TEXAS CAPITAL BANCSHARES INC/TX
Form 10-Q
April 26, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the quarterly period ended March 31, 2012

¨ **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 x No ¨

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

On April 25, 2012, the number of shares set forth below was outstanding with respect to each of the issuer s classes of common stock:

Common Stock, par value $0.01 per share	37,917,789

Table of Contents

Texas Capital Bancshares, Inc.

Form 10-Q

Quarter Ended March 31, 2012

Index

2

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TEXAS CAPITAL BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME UNAUDITED

(In thousands except per share data)

	Three months ended March 31, 2012	2011
Interest income		
Loans	$ 91,774	$ 68,040
Securities	1,307	1,846
Federal funds sold	1	28
Deposits in other banks	49	197
Total interest income	93,131	70,111
Interest expense		
Deposits	3,472	4,871
Federal funds purchased	281	107
Repurchase agreements	3	2
Other borrowings	435	
Trust preferred subordinated debentures	711	633
Total interest expense	4,902	5,613
Net interest income	88,229	64,498
Provision for credit losses	3,000	7,500
Net interest income after provision for credit losses	85,229	56,998
Non-interest income		
Service charges on deposit accounts	1,604	1,783
Trust fee income	1,114	954
Bank owned life insurance (BOLI) income	521	523
Brokered loan fees	3,651	2,520
Equipment rental income	161	783
Other	2,139	1,121
Total non-interest income	9,190	7,684
Non-interest expense		
Salaries and employee benefits	29,019	24,172
Net occupancy expense	3,604	3,310
Leased equipment depreciation	139	556
Marketing	2,823	2,123
Legal and professional	3,991	2,723
Communications and technology	2,483	2,347
FDIC insurance assessment	1,569	2,511
Allowance and other carrying costs for OREO	3,342	4,030
Other	5,306	4,627
Total non-interest expense	52,276	46,399

Income from continuing operations before income taxes	42,143	18,283
Income tax expense	15,062	6,344
Income from continuing operations	27,081	11,939
Income/loss from discontinued operations (after-tax)	4	(60)
Net income	$ 27,085	$ 11,879
Basic earnings per common share		
Income from continuing operations	$ 0.72	$ 0.32
Net income	$ 0.72	$ 0.32
Diluted earnings per common share		
Income from continuing operations	$ 0.70	$ 0.31
Net income	$ 0.70	$ 0.31
Other comprehensive income		
Unrealized loss on available-for-sale securities arising during period, before tax	$ (288)	$ (246)
Income tax benefit related to unrealized gain on available-for-sale securities	(101)	(86)
Other comprehensive loss net of tax	(187)	(160)
Comprehensive income	$ 26,898	$ 11,719

See accompanying notes to consolidated financial statements.

Table of Contents

TEXAS CAPITAL BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands except per share data)

	March 31, 2012 (Unaudited)	December 31, 2011
Assets		
Cash and due from banks	$ 66,806	$ 79,248
Interest-bearing deposits	61,324	22,010
Federal funds sold	20,680	
Securities, available-for-sale	123,828	143,710
Loans held for sale	2,255,281	2,080,081
Loans held for sale from discontinued operations	390	393
Loans held for investment (net of unearned income)	5,792,349	5,572,371
Less: Allowance for loan losses	71,992	70,295
Loans held for investment, net	5,720,357	5,502,076
Premises and equipment, net	11,445	11,457
Accrued interest receivable and other assets	279,866	278,163
Goodwill and intangible assets, net	20,330	20,480
Total assets	$ 8,560,307	$ 8,137,618
Liabilities and Stockholders Equity		
Liabilities:		
Deposits:		
Non-interest bearing	$ 1,751,443	$ 1,751,944
Interest bearing	3,902,123	3,324,040
Interest bearing in foreign branches	409,992	480,273
Total deposits	6,063,558	5,556,257
Accrued interest payable	893	599
Other liabilities	77,381	82,909
Federal funds purchased	383,927	412,249
Repurchase agreements	23,740	23,801
Other borrowings	1,250,061	1,332,066
Trust preferred subordinated debentures	113,406	113,406
Total liabilities	7,912,966	7,521,287
Stockholders equity:		
Preferred stock, $.01 par value, $1,000 liquidation value:		
Authorized shares 10,000,000		
Common stock, $.01 par value:		
Authorized shares 100,000,000		
Issued shares 37,912,054 and 37,666,708 at March 31, 2012 and December 31, 2011	379	376
Additional paid-in capital	353,567	349,458
Retained earnings	288,868	261,783
Treasury stock (shares at cost: 417 at March 31, 2012 and December 31, 2011)	(8)	(8)
Accumulated other comprehensive income, net of taxes	4,535	4,722

Total stockholders equity	647,341	616,331
Total liabilities and stockholders equity	$ 8,560,307	$ 8,137,618

See accompanying notes to consolidated financial statements.

Table of Contents

TEXAS CAPITAL BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(In thousands except share data)

	Preferred Stock		Common Stock				Treasury Stock		Accumulated Other Comprehensive Income, Net of Taxes	
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Shares	Amount		Total
Balance at December 31, 2010		$	36,957,104	$ 369	$ 336,796	$ 185,807	(417)	$ (8)	$ 5,355	$ 528,319
Comprehensive income:										
Net income (unaudited)						11,879				11,879
Change in unrealized gain on available-for-sale securities, net of taxes of $86 (unaudited)									(160)	(160)
Total comprehensive income (unaudited)										11,719
Tax expense related to exercise of stock-based awards (unaudited)					1,160					1,160
Stock-based compensation expense recognized in earnings (unaudited)					2,134					2,134
Issuance of stock related to stock-based awards (unaudited)			260,242	3	1,590					1,593
Balance at March 31, 2011 (unaudited)		$	37,217,346	$ 372	$ 341,680	$ 197,686	(417)	$ (8)	$ 5,195	$ 544,925
Balance at December 31, 2011		$	37,666,708	$ 376	$ 349,458	$ 261,783	(417)	$ (8)	$ 4,722	$ 616,331
Comprehensive income:										
Net income (unaudited)						27,085				27,085
Change in unrealized gain on available-for-sale securities, net of taxes of $101 (unaudited)									(187)	(187)
Total comprehensive income (unaudited)										26,898
Tax expense related to exercise of stock-based awards (unaudited)					1,521					1,521
Stock-based compensation expense recognized in earnings (unaudited)					1,952					1,952
Issuance of stock related to stock-based awards (unaudited)			245,763	3	636					639
Balance at March 31, 2012 (unaudited)		$	37,912,471	$ 379	$ 353,567	$ 288,868	(417)	$ (8)	$ 4,535	$ 647,341

See accompanying notes to consolidated financial statements

5

Table of Contents

TEXAS CAPITAL BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

(In thousands)

	Three months ended March 31, 2012	2011
Operating activities		
Net income from continuing operations	$ 27,081	$ 11,939
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for credit losses	3,000	7,500
Depreciation and amortization	1,186	1,469
Amortization and accretion on securities	14	25
Bank owned life insurance (BOLI) income	(521)	(523)
Stock-based compensation expense	1,952	2,134
Tax benefit from stock option exercises	1,521	1,160
Excess tax benefits from stock-based compensation arrangements	(4,345)	(3,313)
Originations of loans held for sale	(10,334,353)	(4,725,151)
Proceeds from sales of loans held for sale	10,159,156	5,107,959
Gain on sale of assets	(33)	(63)
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	(2,555)	20,136
Accrued interest payable and other liabilities	(5,134)	(3,852)
Net cash provided by (used in) operating activities of continuing operations	(153,031)	419,420
Net cash provided by (used in) operating activities of discontinued operations	7	(58)
Net cash provided by (used in) operating activities	(153,024)	419,362
Investing activities		
Purchases of available-for-sale securities	(6)	
Maturities and calls of available-for-sale securities	12,420	1,610
Principal payments received on available-for-sale securities	7,167	11,552
Net increase in loans held for investment	(221,284)	(8,855)
Purchase of premises and equipment, net	(885)	(916)
Proceeds from sale of foreclosed assets	1,267	13,497
Net cash provided by (used in) investing activities of continuing operations	(201,321)	16,888
Financing activities		
Net increase (decrease) in deposits	507,301	(233,410)
Proceeds from issuance of stock related to stock-based awards	639	1,593
Net increase (decrease) in other borrowings	(82,066)	4,019
Excess tax benefits from stock-based compensation arrangements	4,345	3,313
Net decrease in federal funds purchased	(28,322)	(167,911)
Net cash provided by (used in) financing activities of continuing operations	401,897	(392,396)
Net increase in cash and cash equivalents	47,552	43,854
Cash and cash equivalents at beginning of period	101,258	179,866
Cash and cash equivalents at end of period	$ 148,810	$ 223,720

Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	$ 4,608	$ 5,989
Cash paid during the period for income taxes	8,806	173
Non-cash transactions:		
Transfers from loans/leases to OREO and other repossessed assets	2,534	926

See accompanying notes to consolidated financial statements.

6

Table of Contents

TEXAS CAPITAL BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

(1) OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Business

Texas Capital Bancshares, Inc. (the Company), a Delaware financial holding company, was incorporated in November 1996 and commenced doing business in March 1998, but did not commence banking operations until December 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 businesses and successful professionals and entrepreneurs.

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, 2011, included in our Annual Report on Form 10-K filed with the SEC on February 23, 2012 (the 2010 Form 10-K). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for possible loan losses, the 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.

Cash and Cash Equivalents

Cash equivalents include amounts due from banks and federal funds sold.

Securities

Securities are classified as trading, available-for-sale or held-to-maturity. Management classifies securities at the time of purchase and re-assesses such designation at each balance sheet date; however, transfers between categories from this re-assessment are rare.

Trading Account

Securities acquired for resale in anticipation of short-term market movements are classified as trading, with realized and unrealized gains and losses recognized in income. To date, we have not had any activity in our trading account.

7

Table of Contents

Held-to-Maturity and Available-for-Sale

Debt securities are classified as held-to-maturity when we have the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost. Debt securities not classified as held-to-maturity or trading and marketable equity securities not classified as trading are classified as available-for-sale.

Available-for-sale securities are stated at fair value, with the unrealized gains and losses reported in a separate component of accumulated other comprehensive income, net of tax. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity, or in the case of mortgage-backed securities, over the estimated life of the security. Such amortization and accretion is included in interest income from securities. 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.

All securities are available-for-sale as of March 31, 2012 and December 31, 2011.

Loans

Loans Held for Investment

Loans held for investment (which include equipment leases accounted for as financing leases) are stated at the amount of unpaid principal reduced by deferred income (net of costs). Interest on loans is recognized using the simple-interest method on the daily balances of the principal amounts outstanding. Loan origination fees, net of direct loan origination costs, and commitment fees, are deferred and amortized as an adjustment to yield over the life of the loan, or over the commitment period, as applicable.

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

The accrual of interest on loans is discontinued when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining book balance of the asset is deemed to be collectible. If collectibility is questionable, then cash payments are applied to principal. A loan is placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

Loans Held for Sale

We purchase participations in mortgage loans primarily for sale in the secondary market through our mortgage warehouse lending division. These are participations purchased from non-bank mortgage originators who are seeking additional funding through participation interests to facilitate their ability to originate loans in their own name. The mortgage originator has no obligation to offer and we have no obligation to purchase these participation interests. The originator closes mortgage loans consistent with underwriting standards established by approved investors and once the loan closes, the originator delivers the loan to the investor. We typically purchase up to a 99% participation interest with the originator financing the remaining percentage. These loans are held by us for an interim period, usually less than 30 days and more typically 10-15 days. Accordingly, these loans are classified as held for sale and are carried at the lower of cost or fair value, determined on an aggregate basis.

If loan participations are not sold within the normal time frames or at previously negotiated prices, due to market conditions, the mortgage warehouse lending loans will be transferred to our loans held for investment portfolio at the lower of cost or market. Mortgage warehouse lending loans transferred to our loans held for investment portfolio could require future allocations of the allowance for loan losses or be subject to charge off in the event the loans become impaired.

Table of Contents

Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses charged against income. The allowance for loan losses includes specific reserves for impaired loans and an estimate of losses inherent in the loan portfolio at the balance sheet date, but not yet identified with specific loans. Loans deemed to be uncollectible are charged against the allowance when management believes that the collectibility of the principal is unlikely and subsequent recoveries, if any, are credited to the allowance. Management s periodic evaluation of the adequacy of the allowance is based on an assessment of the current loan portfolio, including known inherent risks, adverse situations that may affect the borrowers ability to repay, the estimated value of any underlying collateral and current economic conditions.

Repossessed Assets

Repossessed assets, which are included in other assets on the balance sheet, consist of collateral that has been repossessed. Collateral that has been repossessed is recorded at fair value less selling costs through a charge to the allowance for loan losses, if necessary. Write-downs are provided for subsequent declines in value and are recorded in allowance and other carrying costs expense included in allowance and other carrying costs for OREO in non-interest expense.

Other Real Estate Owned

Other Real Estate Owned (OREO), which is included in other assets on the balance sheet, consists of real estate that has been foreclosed. Real estate that has been foreclosed is recorded at the fair value of the real estate, less selling costs, through a charge to the allowance for loan losses, if necessary. Subsequent write-downs required for declines in value are recorded through a valuation allowance, or taken directly to the asset, charged to other non-interest expense.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from three to ten years. Gains or losses on disposals of premises and equipment are included in results of operations.

Marketing and Software

Marketing costs are expensed as incurred. Ongoing maintenance and enhancements of websites are expensed as incurred. Costs incurred in connection with development or purchase of internal use software are capitalized and amortized over a period not to exceed five years. Internal use software costs are included in other assets in the consolidated financial statements.

Goodwill and Other Intangible Assets

Intangible assets are acquired assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. Our intangible assets relate primarily to loan customer relationships. Intangible assets with definite useful lives are amortized on an accelerated basis over their estimated life. Intangible assets are tested for impairment annually or whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Segment Reporting

We have determined that all of our lending divisions and subsidiaries meet the aggregation criteria of ASC 280, *Segment Reporting*, since all offer similar products and services, operate with similar processes, and have similar customers.

Stock-based Compensation

We account for all stock-based compensation transactions in accordance with ASC 718, *Compensation Stock Compensation* (ASC 718), which requires that stock compensation transactions be recognized as compensation expense in the statement of operations based on their fair values on the measurement date, which

is the date of the grant. We transitioned to fair value based accounting for stock-based compensation using a modified version of prospective application (modified prospective application). Under modified prospective application, as it is applicable to us, ASC 718 applies to new awards and to awards modified, repurchased or cancelled after January 1, 2006. Additionally, compensation expense for the portion of awards for which the requisite period has not been rendered (generally referring to nonvested awards) that are outstanding as of January 1, 2006 are being recognized as the remaining requisite service is rendered during and after the period of adoption of ASC 718.

The compensation expense for the earlier awards is based on the same method and on the same grant date fair values previously determined for the pro forma disclosures required for all companies that did not previously adopt the fair value accounting method for stock-based compensation.

Accumulated Other Comprehensive Income

Unrealized gains or losses on our available-for-sale securities (after applicable income tax expense or benefit) are included in accumulated other comprehensive income, net. Accumulated comprehensive income, net for the three months ended March 31, 2012 and March 31, 2011 is reported in the accompanying consolidated statements of changes in stockholders equity.

Income Taxes

The Company and its subsidiary file a consolidated federal income tax return. We utilize the liability method in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based upon the difference between the values of the assets and liabilities as reflected in the financial statements and their related tax basis using enacted tax rates in effect for the year in which the differences are expected to be recovered or settled. As changes in tax law or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. A valuation reserve is provided against deferred tax assets unless it is more likely than not that such deferred tax assets will be realized.

Basic and Diluted Earnings Per Common Share

Basic earnings per common share is based on net income available to common stockholders divided by the weighted-average number of common shares outstanding during the period excluding non-vested stock. Diluted earnings per common share include the dilutive effect of stock options and non-vested stock awards granted using the treasury stock method. A reconciliation of the weighted-average shares used in calculating basic earnings per common share and the weighted average common shares used in calculating diluted earnings per common share for the reported periods is provided in Note 2 Earnings Per Common Share.

Fair Values of Financial Instruments

ASC 820, *Fair Value Measurements and Disclosures* (ASC 820), defines fair value, establishes a framework for measuring fair value under GAAP and enhances disclosures about fair value measurements.

Table of Contents

(2) EARNINGS PER COMMON SHARE

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

	Three months ended March 31, 2012	2011
Numerator:		
Net income from continuing operations	$ 27,081	$ 11,939
Income (loss) from discontinued operations	4	(60)
Net income	$ 27,085	$ 11,879
Denominator:		
Denominator for basic earnings per share - weighted average shares	37,795,230	37,090,882
Effect of employee stock-based awards[(1)]	699,271	957,779
Effect of warrants to purchase common stock	419,740	293,018
Denominator for dilutive earnings per share - adjusted weighted average shares and assumed conversions	38,914,241	38,341,679
Basic earnings per common share from continuing operations	$ 0.72	$ 0.32
Basic earnings per common share	$ 0.72	$ 0.32
Diluted earnings per share from continuing operations	$ 0.70	$ 0.31
Diluted earnings per common share	$ 0.70	$ 0.31

(1) Stock options, SARs and RSUs outstanding of 6,000 at March 31, 2012 and 116,000 at March 31, 2011 have not been included in diluted earnings per share because to do so would have been anti-dilutive for the periods presented.

(3) SECURITIES

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

Our net unrealized gain on the available-for-sale securities portfolio value decreased from a gain of $7.3 million, which represented 5.32% of the amortized cost at December 31, 2011, to a gain of $7.0 million, which represented 5.97% of the amortized cost at March 31, 2012.

Table of Contents

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

	March 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Securities:				
Residential mortgage-backed securities	$ 77,188	$ 5,557	$	$ 82,745
Corporate securities	5,000	218		5,218
Municipals	27,150	1,056		28,206
Equity securities[(1)]	7,513	146		7,659
	$ 116,851	$ 6,977	$	$ 123,828

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Securities:				
Residential mortgage-backed securities	$ 84,363	$ 5,720	$	$ 90,083
Corporate securities	5,000	225		5,225
Municipals	29,577	1,165		30,742
Equity securities[(1)]	7,506	154		7,660
Other	10,000			10,000
	$ 136,446	$ 7,264	$	$ 143,710

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

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

	March 31, 2012				
	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	$	$ 10,251	$ 27,126	$ 39,811	$ 77,188
Estimated fair value		11,014	29,172	42,559	82,745
Weighted average yield[(3)]		4.98%	4.67%	3.75%	4.24%
Corporate securities:					
Amortized cost		5,000			5,000
Estimated fair value		5,218			5,218
Weighted average yield[(3)]		7.38%			7.38%
Municipals:[(2)]					
Amortized cost	3,114	20,499	3,537		27,150
Estimated fair value	3,154	21,352	3,700		28,206
Weighted average yield[(3)]	5.26%	5.55%	5.94%		5.57%
Equity securities:					
Amortized cost	7,513				7,513
Estimated fair value	7,659				7,659

Total available-for-sale securities:	
Amortized cost	$ 116,851
Estimated fair value	$ 123,828

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

Table of Contents

Securities with carrying values of approximately $50.6 million were pledged to secure certain borrowings and deposits at March 31, 2012. Of the pledged securities at March 31, 2012, approximately $24.5 million were pledged for certain deposits, and approximately $26.1 million were pledged for repurchase agreements.

At March 31, 2012 and December 31, 2011, we did not have any investment securities in an unrealized loss position.

(4) LOANS AND ALLOWANCE FOR LOAN LOSSES

At March 31, 2012 and December 31, 2011, loans were as follows (in thousands):

	March 31, 2012	December 31, 2011
Commercial	$ 3,469,633	$ 3,275,150
Construction	514,821	422,026
Real estate	1,756,267	1,819,251
Consumer	21,967	24,822
Leases	62,088	61,792
Gross loans held for investment	5,824,776	5,603,041
Deferred income (net of direct origination costs)	(32,427)	(30,670)
Allowance for loan losses	(71,992)	(70,295)
Total loans held for investment, net	5,720,357	5,502,076
Loans held for sale	2,255,281	2,080,081
Total	$ 7,975,638	$ 7,582,157

Commercial Loans and Leases. Our commercial loan portfolio is comprised of lines of credit for working capital and term loans and leases to finance equipment and other business assets. Our energy production loans are generally collateralized with proven reserves based on appropriate valuation standards. Our commercial loans and leases are underwritten after carefully evaluating and understanding the borrower s ability to operate profitably. Our underwriting standards are designed to promote relationship banking rather than making loans on a transaction basis. Our lines of credit typically are limited to a percentage of the value of the assets securing the line. Lines of credit and term loans typically are reviewed annually and are supported by accounts receivable, inventory, equipment and other assets of our clients businesses.

Real Estate Loans. A portion of our real estate loan portfolio is comprised of loans secured by properties other than market risk or investment-type real estate. Market risk loans are real estate loans where the primary source of repayment is expected to come from the sale or lease of the real property collateral. We generally provide temporary financing for commercial and residential property. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Our real estate loans generally have maximum terms of five to seven years, and we provide loans with both floating and fixed rates. We generally avoid long-term loans for commercial real estate held for investment. Real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Appraised values may be highly variable due to market conditions and impact of the inability of potential purchasers and lessees to obtain financing and lack of transactions at comparable values.

Construction Loans. Our construction loan portfolio consists primarily of single- and multi-family residential properties and commercial projects used in manufacturing, warehousing, service or retail businesses. Our construction loans generally have terms of one to three years. We typically make construction loans to developers, builders and contractors that have an established record of successful project completion and loan repayment and have a substantial investment in the borrowers equity. However, construction loans are generally based upon estimates of costs and value associated with the completed project. Sources of repayment for these types of loans may be pre-committed permanent loans from other lenders, sales of developed property, or an interim loan commitment from us until permanent financing is obtained. The nature of these loans makes ultimate repayment extremely sensitive to overall economic conditions. Borrowers may not be able to correct conditions of default in loans, increasing risk of exposure to classification, NPA status, reserve allocation and actual credit loss and foreclosure. These loans typically have floating rates and commitment fees.

Table of Contents

Loans Held for Sale. Our loans held for sale consist of participations purchased in single-family residential mortgages funded through our warehouse lending group. These loans are typically on our balance sheet for 10 to 20 days or less. We have agreements with mortgage lenders and participate in individual loans they originate. All loans are underwritten consistent with established programs for permanent financing with financially sound investors. Substantially all loans are conforming loans.

As of March 31, 2012, 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 appropriate to cover estimated losses on loans at each balance sheet date.

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

We have several pass credit grades that are assigned to loans based on varying levels of risk, ranging from credits that are secured by cash or marketable securities, to watch credits which have all the characteristics of an acceptable credit risk but warrant more than the normal level of monitoring. Within our criticized/classified credit grades are special mention, substandard, and doubtful. Special mention loans are those that are currently protected by sound worth and paying capacity of the borrower, but that are potentially weak and constitute an additional credit risk. The loan has the potential to deteriorate to a substandard grade due to the existence of financial or administrative deficiencies. Substandard loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Some substandard loans are inappropriately protected by sound worth and paying capacity of the borrower and of the collateral pledged and may be considered impaired. Substandard loans can be accruing or can be on nonaccrual depending on the circumstances of the individual loans. Loans classified as doubtful have all the weaknesses inherent in substandard loans with the added characteristics that the weaknesses make collection or liquidation in full highly questionable and improbable. The possibility of loss is extremely high. All doubtful loans are on nonaccrual.

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

Table of Contents

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

The following tables summarize the credit risk profile of our loan portfolio by internally assigned grades and nonaccrual status as of March 31, 2012 and December 31, 2011 (in thousands):

March 31, 2012	$3,275,150 Commercial	$3,275,150 Construction	$3,275,150 Real Estate	$3,275,150 Consumer	$3,275,150 Leases	$3,275,150 Total
Grade:						
Pass	$ 3,387,233	$ 483,830	$ 1,655,966	$ 21,674	$ 60,416	$ 5,609,119
Special mention	22,639	5,792	35,928		1,194	65,553
Substandard-accruing	50,276	4,500	45,027		141	99,944
Non-accrual	9,485	20,699	19,346	293	337	50,160
Total loans held for investment	$ 3,469,633	$ 514,821	$ 1,756,267	$ 21,967	$ 62,088	$ 5,824,776

December 31, 2011	$3,275,150 Commercial	$3,275,150 Construction	$3,275,150 Real Estate	$3,275,150 Consumer	$3,275,150 Leases	$3,275,150 Total
Grade:						
Pass	$ 3,185,625	$ 385,639	$ 1,717,434	$		