TEXAS CAPITAL BANCSHARES INC/TX
Form 10-Q
July 22, 2010

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

þ **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the quarterly period ended June 30, 2010

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

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

Delaware	**75-2679109**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
2000 McKinney Avenue, Suite 700, Dallas, Texas, U.S.A.	**75201**
(Address of principal executive officers)	(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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). o Yes o 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 o Accelerated Filer þ Non-Accelerated Filer o (Do not check if a smaller reporting company) Non-Accelerated Filer o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

On July 21, 2010, the number of shares set forth below was outstanding with respect to each of the issuer s classes of common stock:

Common Stock, par value $0.01 per share 36,776,836

Texas Capital Bancshares, Inc.
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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 June 30		Six months ended June 30	
	2010	2009	2010	2009
Interest income				
Interest and fees on loans	$ 64,935	$ 56,455	$ 126,504	$ 108,367
Securities	2,491	3,544	5,217	7,395
Federal funds sold	40	9	42	24
Deposits in other banks	6	5	15	33
Total interest income	67,472	60,013	131,778	115,819
Interest expense				
Deposits	8,420	8,769	16,178	20,348
Federal funds purchased	244	740	609	1,358
Repurchase agreements	2	14	6	28
Other borrowings	1	570	48	1,748
Trust preferred subordinated debentures	920	1,118	1,824	2,318
Total interest expense	9,587	11,211	18,665	25,800
Net interest income	57,885	48,802	113,113	90,019
Provision for credit losses	14,500	11,000	28,000	19,500
Net interest income after provision for credit losses	43,385	37,802	85,113	70,519
Non-interest income				
Service charges on deposit accounts	1,539	1,614	3,022	3,139
Trust fee income	980	952	1,934	1,836
Bank owned life insurance (BOLI) income	481	423	952	697
Brokered loan fees	2,221	2,670	4,125	4,702
Equipment rental income	1,196	1,453	2,540	2,909
Other	1,619	304	2,411	1,033
Total non-interest income	8,036	7,416	14,984	14,316
Non-interest expense				
Salaries and employee benefits	21,393	18,000	41,462	34,219
Net occupancy expense	3,032	3,387	6,046	6,141
Leased equipment depreciation	1,035	1,115	2,094	2,238
Marketing	1,101	655	1,888	1,210
Legal and professional	3,298	3,291	5,248	5,542
Communications and data processing	911	979	1,927	1,815
FDIC insurance assessment	2,241	3,493	4,109	5,040
Allowance and other carrying costs for OREO	808	378	3,100	1,578
Other	5,299	4,075	10,430	7,896

Total non-interest expense	39,118	35,373	76,304	65,679
Income from continuing operations before income taxes	12,303	9,845	23,793	19,156
Income tax expense	4,187	3,363	8,077	6,549
Income from continuing operations	8,116	6,482	15,716	12,607
Loss from discontinued operations (after-tax)	(54)	(44)	(109)	(139)
Net income	8,062	6,438	15,607	12,468
Preferred stock dividends		4,453		5,383
Net income available to common stockholders	$ 8,062	$ 1,985	$ 15,607	$ 7,085
Basic earnings per common share:				
Income from continuing operations	$ .22	$ .06	$ .43	$ .22
Net income	$ .22	$ .06	$ .43	$ .22
Diluted earnings per common share:				
Income from continuing operations	$ .22	$ .06	$ .42	$ .22
Net income	$ .22	$ .06	$ .42	$ .22

See accompanying notes to consolidated financial statements.

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TEXAS CAPITAL BANCSHARES, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands except per share data)

	June 30, 2010 (Unaudited)	December 31, 2009
Assets		
Cash and due from banks	$ 93,159	$ 80,459
Federal funds sold	27,990	44,980
Securities, available-for-sale	227,029	266,128
Loans held for sale	997,150	693,504
Loans held for sale from discontinued operations	582	586
Loans held for investment (net of unearned income)	4,462,830	4,457,293
Less: Allowance for loan losses	74,881	67,931
Loans held for investment, net	4,387,949	4,389,362
Premises and equipment, net	11,065	11,189
Accrued interest receivable and other assets	207,486	202,890
Goodwill and intangible assets, net	9,644	9,806
Total assets	$ 5,962,054	$ 5,698,904
Liabilities and Stockholders Equity		
Liabilities:		
Deposits:		
Non-interest bearing	$ 1,120,664	$ 899,492
Interest bearing	3,394,648	2,837,163
Interest bearing in foreign branches	410,757	384,070
Total deposits	4,926,069	4,120,725
Accrued interest payable	2,503	2,468
Other liabilities	29,352	23,916
Federal funds purchased	309,722	580,519
Repurchase agreements	13,812	25,070
Other borrowings	53,112	351,440
Trust preferred subordinated debentures	113,406	113,406
Total liabilities	5,447,976	5,217,544
Stockholders equity:		
Preferred stock, $.01 par value, $1,000 liquidation value		
Authorized shares 10,000,000		
Issued shares		
Common stock, $.01 par value:		
Authorized shares 100,000,000		
	368	359

Issued shares 36,777,253 and 35,919,941 at June 30, 2010 and December 31, 2009, respectively		
Additional paid-in capital	342,724	326,224
Retained earnings	164,227	148,620
Treasury stock (shares at cost: 417 at June 30, 2010 and December 31, 2009)	(8)	(8)
Accumulated other comprehensive income, net of taxes	6,767	6,165
Total stockholders equity	514,078	481,360
Total liabilities and stockholders equity	$ 5,962,054	$ 5,698,904

See accompanying notes to consolidated financial statements.

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

	Preferred Stock		Common Stock				Treasury Stock				
					Additional Paid-in				Deferred	Accumulated Other Comprehensive Income, Net of	
	Shares	Amount	Shares	Amount	Capital	Retained Earnings	Shares	Amount	Compensation	Taxes	Total
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)						12,468					12,468
Change in unrealized gain on available-for-sale securities, net of taxes of $1,553 (unaudited)										2,885	2,885
Total comprehensive income (unaudited)											15,353
Tax expense related to exercise of stock options (unaudited)					(129)						(129)
Stock-based compensation expense recognized in earnings (unaudited)					2,889						2,889
Deferred compensation (unaudited)							84,274	573	(573)		
Issuance of stock related to stock-based			117,472	1	612						613

awards (unaudited)											
Issuance of common stock (unaudited)			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)
Preferred stock dividend and accretion of preferred stock discount (unaudited)		233				(1,452)					(1,219)
Balance at June 30, 2009 (unaudited)		$	35,688,661	$ 357	$ 321,987	$ 136,936	(417)	$ (8)	$	$ 4,754	$ 464,026
Balance at December 31, 2009		$	35,919,941	$ 359	$ 326,224	$ 148,620	(417)	$ (8)	$	$ 6,165	$ 481,360
Comprehensive income:											
Net income (unaudited)						15,607					15,607
Change in unrealized gain on available-for-sale securities, net of taxes of $324 (unaudited)										602	602
Total comprehensive income (unaudited)											16,209
Tax expense related to exercise of stock options (unaudited)					286						286
Stock-based compensation expense					3,166						3,166

recognized in earnings (unaudited)										
Issuance of stock related to stock-based awards (unaudited)		125,077	2	596						598
Issuance of common stock (unaudited)		732,235	7	12,452						12,459
Balance at June 30, 2010 (unaudited)	$	36,777,253	$ 368	$ 342,724	$ 164,227	(417)	$ (8)	$	$ 6,767	$ 514,078

See accompanying notes to consolidated financial statements.

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TEXAS CAPITAL BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED
(In thousands)

	Six months ended June 30	
	2010	2009
Operating activities		
Net income from continuing operations	$ 15,716	$ 12,607
Adjustments to reconcile net income to net cash (used in) operating activities:		
Provision for credit losses	28,000	19,500
Depreciation and amortization	3,796	4,087
Amortization and accretion on securities	75	128
Bank owned life insurance (BOLI) income	(952)	(697)
Stock-based compensation expense	3,166	2,889
Tax benefit from stock option exercises	286	(129)
Excess tax benefits from stock-based compensation arrangements	816	369
Originations of loans held for sale	(7,572,908)	(8,990,736)
Proceeds from sales of loans held for sale	7,269,262	8,942,435
Loss on sale of assets	32	
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	(7,766)	(14,675)
Accrued interest payable and other liabilities	6,375	(3,700)
Net cash (used in) operating activities of continuing operations	(254,102)	(27,922)
Net cash (used in) operating activities of discontinued operations	(105)	(82)
Net cash (used in) operating activities	(254,207)	(28,004)
Investing activities		
Maturities and calls of available-for-sale securities	3,650	28,500
Principal payments received on available-for-sale securities	36,301	46,375
Net (increase) in loans held for investment	(27,725)	(192,862)
Purchase of premises and equipment, net	(1,507)	(3,389)
Proceeds from sale of foreclosed assets	1,996	
Net cash provided by (used in) investing activities of continuing operations	12,715	(121,376)
Financing activities		
Net increase in deposits	805,344	310,395
Proceeds from issuance of stock related to stock-based awards	598	60,059
Proceeds from issuance of preferred stock and related warrants		75,000
Proceeds from issuance of common stock	12,459	
Repurchase of preferred stock		(75,000)
Dividends paid		(1,219)
Net decrease in other borrowings	(309,586)	(503,825)
Excess tax benefits from stock-based compensation arrangements	(816)	(369)
Net increase (decrease) in federal funds purchased	(270,797)	282,790
Net cash provided by financing activities of continuing operations	237,202	147,831

Net decrease in cash and cash equivalents		(4,290)		(1,549)
Cash and cash equivalents at beginning of period		125,439		82,027
Cash and cash equivalents at end of period	$	121,149	$	80,478
Supplemental disclosures of cash flow information:				
Cash paid during the period for interest	$	18,630	$	28,530
Cash paid during the period for income taxes		12,767		10,700
Non-cash transactions:				
Transfers from loans/leases to OREO and other repossessed assets		19,358		5,501

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

Basis of Presentation

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

The consolidated interim financial statements have been prepared without audit. Certain information and footnote disclosures presented in accordance with accounting principles generally accepted in the United States have been condensed or omitted. In the opinion of management, the interim financial statements include all normal and recurring adjustments and the disclosures made are adequate to make interim financial information not misleading. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (SEC). Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with our consolidated financial statements, and notes thereto, for the year ended December 31, 2009, included in our Annual Report on Form 10-K filed with the SEC on February 18, 2010 (the 2009 Form 10-K). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

Use of Estimates

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

Accumulated Other Comprehensive Income, 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 six months ended June 30, 2010 and 2009 is reported in the accompanying consolidated statements of changes in stockholders equity.

Fair Values of Financial Instruments

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

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(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 June 30		Six months ended June 30	
	2010	2009	2010	2009
Numerator:				
Net income from continuing operations	$ 8,116	$ 6,482	$ 15,716	$ 12,607
Preferred stock dividends		4,453		5,383
Net income from continuing operations available to common shareholders	8,116	2,029	15,716	7,224
Loss from discontinued operations	(54)	(44)	(109)	(139)
Net income available to common shareholders	$ 8,062	$ 1,985	$ 15,607	$ 7,085
Denominator:				
Denominator for basic earnings per share-weighted average shares	36,669,518	33,784,178	36,431,766	32,396,804
Effect of employee stock options [1]	658,541	82,059	584,649	85,018
Effect of warrants to purchase common stock	158,726		120,779	
Denominator for dilutive earnings per share-adjusted weighted average shares and assumed conversions	37,486,785	33,866,237	37,137,194	32,481,822
Basic earnings per common share from continuing operations	$ .22	$ .06	$ .43	$ .22
Basic earnings per common share from discontinued operations				
Basic earnings per common share	$ .22	$ .06	$ .43	$ .22
Diluted earnings per share from continuing operations	$ .22	$ .06	$ .42	$ .22
Diluted earnings per share from discontinued operations				
Diluted earnings per common share	$ .22	$ .06	$ .42	$ .22

(1) Stock options outstanding of 1,235,969 at

June 30, 2010 and 1,966,330 at June 30, 2009 have not been included in diluted earnings per share because to do so would have been anti-dilutive for the periods presented. Stock options and SARs are anti-dilutive when the exercise price is higher than the average market price of our common stock.

(3) SECURITIES

Securities are identified as either held-to-maturity or available-for-sale based upon various factors, including asset/liability management strategies, liquidity and profitability objectives, and regulatory requirements. Held-to-maturity securities are carried at cost, adjusted for amortization of premiums or accretion of discounts. Available-for-sale securities are securities that may be sold prior to maturity based upon asset/liability management decisions. Securities identified as available-for-sale are carried at fair value. Unrealized gains or losses on available-for-sale securities are recorded as accumulated other comprehensive income (loss) in stockholders equity, net of taxes. Amortization of premiums or accretion of discounts on mortgage-backed securities is periodically adjusted for estimated prepayments. Realized gains and losses and declines in value judged to be other-than-temporary are included in gain (loss) on sale of securities. The cost of securities sold is based on the specific identification method.

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Our net unrealized gain on the available-for-sale securities portfolio value increased from a gain of $9.5 million, which represented 3.70% of the amortized cost at December 31, 2009, to a gain of $10.4 million, which represented 4.81% of the amortized cost at June 30, 2010.
The following is a summary of securities (in thousands):

	June 30, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Securities:				
Residential mortgage-backed securities	$ 165,472	$ 8,579	$ (4)	$ 174,047
Corporate securities	5,000			5,000
Municipals	38,640	1,581		40,221
Equity securities [(1)]	7,506	255		7,761
	$ 216,618	$ 10,415	$ (4)	$ 227,029

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

(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 June 30, 2010				
	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: (1)					
Amortized cost	$ 18,212	$ 22,087	$ 59,314	$65,859	$165,472
Estimated fair value	18,350	22,679	63,391	69,627	174,047
Weighted average yield (3)	4.349%	4.374%	4.800%	4.221%	4.463%
Corporate securities:					
Amortized cost	5,000				5,000
Estimated fair value	5,000				5,000
Weighted average yield (3)	7.375%				7.375%
Municipals: (2)					
Amortized cost	2,702	21,441	14,497		38,640
Estimated fair value	2,735	22,417	15,069		40,221
Weighted average yield (3)	4.798%	5.408%	5.746%		5.493%
Equity securities:					
Amortized cost	7,506				7,506
Estimated fair value	7,761				7,761
Total available-for-sale securities:					
Amortized cost					$ 216,618
Estimated fair value					$ 227,029

(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 $152.3 million were pledged to secure certain borrowings and deposits at June 30, 2010. Of the pledged securities at June 30, 2010, approximately $122.0 million were pledged for certain deposits, and approximately $30.3 million were pledged for repurchase agreements.

The following table discloses, as of June 30, 2010 and June 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):

June 30, 2010

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed securities	$	$	$ 2,247	$ (4)	$ 2,247	$ (4)
Corporate securities						
	$	$	$ 2,247	$ (4)	$ 2,247	$ (4)

December 31, 2009

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed securities	$ 452	$ (1)	$ 2,553	$ (28)	$ 3,005	$ (29)
Corporate securities			4,683	(317)	4,683	(317)
Municipals	1,018	(2)			1,018	(2)
	$ 1,470	$ (3)	$ 7,236	$ (345)	$ 8,706	$ (348)

At June 30, 2010, the number of investment positions in this unrealized loss position totals 1. We do not believe these unrealized losses are other than temporary as (1) we do not have the intent to sell any of the securities in the table above, and (2) it is not probable that we will be unable to collect the amounts contractually due. The unrealized losses noted are interest rate related, and losses have decreased as rates have decreased in 2009 and remained low during 2010. We have not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities.

(4) LOANS AND ALLOWANCE FOR LOAN LOSSES

At June 30, 2010 and December 31, 2009, loans were as follows (in thousands):

	June 30, 2010	December 31, 2009
Commercial	$ 2,426,940	$ 2,457,533
Construction	395,266	669,426
Real estate	1,556,985	1,233,701
Consumer	16,107	25,065
Leases	94,567	99,129
Gross loans held for investment	4,489,865	4,484,854
Deferred income (net of direct origination costs)	(27,035)	(27,561)
Allowance for loan losses	(74,881)	(67,931)
Total loans held for investment, net	4,387,949	4,389,362
Loans held for sale	997,150	693,504
Total	$ 5,385,099	$ 5,082,866

We continue to lend primarily in Texas. As of June 30, 2010, a substantial majority of the principal amount of the loans held for investment in our portfolio was to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions within this area. The risks created by this concentration have been considered by management in the determination of the adequacy of the allowance for loan losses. Management believes the allowance for loan losses is adequate to cover estimated losses on loans at each balance sheet date.

Allowance for Loan Losses

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

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Balance at the beginning of the period	$ 71,705	$ 50,145	$ 67,931	$ 45,365
Provision for loan losses	15,729	10,975	28,783	18,363
Net charge-offs:				
Loans charged-off	12,660	6,887	21,991	9,523
Recoveries	107	53	158	81
Net charge-offs	12,553	6,834	21,833	9,442
Balance at the end of the period	$ 74,881	$ 54,286	$ 74,881	$ 54,286

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

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Balance at the beginning of the period	$ 3,394	$ 2,582	$ 2,948	$ 1,470
Provision (benefit) for off-balance sheet credit losses	(1,229)	25	(783)	1,137
Balance at the end of the period	$ 2,165	$ 2,607	$ 2,165	$ 2,607

Reserves on impaired loans were $18.8 million at June 30, 2010.

(5) OREO AND VALUATION ALLOWANCE FOR LOSSES ON OREO

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

	Six months ended June 30,	
	2010	2009
Beginning balance	$ 27,264	$ 25,904
Additions	19,358	14,883
Sales	(2,040)	(9,383)
Valuation allowance for OREO	(2,394)	
Direct write-downs	(111)	
Ending balance	$ 42,077	$ 31,404

(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, and obligations to extend credit are subject to borrowers adherence to credit agreements. Failure to comply with certain conditions of the credit agreement may eliminate our requirement to fund committed amounts.

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.

June 30, 2010

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

Commitments to extend credit	$ 1,261,194
Standby letters of credit	64,583

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(7) REGULATORY MATTERS

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of June 30, 2010, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

Financial institutions are categorized as well capitalized or adequately capitalized, based on minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the tables below. As shown below, the Company s capital ratios exceed the regulatory definition of well capitalized as of June 30, 2010 and 2009. As of June 30, 2009, the most recent notification from the OCC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There have been no conditions or events since the notification that management believes have changed the Bank s category. Based upon the information in its most recently filed call report, the Bank continues to meet the capital ratios necessary to be well capitalized under the regulatory framework for prompt corrective action.

	June 30,	
	2010	2009
Risk-based capital:		
Tier 1 capital	11.00%	11.20%
Total capital	12.26%	12.33%
Leverage	10.69%	10.56%

(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.

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

(in thousands)	Three months ended June 30 2010	Three months ended June 30 2009	Six months ended June 30 2010	Six months ended June 30 2009
Stock- based compensation expense recognized:				
Unvested options	$ 60	$ 168	$ 170	$ 348
SARs	498	413	976	808
RSUs	1,037	884	2,020	1,735
Total compensation expense recognized	$ 1,595	$ 1,465	$ 3,166	$ 2,891

	June 30, 2010 Options	June 30, 2010 SARs and RSUs
Unrecognized compensation expense related to unvested awards	$ 49	$ 13,163
Weighted average period over which expense is expected to be recognized, in years	.50	1.88

(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 June 30, 2010 and June 30, 2009, the loss from discontinued operations was $54,000 and $44,000, net of taxes, respectively. For the six months ended June 30, 2010 and 2009, the loss from discontinued operations was $109,000 and $139,000, respectively. The 2010 and 2009 losses are primarily related to continuing legal and salary expenses incurred in dealing with the remaining loans and requests from investors related to the repurchase of previously sold loans. We still have approximately $582,000 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 June 30, 2010 include a liability for exposure to additional contingencies, including risk of having to repurchase loans previously sold, we recognize that market conditions may result in additional exposure to loss and the extension of time necessary to complete the discontinued mortgage operation.

(10) FAIR VALUE DISCLOSURES

Effective January 1, 2008, we adopted Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures* (ASC 820), which defines fair value, establishes a framework for measuring fair value under GAAP and enhances disclosures about fair value measurements. Fair value is defined under ASC 820 as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal market for the asset or liability in an orderly transaction between market participants on the measurement date. The adoption of ASC 820 did not have an impact on our financial statements except for the expanded disclosures noted below.

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

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

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or

can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets include U.S. government and agency mortgage-backed debt securities, corporate securities, municipal bonds, and Community Reinvestment Act funds. This category includes derivative assets and liabilities where values are based on internal cash flow models supported by market data inputs.

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

Assets and liabilities measured at fair value at June 30, 2010 are as follows (in thousands):

	Fair Value Measurements Using		
	Level 1	Level 2	Level 3
Available for sale securities: [1]			
Mortgage-backed securities	$	$ 174,047	$
Corporate securities		5,000	
Municipals		40,221	
Other		7,761	
Loans [2] [4]			69,226
OREO [3] [4]			42,077
Derivative asset [5]		8,400	
Derivative liability [5]		(8,400)	

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

(2) Includes certain mortgage loans that have been transferred to loans held for investment from loans held for sale at the lower of cost or market. Also, includes

impaired loans that have been measured for impairment at the fair value of the loan s collateral.

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

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

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

Level 3 Valuations

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

Loans During the three months ended June 30, 2010, certain impaired loans were remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for possible loan losses based upon the fair value of the underlying collateral. The $69.2 million total above includes impaired loans at June 30, 2010 with a carrying value of $72.1 million that were reduced by specific valuation allowance allocations totaling $8.7 million for a total reported fair value of $63.4 million based on collateral valuations utilizing Level 3 valuation inputs. Fair values were based on third party appraisals; however, based on the current economic conditions, comparative sales data typically used in the appraisals may be unavailable or more subjective due to the lack of real estate market activity. Also included in this total are $6.8 million in mortgage warehouse loans that were reduced by specific valuation allowance allocations totaling $1.0 million, for a total reported fair value of $5.8 million. Certain mortgage loans that are transferred from loans held for sale to loans held for investment are valued based on third party broker pricing. As

the dollar amount and number of loans being valued is very small, a comprehensive market analysis is not obtained or considered necessary. Instead, we conduct a general polling of one or more mortgage brokers for indications of general market prices for the types of mortgage valued based on third party broker pricing. As the dollar amount and number of loans being valued is very small, a comprehensive market analysis is not obtained or considered necessary. Instead, we conduct a general polling of one or more mortgage brokers for indications of general market prices for the types of mortgage

loans being valued, and we consider values based on recent experience in selling loans of like terms and comparable quality.

OREO Certain foreclosed assets, upon initial recognition, were valued based on third party appraisals. At June 30, 2010, OREO with a carrying value of $51.0 million was reduced by specific valuation allowance allocations totaling $8.9 million for a total reported fair value of $42.1 million based on valuations utilizing Level 3 valuation inputs. Fair values were based on third party appraisals; however, based on the current economic conditions, comparative sales data typically used in the appraisals may be unavailable or more subjective due to the lack of real estate market activity.

Fair Value of Financial Instruments

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

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

	June 30, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Cash and cash equivalents	$ 121,149	$ 121,149	$ 125,439	$ 125,439
Securities, available-for-sale	227,029	227,029	266,128	266,128
Loans held for sale	997,150	997,150	693,504	693,504
Loans held for sale from discontinued operations	582	582	586	586
Loans held for investment, net	4,387,949	4,400,861	4,389,362	4,542,572
Derivative asset	8,400	8,400	1,837	1,837
Deposits	4,926,069	4,926,103	4,120,725	4,121,993
Federal funds purchased	309,722	309,722	580,519	580,519
Borrowings	66,924	66,928	376,510	376,510
Trust preferred subordinated debentures	113,406	113,588	113,406	113,876
Derivative liability	8,400	8,400	1,837	1,837

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

Cash and cash equivalents

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

Securities

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

Loans, net

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

Derivatives

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

Deposits

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

Federal funds purchased, other borrowings and trust preferred subordinated debentures

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

Off-balance sheet instruments

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

(11) STOCKHOLDERS EQUITY

On January 27, 2010, we announced that we entered into an Equity Distribution Agreement with Morgan Stanley & Co. Incorporated, pursuant to which we may, from time to time, offer and sell shares of our common stock, having aggregate gross sales proceeds of up to $40,000,000. Sales of the shares are being made by means of brokers transactions on or through the NASDAQ Global Select Market at market prices prevailing at the time of the sale or as otherwise agreed to by the Company and Morgan Stanley. As of June 30, 2010, we have sold 732,235 shares at an average price of $17.58. Net proceeds of $12.5 million are being used for general corporate purposes.

We had comprehensive income of $8.5 million for the three months ended June 30, 2010 and comprehensive income of $6.1 million for the three months ended June 30, 2009. Comprehensive income during the three months ended June 30, 2010 included a net after-tax gain of $417,000, and comprehensive income during the three months ended June 30, 2009 included a net after-tax loss of $352,000 due to changes in the net unrealized gains/losses on securities available-for-sale.

(12) NEW ACCOUNTING PRONOUNCEMENTS

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

FASB ASC 810 Consolidation (ASC 810) became effective for us on January 1, 2010, and was amended to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. The new authoritative accounting guidance requires additional disclosures about the reporting entity s involvement with

variable-interest entities and any significant changes in risk exposure due to that involvement as well as its affect on the entity s financial statements. The new authoritative accounting guidance under ASC 810 was effective January 1, 2010 and did not have a significant impact on our financial statements.

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

FASB ASC 310 Receivables, Sub-Topic 310-30 Loans and Debt Securities Acquired with Deteriorated Credit Quality (Subtopic 310-30) was amended to clarify that modifications of loans that are accounted for within a pool under Subtopic 310-30 do not result in the removal of those loans from the pool even if the modification would otherwise be considered a troubled debt restructuring. The amendments do not affect the accounting for loans under the scope of Subtopic 310-30 that are not accounted for within pools. Loans accounted for individually under Subtopic 310-30 continue to be subject to the troubled debt restructuring accounting provisions within *ASC 310 Subtopic 310-40 Troubled Debt Restructurings by Creditors*. The new authoritative accounting guidance under Subtopic 310-30 will be effective in the third quarter of 2010. We do not expect this amendment to have a significant impact on our financial statements.

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QUARTERLY FINANCIAL SUMMARY UNAUDITED
Consolidated Daily Average Balances, Average Yields and Rates
(In thousands)

	For the three months ended June 30, 2010			For the three months ended June 30, 2009		
	Average Balance	Revenue/ Expense[1]	Yield/ Rate	Average Balance	Revenue/ Expense[1]	Yield/ Rate
Assets						
Securities taxable	$ 193,542	$ 2,126	4.41%	$ 280,372	$ 3,124	4.47%
Securities non-taxable[2]	39,635	562	5.69%	45,901	646	5.64%
Federal funds sold	91,564	40	0.18%	5,649	9	0.64%
Deposits in other banks	12,449	6	0.19%	12,268	5	0.16%
Loans held for sale from continuing operations	664,474	8,244	4.98%	656,462	7,727	4.72%
Loans	4,459,790	56,691	5.10%	4,124,937	48,728	4.74%
Less reserve for loan losses	71,536			51,601		
Loans, net of reserve	5,052,728	64,935	5.15%	4,729,798	56,455	4.79%
Total earning assets	5,389,918	67,669	5.04%	5,073,988	60,239	4.76%
Cash and other assets	261,668			251,960		
Total assets	$ 5,651,586			$ 5,325,948		
Liabilities and Stockholders Equity						
Transaction deposits	$ 484,900	$ 389	0.32%	$ 135,756	$ 55	0.16%
Savings deposits	2,054,199	4,047	0.79%	974,275	2,003	0.82%
Time deposits	832,973	2,808	1.35%	1,082,691	5,105	1.89%
Deposits in foreign branches	380,361	1,176	1.24%	394,251	1,606	1.63%
Total interest bearing deposits	3,752,433	8,420	0.90%	2,586,973	8,769	1.36%
Other borrowings	222,427	247	0.45%	1,404,881	1,324	0.38%
Trust preferred subordinated debentures	113,406	920	3.25%	113,406	1,118	3.95%
Total interest bearing liabilities	4,088,266	9,587	0.94%	4,105,260	11,211	1.10%
Demand deposits	1,024,292			724,487		
Other liabilities	24,693			18,899		
Stockholders equity	514,335			477,302		
Total liabilities and stockholders equity	$ 5,651,586			$ 5,325,948		

Net interest income	$ 58,082	$ 49,028
Net interest margin	4.32%	3.88%
Net interest spread	4.10%	3.66%

(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	$ 583			$ 582		
Borrowed funds	583			582		
Net interest income		$ 12			$ 14	
Net interest margin consolidated			4.32%			3.88%

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QUARTERLY FINANCIAL SUMMARY UNAUDITED
Consolidated Daily Average Balances, Average Yields and Rates
(In thousands)

	For the six months ended June 30, 2010			For the six months ended June 30, 2009		
	Average Balance	Revenue/ Expense[1]	Yield/ Rate	Average Balance	Revenue/ Expense[1]	Yield/ Rate
Assets						
Securities taxable	$ 202,530	$ 4,467	4.45%	$ 300,973	$ 6,555	4.39%
Securities non-taxable[2]	40,639	1,154	5.73%	45,978	1,292	5.67%
Federal funds sold	49,750	42	0.17%	10,260	24	0.47%
Deposits in other banks	12,453	15	0.24%	11,740	33	0.57%
Loans held for sale from continuing operations	561,538	13,734	4.93%	622,122	14,214	4.61%
Loans	4,437,001	112,770	5.13%	4,073,842	94,153	4.66%
Less reserve for loan losses	69,144			49,157		
Loans, net of reserve	4,929,395	126,504	5.18%	4,646,807	108,367	4.70%
Total earning assets	5,234,767	132,182	5.09%	5,015,758	116,271	4.67%
Cash and other assets	286,262			245,379		
Total assets	$ 5,521,029			$ 5,261,137		
Liabilities and Stockholders Equity						
Transaction deposits	$ 425,383	$ 653	0.31%	$ 132,819	$ 99	0.15%
Savings deposits	1,914,476	7,571	0.80%	860,447	3,423	0.80%
Time deposits	836,875	5,595	1.35%	1,179,719	13,171	2.25%
Deposits in foreign branches	367,155	2,359	1.30%	419,261	3,655	1.76%
Total interest bearing deposits	3,543,889	16,178	0.92%	2,592,246	20,348	1.58%
Other borrowings	341,292	663	0.39%	1,386,389	3,134	0.46%
Trust preferred subordinated debentures	113,406	1,824	3.24%	113,406	2,318	4.12%
Total interest bearing liabilities	3,998,587	18,665	0.94%	4,092,041	25,800	1.27%
Demand deposits	990,513			680,838		
Other liabilities	26,658			21,247		
Stockholders equity	505,271			467,011		
Total liabilities and stockholders equity	$ 5,521,029			$ 5,261,137		

Net interest income	$ 113,517	$ 90,471
Net interest margin	4.37%	3.64%
Net interest spread	4.15%	3.40%

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

(4) Taxable equivalent rates used where applicable.

Additional information from discontinued operations:

Loans held for sale	$ 584			$ 614		
Borrowed funds	584			614		
Net interest income		$ 25			$ 28	
Net interest margin consolidated			4.37%			3.64%

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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 and differences in assumptions utilized by banking regulators which could have retroactive impact

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

(7) Changes in government regulations including changes as a result of the current economic crisis

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

Results of Operations

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

Summary of Performance

We reported net income of $8.1 million for the second quarter of 2010 compared to $6.5 million for the second quarter of 2009. We reported net income available to common shareholders of $8.1 million, or $.22 per diluted common share, for the second quarter of 2010 compared to $2.0 million, or $.06 per diluted common share, for the second quarter of 2009. Return on average equity was 6.33% and return on average assets was .58% for the second quarter of 2010, compared to 5.45% and .49%, respectively, for the second quarter of 2009. Net income for the six months ended June 30, 2010, totaled $15.7 million compared to $12.6 million for the same period in 2009. Net income available to common shareholders was $15.7 million, or $.42 per diluted common share, for the six months ended June 30, 2010, compared to $7.2 million, or $.22 per diluted common share,

for the same period in 2009. Return on average equity was 6.27% and return on average assets was .57% for the six months ended June 30, 2010 compared to 5.44% and .48%, respectively, for the same period in 2009.

Net income increased $1.6 million, or 25%, for the three months ended June 30, 2010, and net income available to common shareholders increased $6.1 million, or 300%, for the three months ended June 30, 2010 compared to the same period in 2009; and increased $3.1 million, or 25%, and increased $8.5 million, or 118%, respectively, for the six months ended June 30, 2010 compared to the same period in 2009. The $1.6 million increase during the three months ended June 30, 2010 was primarily the result of a $9.1 million increase in net interest income and $620,000 increase in non-interest income, offset by a $3.5 million increase in the provision for credit losses, a $3.7 million increase in non-interest expense and an $824,000 increase in income tax expense. The $3.1 million increase during the six months ended June 30, 2010 was primarily the result of a $23.1 million increase in net interest income and a $668,000 increase in non-interest income, offset by an $8.5 million increase in the provision for credit losses, a $10.6 million increase in non-interest income and a $1.5 million increase in income tax expense.

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

Net Interest Income

Net interest income was $57.9 million for the second quarter of 2010, compared to $48.8 million for the second quarter of 2009. The increase was due to an increase in average earning assets of $315.9 million as compared to the second quarter of 2009 and an increase in the net interest margin from 3.88% to 4.32%. The increase in average earning assets included a $334.9 million increase in average loans held for investment and an $8.0 million increase in loans held for sale, offset by a $93.1 million decrease in average securities. For the quarter ended June 30, 2010, average net loans and securities represented 95% and 4%, respectively, of average earning assets compared to 94% and 6% in the same quarter of 2009.

Average interest bearing liabilities decreased $17.0 million from the second quarter of 2010, which included a $1.17 billion increase in interest bearing deposits offset by a $1.18 billion decrease in other borrowings. The significant decrease in average other borrowings is a result of the growth in demand and interest bearing deposits, reducing the need for borrowed funds. The average cost of interest bearing deposits and borrowed funds decreased from 1.01% for the quarter ended June 30, 2009 to .87% for the same period of 2010.

Net interest income was $113.1 million for the six months ended of 2010, compared to $90.0 million for the same period of 2009. The increase was due to an increase in average earning assets of $219.0 million as compared to June 30, 2009 and an increase in the net interest margin from $3.64% to 4.37%. The increase in average earning assets included a $363.2 million increase in average loans held for investment, offset by a decrease of $60.6 million in loans held for sale and a $103.8 million decrease in average securities. For the six months ended June 30, 2010, average net loans and securities represented 95% and 5%, respectively, of average earning assets compared to 93% and 7% in the same quarter of 2009.

Average interest bearing liabilities decreased $93.5 million compared to the first six months of 2009, which included a $951.6 million increase in interest bearing deposits offset by a $1.0 billion decrease in other borrowings. The significant decrease in average other borrowings is a result of the growth in demand and interest bearing deposits and the reduction in average balances of loans held for sale, reducing the need for borrowed funds. The average cost of interest bearing deposits and borrower funds decreased from 1.19% for the six months ended June 30, 2009 to .87% for the same period of 2010.

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

	Three months ended June 30, 2010/2009			Six months ended June 30, 2010/2009		
		Change Due To [1]			Change Due To [1]	
	Change	Volume	Yield/Rate	Change	Volume	Yield/Rate
Interest income:						
Securities[2]	$ (1,082)	$ (1,062)	$ (20)	$ (2,226)	$ (2,294)	$ 68
Loans held for sale	517	94	423	(480)	(1,386)	906
Loans held for investment	7,963	3,956	4,007	18,617	8,393	10,224
Federal funds sold	31	137	(106)	18	92	(74)
Deposits in other banks	1		1	(18)	2	(20)
Total	7,430	3,125	4,305	15,911	4,807	11,104
Interest expense:						
Transaction deposits	334	141	193	554	218	336
Savings deposits	2,044	2,220	(176)	4,148	4,193	(45)
Time deposits	(2,297)	(1,177)	(1,120)	(7,576)	(3,828)	(3,748)
Deposits in foreign branches	(430)	(57)	(373)	(1,296)	(454)	(842)
Borrowed funds	(1,275)	(1,114)	(161)	(2,965)	(2,363)	(602)
Total	(1,624)	13	(1,637)	(7,135)	(2,234)	(4,901)
Net interest income	$ 9,054	$ 3,112	$ 5,942	$ 23,046	$ 7,041	$ 16,005

(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 4.32% for the second quarter of 2010 compared to 3.88% for the second quarter of 2009. This 44 basis point increase was a result of a steep decline in the costs of interest bearing liabilities and growth in non-interest bearing deposits and stockholders equity, as well as improved pricing on loans. Total cost of funding, including demand deposits and stockholders equity decreased from 0.84% for the second quarter of 2009 to .68% for the second quarter of 2010. The benefit of the reduction in funding costs was complimented by a 28 basis point

increase in yields on earning assets.

Non-interest Income

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

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Service charges on deposit accounts	$ 1,539	$ 1,614	$ 3,022	$ 3,139
Trust fee income	980	952	1,934	1,836
Bank owned life insurance (BOLI) income	481	423	952	697
Brokered loan fees	2,221	2,670	4,125	4,702
Equipment rental income	1,196	1,453	2,540	2,909
Other	1,619	304	2,411	1,033
Total non-interest income	$ 8,036	$ 7,416	$ 14,984	$ 14,316

Non-interest income increased $620,000 during the three months ended June 30, 2010 to $8.0 million compared to $7.4 million during the same period of 2009 primarily related to a $1.3 million increase in other non-interest income due to gains on sale of leased equipment. Offsetting this increase was a $449,000 decrease in brokered loan fees related to a decline in volume, and a $257,000 decrease in equipment rental income related to a decline in the leased equipment portfolio.

Non-interest income increased $668,000 during the six months ended June 30, 2010 to $15.0 million compared to $14.3 million during the same period of 2009 primarily related to a $1.4 million increase in other non-interest income due to gains on sale of leased equipment. Offsetting this increase was a $577,000 decrease

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in brokered loan fees related to a decline in volume, and a $369,000 decrease in equipment rental income related to a decline in the leased equipment portfolio.

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

Non-interest Expense

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

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Salaries and employee benefits	$ 21,393	$ 18,000	$ 41,462	$ 34,219
Net occupancy expense	3,032	3,387	6,046	6,141
Leased equipment depreciation	1,035	1,115	2,094	2,238
Marketing	1,101	655	1,888	1,210
Legal and professional	3,298	3,291	5,248	5,542
Communications and data processing	911	979	1,927	1,815
FDIC insurance assessment	2,241	3,493	4,109	5,040
Allowance and other carrying costs for OREO	808	378	3,100	1,578
Other	5,299	4,075	10,430	7,896
Total non-interest expense	$ 39,118	$ 35,373	$ 76,304	$ 65,679

Non-interest expense for the second quarter of 2010 increased $3.7 million, or 10%, to $39.1 million from $35.4 million in the second quarter of 2009. The increase is primarily attributable to a $3.4 million increase in salaries and employee benefits to $21.4 million from $18.0 million, which was primarily due to general business growth.

Occupancy expense for the three months ended June 30, 2010 decreased $355,000, or 10%, compared to the same quarter in 2009 as a result of additional expenses incurred in 2009 related to the relocation of our new corporate headquarters and new operations center.

Marketing expense for the three months ended June 30, 2010 increased $446,000, or 68%, compared to the same quarter in 2009, which was primarily due to general business growth.

Legal and professional expense for the three months ended June 30, 2010 was consistent with the same quarter in 2009.

FDIC insurance assessment expense decreased by $1.3 million from $3.5 million in 2009 to $2.2 million. The second quarter of 2009 included a special one-time assessment of $2.4 million.

Allowance and other carrying costs for OREO increased $430,000 for the three months ended June 30, 2010 related to deteriorating values of assets held in OREO. Of the $808,000 expense for the second quarter of 2010, $557,000 was related to increasing the valuation allowance during the quarter.

Other non-interest expense for the three months ended June 30, 2010 increased $1.2 million, or 30%, compared to the same quarter in 2009 related to general business growth.

Non-interest expense for the first six months of 2010 increased $10.6 million, or 16%, to $76.3 million from $65.7 million for the same period of 2009. The increase is primarily attributable to a $7.3 million increase in salaries and employee benefits to $41.5 million from $34.2 million, which was primarily due to general business growth.

Occupancy expense for the six months ended June 30, 2010 decreased $95,000, or 2%, compared to the same period in 2009 as a result of additional expenses incurred in 2009 related to the relocation of our new corporate headquarters and new operations center.

Marketing expense for the six months ended June 30, 2010 increased $678,000, or 56%, compared to the same period in 2009.

Legal and professional expense for the six months ended June 30, 2010 decreased $294,000, or 5%, compared to the same period in 2009.

FDIC insurance assessment expense for the six months ended June 30, 2010 decreased $931,000, or 18%, compared to the same period in 2009. The second quarter of 2009 included a special one-time assessment of $2.4 million.

Allowance and other carrying costs for OREO increased $1.5 million for the six months ended June 30, 2010 related to deteriorating values of assets held in OREO. Of the $3.0 million expense for the first half of 2010, $2.4 million was related to increasing the valuation allowance during the quarter and $111,000 related to direct write-downs of OREO balances.

Other non-interest expense for the six months ended June 30, 2010 increased $2.5 million, or 32%, compared to the same period in 2009 related to general business growth.

Analysis of Financial Condition

Loan Portfolio

Total loans net of allowance for loan losses at June 30, 2010 increased $302.2 million from December 31, 2009 to $5.4 billion. Combined commercial, construction, real estate, consumer loans and leases increased $5.0 million. Loans held for sale increased $303.6 million from December 31. We anticipate that overall loan growth during the remainder of 2010 will be less than experienced in prior years as a result of tightened credit standards and reduced demand for credit due to overall economic conditions.

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

	June 30, 2010	December 31, 2009
Commercial	$ 2,426,940	$ 2,457,533
Construction	395,266	669,426
Real estate	1,556,985	1,233,701
Consumer	16,107	25,065
Leases	94,567	99,129
Gross loans held for investment	4,489,865	4,484,854
Deferred income (net of direct origination costs)	(27,035)	(27,561)
Allowance for loan losses	(74,881)	(67,931)
Total loans held for investment, net	4,387,949	4,389,362
Loans held for sale	997,150	693,504
Total	$ 5,385,099	$ 5,082,866

We continue to lend primarily in Texas. As of June 30, 2010, a substantial majority of the principal amount of the loans held for investment in our portfolio was to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions in Texas. The risks created by these concentrations have been considered by management in the determination of the adequacy of the allowance for loan losses. Management believes the allowance for loan losses is adequate to cover estimated losses on loans at each balance sheet date.

We originate substantially all of the loans in our portfolio, except participations in residential mortgage loans held for sale, select loan participations and syndications, which are underwritten independently by us prior to purchase and certain USDA and SBA government guaranteed loans that we purchase in the secondary market. We also participate in syndicated loan relationships, both as a participant and as an agent. As of June 30, 2010, we have $380.7 million in syndicated loans, $90.4 million of which we acted as agent. All syndicated loans,

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whether we act as agent or participant, are underwritten to the same standards as all other loans originated by us. In addition, as of June 30, 2010, $3.9 million of our syndicated loans were nonperforming and none are considered potential problem loans.

Summary of Loan Loss Experience

During the second quarter of 2010, we recorded net charge-offs in the amount of $12.6 million, compared to net charge-offs of $6.8 million for the same period in 2009. For the first half of 2010, the ratio of net charge-offs to loans held for investment was .99% compared to .47% for the same period in 2009. The reserve for loan losses, which is available to absorb losses inherent in the loan portfolio, totaled $74.9 million at June 30, 2010, $67.9 million at December 31, 2009 and $54.3 million at June 30, 2009. This represents 1.68%, 1.52% and 1.29% of loans held for investment (net of unearned income) at June 30, 2010, December 31, 2009 and June 30, 2009, respectively. Including the $2.2 million of allowance for loss on off-balance sheet exposure, the total reserve percentage increased to 1.73% at June 30, 2010 from 1.59% and 1.35% of loans held for investment at December 31, 2009 and June 30, 2009, respectively. The total reserve percentage has increased over the past year as a result of the effects of national and regional economic conditions on borrowers and values of assets pledged as collateral.

The provision for credit losses is a charge to earnings to maintain the reserve for loan losses at a level consistent with management s assessment of the loan portfolio in light of current economic conditions and market trends. We recorded a provision of $14.5 million during the second quarter of 2010 compared to $11.0 million in the second quarter of 2009 and $13.5 million in the first quarter of 2010.

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

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

The methodology used in the periodic review of reserve adequacy, which is performed at least quarterly, is designed to be dynamic and responsive to changes in portfolio credit quality and anticipated future credit losses. The changes are reflected in the general reserve and in specific reserves as the collectability of larger classified loans is evaluated with new information. As our portfolio has matured, historical loss ratios have been closely monitored, and our

reserve adequacy relies primarily on our loss history. Currently, the review of

reserve adequacy is performed by executive management and presented to our board of directors for their review, consideration and ratification on a quarterly basis.

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

	Six months ended June 30, 2010	Six months ended June 30, 2009	Year ended December 31, 2009
Reserve for loan losses:			
Beginning balance	$ 67,931	$ 45,365	$ 45,365
Loans charged-off:			
Commercial	14,204	1,787	4,000
Real estate construction	6,209	1,881	6,508
Real estate term	766	1,486	4,696
Consumer		419	502
Equipment leases	812	3,950	4,022
Total charge-offs	21,991	9,523	19,728
Recoveries:			
Commercial	64	69	124
Real estate construction			13
Real estate term	14		53
Consumer		5	28
Equipment leases	80	7	54
Total recoveries	158	81	272
Net charge-offs	21,833	9,442	19,456
Provision for loan losses	28,783	18,363	42,022
Ending balance	$ 74,881	$ 54,286	$ 67,931
Reserve for off-balance sheet credit losses:			
Beginning balance	$ 2,948	$ 1,470	$ 1,470
Provision (benefit) for off-balance sheet credit losses	(783)	1,137	1,478
Ending balance	$ 2,165	$ 2,607	$ 2,948
Total reserve for credit losses	$ 77,046	$ 56,893	$ 70,879
Total provision for credit losses	$ 28,000	$ 19,500	$ 43,500
Reserve for loan losses to loans held for investment [2]	1.68%	1.29%	1.52%
Net charge-offs to average loans P[1][2]	.99%	.47%	.46%
Total provision for credit losses to average loans [1][2]	1.27%	.97%	1.04%

Recoveries to total charge-offs	.72%	.85%	1.38%
Reserve for loan losses as a multiple of net charge-offs	3.4x	5.7x	3.5x
Reserve for off-balance sheet credit losses to off-balance sheet credit commitments	.17%	.21%	.24%
Combined reserves for credit losses to loans held for investment [2]	1.73%	1.35%	1.59%
Non-performing assets: [4]			
Non-accrual loans	$ 138,236	$ 49,592	$ 95,625
OREO [5]	42,077	31,404	27,264
Total	$ 180,313	$ 80,996	$ 122,889
Loans past due 90 days and still accruing [3]	$ 13,962	$ 3,539	$ 6,081
Reserve as a percent of non-performing loans [2]	.5x	1.1x	.7x

(1) Interim period ratios are annualized.

(2) Excludes loans held for sale.

(3) At June 30, 2010, December 31, 2009 and June 30, 2009, loans past due 90 days and still accruing includes premium finance loans for $1.7 million, $2.4 million and $1.7 million, respectively. These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The

refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

(4) At June 30, 2010, December 31, 2009 and June 30, 2009, non-performing assets include $1.5 million, $2.6 million and $4.0 million, respectively, of mortgage warehouse loans which were transferred to the loans held for investment portfolio at lower of cost or market during the past eighteen months, and some were subsequently moved to OREO.

(5) At June 30, 2010 and December 31, 2009, OREO balance is net of $8.9 million and $6.6 million valuation allowance, respectively.

Non-performing Assets

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

	June 30, 2010	June 30, 2009	December 31, 2009
Non-accrual loans:			
Commercial	$ 54,862	$ 22,548	$ 34,021
Construction	47,952	23,123	44,598
Real estate	28,227	3,617	10,189
Consumer	351	96	273
Leases	6,844	208	6,544
Total non-accrual loans	$ 138,236	$ 49,592	$ 95,625

At June 30, 2010, our total non-accrual loans were $138.2 million. Of these, $54.9 million were characterized as commercial loans. This included a $19.9 million line of credit secured by oil and gas properties, a $6.4 million line of credit secured by single family residences and the borrower s notes receivable, a $5.6 million line of credit secured by various single family properties, a $5.8 million line of credit secured by the assets of the borrower, a $4.2 million manufacturing loan secured by the assets of the borrower, a $3.9 million residence rehabilitation loan secured by single family residences, a $2.5 million loan secured by a first lien security interest in the borrower s accounts receivable and assets, a $1.7 million loan secured by the borrower s assets and a $2.4 million loan secured by the borrower s assets. Non-accrual loans also included $48.0 million characterized as construction loans. This included a $12.1 million commercial real estate loan secured by condominiums, a $10.7 million line of credit secured by unimproved land, $5.4 million term loan secured by commercial lots, a $4.8 million commercial real estate loan secured by unimproved land, a $2.8 million line of credit secured by unimproved land, a $2.7 million line of credit secured by unimproved land, a $2.6 million line of credit secured by residential lots, $1.3 million in commercial real estate loans secured by single family residences, a $1.2 million line of credit secured by unimproved land, and a $1.0 million real estate investment loan secured by unimproved land. Non-accrual loans also included $28.2 million characterized as real estate loans. This included an $11.0 million line of credit secured by commercial property, a $6.9 million real estate loan secured by an apartment building and a $6.2 million term loan secured by rental properties. Also included in this category are $1.4 million in single family mortgages that were originated in our mortgage warehouse operation. The $6.8 million characterized as leases is comprised of commercial leases, of which $3.6 million is secured by heavy duty vehicles, $1.4 million is secured by hospital equipment and $1.7 million is secured by the assets of the lessor. Each of these loans and leases were reviewed for impairment and specific reserves were allocated as necessary and included in the allowance for loan losses as of June 30, 2010 to cover any probable loss.

At June 30, 2010, we had $14.0 million in loans past due 90 days and still accruing interest. At June 30, 2010, $1.7 million of the loans past due 90 days and still accruing are premium finance loans. These loans are primarily secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

Generally, we place loans on non-accrual when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectability is questionable, then cash payments are applied to principal. As of June 30, 2010, none of our non-accrual loans were earning on a cash basis.

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

Restructured loans are loans on which, due to the borrower s financial difficulties, we have granted a concession that we would not otherwise consider. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of the two. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the

maturity date at a contractual interest rate lower than the current rate for new debt with similar risk, or a reduction of the face amount of debt, either forgiveness of principal or accrued interest. Of the nonaccrual loans at June 30, 2010, $46.0 million met the criteria for restructured. A loan continues to qualify as restructured until a consistent payment history has been evidenced, generally no less than a year. If a restructured loan is on nonaccrual, it can be placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which we have concerns about the borrower s ability to comply with repayment terms because of the borrower s potential financial difficulties. We monitor these loans closely and review their performance on a regular basis. At June 30, 2010, we had $24.1 million in loans of this type which were not included in either non-accrual or 90 days past due categories. The increase in the amount of potential problem loans from June 2009 to June 2010 is consistent with the overall economic deterioration and the increase in nonperforming loans that we have experienced this year.

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

	For the six months ended June 30,	
	2010	2009
Beginning balance	$ 27,264	$ 25,904
Additions	19,358	14,883
Sales	(2,040)	(9,383)
Valuation allowance for OREO	(2,394)	
Direct write-downs	(111)	
Ending balance	$ 42,077	$ 31,404

At June 30, 2010, our other real estate owned totaled $42.1 million, net of valuation reserves. This included an unimproved commercial real estate lot carried on our books at $4.0 million, residential real estate lots and undeveloped land carried at $5.3 million and residential lots carried at $2.0 million, a commercial office building carried at $13.0 million and unimproved retail land carried at $2.1 million. Also included is a commercial real estate property consisting of unimproved single family residential land carried at $3.4 million, a commercial multifamily real estate lot carried at $1.4 million, a commercial lot carried at $1.1 million, and office building carried at $2.1 million and residential condominiums carried at $1.8 million.

When foreclosure occurs, fair value, which is generally based on appraised values, may result in partial charge-off of a loan upon taking property, and so long as property is retained, subsequent reductions in appraised values will result in valuation adjustment taken as non-interest expense. In addition, if the decline in value is believed to be permanent and not just driven by market conditions, a direct write-down to the OREO balance may be taken. We generally pursue sales of OREO when conditions warrant, but we may choose to hold certain properties for a longer term, which can result in additional exposure related to the appraised values during that holding period. During the six months ended June 30, 2010, we recorded $2.5 million in valuation expense. Of the $2.5 million, $2.4 million related to increases to the valuation allowance, and $111,000 related to direct write-downs.

Liquidity and Capital Resources

In general terms, liquidity is a measurement of our ability to meet our cash needs. Our objective in managing our liquidity is to maintain our ability to meet loan commitments, purchase securities or repay deposits and other liabilities in accordance with their terms, without an adverse impact on our current or future earnings. Our liquidity strategy is guided by policies, which are formulated and monitored by our senior management and our Balance Sheet Management Committee (BSMC), and which take into account the marketability of assets, the sources and stability of funding and the level of unfunded commitments. We regularly evaluate all of our various funding sources with an emphasis on accessibility, stability, reliability and cost-effectiveness. For the year ended December 31, 2009 and for the six months ended June 30, 2010, our principal source of funding has been our customer deposits, supplemented by

our short-term and long-term borrowings, primarily from federal funds purchased and Federal Home Loan Bank (FHLB) borrowings.

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Our liquidity needs have typically been fulfilled through growth in our core customer deposits, and supplemented with brokered deposits and borrowings as needed. Our goal is to obtain as much of our funding as possible from deposits of these core customers. These deposits are generated principally through development of long-term relationships with customers and stockholders and our retail network which is mainly through BankDirect. In addition to deposits from our core customers, we also have access to incremental deposits through brokered retail certificates of deposit, or CDs. These CDs are generally of short maturities, 30 to 90 days, and are used to supplement temporary differences in the growth in loans, including growth in specific categories of loans, compared to customer deposits. The following table summarizes our core customer deposits and brokered deposits as of June 30, 2010 (in thousands):

	June 30, 2010	June 30, 2009	December 31, 2009
Deposits from core customers	$4,926.1	$2,861.3	$3,902.4
Deposits from core customers as a percent of total deposits	100.0%	78.5%	94.7%
Brokered deposits	$	$ 782.3	$ 218.3
Brokered deposits as a percent of total deposits	0.0%	21.5%	5.3%
Average deposits from core customers [1]	$4,758.8	$2,873.9	$3,163.8
Average deposits from core customers as a percent of total quarterly average deposits [1]	99.6%	86.8%	85.7%
Average brokered deposits [1]	$ 17.9	$ 437.6	$ 527.5
Average brokered deposits as a percent of total quarterly average deposits [1]	0.4%	13.2%	14.3%

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

We believe the Company has access to sources of brokered deposits of not less than an additional $3.3 billion. Based on the reduction in brokered CDs, customer deposits (total deposits minus brokered CDs) increased by $2.1 billion from June 30, 2009 and $1.0 billion from December 31, 2009.

Additionally, we have borrowing sources available to supplement deposits and meet our funding needs. Such borrowings are generally used to fund our loans held for sale, due to their liquidity, short duration and interest spreads available. These borrowing sources include federal funds purchased from our downstream correspondent bank relationships (which consist of banks that are smaller than our bank) and from our upstream correspondent bank relationships (which consist of banks that are larger than our bank), customer repurchase agreements, treasury, tax and loan notes, and advances from the FHLB and the Federal Reserve. The following table summarizes our borrowings as of June 30, 2010 (in thousands):

Federal funds purchased	$ 309,722
Customer repurchase agreements	13,812
Treasury, tax and loan notes	3,015
FHLB borrowings	50,097
Trust preferred subordinated debentures	113,406
Total borrowings	$ 490,052

Maximum outstanding at any month-end during the year	$ 653,665

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The following table summarizes our other borrowing capacities in excess of balances outstanding at June 30, 2010 (in thousands):

FHLB borrowing capacity relating to loans	$ 1,068,138
FHLB borrowing capacity relating to securities	54,529
Total FHLB borrowing capacity	$ 1,122,667
Unused federal funds lines available from commercial banks	$ 482,460

Our equity capital averaged $505.3 million for the six months ended June 30, 2010 as compared to $467.0 million for the same period in 2009. This increase reflects our retention of net earnings during this period. We have not paid any cash dividends on our common stock since we commenced operations and have no plans to do so in the near future.

On January 27, 2010, we announced that we entered into an Equity Distribution Agreement with Morgan Stanley & Co. Incorporated, pursuant to which we may, from time to time, offer and sell shares of our common stock, having aggregate gross sales proceeds of up to $40,000,000. Sales of the shares are being made by means of brokers transactions on or through the NASDAQ Global Select Market at market prices prevailing at the time of the sale or as otherwise agreed to by the Company and Morgan Stanley. As of June 30, 2010 we have sold 732,235 shares at an average price of $17.58. Net proceeds of $12.5 million, are being used for general corporate purposes.

Our capital ratios remain above the levels required to be well capitalized and have been enhanced with the additional capital raised since 2008 through June 30, 2010 and will allow us to grow organically with the addition of loan and deposit relationships.

Commitments and Contractual Obligations

The following table presents significant fixed and determinable contractual obligations to third parties by payment date. Payments for borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts. As of June 30, 2010, our significant fixed and determinable contractual obligations to third parties were as follows (in thousands):

	Within One Year	After One but Within Three Years	After Three but Within Five Years	After Five Years	Total
Deposits without a stated maturity [1]	$ 3,663,205	$	$	$	$ 3,663,205
Time deposits [1]	1,219,847	25,362	16,879	776	1,262,864
Federal funds purchased [1]	309,722				309,722
Customer repurchase agreements [1]	13,812				13,812
Treasury, tax and loan notes [1]	3,015				3,015
FHLB borrowings [1]	50,000		97		50,097
Operating lease obligations [1] [2]	7,831	15,853	14,918	45,293	83,895
Trust preferred subordinated debentures [1]				113,406	113,406
Total contractual obligations	$ 5,267,432	$ 41,215	$ 31,894	$ 159,475	$ 5,500,016

(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

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difficult, subjective or complex judgments. However, the policy noted below could be deemed to meet the SEC s definition of critical accounting policies.

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

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 June 30, 2010, and is not necessarily indicative of positions on other dates. The balances of interest rate sensitive assets and liabilities are presented in the periods in which they next reprice to market rates or mature and are aggregated to show the interest rate sensitivity gap. The mismatch between repricings or maturities within a time period is commonly referred to as the gap for that period. A positive gap (asset sensitive), where interest rate sensitive assets exceed interest rate sensitive liabilities, generally will result in the net interest margin increasing in a rising rate environment and decreasing in a falling rate environment. A negative gap (liability sensitive) will generally have the opposite results on the net interest margin. To reflect anticipated prepayments, certain asset and liability categories are shown in the table using estimated cash flows rather than contractual cash flows.

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Interest Rate Sensitivity Gap Analysis
June 30, 2010
(In thousands)

	0-3 mo Balance	4-12 mo Balance	1-3 yr Balance	3+ yr Balance	Total Balance
Securities [1]	$ 51,896	$ 62,061	$ 55,291	$ 57,781	$ 227,029
Total variable loans	4,617,240	33,719	16,832		4,667,791
Total fixed loans	341,110	192,685	196,955	89,056	819,806
Total loans [2]	4,958,350	226,404	213,787	89,056	5,487,597
Total interest sensitive assets	$ 5,010,246	$ 288,465	$ 269,078	$ 146,837	$ 5,714,626
Liabilities:					
Interest bearing customer deposits	$ 2,953,298	$	$	$	$ 2,953,298
CDs & IRAs	491,655	317,435	25,362	17,655	852,107
Total interest bearing deposits	3,444,953	317,435	25,362	17,655	3,805,405
Repurchase agreements, Federal funds purchased, FHLB borrowings	376,549			97	376,646
Trust preferred subordinated debentures				113,406	113,406
Total borrowings	376,549			113,503	490,052
Total interest sensitive liabilities	$ 3,821,502	$ 317,435	$ 25,362	$ 131,158	$ 4,295,457
GAP	1,188,744	(28,970)	243,716	15,679	
Cumulative GAP	1,188,744	1,159,774	1,403,490	1,419,169	1,419,169
Demand deposits					$ 1,120,664
Stockholders equity					514,078
Total					$ 1,634,742

(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 June 30, 2010 for interest bearing assets, interest bearing liabilities, and the total of non-interest bearing deposits and stockholders equity. While a gap interest table is useful in analyzing interest rate sensitivity, an interest rate sensitivity simulation provides a better illustration of the sensitivity of earnings to changes in interest rates. Earnings are also affected by the effects of changing interest rates on the value of funding derived from demand deposits and stockholders equity. We perform a sensitivity analysis to identify interest rate risk exposure on net interest income. We quantify and measure interest rate risk exposure using a model to dynamically simulate the effect of changes in net interest income relative to changes in interest rates and account balances over the next twelve months based on three interest rate scenarios. These are a most likely rate scenario and two shock test scenarios.

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

The two shock test scenarios assume a sustained parallel 200 basis point increase or decrease, respectively, in interest rates. As short-term rates continued to fall during 2009 and remain low in 2010, we could not assume interest rate decreases of any amount as the results of the decreasing rates scenario would not be 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
	June 30, 2010
Change in net interest income	$ 15,963

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 June 30, 2010, and concluded that those disclosure controls and procedures are effective. There have been no changes in our internal controls or in other factors known to us that could materially affect these controls subsequent to their evaluation, nor any corrective actions with regard to significant deficiencies and material weaknesses. While we believe that our existing disclosure controls and procedures have been effective to accomplish these objectives, we intend to continue to examine, refine and formalize our disclosure controls and procedures and to monitor ongoing developments in this area.

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

ITEM 5. EXHIBITS

(a) Exhibits

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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

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

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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: July 22, 2010	/s/ Peter B. Bartholow Peter B. Bartholow Chief Financial Officer (Duly authorized officer and principal financial officer)

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