TEXAS CAPITAL BANCSHARES INC/TX
Form 10-Q/A
November 15, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Amendment No. 1
to
FORM 10-Q

|X| Quarterly Report pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934.

For the quarterly period ended September 30, 2002

[ ] Transition Report pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934.

For the transition period from ________________ to ________________

Commission file number 0-30533

TEXAS CAPITAL BANCSHARES, INC.
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	75-2679109
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
2100 MCKINNEY AVENUE, SUITE 900, 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 whether the issuer (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 |X| No [ ]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check whether the issuer has filed all reports required to be filed by Section 12, 13 or 15(d) of the Securities and Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes [ ] No [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS:

On November 13, 2002, the number of shares set forth below was outstanding with respect to each of the issuer's classes of common stock:

Common Stock	18,460,674
Series A-1 Non-voting Common Stock	697,166

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CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED
(In thousands except share data)

	Three Months Ended September 30		Nine Months Ended September 30	
	2002	2001	2002	2001

INTEREST INCOME				
Interest and fees on loans	$ 14,219	$ 15,670	$ 39,545	$ 45,364
Securities	3,815	2,813	10,320	8,353
Federal funds sold	25	24	204	470
Deposits in other banks	3	7	6	16
Total interest income	18,062	18,514	50,075	54,203
INTEREST EXPENSE				
Deposits	5,617	7,486	15,650	25,710
Federal funds purchased	402	--	1,145	--
Other borrowings	1,169	1,376	2,798	2,811
Total interest expense	7,188	8,862	19,593	28,521
NET INTEREST INCOME	10,874	9,652	30,482	25,682
PROVISION FOR LOAN LOSSES	2,380	1,730	4,359	3,852
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	8,494	7,922	26,123	21,830
NON-INTEREST INCOME				
Service charges on deposit accounts	710	473	2,055	1,274
Trust fee income	235	196	727	600
Gain on sale of securities	1,375	354	1,375	1,335
Cash processing fees	--	--	993	--
Other	543	337	1,369	866
Total non-interest income	2,863	1,360	6,519	4,075
NON-INTEREST EXPENSE				
Salaries and employee benefits	4,163	3,783	12,492	11,774
Net occupancy expense	1,214	1,222	3,767	3,522
Advertising and affinity payments	448	31	1,010	209
Legal and professional	724	435	2,175	1,262
Communications and data processing	717	711	2,117	2,156
Franchise taxes	34	39	81	105
Other	1,263	1,014	3,701	3,127
Total non-interest expense	8,563	7,235	25,343	22,155
INCOME BEFORE INCOME TAXES	2,794	2,047	7,299	3,750
Income tax expense	700	--	1,828	--
NET INCOME	2,094	2,047	5,471	3,750
Preferred stock dividends	(280)	--	(817)	--
INCOME AVAILABLE TO COMMON STOCKHOLDERS	$ 1,814	$ 2,047	$ 4,654	$ 3,750
EARNINGS PER SHARE:				
Basic	$ .09	$ .11	$ .24	$ .20
Diluted	$ .09	$ .11	$ .24	$ .20

See accompanying notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEETS - UNAUDITED
(In thousands except share data)

	September 30, 2002	Dec
ASSETS		
Cash and due from banks	$ 81,359	$
Federal funds sold	8,850	
Securities available for sale	446,783	2
Loans, net	959,759	8
Loans held for sale	76,053	
Premises and equipment, net	4,059	
Accrued interest receivable and other assets	39,110	
Goodwill, net	1,496	
Total assets	$ 1,617,469	$ 1,1
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing	$ 219,160	$ 1
Interest bearing	900,432	7
Total deposits	1,119,592	8
Accrued interest payable	2,279	
Other liabilities	6,683	
Federal funds purchased	79,699	
Other borrowings	288,388	
Total liabilities	1,496,641	1,0
Stockholders' equity:		
Convertible preferred stock, non-voting, $.01 par value; 6%:		
Authorized shares - 10,000,000		
Issued shares - 1,057,142 and 753,301 at September 30, 2002 and December 31, 2001, respectively	11	
Common stock, $.01 par value:		
Authorized shares - 100,000,000		
Issued shares -18,473,646 and 18,400,310 at September 30, 2002 and December 31, 2001, respectively	184	
Series A-1 Non-voting common stock, $.01 par value:		
Issued shares - 697,166 and 741,392 at September 30, 2002 and December 31, 2001, respectively	7	
Additional paid-in capital	132,004	1
Accumulated deficit	(15,219)	(
Treasury stock (shares at cost: 97,246 and 87,516 at September 30, 2002 and December 31, 2001, respectively)	(667)	
Deferred compensation	573	
Accumulated other comprehensive income (loss)	3,935	
Total stockholders' equity	120,828	1

Total liabilities and stockholders' equity	$ 1,617,469	$ 1,1

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY -UNAUDITED
(In thousands, except share data)

	Convertible Preferred Stock		Common Stock		Series A Non-voti Common S
	Shares	Amount	Shares	Amount	Shares
Balance at December 31, 2000	--	$--	18,303,594	$ 183	812,256
Comprehensive income:					
Net income	--	--	--	--	--
Change in unrealized gain (loss) on available-for-sale securities, net reclassification amount of $1,902	--	--	--	--	--
Total comprehensive income					
Sale of convertible preferred stock	753,301	8	--	--	--
Sale of common stock	--	--	25,852	--	--
Preferred dividends payable	--	--	--	--	--
Transfers	--	--	70,864	1	(70,864)
Purchase of treasury stock	--	--	--	--	--
Sale of treasury stock	--	--	--	--	--
Balance at December 31, 2001	753,301	8	18,400,310	184	741,392
Comprehensive income:					
Net income	--	--	--	--	--
Change in unrealized gain (loss) on available-for-sale securities, net of tax of $2,392, net of reclassification amount of $1,375	--	--	--	--	--
Total comprehensive income					
Sale of convertible preferred stock	303,841	3	--	--	--
Sale of common stock	--	--	29,110	--	--
Preferred dividends	--	--	--	--	--
Transfers	--	--	44,226	--	(44,226)
Purchase of treasury stock	--	--	--	--	--
Sale of treasury stock	--	--	--	--	--

Balance at September 30, 2002	1,057,142	$11	18,473,646	$ 184	697,166

	Treasury Stock Shares	Treasury Stock Amount	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 2000	(220,828)	$(1,427)	$573	$ (482)
Comprehensive income:				
Net income	--	--	--	--
Change in unrealized gain (loss) on available-for-sale securities, net reclassification amount of $1,902	--	--	--	(25)
Total comprehensive income				
Sale of convertible preferred stock	--	--	--	--
Sale of common stock	--	--	--	--
Preferred dividends payable	--	--	--	--
Transfers	--	--	--	--
Purchase of treasury stock	(70,670)	(452)	--	--
Sale of treasury stock	203,982	1,285	--	--
Balance at December 31, 2001	(87,516)	(594)	573	(507)
Comprehensive income:				
Net income	--	--	--	--
Change in unrealized gain (loss) on available-for-sale securities, net of tax of $2,392, net of reclassification amount of $1,375	--	--	--	4,442
Total comprehensive income				
Sale of convertible preferred stock	--	--	--	--
Sale of common stock	--	--	--	--
Preferred dividends	--	--	--	--
Transfers	--	--	--	--
Purchase of treasury stock	(14,144)	(102)	--	--
Sale of treasury stock	4,414	29	--	--
Balance at September 30, 2002	(97,246)	$ (667)	$573	$ 3,935

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED
(In thousands)

	Nine Months Ended September 30 2002	2001
OPERATING ACTIVITIES		
Net income	$ 5,471	$ 3,750
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	4,359	3,852
Depreciation and amortization	1,299	1,423
Gain on sale of securities	(1,375)	(1,335)
Amortization and accretion on securities	1,258	181
Bank owned life insurance (BOLI) income	(144)	--
Originations of loans held for sale	(744,241)	(211,026)
Proceeds from sales of loans held for sale	711,952	190,332
Loss on sale of premises and equipment	--	10
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	(3,947)	(420)
Accrued interest payable and other liabilities	(2,429)	912
Net cash used in operating activities	(27,797)	(12,321)
INVESTING ACTIVITIES		
Purchases of available-for-sale securities	(329,361)	(170,654)
Proceeds from sale of available-for-sale securities	41,471	113,914
Proceeds from maturities and calls	4,700	68,195
Principal payments received on securities	49,723	41,700
Net increase in loans	(122,832)	(202,664)
Purchase of premises and equipment, net	(129)	(277)
Purchase of BOLI	(25,000)	--
Net cash used in investing activities	(381,428)	(149,786)
FINANCING ACTIVITIES		
Net increase in checking, money market and savings accounts	83,473	99,531
Net increase (decrease) in certificates of deposit	150,042	(52,846)
Issuance of common stock	193	81
Net other borrowings	201,489	37,060
Federal funds purchased	3,000	55,680
Sale of preferred stock	5,250	--
(Purchase) sale of treasury stock, net	(70)	984
Dividends paid	(563)	--
Net cash provided by financing activities	442,814	140,490
Net increase (decrease) in cash and cash equivalents	33,589	(21,617)
Cash and cash equivalents at beginning of period	56,620	60,291
Cash and cash equivalents at end of period	$ 90,209	$ 38,674
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	$ 20,162	$ 29,625
Non-cash transactions:		
Transfers from loans/leases to other repossessed assets	342	--
Transfers from loans/leases to premises and equipment	279	--

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

(1) ACCOUNTING POLICIES

Basis of Presentation

The accounting and reporting policies of Texas Capital Bancshares, Inc. (the "Company") conform to accounting principles generally accepted in the United States and to generally accepted practices within the banking industry. The Consolidated Financial Statements of the Company include the accounts of the Company and its subsidiary, Texas Capital Bank, National Association (the "Bank"). Certain prior period balances have been reclassified to conform with the current period presentation.

Amounts and disclosures have been adjusted to reflect a one-for-one stock dividend which was declared on July 30, 2002, and was paid in September 2002, pursuant to which each stockholder received one additional share of common stock for each share of common stock owned as of July 30, 2002.

Of the total estimated offering expenses disclosed in our Registration Statement, approximately $434,000 had been paid and is included in other assets as of September 30, 2002. Should the offering not be completed, all expenses associated with the offering would be charged to non-interest expense in the period that we determine the offering will be abandoned or indefinitely postponed.

(2) EARNINGS PER SHARE

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

	Three Months Ended September 30 2002	Three Months Ended September 30 2001	Nine Months Ended September 30 2002	Nine Months Ended September 30 20
Numerator:				
Net income	$ 2,094	$ 2,047	$ 5,471	$
Preferred stock dividends	(280)	--	(817)	
Numerator for basic earnings per share-income available to common stockholders	1,814	2,047	4,654	
Effective of dilutive securities:				
Preferred stock dividends(1)	--	--	--	
Numerator for dilutive earnings per share-income available to common stock-holder and assumed conversion	$ 1,814	$ 2,047	$ 4,654	$
Denominator:				
Denominator for basic earnings per share-weighted average shares	19,148,908	18,975,132	19,140,206	18,9
Effective of dilutive securities:				
Employee stock options	573,922	170,010	332,666	1
Convertible preferred stock(1)	--	--	--	

Dilutive potential common shares	573,922	170,010	332,666	1
Denominator for dilutive earnings per share-adjusted weighted average shares and assumed conversions	19,722,830	19,145,142	19,472,872	19,1
Basic earnings per share	$ .09	$ .11	$ .24	$
Diluted earnings per share	$ .09	$ .11	$ .24	$

(1) Effects of convertible preferred stock are anti-dilutive and are not included.

(3) REPORTABLE SEGMENTS

The Company operates two principal lines of business under the Bank: the traditional bank and BankDirect, an internet only bank.

BankDirect has been a net provider of funds and the traditional bank has been a net user of funds. In order to provide a consistent measure of the net interest margin for BankDirect, a multiple pool funds transfer pricing method was used to calculate credit for funds provided. This method takes into consideration the current market conditions during the reporting period.

TRADITIONAL BANKING
(In thousands)

	Three Months Ended September 30		Nine Months Ended September 30	
	2002	2001	2002	2001
Net interest income	$ 10,752	$ 9,292	$ 29,550	$ 25,236
Provision for loan losses	2,380	1,730	4,359	3,852
Non-interest income	2,834	1,295	6,417	3,807
Non-interest expense	7,752	6,400	22,820	18,976
Net income	$ 3,454	$ 2,457	$ 8,788	$ 6,215
Average assets	$1,368,089	$1,070,029	$1,263,797	$ 983,004
Total assets	1,616,520	1,056,650	1,616,520	1,056,650
Return on average assets	1.00%	.91%	.93%	.85%

BANKDIRECT
(In thousands)

	Three Months Ended September 30		Nine Months Ended September 30	

	2002	2001	2002	2001
Net interest income	$ 122	$ 360	$ 932	$ 446
Non-interest income	29	65	102	268
Non-interest expense	658	626	1,947	2,421
Net loss	$(507)	$(201)	$ (913)	$(1,707)

(3) REPORTABLE SEGMENTS (CONTINUED)

Reportable segments reconciliations to the Consolidated Financial Statements for the three month and nine month periods ended September 30, 2002 are as follows (in thousands):

	Three months ended September 30, 2002			
	Net Interest Income	Provision for Loan Losses	Non-interest Income	Non-interest Expense
Total reportable lines of business	$ 10,874	$ 2,380	$ 2,863	$ 8,410
Unallocated items:				
Holding company	--	--	--	153
The Company consolidated	$ 10,874	$ 2,380	$ 2,863	$ 8,563

	Nine months ended September 30, 2002			
	Net Interest Income	Provision for Loan Losses	Non-interest Income	Non-interest Expense
Total reportable lines of business	$ 30,482	$ 4,359	$ 6,519	$ 24,767
Unallocated items:				
Holding company	--	--	--	576
The Company consolidated	$ 30,482	$ 4,359	$ 6,519	$ 25,343

Reportable segments reconciliations to the Consolidated Financial Statements for the three month and nine month periods ended September 30, 2001 are as follows (in thousands):

	Three months ended September 30, 2001			
	Net Interest Income	Provision for Loan Losses	Non-interest Income	Non-interest Expense
Total reportable lines of business	$ 9,652	$ 1,730	$ 1,360	$ 7,026
Unallocated items:				
Holding company	--	--	--	209
The Company consolidated	$ 9,652	$ 1,730	$ 1,360	$ 7,235

	Nine months ended September 30, 2001			
	Net Interest Income	Provision for Loan Losses	Non-interest Income	Non-interest Expense
Total reportable lines of business	$ 25,682	$ 3,852	$ 4,075	$ 21,397
Unallocated items:				
Holding company	--	--	--	758
The Company consolidated	$ 25,682	$ 3,852	$ 4,075	$ 22,155

(4) NEW ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets. Statement 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Statement 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. Statement 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives. Statement 142 requires that these assets be reviewed for impairment at least annually. Intangible assets with finite lives will continue to be amortized over their estimated useful lives. Additionally, Statement 142 requires that goodwill included in the carrying value of equity method investments no longer be amortized.

The Company has tested goodwill for impairment using the two-step process prescribed in Statement 142. The first step is a screen for potential impairment, while the second step measures the amount of the impairment, if any.

The Company performed the first of the required impairment tests of goodwill and intangible assets with an indefinite life as of January 1, 2002 in the first quarter of 2002 and no impairment was noted.

For disclosure purposes, the prior year results shown below have been adjusted to reflect the impact the change in accounting would have.

	Three Months Ended September 30		Nine Months Ended September 30	
	2002	2001	2002	2001
Net income:				
As reported	$ 2,094	$ 2,047	$ 5,471	$ 3,750
Amortization expense	--	31	--	94
Net income without amortization expense	$ 2,094	$ 2,078	$ 5,471	$ 3,844
Basic income per share:				
As reported	$ .09	$ .11	$ .24	$ .20
Excluding amortization expense	.09	.11	.24	.20
Diluted income per share:				
As reported	$ .09	$ .11	$ .24	$ .20
Excluding amortization expense	.09	.11	.24	.20

QUARTERLY FINANCIAL SUMMARY - UNAUDITED
Consolidated Daily Average Balances, Average Yields and Rates
(In Thousands Except Share)

	For the three months ended September 30, 2002			For the three m September	
	Average Balance	Revenue/ Expense(1)	Yield/ Rate	Average Balance	Reve Expen
ASSETS					
Taxable securities	$ 304,724	$ 3,815	4.97%	$ 185,523	$ 2
Federal funds sold	5,903	25	1.68%	2,853	
Deposits in other banks	621	3	1.92%	312	
Loans (1)	1,000,356	14,219	5.64%	839,836	15
Less reserve for loan losses	12,871	--	--	10,444	
Loans, net of reserve	987,485	14,219	5.71%	829,392	15
Total earning assets	1,298,733	18,062	5.52%	1,018,080	18

Cash and other assets	69,876			51,966	
Total assets	$ 1,368,609			$1,070,046	
LIABILITIES AND STOCKHOLDERS' EQUITY					
Transaction deposits	$ 52,478	$ 123	0.93%	$ 42,955	$
Savings deposits	352,364	1,880	2.12%	341,207	3
Time deposits	451,391	3,614	3.18%	329,413	4
Total interest bearing deposits	856,233	5,617	2.60%	713,575	7
Other borrowings	227,420	1,571	2.74%	147,583	1
Total interest bearing liabilities	1,083,653	7,188	2.63%	861,158	8
Demand deposits	156,950			108,133	
Other liabilities	8,417			9,639	
Stockholders' equity	119,589			91,116	
Total liabilities and stockholders' equity	$ 1,368,609			$1,070,046	
Net interest income		$ 10,874			$ 9
Net interest income to earning assets			3.32%		
Provision for loan losses		2,380			1
Non-interest income		2,863			1
Non-interest expense		8,563			7
INCOME BEFORE TAXES		2,794			2
Federal and state income tax		(700)			
NET INCOME		$ 2,094			$ 2
EARNINGS PER SHARE:					
NET INCOME					
Basic		$ .09			$
Diluted		$ .09			$
Return on average equity		6.95%			
Return on average assets		.61%			
Equity to assets		8.74%			

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

QUARTERLY FINANCIAL SUMMARY - UNAUDITED
Consolidated Daily Average Balances, Average Yields and Rates
(In Thousands Except Share)

	For the nine months ended September 30, 2002			For the nine m September	
	Average Balance	Revenue/ Expense(1)	Yield/ Rate	Average Balance	Reve Expen
ASSETS					
Taxable securities	$ 262,584	$ 10,320	5.25%	$177,779	$ 8,
Federal funds sold	15,813	204	1.72%	12,273	
Deposits in other banks	316	6	2.54%	404	
Loans (1)	927,936	39,545	5.70%	756,379	45,
Less reserve for loan losses	12,903	--	--	9,970	
Loans, net of reserve	915,033	39,545	5.78%	746,409	45,
Total earning assets	1,193,746	50,075	5.61%	936,865	54,
Cash and other assets	70,165			46,154	
Total assets	$ 1,263,911			$983,019	
LIABILITIES AND STOCKHOLDERS' EQUITY					
Transaction deposits	$ 50,177	$ 366	0.98%	$ 38,891	$
Savings deposits	340,706	4,981	1.95%	359,378	11,
Time deposits	414,413	10,303	3.32%	303,811	13,
Total interest bearing deposits	805,296	15,650	2.60%	702,080	25,
Other borrowings	193,711	3,943	2.72%	89,232	2,
Total interest bearing liabilities	999,007	19,593	2.62%	791,312	28,
Demand deposits	142,130			93,831	
Other liabilities	7,485			8,619	
Stockholders' equity	115,289			89,257	
Total liabilities and stockholders' equity	$ 1,263,911			$983,019	
Net interest income		$ 30,482			$25,
Net interest income to earning assets			3.41%		
Provision for loan losses		4,359			3,
Non-interest income		6,519			4,
Non-interest expense		25,343			22,
INCOME BEFORE TAXES		7,299			3,
Federal and state income tax		(1,828)			
NET INCOME		$ 5,471			$ 3,
EARNINGS PER SHARE:					
NET INCOME					
Basic		$ .24			$
Diluted		$ .24			$
Return on average equity		6.34%			5
Return on average assets		.58%			

Equity to assets	9.12%	9

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

ITEM 2. MANAGEMENT'S ASSESSMENT OF OPERATIONS AND FINANCIAL CONDITION

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. Forward looking statements describe our future plans, strategies and expectations and are based on certain assumptions. As a result, these forward looking statements involve substantial risks and uncertainties, many of which are beyond our control. The important factors that could cause actual results to differ materially from the forward looking statements include the following:

(1) Changes in interest rates

(2) Changes in the levels of loan prepayments, which could affect the value of our loans

(3) Changes in general economic and business conditions in areas or markets where we compete

(4) Competition from banks and other financial institutions for loans and customer deposits

(5) The failure of assumptions underlying the establishment of and provisions made to the allowance for credit losses

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

(7) Changes in government regulations

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

SUMMARY OF PERFORMANCE

The Company recorded net income of $2.1 million (net of $700,000 of income tax expense) or $.09 per diluted common share for the third quarter of 2002 compared to $2.0 million or $.11 per diluted common share for the third quarter of 2001. The decrease in earnings per diluted share is related to a decrease in income available to common stockholders, which includes $280,000 of preferred stock dividends. Return on average assets was .61% for the third quarter of 2002 compared to .76% for the third quarter of 2001. Return on average equity was 6.95% and 8.91%, for the third quarter of 2002 and 2001, respectively.

The increase in net income for the quarter ended September 30, 2002 over the same period of 2001 was primarily due to an increase in net interest income and an increase in non-interest income, offset by an increase in non-interest expenses and an increase in provision for loan losses. Net interest income for the third quarter of 2002 increased by $1.2 million or 12.7% from $9.7 million to $10.9 million over the third quarter of 2001. The increase in net interest income was due to an increase in average earning assets of $280.7 million or 27.6%, which offset a 44 basis point decrease in net interest margin.

Non-interest expense increased $1.3 million or 18.4% compared to the third quarter of 2001. This increase was partially due to an increase in salaries and employee benefits of $380,000 related to an increase in full-time employees. Advertising expense increased $417,000 from $31,000 during the quarter ended September 30, 2001 to $448,000 during the quarter ended September 30, 2002, which included $264,000 of direct marketing and branding, including print ads for the traditional banking activities of our bank and $184,000 for the purchase of miles related to the American Airlines AAdvantage(R) program. In May 2000, BankDirect entered into the American Airlines AAdvantage(R) travel benefits program and began offering AAdvantage(R) awards to AAdvantage(R) members who opened and maintained accounts with BankDirect. We did not purchase any miles in 2001 because the miles that we were contractually required to purchase in 2000 were sufficient to cover our mile rewards to customers for 2001. Our legal and professional expenses increased $289,000 to $724,000 for the quarter ended September 30, 2002, mainly related to legal expenses incurred in connection with non-performing loans and leases.

NET INTEREST INCOME

Net interest income was $10.9 million for the third quarter of 2002 compared to $9.7 million for the third quarter of 2001. The increase was primarily due to an increase in average earning assets of $280.7 million as compared to the third quarter of 2001. The increase in average earning assets from the third quarter of 2001 included a $158.1 million increase in average net loans which represented 76.0% of average earning assets for the quarter ended September 30, 2002 compared to 81.5% for the same period of 2001. The decrease reflected management's decision to tighten lending standards during the second half of 2001 and the first quarter of 2002 pending clearer signs of improvement in the U.S. economy. Average interest bearing liabilities increased $222.5 million from the third quarter of 2001 which included a $142.7 million increase in interest bearing deposits and a $79.8 million increase in borrowings. Average borrowings were 16.6% of average total assets for the third quarter of 2002 compared to 13.8% in the same period in 2001. The increase in average borrowings was primarily related to an increase in federal funds purchased and securities sold under repurchase agreements and was used to supplement deposits in funding loan growth and securities purchases. The average cost of interest bearing liabilities decreased from 4.08% for the quarter ended September 30, 2001 to 2.63% for the same period of 2002, reflecting the continuing decline in market interest rates.

Net interest income was $30.5 million for the nine months ended September 30, 2002 compared to $25.7 million for the same period of 2001. The increase was primarily due to an increase in average earning assets of $256.9 million for the first nine months of 2002 as compared to the same period of 2001. The increase in average earning assets from the first nine months of 2001 included a $168.6 million increase in average net loans, which represented 76.7% of average earning assets for the nine months ended September 30, 2002 compared to 79.7% for the same period of 2001. The decrease reflected management's decision to tighten lending standards during the second half of 2001 and the first quarter of 2002 pending clearer signs of improvement in the U.S. economy. Average interest bearing liabilities increased $207.7 million in the first nine months of 2002 compared to the same period of 2001, due, in part, to a $103.2 million increase in interest bearing deposits and a $104.5 million increase in borrowings. Average borrowings were 15.3% of average total assets for the first nine months of 2002 compared to 9.1% in the same period in 2001. The increase in average borrowings was primarily related to an increase in federal funds purchased and securities sold under repurchase agreements, and was used to supplement deposits in funding loan growth and securities purchases. The average cost of interest bearing liabilities decreased from 4.82% for the nine months ended September 30, 2001 to 2.62% for the same period of 2002, reflecting the continuing decline in market interest rates.

TABLE 1 - VOLUME/RATE ANALYSIS
(In thousands)

	Three months ended September 30, 2002/2001			Nine months e September 30, 20	
		Change Due To			Chang
	Change	Volume	Yield/Rate	Change	Volume
Interest income:					
Securities	$ 1,002	$ 1,807	$ (805)	$ 1,967	$ 3,985
Loans	(1,451)	2,995	(4,446)	(5,819)	10,289
Federal funds sold	1	26	(25)	(266)	136
Deposits in other banks	(4)	7	(11)	(10)	(3
Total	(452)	4,835	(5,287)	(4,128)	14,407
Interest expense:					
Transaction deposits	(122)	54	(176)	(345)	206
Savings deposits	(1,139)	99	(1,238)	(6,761)	(610
Time deposits	(608)	1,562	(2,170)	(2,954)	4,825
Borrowed funds	195	745	(550)	1,132	3,292
Total	(1,674)	2,460	(4,134)	(8,928)	7,713
Net interest income	$ 1,222	$ 2,375	$ (1,153)	$ 4,800	$ 6,694

Net interest margin, the ratio of net interest income to average earning assets, was 3.32% for the third quarter of 2002 compared to 3.76% for the third quarter of 2001. The decrease in the net interest margin during the third quarter of 2002 was due to an overall decline in market interest rates.

NON-INTEREST INCOME

Non-interest income increased $1.5 million compared to the same quarter of 2001. Service charges on deposit accounts increased $237,000. This increase was due to the increase in deposits, which resulted in a higher volume of transactions. Trust fee income increased $39,000, due to continued growth of trust assets in 2002. Other non-interest income increased by $206,000 primarily due to bank owned life insurance (BOLI) income of $144,000 and an increase in mortgage warehouse fees. The third quarter of 2002 non-interest income includes a $1.4 million gain on sale of securities compared to a gain of $354,000 in the third quarter of 2001.

Non-interest income increased $2.4 million, or 60.0%, in the first nine months of 2002 as compared to the first nine months of 2001. Service charges on deposit accounts increased $781,000 for the nine month period ended September 30, 2002 as compared to the same period in 2001. This increase was due to the significant increase in deposits, which resulted in a higher volume of transactions. Trust fee income increased $127,000 due to continued growth of trust assets during 2002. Cash processing fees totaled $993,000 for the nine month period ended September 30, 2002. These fees were related to a special project that occurred during the first quarter of 2002 and will not be recurring in future quarters in 2002. Other non-interest income increased by $503,000 due to BOLI income, mortgage warehouse fees and a gain on sale of leases.

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 would likely place additional demands on capital and managerial resources.

TABLE 2 - NON-INTEREST INCOME
(In thousands)

	Three Months Ended September 30		Nine Months Ended September 30	
	2002	2001	2002	2001
Service charges on deposit accounts	$ 710	$ 473	$2,055	$1,274
Trust fee income	235	196	727	600
Gain on sale of securities	1,375	354	1,375	1,335
Cash processing fees	--	--	993	--
Other	543	337	1,369	866
Total non-interest income	$2,863	$1,360	$6,519	$4,075

NON-INTEREST EXPENSE

Non-interest expense for the third quarter of 2002 increased $1.3 million or 18.4% compared to the third quarter of 2001. Salaries and employee benefits increased by $380,000 or 10.0%. The increase in salaries and employee benefits was due to an increase in full time employees from 206 at September 30, 2001 to 214 at September 30, 2002.

Advertising expense increased $417,000 or 1,345.2%. Advertising expense for the three months ended September 30, 2002 included $264,000 of direct marketing and branding, including print ads for the traditional bank, and $184,000 for the purchase of miles related to the American Airlines AAdvantage(R) program. We did not purchase any miles in 2001 because the miles that we were contractually required to purchase in 2000 were sufficient to cover our mileage rewards to customers for 2001. In 2002, we are purchasing miles as we utilize them. Legal and professional expenses increased $289,000 or 66.4%, mainly related to legal expenses incurred with our non-performing loans and leases.

Non-interest expense for the nine months ended September 30, 2002 increased $3.2 million, or 14.4%, compared to the same period of 2001. Salaries and employee benefits increased by $718,000 or 6.1% which accounts for 22.5% of the increase in non-interest expense.

Net occupancy expense for the nine months ended September 30, 2002 increased by $245,000, or 6.9%, mainly related to the relocation of our operations center in the last quarter of 2001.

Advertising expense for the nine months ended September 30, 2002 increased $801,000, or 383.3%, compared to the same period of 2001. Advertising expense for the nine months ended September 30, 2002 included $553,000 of direct marketing and branding, including print ads for the traditional bank, and $457,000 for the purchase of miles related to the American Airlines AAdvantage(R) program. Legal and professional expenses increased $913,000 or 72.3%, mainly related to legal expenses incurred with our non-performing loans and leases. Communications and data processing expense for the nine months ended September 30, 2002 decreased $39,000, or 1.8%, due to some increased efficiencies in our communications costs.

TABLE 3 -NON-INTEREST EXPENSE
(In thousands)

	Three Months Ended September 30		Nine Months Ended September 30	
	2002	2001	2002	2001
Salaries and employee benefits	$4,163	$3,783	$12,492	$11,774
Net occupancy expense	1,214	1,222	3,767	3,522
Advertising and affinity payments	448	31	1,010	209
Legal and professional	724	435	2,175	1,262
Communications and data processing	717	711	2,117	2,156

Franchise taxes	34	39	81	105
Other	1,263	1,014	3,701	3,127
Total non-interest expense	$8,563	$7,235	$25,343	$22,155

INCOME TAXES

The Company utilized net operating loss carryforwards for the first nine months of 2002, but has expensed $700,000 of current tax expense during the third quarter and $1,828,000 for the nine months ended September 30, 2002 based on the expected effective rate for 2002.

ANALYSIS OF FINANCIAL CONDITION

The aggregate loan portfolio at September 30, 2002 increased $149.8 million from December 31, 2001 to $1.1 billion. Commercial loans increased $83.8 million and real estate loans increased $51.4 million. Construction loans decreased $869,000 and leases decreased $14.3 million.

TABLE 4 - LOANS
(In thousands)

	September 30, 2002	December 31, 2001
Commercial	$ 486,140	$402,302
Construction	179,246	180,115
Real estate	269,584	218,192
Consumer	22,546	25,054
Leases receivable	20,211	34,552
Loans held for sale	76,053	43,764
Total	$1,053,780	$903,979

We continue to lend primarily in Texas. As of September 30, 2002, a substantial majority of the principal amount of the loans in our portfolio was to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions within this area. We originate substantially all of the loans in our portfolio, except in certain instances we have purchased individual leases and lease pools (primarily commercial and industrial equipment and vehicles), as well as selected loan participations and USDA government guaranteed loans.

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SUMMARY OF LOAN LOSS EXPERIENCE

The reserve for loans losses, which is available to absorb losses inherent in the loan portfolio, totaled $13.8 million at September 30, 2002, $12.6 million at December 31, 2001 and $11.0 million at September 30, 2001. This represents 1.31%, 1.39% and 1.29% of total loans at September 30, 2002, December 31, 2001 and September 30, 2001, respectively.

The provision for loan losses is a charge to earnings to maintain the reserve for loan losses at a level consistent with management's assessment of the loan portfolio in light of current economic conditions and market trends. The Company recorded a provision of $2.4 million for the quarter ended September 2002 and $1.7 million for the same quarter in 2001. These provisions were made to reflect management's assessment of the risk of loan losses specifically including risk associated with the continued rapid growth in the loan portfolio and the unseasoned nature of the current portfolio.

The reserve for loan losses is comprised of specific reserves assigned to classified loans and general reserves. We continuously 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 specific 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 $1,000,000 are specifically reviewed and a specific allocation is assigned based on the losses expected to be realized from those loans. For purposes of determining the general reserve, the portfolio is segregated by product types to recognize differing risk profiles among categories, and then further segregated by credit grades. Credit grades are assigned to all loans greater than $50,000. Each credit grade is assigned a risk factor, or reserve allocation percentage. These risk factors are multiplied by the outstanding principal balance and risk-weighted by product type to calculate the required reserve. A similar process is employed to calculate that portion of the required reserve assigned to unfunded loan commitments.

The reserve allocation percentages assigned to each credit grade have been developed based on an analysis of historical loss rates at selected peer banks, adjusted for certain qualitative factors. Qualitative adjustments for such things as general economic conditions, changes in credit policies and lending standards, and changes in the trend and severity of problem loans, can cause the estimation of future losses to differ from past experience. The unallocated portion of the general reserve serves to compensate for additional areas of uncertainty and considers industry comparable reserve ratios. 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 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 actual credit losses. The changes are reflected in the general reserve and in specific reserves as the collectibility of larger classified loans is continuously recalculated with new information. As our portfolio matures, historical loss ratios are being closely monitored. Eventually our reserve adequacy analysis will rely more on our loss history and less on the experience of peer banks. Currently, the review of reserve adequacy is performed by executive management and presented to the Board of Directors for their review, consideration and ratification on a quarterly basis.

TABLE 5 - SUMMARY OF LOAN LOSS EXPERIENCE
(In thousands)

	Nine months ended September 30, 2002	Nine months ended September 30, 2001	Year ended December 31, 2001
Beginning balance	$12,598	$ 8,910	$ 8,910
Loans charged-off:			
Commercial	2,085	1,388	1,418
Consumer	6	--	--
Leases	1,042	353	656
Total	3,133	1,741	2,074
Recoveries:			
Consumer	11	--	--
Leases	9	--	--
Total for recoveries	20	--	--
Net chargeoffs	3,113	1,741	2,074
Provision for loan losses	4,359	3,852	5,762
Ending balance	$13,844	$11,021	$12,598
Reserve for loan losses to loans outstanding at end of period	1.31%	1.29%	1.39%
Net charge-offs to average loans(1)	.45%	.31%	.26%
Provision for loan losses to average loans(1)	.63%	.68%	.73%
Recoveries to gross charge-offs	.64%	--	--
Reserve as a multiple of net chargeoffs	4.5x	6.3x	6.1x
Non-performing and renegotiated loans:			
Loans past due (90 days)	$ 1,686	$-	$ 384
Non-accrual	6,474	5,454	6,032
Renegotiated	--	--	5,013
Total	$ 8,160	$ 5,454	$11,429
Reserve as a percent of non-performing and renegotiated loans	169.66%	202.07%	110.23%

(1) Interim period ratios are annualized.

NON-PERFORMING ASSETS

Non-performing assets include non-accrual loans and leases, accruing loans 90 or more days past due, restructured loans, and other repossessed assets. We had non-accrual loans and leases of $6,474,000, $5,454,000 and $6,032,000 at September 30, 2002, September 30, 2001, and December 31, 2001, respectively. At September 30, 2002, one loan relationship represented $3,056,000 of total non-accruals. We have specific reserves of $500,000 related to this relationship. At September 30, 2002, our non-accrual loans and leases consisted of $3,098,000 in commercial loans, $2,039,000 in real estate loans, and

$1,337,000 in leases. At December 31, 2001, our non-accrual loans and leases consisted of $5,767,000 in commercial loans and $265,000 in leases. At September 30, 2002, we had $1,686,000 in loans past due 90 days and still accruing interest. Approximately 97% of this balance relates to loans that are 100% government guaranteed and are expected to be paid off in the fourth quarter. At September 30, 2002, we had $284,000 in other repossessed assets, which consist of collateral that has been repossessed.

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.

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

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 bank's balance sheet committee, 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, 2001 and for the nine months ended September 30, 2002, our principal source of funding has been our customer deposits, supplemented by our short-term and long-term borrowings, primarily from securities sold under repurchase agreements and federal funds purchased from our downstream correspondent bank relationships (which consist of banks that are considered to be smaller than our bank).

Since early 2001, our liquidity needs have primarily been fulfilled through growth in our traditional bank customer and stockholder deposits. Our goal is to obtain as much of our funding as possible from deposits of these customers and stockholders, which as of September 30, 2002, comprised $761.0 million, or 68%, of total deposits, compared to $512.4 million, or 58%, of total deposits, at September 30, 2001. These traditional deposits are generated principally through development of long-term relationships with customers and stockholders.

In addition to deposits from our traditional bank customers and stockholders, we also have access to incremental consumer deposits through BankDirect and through brokered retail certificates of deposit, or CDs. As of September 30, 2002, BankDirect deposits comprised $198.6 million, or 18%, of total deposits, and brokered retail CDs comprised $160.0 million, or 14%, of total deposits. Our dependence on internet deposits and retail brokered CDs is limited by our internal funding guidelines, which as of September 30, 2002, limited borrowing from these sources to 15-25% and 10-20%, respectively, of total deposits.

Additionally, we have borrowing sources available to supplement deposits and meet our funding needs. These borrowing sources include federal funds purchased from our downstream correspondent bank relationships and from our upstream correspondent bank relationships (which consist of banks that are larger than our bank), securities sold under repurchase agreements, treasury, tax and loan notes, and advances from the Federal Home Loan Bank, or FHLB. As of September 30, 2002, our borrowings consisted of a total of $246.9 million of securities sold under repurchase agreements, $69.7 million of downstream federal funds purchased, $10.0 million of upstream federal funds purchased, $5.0 million from customer repurchase agreements and $16.4 million of treasury, tax and loan notes. Credit availability from the FHLB is based on our bank's financial and operating condition and borrowing collateral we hold with the FHLB. At September 30, 2002, borrowings from the FHLB consisted of approximately $143,000 of term advances bearing interest at 5.28% and $20.0 million of overnight advances bearing interest at 2.15%. Our unused FHLB borrowing capacity at September 30, 2002 was approximately $205.0 million. As of September 30, 2002, $10.0 million of our borrowings consisted of upstream federal funds purchased, and we had unused upstream federal fund lines available from commercial banks of approximately $70.0 million. During the nine months ended September 30, 2002, our average borrowings from these sources were 15% of average assets, which is well within our internal funding guidelines, which limit our dependence on borrowing sources to 15-25% of total assets. In accordance with our current internal guidelines, excess funding capacity is monitored and maintained at a level in excess of 25% of total assets at all times. Average borrowed funds were $193.7 million during the nine month period ended September 30, 2002. The maximum amount of borrowed funds outstanding at any month-end during the first nine months of 2002 was $368.1 million, or 23%, of total assets.

As of September 30, 2002, our contractual obligations and commercial commitments, other than deposit liabilities, were as follows:

	Within One Year	After One but Within Three Years	After Three but Within Five Years	After Five Years	Tot
			(In Thousands)		
Federal funds purchased	$ 79,699	$ --	$ --	$ --	$ 79
Securities sold under repurchase agreements	28,165	214,215	4,500	--	246
Customer repurchase agreements	4,968	--	--	--	4
Treasury, tax and loan notes	16,397	--	--	--	16
FHLB borrowings	20,143	--	--	--	20
Operating lease obligations	2,438	4,374	4,182	5,953	16
Total contractual obligations	$151,810	$218,589	$ 8,682	$ 5,953	$385

The contractual amount of our financial instruments with off-balance sheet risk expiring by period at September 30, 2002 is presented below:

	Within One Year	After One but Within Three Years	After Three but Within Five Years	After Five Years	Tot
			(In Thousands)		
Commitments to extend credit	$235,309	$81,997	$5,169	$7,092	$329
Standby letters of credit	19,399	5,867	--	--	25
Total financial instruments with off-balance sheet risk	$254,708	$87,864	$5,169	$7,092	$354

Due to the nature of our unfunded loan commitments, including unfunded lines of credit, the amounts presented in the table above do not necessarily represent amounts that we anticipate funding in the periods presented above.

Our equity capital averaged $115.3 million for the nine months ended September 30, 2002 as compared to $89.3 million for the same period in 2001. 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 future.

TABLE 7 - CAPITAL RATIOS

	September 30, 2002	September 30, 2001
Risk-based capital:		
Tier 1 capital	9.59%	9.26%
Total capital	10.75%	10.39%
Leverage	8.45%	8.42%

CRITICAL ACCOUNTING POLICIES

The Securities and Exchange Commission ("SEC") recently issued guidance for the 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 generally accepted accounting principles. Not all these significant accounting policies require management to make difficult, subjective, or complex judgments. However, the policies 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 Statement of Financial Accounting Standards ("SFAS") No. 114, "Accounting by Creditors for Impairment of a Loan" and SFAS No. 5, "Accounting for Contingencies." The allowance for loan losses is established through a provision for loan losses charge 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 creditworthiness 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.

The Company is subject to market risk primarily through the effect of changes in interest rates on its 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 the Company.

The responsibility for managing market risk rests with the Balance Sheet Management Committee (BSMC), which operates under policy guidelines established by the 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 +/- 10%. 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 the full Board of Directors on a quarterly basis.

INTEREST RATE RISK MANAGEMENT

We perform a sensitivity analysis to identify interest rate risk exposure on net interest income. We quantify and measure interest rate exposure using a model to dynamically simulate the effect of changes in net interest income relative to changes in interest rates 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 London Interbank Offering Rate are the basis for most of our variable-rate loan pricing. The 30-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 an instantaneous sustained parallel 200 basis point increase or decrease, respectively, in interest rates. As short-term rates fell below 2.0% by the end of 2001, we could not assume interest rate changes of 200 basis points as the results in the decreasing rates scenario would be negative rates. Therefore, we are using 150 basis point variances for our "shock test" scenarios until short-term rates rise above 2.0%.

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

This modeling indicated interest rate sensitivity is as follows:

TABLE 6 - INTEREST RATE SENSITIVITY
(In thousands)

	Anticipated Impact Over the Next Twelve Months as Compared to Most Likely Scenario	
	150 bp Increase September 2002	150 bp Decrease September 2002
Change in net interest income	$ 7,558	$(10,359)

The estimated changes in interest rates on net interest income are within guidelines established by our Board of Directors for all interest rate scenarios.

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.

We expect our balance sheet will continue to be asset sensitive over the next twelve months, which means that we will have more loans repricing than deposits over this period. This is largely due to the concentration of our assets in variable rate (rather than fixed rate) loans. In the current rate environment, management may choose to fund investment securities purchased with term liabilities/deposits to lock in a return. Investment securities are generally held in the "available for sale" category so that gains and losses can be realized as appropriate. At certain times, we use the "held to maturity" category if we are not planning to sell these securities before maturity.

As of September 30, 2002, the bank sources approximately 18% of its total deposits from retail consumer internet deposit customers through BankDirect. These retail consumer deposits may be more interest rate sensitive than our other deposits as a result of the extremely competitive internet banking market.

ITEM 4. CONTROLS AND PROCEDURES

The Company's chief executive officer and chief financial officer have evaluated the Company's disclosure controls and procedures as of September 30, 2002 and concluded that those disclosure controls and procedures are effective. There have been no changes in the Company's internal controls or in other factors known to the Company that could significantly affect these controls subsequent to their evaluation, nor any corrective actions with regard to significant deficiencies and material weakness. While the Company believes that its existing disclosure controls and procedures have been effective to accomplish these objectives, the Company intends to continue to examine, refine and formalize its disclosure controls and procedures and to monitor ongoing developments in this area.

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PART II - OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES

We amended our Certificate of Designation of 6.0% Series A Convertible Preferred Stock ("Series A Certificate of Designation"). The amendment to our Series A Certificate of Designation provided for adjustment, in the event of a stock dividend, stock split, reclassification or other similar corporate event affecting our Series A Preferred Stock, of the price which triggers automatic conversion of our Series A Preferred Stock into our common stock upon (1) the consummation of an initial public offering or (2) shares of our common stock being quoted on the New York Stock Exchange or Nasdaq National Market for 30 consecutive trading days.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We solicited written consents of the holders of our Series A Preferred Stock and common stock in order to amend the Series A Certificate of Designation. Our Series A Preferred Stock is automatically converted into shares of our common stock upon certain events. The amendment to our Series A Certificate of Designation provided for adjustment, in the event of a stock dividend, stock split, reclassification or other similar corporate event affecting our Series A Preferred Stock, of the price which triggers automatic conversion of our Series A Preferred Stock in to our common stock upon (1) the consummation of an initial public offering or (2) shares of our common stock being quoted on the New York Stock Exchange or Nasdaq National Market for 30 consecutive trading days.

The holders of our Series A Preferred Stock, as a class, and the holders of our Series A Preferred Stock and our common stock collectively, as a class, consented to the amendment of the Series A Certificate of Designation. From the holders of our Series A Preferred Stock we received 529,770 consents, which represents 50.11% of the total shares of our Series A Preferred Stock outstanding. From the holders of our Series A Preferred Stock and our common stock collectively, as a class, we received 11,672,718 consents which represents 56.74% of the total shares of our Series A Preferred Stock and common stock collectively, as a class, outstanding.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

99.1 Certification of Chief Executive Officer

99.2 Certification of Chief Financial Officer

SIGNATURES

Pursuant to the requirements of the Securities and 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: November 13, 2002

/s/ Gregory B. Hultgren

Gregory B. Hultgren
Chief Financial Officer
(Duly authorized officer and principal
financial officer)

CERTIFICATIONS

I, Joseph M. Grant, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Texas Capital Bancshares, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002

/s/ JOSEPH M. GRANT

Joseph M. Grant
Chief Executive Officer

I, Gregory B. Hultgren, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Texas Capital Bancshares, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002

/s/ GREGORY B. HULTGREN

Gregory B. Hultgren
Chief Financial Officer

EXHIBIT INDEX

Exhibit Number

99.1 Certification of Chief Executive Officer

99.2 Certification of Chief Financial Officer