred stock dividends			5,383	
<b>Net income available to common stockholders</b>	\$ 5,312	\$ 7,313	\$ 12,397	\$ 20,879
<b>Basic earnings per common share:</b>				
Income from continuing operations	\$ .15	\$ .27	\$ .38	\$ .79
Net income	\$ .15	\$ .26	\$ .37	\$ .77
<b>Diluted earnings per common share:</b>				
Income from continuing operations	\$ .15	\$ .27	\$ .37	\$ .79
Net income	\$ .15	\$ .26	\$ .37	\$ .77

See accompanying notes to consolidated financial statements

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

(In thousands except per share data)

	September 30, 2009 (Unaudited)	December 31, 2008
<b>Assets</b>		
Cash and due from banks	\$ 60,365	\$ 77,887
Federal funds sold	240	4,140
Securities, available-for-sale	285,869	378,752
Loans held for sale	549,787	496,351
Loans held for sale from discontinued operations	589	648
Loans held for investment (net of unearned income)	4,290,453	4,027,871
Less: Allowance for loan losses	68,368	46,835
Loans held for investment, net	4,222,085	3,981,036
Premises and equipment, net	11,473	9,467
Accrued interest receivable and other assets	180,465	184,242
Goodwill and intangible assets, net	7,567	7,689
Total assets	\$5,318,440	\$5,140,212
<b>Liabilities and Stockholders Equity</b>		
Liabilities:		
Deposits:		
Non-interest bearing	\$ 802,692	\$ 587,161
Interest bearing	2,720,011	2,245,991
Interest bearing in foreign branches	393,865	500,035
Total deposits	3,916,568	3,333,187
Accrued interest payable	2,516	6,421
Other liabilities	21,714	19,518
Federal funds purchased	616,029	350,155
Repurchase agreements	65,422	77,732
Other short-term borrowings	108,741	812,720
Long-term borrowings		40,000
Trust preferred subordinated debentures	113,406	113,406
Total liabilities	4,844,396	4,753,139
Stockholders equity:		
Common stock, \$.01 par value:		
Authorized shares 100,000,000		
Issued shares 35,802,485 and 30,971,189 at September 30, 2009 and December 31, 2008, respectively	358	310
Additional paid-in capital	324,724	255,051

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Retained earnings	142,248	129,851
Treasury stock (shares at cost: 417 at September 30, 2009 and 84,691 at December 31, 2008)	(8)	(581)
Deferred compensation		573
Accumulated other comprehensive income, net of taxes	6,722	1,869
Total stockholders' equity	474,044	387,073
Total liabilities and stockholders' equity	\$5,318,440	\$5,140,212

See accompanying notes to consolidated financial statements.

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**TEXAS CAPITAL BANCSHARES, INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY UNAUDITED**  
(In thousands except share data)

	Preferred Stock		Common Stock		Additional	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income		Total
	Shares	Amount	Shares	Amount	Paid-in Capital		Shares	Amount	Deferred Compensation	(Loss), Net of Taxes	
Balance at December 31, 2007		\$	26,389,548	\$ 264	\$ 190,175	\$ 105,585	(84,691)	\$(581)	\$ 573	\$ (878)	\$ 295,138
Comprehensive income:											
Net income (unaudited)						20,879					20,879
Change in unrealized loss on available-for-sale securities, net of taxes of \$739 (unaudited)										1,373	1,373
Total comprehensive income (unaudited)											22,252
Tax benefit related to exercise of stock options (unaudited)						1,357					1,357
Stock-based compensation expense recognized in earnings (unaudited)						3,839					3,839
Issuance of stock related to stock-based awards (unaudited)			454,654	4	3,265						3,269
Issuance of common stock (unaudited)			4,000,000	40	54,963						55,003

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Balance at September 30, 2008 (unaudited)	\$	30,844,202	\$ 308	\$ 253,599	\$ 126,464	(84,691)	\$(581)	\$ 573	\$ 495	\$ 380,858
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)					17,780					17,780
Change in unrealized loss on available-for-sale securities, net of taxes of \$2,613 (unaudited)									4,853	4,853
Total comprehensive income (unaudited)										22,633
Tax expense related to exercise of stock options (unaudited)				182						182
Stock-based compensation expense recognized in earnings (unaudited)				4,394						4,394
Deferred compensation Issuance of stock related to stock-based awards (unaudited)		231,296	2	1,533		(84,274)	573	(573)		1,535
Issuance of common stock		4,600,000	46	59,400						59,446
Issuance of preferred stock and related warrant (unaudited)	75,000	70,836		4,164						75,000
Repurchase of preferred stock (unaudited)	(75,000)	(71,069)			(3,931)					(75,000)
		233			(1,452)					(1,219)

Preferred stock  
dividend and  
accretion of  
preferred stock  
discount  
(unaudited)

Balance at September 30, 2009 (unaudited)	\$	35,802,485	\$ 358	\$ 324,724	\$ 142,248	(417)	\$	(8)	\$	6,722	\$ 474,044
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See accompanying notes to consolidated financial statements.

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

(In thousands)

	Nine months ended September 30	
	2009	2008
<b>Operating activities</b>		
Net income from continuing operations	\$ 17,960	\$ 21,395
Adjustments to reconcile net income to net cash (used in) operating activities:		
Provision for loan losses	33,000	15,750
Depreciation and amortization	5,946	5,762
Amortization and accretion on securities	182	222
Bank owned life insurance (BOLI) income	(1,115)	(925)
Stock-based compensation expense	4,394	3,839
Tax benefit (expense) from stock option exercises	182	1,357
Excess tax benefits (expense) from stock-based compensation arrangements	(540)	(3,878)
Originations of loans held for sale	(12,556,388)	(5,125,817)
Proceeds from sales of loans held for sale	12,502,952	4,956,982
(Gain)/loss on sale of foreclosed assets	1,233	
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	(9,544)	(16,883)
Accrued interest payable and other liabilities	(4,321)	(4,977)
Net cash (used in) operating activities of continuing operations	(6,059)	(147,173)
Net cash (used in) operating activities of discontinued operations	(134)	(509)
Net cash (used in) operating activities	(6,193)	(147,682)
<b>Investing activities</b>		
Purchases of available-for-sale securities		(4,372)
Maturities and calls of available-for-sale securities	30,880	15,935
Principal payments received on available-for-sale securities	69,286	65,301
Net (increase) in loans held for investment	(274,036)	(385,058)
Purchase of premises and equipment, net	(4,059)	(1,709)
Proceeds from sale of foreclosed assets	9,432	
Net cash (used in) investing activities of continuing operations	(168,497)	(309,903)
<b>Financing activities</b>		
Net increase in deposits	583,381	322,586
Proceeds from issuance of stock related to stock-based awards	1,535	3,269
Proceeds from issuance of common stock	59,446	55,003
Proceeds from issuance of preferred stock and related warrants	75,000	
Repurchase of preferred stock	(75,000)	

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Dividends paid	(1,219)	
Net increase (decrease) in other borrowings	(756,289)	155,582
Excess tax benefits (expense) from stock-based compensation arrangements	540	3,878
Net increase (decrease) in federal funds purchased	265,874	(104,408)
Net cash provided by financing activities of continuing operations	153,268	435,910
Net (decrease) in cash and cash equivalents	(21,422)	(21,675)
Cash and cash equivalents at beginning of period	82,027	89,463
Cash and cash equivalents at end of period	\$ 60,605	\$ 67,788
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	\$ 39,545	\$ 77,154
Cash paid during the period for income taxes	10,739	18,319
Non-cash transactions:		
Transfers from loans/leases to OREO and other repossessed assets	22,444	3,120
See accompanying notes to consolidated financial statements.		

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**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 financial 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 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 accounting principles generally accepted in the United States for complete financial statements and should be read in conjunction with our consolidated financial statements, and notes thereto, for the year ended December 31, 2008, included in our Annual Report on Form 10-K filed with the SEC on February 19, 2009 (the 2008 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. We have evaluated subsequent events for potential recognition and/or disclosure through October 22, 2009, the date the consolidated financial statements were issued.

**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 nine months ended September 30, 2009 and 2008 is reported in the accompanying consolidated statements of changes in stockholders' equity. We had comprehensive income of \$7.3 million for the three months ended September 30, 2009 and comprehensive income of \$9.0 million for the three months ended September 30, 2008. Comprehensive income during the three months ended September 30, 2009 included a net after-tax gain of \$2.0 million, and comprehensive income during the three months ended September 30, 2008 included a net after-tax gain of \$1.7 million due to changes in the net unrealized gains/losses on securities available-for-sale.

**Table of Contents****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. Effective January 1, 2008, we adopted the reporting requirements of Accounting Standards Codification ( ASC ) Topic 820, *Fair Value Measurements and Disclosures* ( ASC 820 ). The adoption of ASC 820 did not have an impact on our financial statements except for the expanded disclosures noted in Note 10 Fair Value Disclosures.

**(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 September 30		Nine months ended September 30	
	2009	2008	2009	2008
Numerator:				
Net income from continuing operations	\$ 5,353	\$ 7,565	\$ 17,960	\$ 21,395
Preferred stock dividends			5,383	
Net income from continuing operations available to common shareholders	5,353	7,565	12,577	21,395
Loss from discontinued operations	(41)	(252)	(180)	(516)
Net income available to common shareholders	\$ 5,312	\$ 7,313	\$ 12,397	\$ 20,879
Denominator:				
Denominator for basic earnings per share-weighted average shares	35,753,731	27,725,573	33,528,076	26,968,720
Effect of employee stock options <sup>(1)</sup>	482,766	67,365	219,058	76,087
Effect of warrants to purchase common stock	67,478		22,740	
Denominator for dilutive earnings per share-adjusted weighted average shares and assumed conversions	36,303,975	27,792,938	33,769,874	27,044,807
Basic earnings per common share from continuing operations	\$ .15	\$ .27	\$ .38	\$ .79
Basic earnings per common share from discontinued operations	(.00)	(.01)	(.01)	(.02)
Basic earnings per common share	\$ .15	\$ .26	\$ .37	\$ .77

Diluted earnings per share from continuing operations	\$	.15	\$	.27	\$	.37	\$	.79
Diluted earnings per share from discontinued operations		(.00)		(.01)		(.00)		(.02)
Diluted earnings per common share	\$	.15	\$	.26	\$	.37	\$	.77

(1) Stock options and stock appreciation rights (SARs) outstanding of 1,477,002 at September 30, 2009 and 1,630,781 at September 30, 2008 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.



**Table of Contents****(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 \$2.9 million, which represented 0.77% of the amortized cost at December 31, 2008, to a gain of \$10.3 million, which represented 3.75% of the amortized cost at September 30, 2009.

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

		September 30, 2009		
	Amortized	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Gains	Losses	Value
Available-for-Sale Securities:				
U. S. Treasuries	\$	\$	\$	\$
Residential mortgage-backed securities	219,274	8,759	(24)	228,009
Corporate securities	5,000		(325)	4,675
Municipals	43,752	1,745		45,497
Equity securities <sup>(1)</sup>	7,506	182		7,688
	\$275,532	\$10,686	\$(349)	\$285,869

		December 31, 2008		
	Amortized	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Gains	Losses	Value
Available-for-Sale Securities:				
U. S. Treasuries	\$ 28,299	\$ 1	\$ (4)	\$ 28,296
Residential mortgage-backed securities	288,701	4,145	(1,130)	291,716
Corporate securities	5,000		(190)	4,810
Municipals	46,370	370	(209)	46,531
Equity securities <sup>(1)</sup>	7,506		(107)	7,399
	\$375,876	\$4,516	\$(1,640)	\$378,752

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



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

	At September 30, 2009				
	Less Than One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	Total
Available-for-sale:					
Residential mortgage-backed securities: <sup>(1)</sup>					
Amortized cost	17,429	47,802	73,788	80,255	219,274
Estimated fair value	17,841	49,112	77,768	83,288	228,009
Weighted average yield <sup>(3)</sup>	4.172%	4.368%	4.820%	4.603%	4.591%
Corporate securities:					
Amortized cost		5,000			5,000
Estimated fair value		4,675			4,675

(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.

Securities with carrying values of approximately \$216,848,000 were pledged to secure certain borrowings and deposits at September 30, 2009. Of the pledged securities at September 30, 2009, approximately \$141,287,000 were pledged for certain deposits, and approximately \$75,561,000 were pledged for repurchase agreements.

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The following table discloses, as of September 30, 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):

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Residential mortgage-backed securities	\$	\$	\$2,763	\$(24)	\$2,763	\$(24)
Corporate securities	4,675	(325)			4,675	(325)
	\$4,675	\$(325)	\$2,763	\$(24)	\$7,438	\$(349)

At September 30, 2009, the number of investment positions in this unrealized loss position totals 4. We do not believe these unrealized losses are other than temporary as (1) we have the ability and intent to hold the investments for a period of time sufficient to allow for a recovery in market value, 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 decreased in 2008 and 2009. We have not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities.

**Table of Contents****(4) LOANS AND ALLOWANCE FOR LOAN LOSSES**

At September 30, 2009 and December 31, 2008, loans were as follows (in thousands):

	September 30, 2009	December 31, 2008
Commercial	\$2,394,174	\$2,276,054
Construction	711,887	667,437
Real estate	1,085,221	988,784
Consumer	26,384	32,671
Leases	97,662	86,937
Gross loans held for investment	4,315,328	4,051,883
Deferred income (net of direct origination costs)	(24,875)	(24,012)
Allowance for loan losses	(68,368)	(46,835)
Total loans held for investment, net	\$4,222,085	\$3,981,036

We continue to lend primarily in Texas. As of September 30, 2009, 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. We originate substantially all of the loans in our portfolio, except in certain instances we have purchased selected loan participations and interests in certain syndicated credits and United States Department of Agriculture ( USDA ) government guaranteed loans. The risks created by this concentration have been considered by management in the determination of the adequacy of the allowance for loan losses. Management believes the allowance for loan losses is adequate to cover estimated losses on loans at each balance sheet date.

**Non-Performing Assets**

Non-performing loans and leases at September 30, 2009, December 31, 2008 and September 30, 2008 are summarized as follows (in thousands):

	September 30, 2009	December 31, 2008	September 30, 2008
Non-accrual loans: <sup>(1)</sup> <sup>(3)</sup>			
Commercial	\$ 34,165	\$ 15,676	\$ 1,525
Construction	35,216	22,362	23,349
Real estate	10,817	6,239	21,121
Consumer	151	296	119
Equipment leases	4,921	2,926	465
Total non-accrual loans	85,270	47,499	46,579
Other repossessed assets:			
Other real estate owned <sup>(3)</sup> <sup>(4)</sup>	34,671	25,904	5,792
Other repossessed assets	35	25	25
Total other repossessed assets	34,706	25,929	5,817

Total non-performing assets	\$ 119,976	\$ 73,428	\$ 52,396
Loans past due (90 days) <sup>(2)</sup>	\$ 7,569	\$ 4,115	\$ 2,970

(1) The accrual of interest on loans is discontinued 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.

(2) At September 30, 2009, \$2.6 million of the loans past

due 90 days and still accruing are premium finance loans. 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.

(3) At September 30, 2009, non-performing assets include \$3.1 million of mortgage warehouse loans that were transferred to our loans held for investment portfolio at lower of cost or market, and some subsequently moved to other real estate owned.

(4) At September 30, 2009, OREO balance is net of \$2.2 million valuation

allowance.



**Table of Contents****Allowance for Loan Losses**

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2009	2008	2009	2008
Balance at the beginning of the period	\$56,893	\$38,460	\$46,835	\$32,821
Provision for loan losses	13,500	4,000	33,000	15,750
Net charge-offs:				
Loans charged-off	2,082	1,541	11,605	8,408
Recoveries	57	79	138	835
Net charge-offs	2,025	1,462	11,467	7,573
Balance at the end of the period	\$68,368	\$40,998	\$68,368	\$40,998

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

Other real estate owned, which is included in other assets on the balance sheet, consists of real estate that has been foreclosed. Real estate that has been foreclosed is recorded at the lower of the amount of the loan balance or the fair value of the real estate, less selling costs prior to foreclosure, through a charge to the allowance for loan losses, if necessary. Subsequent write-downs required for declines in value are recorded through a valuation allowance and a provision for losses charged to other non-interest expense.

Activity in the valuation allowance for losses on OREO was as follows (in thousands):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2009	2008	2009	2008
Balance at the beginning of the period	\$	\$	\$	\$
Provision for losses on OREO	2,181		2,181	
Charge-offs				
Balance at the end of the period	\$2,181	\$	\$2,181	\$

**(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.

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.

**Table of Contents**September 30,  
2009

(In thousands)

Financial instruments whose contract amounts represent credit risk:

Commitments to extend credit

\$ 1,169,579

Standby letters of credit

66,840

**(7) REGULATORY MATTERS**

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of September 30, 2009, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

We participated in the U.S. Treasury Capital Purchase Program in the first quarter 2009 and issued \$75 million of Series A preferred stock and related warrants. In the second quarter 2009, we repurchased the preferred stock related to the Program and completed a public offering of 4.6 million shares of common stock in May 2009. The new capital from this offering qualifies as Tier 1 capital and increased our Tier 1 and total capital ratios. For additional information regarding the preferred stock and warrant and the common stock offering, see Note 11 to the consolidated financial statements.

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 adequately capitalized as of September 30, 2009 and 2008. 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.

September 30,  
2009                      2008

Risk-based capital:

Tier 1 capital

11.20%                      10.54%

Total capital

12.45%                      11.44%

Leverage

10.75%                      10.45%

**(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.

We recognized stock-based compensation expense of \$1.5 million and \$1.3 million for the three months ended September 30, 2009 and 2008, respectively, and \$4.4 million and \$3.8 million for the nine months ended September 30, 2009 and 2008, respectively. The amount for the three months ended September 30, 2009 is comprised of \$145,000 related to unvested options issued prior to the adoption of ASC Topic 718,

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*Compensation* *Stock Compensation* ( ASC 718 ), \$433,000 related to SARs issued in 2006, 2007, 2008, and 2009 and \$926,000 related to restricted stock units ( RSUs ) issued in 2006, 2007, 2008 and 2009. The amount for the nine months ended September 30, 2009 is comprised of \$492,000 related to unvested options issued prior to the adoption of ASC 718, \$1.2 million related to SARs issued in 2006, 2007, 2008 and 2009, and \$2.7 million related to RSUs issued in 2006, 2007, 2008 and 2009. Unrecognized stock-based compensation expense related to unvested options issued prior to adoption of ASC 718 is \$355,000. At September 30, 2009, the weighted average period over which this unrecognized expense is expected to be recognized was 0.9 years. Unrecognized stock-based compensation expense related to grants subsequent to 2005 is \$14.3 million. At September 30, 2009, the weighted average period over which this unrecognized expense is expected to be recognized was 2.0 years.

**(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 September 30, 2009 and 2008, the loss from discontinued operations was \$41,000 and \$252,000, net of taxes, respectively. For the nine months ended September 30, 2009 and 2008, the loss from discontinued operations was \$180,000 and \$516,000, net of taxes, respectively. The 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 \$589,000 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 September 30, 2009 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 ASC 820, which defines fair value, establishes a framework for measuring fair value 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 also includes impaired loans and OREO where collateral values have been based on third party appraisals and derivative assets and liabilities where values are based on internal cash flow models supported by market data inputs.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair



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values requires significant management judgment or estimation. This category generally 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 September 30, 2009 are as follows (in thousands):

	Fair Value Measurements Using		
	Level 1	Level 2	Level 3
Available for sale securities: <sup>(1)</sup>			
Treasuries	\$	\$	\$
Mortgage-backed securities		228,009	
Corporate securities		4,675	
Municipals		45,497	
Other		7,688	
Loans <sup>(2) (4)</sup>		158,591	5,719
OREO <sup>(3) (4)</sup>		34,671	
Derivative asset <sup>(5)</sup>		3,505	
Derivative liability <sup>(5)</sup>		(3,505)	

(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) Other real estate owned 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.
- (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* 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.

**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.



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

	September 30, 2009		December 31, 2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Cash and cash equivalents	\$ 60,365	\$ 60,365	\$ 82,027	\$ 82,027
Securities, available-for-sale	285,869	285,869	378,752	378,752
Loans held for sale	549,787	549,787	496,351	496,351
Loans held for sale from discontinued operations	589	589	648	648
Loans held for investment, net	4,222,085	4,236,299	3,981,036	3,998,208
Derivative asset	3,505	3,505	2,767	2,767
Deposits	3,916,568	3,917,858	3,333,187	3,337,887
Federal funds purchased	616,029	616,029	350,155	350,155
Borrowings	174,163	174,163	930,452	930,452
Trust preferred subordinated debentures	113,406	113,997	113,406	114,157
Derivative liability	3,505	3,505	2,767	2,767

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 other loans is estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying amount of accrued interest approximates its fair value. The carrying amount of loans held for sale approximates fair value.

*Derivatives*

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

*Deposits*

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

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

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

**Table of Contents***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 September 10, 2008, we completed a sale of 4 million shares of our common stock in a private placement to a number of institutional investors. The purchase price was \$14.50 per share, and net proceeds from the sale totaled \$55 million. The new capital has been used for general corporate purposes, including capital for support of anticipated growth of our bank.

On January 16, 2009, we completed the issuance of \$75 million of Series A perpetual preferred stock and related warrant under the U.S. Department of Treasury's voluntary Capital Purchase Program (CPP). The warrant represents the right to purchase 758,086 shares of our common stock at an initial exercise price of \$14.84 per share. The warrant was valued at \$4.2 million, which was calculated using a Black-Scholes option pricing model. The warrant valuation model required several inputs, including the risk free rate, and volatility factor. In addition to the Black-Scholes method we applied the Binomial Lattice Model and determined there was no material difference in value between the two methods. On May 8, 2009, we repurchased the \$75 million in preferred stock from the Treasury. We recorded a \$3.9 million accelerated deemed dividend representing the unamortized value of the outstanding warrants issued to the U.S. Department of Treasury to account for the difference between the book value and the carrying value of the preferred stock repurchased from the Treasury. The \$3.9 million accelerated deemed dividend, combined with the previously scheduled preferred dividend of \$523,000 resulted in a total dividend of \$4.4 million during the second quarter of 2009. We did not repurchase the warrants, so the Treasury has the option to sell the warrants in the open market to a third party.

On May 8, 2009, we completed a sale of 4.6 million shares of our common stock in a public offering. The purchase price was \$13.75 per share, and net proceeds from the sale totaled \$59.4 million. The new capital will be used for general corporate purposes, including capital for support of anticipated growth of our bank.

**(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.

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

Consolidated Daily Average Balances, Average Yields and Rates

(In thousands)

	For the three months ended September 30, 2009			For the three months ended September 30, 2008		
	Average Balance	Revenue/ Expense <sup>(1)</sup>	Yield/ Rate	Average Balance	Revenue/ Expense <sup>(1)</sup>	Yield/ Rate
<b>Assets</b>						
Securities taxable	\$ 247,936	\$ 2,813	4.50%	\$ 325,317	\$ 3,852	4.71%
Securities non-taxable <sup>(2)</sup>	44,642	635	5.64%	47,271	660	5.55%
Federal funds sold	6,782	5	0.29%	8,001	40	1.99%
Deposits in other banks	12,649	7	0.22%	2,554	10	1.56%
Loans held for sale from continuing operations	539,889	6,881	5.06%	288,103	4,137	5.71%
Loans	4,264,202	52,078	4.85%	3,781,289	53,772	5.66%
Less reserve for loan losses	56,429			38,180		
Loans, net of reserve	4,747,662	58,959	4.93%	4,031,212	57,909	5.71%
Total earning assets	5,059,671	62,419	4.89%	4,414,355	62,471	5.63%
Cash and other assets	245,564			201,589		
Total assets	\$ 5,305,235			\$ 4,615,944		
<b>Liabilities and Stockholders Equity</b>						
Transaction deposits	\$ 144,944	\$ 58	0.16%	\$ 103,905	\$ 122	0.47%
Savings deposits	1,377,712	3,090	0.89%	778,956	3,371	1.72%
Time deposits	1,284,220	4,245	1.31%	1,275,798	10,524	3.28%
Deposits in foreign branches	404,545	1,523	1.49%	720,211	4,321	2.39%
Total interest bearing deposits	3,211,421	8,916	1.10%	2,878,870	18,338	2.53%
Other borrowings	724,127	725	0.40%	709,157	4,150	2.33%
Trust preferred subordinated debentures	113,406	990	3.46%	113,406	1,486	5.21%
Total interest bearing liabilities	4,048,954	10,631	1.04%	3,701,433	23,974	2.58%
Demand deposits	764,557			567,914		
Other liabilities	15,617			16,452		
Stockholders equity	476,107			330,145		
	\$ 5,305,235			\$ 4,615,944		

Total liabilities and  
stockholders equity

Net interest income	\$ 51,788		\$ 38,497
Net interest margin		4.06%	3.47%
Net interest spread		3.85%	3.05%

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

(2) Taxable equivalent rates used where applicable.

Additional information from discontinued operations:

Loans held for sale	\$ 585		\$ 686
Borrowed funds	585		686
Net interest income		\$ 17	\$ 15
Net interest margin consolidated		4.06%	3.47%
		18	

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

Consolidated Daily Average Balances, Average Yields and Rates

(In thousands)

	For the nine months ended September 30, 2009			For the nine months ended September 30, 2008		
	Average Balance	Revenue/ Expense <sup>(1)</sup>	Yield/ Rate	Average Balance	Revenue/ Expense <sup>(1)</sup>	Yield/ Rate
<b>Assets</b>						
Securities taxable	\$ 283,099	\$ 9,368	4.42%	\$ 353,902	\$ 12,390	4.68%
Securities non-taxable <sup>(2)</sup>	45,527	1,927	5.66%	47,846	2,002	5.59%
Federal funds sold	9,088	29	0.43%	7,948	141	2.37%
Deposits in other banks	12,047	40	0.44%	1,639	30	2.44%
Loans held for sale from continuing operations	594,410	21,143	4.76%	235,460	10,401	5.90%
Loans	4,137,993	146,183	4.72%	3,621,410	165,794	6.12%
Less reserve for loan losses	51,608			34,972		
Loans, net of reserve	4,680,795	167,326	4.78%	3,821,898	176,195	6.16%
Total earning assets	5,030,556	178,690	4.75%	4,233,233	190,758	6.02%
Cash and other assets	245,442			202,706		
Total assets	\$ 5,275,998			\$ 4,435,939		
<b>Liabilities and Stockholders Equity</b>						
Transaction deposits	\$ 136,905	\$ 157	0.15%	\$ 107,932	\$ 396	.049%
Savings deposits	1,034,764	6,513	0.84%	803,269	12,052	2.00%
Time deposits	1,214,935	17,416	1.92%	979,084	26,744	3.65%
Deposits in foreign branches	414,302	5,178	1.67%	810,472	17,585	2.90%
Total interest bearing deposits	2,800,906	29,264	1.40%	2,700,757	56,777	2.81%
Other borrowings	1,163,209	3,859	0.44%	770,704	15,418	2.67%
Trust preferred subordinated debentures	113,406	3,308	3.90%	113,406	4,837	5.70%
Total interest bearing liabilities	4,077,521	36,431	1.19%	3,584,867	77,032	2.87%
Demand deposits	709,051			517,033		
Other liabilities	19,350			17,708		
Stockholders equity	470,076			316,331		
	\$ 5,275,998			\$ 4,435,939		

Total liabilities and  
stockholders equity

Net interest income	\$ 142,259		\$ 113,726
Net interest margin		3.78%	3.59%
Net interest spread		3.56%	3.15%

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

(2) Taxable equivalent rates used where applicable.

Additional information from discontinued operations:

Loans held for sale	\$ 604		\$ 716
Borrowed funds	604		716
Net interest income		\$ 45	\$ 40
Net interest margin consolidated			
		19	
		3.78%	3.59%

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**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
- (6) The loss of senior management or operating personnel and the potential inability to hire qualified personnel at reasonable compensation levels

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 \$5.4 million, or \$.15 per diluted common share, for the third quarter of 2009 compared to \$7.6 million, or \$.27 per diluted common share, for the third quarter of 2008. Return on average equity was 4.46% and return on average assets was .40% for the third quarter of 2009, compared to 9.12% and .65%, respectively, for the third quarter of 2008. Net income for the nine months ended September 30, 2009, totaled \$18.0 million compared to \$21.4 million for the same period in 2008. Net income available to common shareholders was \$12.6 million, or \$.37 per diluted common share, for the nine months ended September 30, 2009, compared to \$21.4 million, or \$.79 per diluted common share, for the same period in 2008. Return on average equity was 5.11% and return on average assets was .46% for the nine months ended September 30, 2009 compared to 9.03% and .64%, respectively, for the same period in 2008.

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Net income decreased \$2.2 million, or 29%, for the three months ended September 30, 2009, and decreased \$3.4 million, or 16%, respectively, for the nine months ended September 30, 2009 compared to the same period in 2008; and net income available to common shareholders for the nine months ended September 30, 2009 decreased \$8.8 million, or 41%, compared to the same period in 2008. The \$2.2 million decrease during the three months ended September 30, 2009 was primarily the result of a \$9.5 million increase in the provision for loan losses and a \$9.4 million increase in non-interest expense, offset by a \$13.3 million increase in net interest income, a \$2.2 million increase in non-interest income and a \$1.1 million decrease in income tax expense. The \$3.4 million decrease during the nine months ended September 30, 2009 was primarily the result of a \$17.2 million increase in the provision for loan losses and a \$21.5 million increase in non-interest expense, offset by a \$28.6 million increase in net interest income, a \$4.9 million increase in non-interest income and a \$1.9 million decrease 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 \$51.6 million for the third quarter of 2009, compared to \$38.3 million for the third quarter of 2008. The increase was due to an increase in average earning assets of \$645.3 million as compared to the third quarter of 2008. The increase in average earning assets included a \$482.9 million increase in average loans held for investment and an increase of \$251.8 million in loans held for sale, offset by an \$80.0 million decrease in average securities. For the quarter ended September 30, 2009, average net loans and securities represented 94% and 6%, respectively, of average earning assets compared to 91% and 9% in the same quarter of 2008.

Average non-interest bearing deposits increased from \$196.6 million for the third quarter of 2008 to \$764.6 million, and average stockholders' equity increased from \$330.1 million to \$476.1 million for the same periods. Average interest bearing liabilities increased \$347.5 million from the third quarter of 2008, which included a \$332.6 million increase in interest bearing deposits and a \$14.9 million increase in other borrowings. The significant increase in average other borrowings is a result of the combined effects of maturities of transaction-specific deposits and growth in loans during the third quarter of 2009. The average cost of interest bearing liabilities decreased from 2.58% for the quarter ended September 30, 2008 to 1.04% for the same period of 2009.

Net interest income was \$141.6 million for the nine months ended September 30, 2009, compared to \$113.0 million for the same period of 2008. The increase was due to an increase in average earning assets of \$797.3 million as compared to the third quarter of 2008. The increase in average earning assets included a \$516.6 million increase in average loans held for investment and an increase of \$359.0 million in loans held for sale, offset by a \$73.1 million decrease in average securities. For the nine months ended September 30, 2009, average net loans and securities represented 93% and 7%, respectively, of average earning assets compared to 90% and 10% in the same period of 2008.

Average non-interest bearing deposits increased from \$517.0 million for the first nine months of 2008 to \$709.1 million, and average stockholders' equity increased from \$316.3 million to \$470.1 million for the same periods. Average interest bearing liabilities increased \$492.7 million compared to the first nine months of 2008, which included a \$100.1 million increase in interest bearing deposits and a \$392.5 million increase in other borrowings. The significant increase in average other borrowings is a result of the combined effects of maturities of transaction-specific deposits and growth in loans during the first nine months of 2009. The average cost of interest bearing liabilities decreased from 2.87% for the nine months ended September 30, 2008 to 1.19% for the same period of 2009.



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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 September 30, 2009/2008			Nine months ended September 30, 2009/2008		
	Change	Change Due To <sup>(1)</sup>		Change	Change Due To <sup>(1)</sup>	
		Volume	Yield/Rate		Volume	Yield/Rate
Interest income:						
Securities <sup>(2)</sup>	\$ (1,064)	\$ (943)	\$ (121)	\$ (3,097)	\$ (2,586)	\$ (511)
Loans held for sale	2,744	3,641	(897)	10,742	15,827	(5,085)
Loans held for investment	(1,694)	6,336	(8,030)	(19,611)	23,814	(43,425)
Federal funds sold	(35)	(6)	(29)	(112)	20	(132)
Deposits in other banks	(3)	40	(43)	10	190	(180)
Total	(52)	9,068	(9,120)	(12,068)	37,265	(49,333)
Interest expense:						
Transaction deposits	(64)	47	(111)	(239)	106	(345)
Savings deposits	(281)	2,509	(2,790)	(5,539)	3,478	(9,017)
Time deposits	(6,279)	70	(6,349)	(9,328)	6,454	(15,782)
Deposits in foreign branches	(2,798)	(1,891)	(907)	(12,407)	(8,599)	(3,808)
Borrowed funds	(3,921)	88	(4,009)	(13,088)	7,854	(20,942)
Total	(13,343)	823	(14,166)	(40,601)	9,293	(49,894)
Net interest income	\$ 13,291	\$ 8,245	\$ 5,046	\$ 28,533	\$27,972	\$ 561

(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 4.06% for the third quarter of 2009 compared to 3.47% for the third quarter of 2008. This 59 basis points increase in margin was a result of a steep decline in the costs of interest bearing liabilities and growth

in non-interest bearing deposits and stockholders' equity. Total cost of funding decreased from 2.07% for the third quarter of 2008 compared to .80% for the third quarter 2009. The benefit of the reduction in funding costs was partially offset by a 74 basis point decline in yields on earning assets.

#### Non-interest Income

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

	Three months ended September 30		Nine months ended September 30	
	2009	2008	2009	2008
Service charges on deposit accounts	\$1,658	\$1,161	\$ 4,797	\$ 3,566
Trust fee income	1,000	1,234	2,836	3,656
Bank owned life insurance (BOLI) income	418	299	1,115	925
Brokered loan fees	2,120	1,024	6,822	2,168
Equipment rental income	1,291	1,487	4,200	4,513
Other	646	(320)	1,679	1,692
Total non-interest income	\$7,133	\$4,885	\$21,449	\$16,520

Non-interest income increased \$2.2 million compared to the same quarter of 2008. The increase is primarily related to a \$1.1 million increase in brokered loan fees due to an increase in mortgage warehouse volume. Service charges increased \$497,000 due to lower earnings credit rates and some increases in fees. These increases were offset by a \$234,000 decrease in trust fee income, which is due to the overall lower market values of trust assets. Included in the third quarter of 2008, we had a \$1.0 million charge associated with customer fraud on certain mortgage loans recorded in other non-interest income.

Non-interest income increased \$4.9 million during the nine months ended September 30, 2009 to \$21.4 million compared to \$16.5 million during the same period of 2008. The increase is primarily related to a \$4.6 million

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increase in brokered loan fees due to an increase in mortgage warehouse volume. Service charges increased \$1.2 million due to lower earnings credit rates and some increases in fees. These increases were offset by an \$820,000 decrease in trust fee income, which is due to the overall lower market values of trust assets.

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		Nine months ended	
	September 30		September 30	
	2009	2008	2009	2008
Salaries and employee benefits	\$19,569	\$16,039	\$ 53,788	\$46,750
Net occupancy expense	3,164	2,300	9,305	7,097
Leased equipment depreciation	1,050	1,153	3,288	3,525
Marketing	705	521	1,915	1,847
Legal and professional	3,274	2,358	8,816	6,829
Communications and data processing	935	858	2,750	2,482
FDIC insurance assessment	1,452	432	6,492	1,154
Allowance and other carrying costs for OREO	2,390	239	3,968	668
Other	4,528	3,775	12,424	10,856
Total non-interest expense	\$37,067	\$27,675	\$102,746	\$81,208

Non-interest expense for the third quarter of 2009 increased \$9.4 million, or 34%, to \$37.1 million from \$27.7 million. Salaries and employee benefits increased \$3.6 million to \$19.6 million from \$16.0 million, which was primarily due to general business growth.

Occupancy expense for the three months ended September 30, 2009 increased \$864,000, or 38%, compared to the same quarter in 2008 related to general business growth.

Legal and professional expense for the three months ended September 30, 2009 increased \$916,000, or 39%, compared to the same quarter in 2008 mainly related to business growth and continued regulatory and compliance costs. Regulatory and compliance costs continue to be a factor in our expense growth, and we anticipate that they will continue to increase.

FDIC insurance assessment expense for the third quarter of 2009 increased \$1.0 million compared to the same period in 2008 due to the rate increase effective for the first quarter 2009. The FDIC assessment rates will continue to increase and will continue to be a factor in our expense growth.

Valuation allowance for foreclosed assets and other carrying costs expense increased \$2.2 million for the three months ended September 30, 2009, related to establishing a valuation allowance of \$2.2 million in 2009.

Non-interest expense for the first nine months of 2009 increased \$21.5 million, or 26%, to \$102.7 million from \$81.2 million. Salaries and employee benefits increased \$7.0 million to \$53.8 million from \$46.8 million, which was primarily due to general business growth.

Occupancy expense for the nine months ended September 30, 2009 increased \$2.2 million, or 31%, compared to the same quarter in 2008 related to general business growth.

Legal and professional expense for the nine months ended September 30, 2009 increased \$1.9 million, or 28%, compared to the same quarter in 2008 mainly related to business growth and continued regulatory and compliance costs. Regulatory and compliance costs continue to be a factor in our expense growth, and we anticipate that they will

continue to increase.

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FDIC insurance assessment expense for the nine months ended September 30, 2009 increased \$5.3 million compared to the same period in 2008 due to the rate increase effective for the first quarter 2009 and the special assessment in the second quarter of 2009. The FDIC assessment rates will continue to increase and will continue to be a factor in our expense growth.

Valuation allowance for foreclosed assets and other carrying costs expense increased \$3.3 million for the nine months ended September 30, 2009, primarily related to establishing a valuation allowance of \$2.2 million in the third quarter of 2009.

**Analysis of Financial Condition**

The aggregate loan portfolio at September 30, 2009 increased \$294.5 million from December 31, 2008 to \$4.8 billion. Commercial loans, construction loans, real estate loans, leases and loans held for sale increased \$118.1 million, \$44.5 million, \$96.4 million, \$10.7 million and \$53.4 million, respectively. Consumer loans decreased \$6.3 million. We anticipate that overall loan growth during the remainder of 2009 will be down from 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):

	September 30, 2009	December 31, 2008
Commercial	\$2,394,174	\$2,276,054
Construction	711,887	667,437
Real estate	1,085,221	988,784
Consumer	26,384	32,671
Leases	97,662	86,937
Gross loans held for investment	4,315,328	4,051,883
Deferred income (net of direct origination costs)	(24,875)	(24,012)
Allowance for loan losses	(68,368)	(46,835)
Total loans held for investment, net	4,222,085	3,981,036
Loans held for sale	549,787	496,351
Total	\$4,771,872	\$4,477,387

We continue to lend primarily in Texas. As of September 30, 2009, a substantial majority of the principal amount of the loans 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. We originate substantially all of the loans in our portfolio, except in certain instances we have purchased selected loan participations and interests in certain syndicated credits and USDA government guaranteed loans. The risks created by this concentration have been considered by management in the determination of the adequacy of the allowance for loan losses. Management believes the allowance for loan losses is adequate to cover estimated losses on loans at each balance sheet date.

**Summary of Loan Loss Experience**

During the third quarter of 2009, we recorded net charge-offs in the amount of \$2.0 million, compared to net charge-offs of \$1.5 million for the same period in 2008. For the first nine months of 2009, the ratio of net charge-offs to loans held for investment was .37% compared to .28% for the same period in 2008. The reserve for loan losses, which is available to absorb losses inherent in the loan portfolio, totaled \$68.4 million at September 30, 2009, \$46.8 million at December 31, 2008 and \$41.0 million at September 30, 2008. This represents 1.59%, 1.16% and 1.07% of loans held for investment (net of unearned income) at September 30, 2009, December 31, 2008 and September 30, 2008, respectively.

The provision for loan 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 \$13.5 million provision for loan losses during the third quarter of 2009 compared to \$4.0 million in the third quarter of 2008 and \$11.0 million in the second quarter of 2009.

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The reserve for loan losses is comprised of specific reserves for impaired loans and an estimate of losses inherent in the portfolio at the balance sheet date, but not yet identified with specified loans. We regularly evaluate our reserve for loan losses to maintain an adequate level to absorb estimated loan losses inherent in the loan portfolio. Factors contributing to the determination of reserves include the credit worthiness of the borrower, changes in the value of pledged collateral, and general economic conditions. All loan commitments rated substandard or worse and greater than \$500,000 are specifically reviewed for 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 greater than \$50,000. 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 that portion of the required reserve assigned to unfunded loan commitments. 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, and historical loss rates at selected peer banks, adjusted for certain qualitative factors. Qualitative adjustments for such things as general economic conditions, changes in credit policies and lending standards, and changes in the trend and severity of problem loans, can cause the estimation of future 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.

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

	Nine months ended September 30, 2009	Nine months ended September 30, 2008	Year ended December 31, 2008
Beginning balance	\$ 46,835	\$ 32,821	\$ 32,821
Loans charged-off:			
Commercial	1,902	6,843	7,395
Real estate construction	2,457	671	1,866
Real estate term	2,725	736	4,168
Consumer	499	129	193
Leases	4,022	29	12
Total charge-offs	11,605	8,408	13,634
Recoveries:			
Commercial	90	716	759
Real estate construction	7		
Real estate term		27	47
Consumer	21	13	13
Leases	20	79	79
Total recoveries	138	835	898
Net charge-offs	11,467	7,573	12,736
Provision for loan losses	33,000	15,750	26,750
Ending balance	\$ 68,368	\$ 40,998	\$ 46,835
Reserve to loans held for investment <sup>(2)</sup>	1.59%	1.07%	1.16%
Net charge-offs to average loans <sup>(1)(2)</sup>	.37%	.28%	.35%
Provision for loan losses to average loans <sup>(1)(2)</sup>	1.07%	.58%	.73%
Recoveries to total charge-offs	1.19%	9.93%	6.59%
Reserve as a multiple of net charge-offs	6.0x	5.4x	3.7x
Non-performing assets (NPAs): <sup>(4)</sup>			
Non-accrual	\$ 85,270	\$ 46,579	\$ 47,499
Other real estate owned (OREO) <sup>(5)P</sup>	34,671	5,792	25,904
Total	\$ 119,941	\$ 52,371	\$ 73,403
Non-accrual loans to loans <sup>(2)</sup>	1.99%	1.21%	1.18%
Total NPAs to loans plus OREO <sup>(2)</sup>	2.77%	1.36%	1.81%
Reserve to non-accrual loans <sup>(2)</sup>	.8x	.9x	1.0x



Loans past due 90 days and still accruing <sup>(3)</sup>	\$ 7,569	\$ 2,970	\$ 4,115
Loans past due 90 days to loans <sup>(2)</sup>	.18%	.08%	.10%

(1) Interim period ratios are annualized.

(2) Excludes loans held for sale.

(3) At September 30, 2009, \$2.6 million of the loans past due 90 days and still accruing are premium finance loans. 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 up to 180 days or longer from the cancellation date.

(4) At September 30, 2009, non-performing assets include \$3.1 million of mortgage warehouse loans which were transferred to

the loans held  
for investment  
portfolio at  
lower of cost or  
market, and  
some were  
subsequently  
moved to other  
real estate  
owned.

- (5) At  
September 30,  
2009, OREO  
balance is net of  
\$2.2 million  
valuation  
allowance.

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

	September 30, 2009	September 30, 2008	December 31, 2008
Non-accrual loans:			
Commercial	\$ 34,165	\$ 1,525	\$ 15,676
Construction	35,216	23,349	22,362
Real estate	10,817	21,121	6,239
Consumer	151	119	296
Leases	4,921	465	2,926
Total non-accrual loans	\$ 85,270	\$ 46,579	\$ 47,499

At September 30, 2009, our total non-accrual loans were \$85.3 million. Of these, \$34.2 million were characterized as commercial loans. This included a \$9.8 million residential line of credit secured by single family residences and the borrower's notes receivable, a \$6.6 million lender finance loan secured by the borrower's material assets, a \$5.7 million residence rehabilitation loan secured by single family residences, a \$4.3 million manufacturing loan secured by the assets of the borrower, 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 \$1.3 million in auto dealer loans secured by the borrower's accounts receivable and inventory. Non-accrual loans also included \$35.2 million characterized as construction loans. This included a \$20.0 million commercial real estate loan secured by condominiums, a \$5.0 million commercial real estate loan secured by unimproved land, a \$3.8 million commercial real estate loan secured by retail property, \$1.6 million in commercial real estate loans secured by single family residences, \$1.5 million in residential real estate loans secured by single family residences, \$1.0 million real estate investment loan secured by unimproved lots and \$1.0 million in commercial real estate loans secured by single family residences. Non-accrual loans also included \$10.8 million characterized as real estate loans, \$7.1 of which relates to a real estate loan secured by an apartment building. Also included in this category is \$2.7 million in single family mortgages that were originated in our mortgage warehouse operation. Each of these loans were reviewed for impairment and specific reserves were allocated as necessary and included in the allowance for loan losses as of September 30, 2009 to cover any probable loss. Substantially all of the non-accrual loans as of September 30, 2009 were to businesses and individuals in Texas and are secured by properties located in Texas.

At September 30, 2009, OREO totaled \$34.7 million, net of a \$2.2 million valuation allowance. This included an unimproved commercial real estate lot valued at \$7.5 million, partially developed residential real estate lots and undeveloped land valued at \$7.1 million, partially developed residential real estate lots and undeveloped land valued at \$5.8 million, commercial real estate property consisting of single family residences and developed lots valued at \$3.6 million, an unimproved commercial real estate lot valued at \$2.9 million, an office building valued at \$2.6 million, a commercial real estate lot valued at \$1.6 million, commercial real estate property consisting of single family residences and a mix of lots at various levels of completion valued at \$1.6 million and fully developed residential lots valued at \$1.2 million.

At September 30, 2009, we had \$7.6 million in loans past due 90 days and still accruing interest. At September 30, 2009, \$2.6 million of the loans past due 90 days and still accruing are premium finance loans. 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 up to 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 September 30, 2009, 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 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.

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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 September 30, 2009 and December 31, 2008, we had \$78.9 million and \$22.5 million in loans of this type which were not included in either non-accrual or 90 days past due categories.

**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, 2008 and for the nine months ended September 30, 2009, our principal source of funding has been our customer deposits, supplemented by our short-term and long-term borrowings, primarily from securities sold under repurchase agreements and federal funds purchased from our downstream correspondent bank relationships (which consist of banks that are considered to be smaller than our bank) Federal Home Loan Bank ( FHLB ) borrowings and Fed 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, which as of September 30, 2009, comprised \$3,421.6 million, or 87.4%, of total deposits. On an average basis, for the quarter ended September 30, 2009, deposits from core customers comprised \$3,369.7 million, or 84.8%, of total quarterly average deposits. 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, 90 to 180 days or less, and are used to supplement temporary differences in the growth in loans, including growth in specific categories of loans, compared to customer deposits. As of September 30, 2009, brokered retail CDs comprised \$495.0 million, or 12.6%, of total deposits. On an average basis, for the quarter ended September 30, 2009, brokered retail CDs comprised \$606.3 million, or 15.2%, of total quarterly average deposits. We believe the Company has access to sources of brokered deposits of not less than an additional \$2.8 billion.

Additionally, we have borrowing sources available to supplement deposits and meet our funding needs. 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 Fed. The following table summarizes our borrowings (in thousands):

	September 30, 2009
Federal funds purchased	\$ 616,029
Customer repurchase agreements	65,422
Treasury, tax and loan notes	2,741
FHLB borrowings	100,000
TLGP borrowings	6,000
Trust preferred subordinated debentures	113,406
Total borrowings	\$ 903,598

Maximum outstanding at any month end during the year \$ 1,866,587

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The following table summarizes our other borrowing capacities in excess of balances outstanding at September 30, 2009 (in thousands):

FHLB borrowing capacity relating to loans	\$ 1,732,375
FHLB borrowing capacity relating to securities	59,182
Total FHLB borrowing capacity	\$ 1,791,557

Unused federal funds lines available from commercial banks	\$ 719,400
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In connection with the FDIC's Temporary Liability Guarantee Program ( TLGP ), we have 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. We may issue any notes prior to October 31, 2009 with maturities no later than December 31, 2012. As of September 30, 2009, \$6.0 million of these notes was outstanding.

Our equity capital averaged \$470.1 million for the nine months ended September 30, 2009 as compared to \$316.3 million for the same period in 2008. This increase reflects our retention of net earnings during this period and the proceeds of sales of our common stock. 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 September 10, 2008, we completed a sale of 4 million shares of our common stock in a private placement to a number of institutional investors. The purchase price was \$14.50 per share, and net proceeds from the sale totaled \$55 million. On May 8, 2009, we completed a sale of 4.6 million shares of our common stock in a public offering. The purchase price was \$13.75 per share, and net proceeds from the sale totaled \$59.4 million. The new capital from these offerings is being used for general corporate purposes, including capital for support of anticipated growth of our bank.

On January 16, 2009, we completed the issuance of \$75 million of Series A perpetual preferred stock and related warrant under the U.S. Department of Treasury's voluntary Capital Purchase Program ( CPP ). The preferred stock was repurchased in May 2009. In connection with the repurchase, we recorded a \$3.9 million accelerated deemed dividend in the second quarter of 2009 representing the unamortized value of the outstanding warrants issued to the U.S.

Department of Treasury to account for the difference between the book value and the carrying value of the preferred stock repurchased from the Treasury. The \$3.9 million accelerated deemed dividend, combined with the previously scheduled preferred dividend of \$523,000 resulted in a total dividend and reduction of earnings available to common stock of \$4.4 million during the second quarter of 2009.

Our Bank capital ratios remain above the levels required to be well capitalized and our consolidated capital ratios have been enhanced with \$114.4 million from the two common stock transactions discussed above and will allow us to grow organically with the addition of loan and deposit relationships.

**Table of Contents****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 September 30, 2009, 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)	\$ 2,314,741	\$	\$	\$	\$ 2,314,741
Time deposits (1)	1,567,289	27,561	6,878	99	1,601,827
Federal funds purchased (1)	616,029				616,029
Customer repurchase agreements (1)	65,422				65,422
Treasury, tax and loan notes (1)	2,741				2,741
FHLB borrowings (1)	100,000				100,000
TLGP borrowings (1)	6,000				6,000
Operating lease obligations (1) (2)	7,168	12,948	12,116	40,276	72,508
Trust preferred subordinated debentures (1)				113,406	113,406
Total contractual obligations	\$ 4,679,390	\$ 40,509	\$ 18,994	\$ 153,781	\$ 4,892,674

(1) Excludes interest.

(2) Non-balance sheet item.

**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 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.

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**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 September 30, 2009, 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****September 30, 2009**

(In thousands)

	0-3 mo Balance	4-12 mo Balance	1-3 yr Balance	3+ yr Balance	Total Balance
Securities <sup>(1)</sup>	\$ 51,630	\$ 75,854	\$ 70,361	\$ 88,024	\$ 285,869
Total variable loans	4,131,421	15,428			4,146,849
Total fixed loans	235,694	175,919	229,953	77,289	718,855
Total loans <sup>(2)</sup>	4,367,115	191,347	229,953	77,289	4,865,704
Total interest sensitive assets	\$ 4,418,745	\$ 267,201	\$ 300,314	\$ 165,313	\$ 5,151,573
Liabilities:					
Interest bearing customer deposits	\$ 1,905,914	\$	\$	\$	\$ 1,905,914
CDs & IRAs	395,107	283,493	27,560	6,978	713,138
Wholesale deposits	489,911	4,913			494,824
Total interest bearing deposits	2,790,932	288,406	27,560	6,978	3,113,876
Repurchase agreements, Federal funds purchased, FHLB borrowings	781,451	8,741			790,192
Trust preferred subordinated debentures				113,406	113,406
Total borrowings	781,451	8,741		113,406	903,598
Total interest sensitive liabilities	\$ 3,572,383	\$ 297,147	\$ 27,560	\$ 120,384	\$ 4,017,474
GAP	846,362	(29,946)	272,754	44,929	
Cumulative GAP	846,362	816,416	1,089,170	1,134,099	1,134,099
Demand deposits					\$ 802,692
Stockholders equity					474,044
Total					\$ 1,276,736

(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 September 30, 2009 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 2008, we could not assume interest rate decreases of any amount as the results of the decreasing rates scenario would not be meaningful. We will continue to evaluate these scenarios as interest rates change, until short-term rates rise above 3.0%.

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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  
September 30, 2009

Change in net interest income	\$ 15,980
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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 September 30, 2009, 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.

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**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 2008 Form 10-K for the fiscal year ended December 31, 2008.

**ITEM 6. 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.

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**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: October 22, 2009

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

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