

TEXAS CAPITAL BANCSHARES INC/TX  
Form 10-Q  
October 25, 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 September 30, 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)

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

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**75-2679109**  
(I.R.S. Employer  
Identification Number)

**2000 McKinney Avenue, Suite 700,**  
**Dallas, Texas, U.S.A.**  
(Address of principal executive officers)

**75201**  
(Zip Code)

**214/932-6600**  
(Registrant's telephone number, including area code)

N/A

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of large accelerated filer and accelerated filer Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer   
Non-Accelerated Filer  (Do not check if a smaller reporting company) Small Reporting Company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

On October 23, 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	40,587,532
--	------------

**Table of Contents**

Texas Capital Bancshares, Inc.  
Form 10-Q  
Quarter Ended September 30, 2012  
Index

**Part I. Financial Information**

Item 1.	<u>Financial Statements</u>	
	<u>Consolidated Statements of Income and Other Comprehensive Income - Unaudited</u>	3
	<u>Consolidated Balance Sheets - Unaudited</u>	4
	<u>Consolidated Statements of Stockholders' Equity - Unaudited</u>	5
	<u>Consolidated Statements of Cash Flows - Unaudited</u>	6
	<u>Notes to Consolidated Financial Statements - Unaudited</u>	7
	<u>Financial Summaries - Unaudited</u>	31
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	33
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	45
Item 4.	<u>Controls and Procedures</u>	48
<b><u>Part II. Other Information</u></b>		48
Item 1.	<u>Legal Proceedings</u>	48
Item 1A.	<u>Risk Factors</u>	49
Item 5.	<u>Exhibits</u>	50
<b><u>Signatures</u></b>		51

**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 September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
<b>Interest income</b>				
Loans	\$ 100,830	\$ 81,692	\$ 286,895	\$ 223,241
Securities	1,125	1,524	3,635	5,050
Federal funds sold	2	3	7	36
Deposits in other banks	54	44	151	306
Total interest income	102,011	83,263	290,688	228,633
<b>Interest expense</b>				
Deposits	3,378	3,191	10,332	11,479
Federal funds purchased	268	128	789	329
Repurchase agreements	3	2	10	6
Other borrowings	607	110	1,534	124
Subordinated notes	208		208	
Trust preferred subordinated debentures	692	634	2,091	1,905
Total interest expense	5,156	4,065	14,964	13,843
<b>Net interest income</b>	96,855	79,198	275,724	214,790
<b>Provision for credit losses</b>	3,000	7,000	7,000	22,500
<b>Net interest income after provision for credit losses</b>	93,855	72,198	268,724	192,290
<b>Non-interest income</b>				
Service charges on deposit accounts	1,684	1,585	4,912	4,976
Trust fee income	1,216	1,091	3,562	3,111
Bank owned life insurance (BOLI) income	549	533	1,658	1,595
Brokered loan fees	4,839	2,849	12,618	7,927
Other	2,264	1,545	7,454	5,629
Total non-interest income	10,552	7,603	30,204	23,238
<b>Non-interest expense</b>				
Salaries and employee benefits	31,009	25,596	90,258	73,877
Net occupancy expense	3,653	3,367	10,936	10,120
Marketing	3,472	2,455	9,469	7,311
Legal and professional	4,916	3,647	12,237	10,634
Communications and technology	2,885	2,210	8,088	7,141
FDIC insurance assessment	1,332	1,465	4,497	5,948
Allowance and other carrying costs for OREO	552	2,150	7,706	7,203
Other	5,702	5,296	16,579	15,614
Total non-interest expense	53,521	46,186	159,770	137,848

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

<b>Income from continuing operations before income taxes</b>	50,886	33,615	139,158	77,680
Income tax expense	18,316	11,905	49,884	27,323
<b>Income from continuing operations</b>	<b>32,570</b>	<b>21,710</b>	<b>89,274</b>	<b>50,357</b>
<b>Loss from discontinued operations (after-tax)</b>	<b>(34)</b>	<b>(7)</b>	<b>(31)</b>	<b>(121)</b>
<b>Net income</b>	<b>\$ 32,536</b>	<b>\$ 21,703</b>	<b>\$ 89,243</b>	<b>\$ 50,236</b>
<b>Basic earnings per common share</b>				
Income from continuing operations	\$ 0.82	\$ 0.58	\$ 2.32	\$ 1.35
Net income	\$ 0.82	\$ 0.58	\$ 2.32	\$ 1.35
<b>Diluted earnings per common share</b>				
Income from continuing operations	\$ 0.80	\$ 0.56	\$ 2.25	\$ 1.31
Net income	\$ 0.80	\$ 0.56	\$ 2.25	\$ 1.31
<b>Other comprehensive income</b>				
Unrealized (loss) on available-for-sale securities arising during period, before tax	\$ (386)	\$ (142)	\$ (1,298)	\$ (346)
Income tax benefit (expense) related to unrealized gain (loss) on available-for-sale securities	(135)	(50)	(454)	(121)
<b>Other comprehensive loss net of tax</b>	<b>(251)</b>	<b>(92)</b>	<b>(844)</b>	<b>(225)</b>
<b>Comprehensive income</b>	<b>\$ 32,285</b>	<b>\$ 21,611</b>	<b>\$ 88,399</b>	<b>\$ 50,011</b>

See accompanying notes to consolidated financial statements.

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

(In thousands except per share data)

	September 30, 2012 (Unaudited)	December 31, 2011
<b>Assets</b>		
Cash and due from banks	\$ 88,220	\$ 79,248
Interest-bearing deposits	60,971	31,310
Securities, available-for-sale	107,288	143,710
Loans held for sale	2,818,622	2,080,081
Loans held for sale from discontinued operations	304	393
Loans held for investment (net of unearned income)	6,549,089	5,572,371
Less: Allowance for loan losses	73,722	70,295
Loans held for investment, net	6,475,367	5,502,076
Premises and equipment, net	11,280	11,457
Accrued interest receivable and other assets	299,582	268,863
Goodwill and intangible assets, net	20,032	20,480
<b>Total assets</b>	<b>\$ 9,881,666</b>	<b>\$ 8,137,618</b>
<b>Liabilities and Stockholders Equity</b>		
<b>Liabilities:</b>		
<b>Deposits:</b>		
Non-interest bearing	\$ 2,114,279	\$ 1,751,944
Interest bearing	4,171,405	3,324,040
Interest bearing in foreign branches	431,895	480,273
<b>Total deposits</b>	<b>6,717,579</b>	<b>5,556,257</b>
Accrued interest payable	1,039	599
Other liabilities	90,067	82,909
Federal funds purchased	473,330	412,249
Repurchase agreements	22,788	23,801
Other borrowings	1,550,051	1,332,066
Subordinated notes	111,000	
Trust preferred subordinated debentures	113,406	113,406
<b>Total liabilities</b>	<b>9,079,260</b>	<b>7,521,287</b>
<b>Stockholders equity:</b>		
<b>Preferred stock, \$.01 par value, \$1,000 liquidation value:</b>		
Authorized shares 10,000,000		
<b>Common stock, \$.01 par value:</b>		
Authorized shares 100,000,000		
Issued shares 40,580,700 and 37,666,708 at September 30, 2012 and December 31, 2011	406	376
Additional paid-in capital	447,104	349,458
Retained earnings	351,026	261,783
Treasury stock (shares at cost: 417 at September 30, 2012 and December 31, 2011)	(8)	(8)
Accumulated other comprehensive income, net of taxes	3,878	4,722

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

Total stockholders' equity	802,406	616,331
Total liabilities and stockholders' equity	\$ 9,881,666	\$ 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	Total	
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Shares			Amount
Balance at December 31, 2010		\$	36,957,104	\$ 369	\$ 336,796	\$ 185,807	(417)	\$ (8)	\$ 5,355	\$ 528,319
Comprehensive income:										
Net income (unaudited)						50,236				50,236
Change in unrealized gain on available-for-sale securities, net of taxes of \$121 (unaudited)									(225)	(225)
Total comprehensive income (unaudited)										50,011
Tax expense related to exercise of stock-based awards (unaudited)					2,196					2,196
Stock-based compensation expense recognized in earnings (unaudited)					5,802					5,802
Issuance of stock related to stock-based awards (unaudited)			501,075	5	1,611					1,616
Balance at September 30, 2011 (unaudited)		\$	37,458,179	\$ 374	\$ 346,405	\$ 236,043	(417)	\$ (8)	\$ 5,130	\$ 587,944
Balance at December 31, 2011		\$	37,666,708	\$ 376	\$ 349,458	\$ 261,783	(417)	\$ (8)	\$ 4,722	\$ 616,331
Comprehensive income:										
Net income (unaudited)						89,243				89,243
Change in unrealized gain on available-for-sale securities, net of taxes of \$454 (unaudited)									(844)	(844)
Total comprehensive income (unaudited)										88,399
Tax expense related to exercise of stock-based awards (unaudited)					5,773					5,773
Stock-based compensation expense recognized in earnings (unaudited)					4,648					4,648
Issuance of stock related to stock-based awards (unaudited)			613,992	7	261					268
Issuance of stock (unaudited)			2,300,000	23	86,964					86,987
		\$	40,580,700	\$ 406	\$ 447,104	\$ 351,026	(417)	\$ (8)	\$ 3,878	\$ 802,406



Balance at September 30, 2012  
(unaudited)

See accompanying notes to consolidated financial statements

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

(In thousands)

	Nine months ended September 30,	
	2012	2011
<b>Operating activities</b>		
Net income from continuing operations	\$ 89,274	\$ 50,357
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for credit losses	7,000	22,500
Depreciation and amortization	3,569	4,114
Amortization and accretion on securities	31	63
Bank owned life insurance (BOLI) income	(1,658)	(1,595)
Stock-based compensation expense	9,886	5,802
Tax benefit from stock option exercises	5,773	2,196
Excess tax benefits from stock-based compensation arrangements	(16,493)	(6,274)
Originations of loans held for sale	(36,239,859)	(17,790,459)
Proceeds from sales of loans held for sale	35,501,320	17,075,496
Gain on sale of assets	(357)	(145)
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	(41,625)	(59,388)
Accrued interest payable and other liabilities	2,814	15,026
Net cash used in operating activities of continuing operations	(680,325)	(682,307)
Net cash provided by (used in) operating activities of discontinued operations	57	(26)
Net cash used in operating activities	(680,268)	(682,333)
<b>Investing activities</b>		
Purchases of available-for-sale securities	(6)	
Maturities and calls of available-for-sale securities	14,260	7,575
Principal payments received on available-for-sale securities	20,839	34,544
Net increase in loans held for investment	(980,292)	(617,762)
Purchase of premises and equipment, net	(2,505)	(2,539)
Proceeds from sale of foreclosed assets	12,482	19,741
Cash paid for acquisition		(11,482)
Net cash used in investing activities of continuing operations	(935,222)	(569,923)
<b>Financing activities</b>		
Net increase in deposits	1,161,322	31,062
Proceeds from issuance of stock related to stock-based awards	268	1,616
Proceeds from issuance of stock	86,987	
Net increase in other borrowings	216,972	1,115,858
Excess tax benefits from stock-based compensation arrangements	16,493	6,274
Net increase in federal funds purchased	61,081	38,149
Issuance of subordinated notes	111,000	
Net cash provided by financing activities of continuing operations	1,654,123	1,192,959
Net increase (decrease) in cash and cash equivalents	38,633	(59,297)
Cash and cash equivalents at beginning of period	110,558	179,866

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

Cash and cash equivalents at end of period	\$	149,191	120,569
--	----	---------	---------

Supplemental disclosures of cash flow information:

Cash paid during the period for interest	\$	14,524	\$	15,210
Cash paid during the period for income taxes		56,552		19,516

Non-cash transactions:

Transfers from loans/leases to OREO and other repossessed assets		3,410		19,254
--	--	-------	--	--------

See accompanying notes to consolidated financial statements.

## **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 largely 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 2011 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 GAAP 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 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.



## **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 September 30, 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 collectability 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 a third party investor. We typically purchase up to a 99% participation interest with the originator financing the remaining percentage. The loan participations are highly liquid and held by us for a short period, usually less than 30 days and more typically 10-20 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 in accordance with the terms of the agreements, loans could 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 a general reserve for estimated 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 collectability 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.

### **Reposessed Assets**

Reposessed assets, which are included in other assets on the balance sheet, consist of collateral that has been reposessed. Collateral that has been reposessed 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, and 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. Capitalized 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.





## **Table of Contents**

### **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 nine months ended September 30, 2012 and 2011 is reported in the accompanying consolidated statements of changes in stockholders' equity and consolidated statements of income and comprehensive income.

### **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. In general, fair values of financial instruments are based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows.

**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 September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
<b>Numerator:</b>				
Net income from continuing operations	\$ 32,570	\$ 21,710	\$ 89,274	\$ 50,357
Loss from discontinued operations	(34)	(7)	(31)	(121)
Net income	\$ 32,536	\$ 21,703	\$ 89,243	\$ 50,236
<b>Denominator:</b>				
Denominator for basic earnings per share - weighted average shares	39,618,007	37,411,851	38,513,515	37,262,658
Effect of employee stock-based awards <sup>(1)</sup>	632,790	714,192	677,782	888,027
Effect of warrants to purchase common stock	504,936	309,343	459,898	304,199
Denominator for dilutive earnings per share - adjusted weighted average shares and assumed conversions	40,755,733	38,435,386	39,651,195	38,454,884
Basic earnings per common share from continuing operations	\$ 0.82	\$ 0.58	\$ 2.32	\$ 1.35
Basic earnings per common share	\$ 0.82	\$ 0.58	\$ 2.32	\$ 1.35
Diluted earnings per share from continuing operations	\$ 0.80	\$ 0.56	\$ 2.25	\$ 1.31
Diluted earnings per common share	\$ 0.80	\$ 0.56	\$ 2.25	\$ 1.31

(1) Stock options, SARs and RSUs outstanding of 47,000 at September 30, 2012 and 93,400 at September 30, 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.

At September 30, 2012, our net unrealized gain on the available-for-sale securities portfolio value was \$6.0 million, which represented 5.89% of the amortized cost. At December 31, 2011, the unrealized gain was \$7.3 million, or 5.32% of the amortized cost. As indicated by the difference in the gain as a percent of the amortized cost, the reduction in the total unrealized gain was due almost entirely to the reduction in the balances of the securities held.



**Table of Contents**

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

	Amortized Cost	September 30, 2012 Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Available-for-Sale Securities:</b>				
Residential mortgage-backed securities	\$ 63,507	\$ 4,847	\$	\$ 68,354
Corporate securities	5,000	150		5,150
Municipals	25,302	761		26,063
Equity securities <sup>(1)</sup>	7,513	208		7,721
	\$ 101,322	\$ 5,966	\$	\$ 107,288
	Amortized Cost	December 31, 2011 Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Available-for-Sale Securities:</b>				
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 <sup>(1)</sup>	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.

**Table of Contents**

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

	September 30, 2012				Total
	Less Than One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	
<b>Available-for-sale:</b>					
<b>Residential mortgage-backed securities:<sup>(1)</sup></b>					
Amortized cost	\$ 1,059	\$ 6,657	\$ 23,037	\$ 32,754	\$ 63,507
Estimated fair value	1,113	7,164	25,000	35,077	68,354
Weighted average yield <sup>(3)</sup>	4.19%	5.26%	4.74%	3.63%	4.21%
<b>Corporate securities:</b>					
Amortized cost		5,000			5,000
Estimated fair value		5,150			5,150
Weighted average yield <sup>(3)</sup>		7.38%			7.38%
<b>Municipals:<sup>(2)</sup></b>					
Amortized cost	5,493	16,872	2,937		25,302
Estimated fair value	5,583	17,429	3,051		26,063
Weighted average yield <sup>(3)</sup>	5.75%	5.59%	5.92%		5.66%
<b>Equity securities:</b>					
Amortized cost	7,513				7,513
Estimated fair value	7,721				7,721
<b>Total available-for-sale securities:</b>					
Amortized cost					\$ 101,322
Estimated fair value					\$ 107,288

	December 31, 2011				Total
	Less Than One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	
<b>Available-for-sale:</b>					
<b>Residential mortgage-backed securities:<sup>(1)</sup></b>					
Amortized cost	\$ 13	\$ 10,420	\$ 31,502	\$ 42,428	\$ 84,363
Estimated fair value	13	11,095	33,745	45,230	90,083
Weighted average yield <sup>(3)</sup>	6.50%	4.85%	4.71%	3.79%	4.26%
<b>Corporate securities:</b>					
Amortized cost		5,000			5,000
Estimated fair value		5,225			5,225
Weighted average yield <sup>(3)</sup>		7.38%			7.38%
<b>Municipals:<sup>(2)</sup></b>					
Amortized cost	4,184	18,980	6,413		29,577
Estimated fair value	4,213	19,784	6,745		30,742
Weighted average yield <sup>(3)</sup>	5.36%	5.51%	5.86%		5.57%
<b>Equity securities:</b>					
Amortized cost	7,506				7,506
Estimated fair value	7,660				7,660
<b>Other:<sup>(3)</sup></b>					
Amortized cost	10,000				10,000
Estimated fair value	10,000				10,000
Weighted average yield <sup>(3)</sup>	0.10%				0.10%
<b>Total available-for-sale securities:</b>					

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

Amortized cost	\$ 136,446
Estimated fair value	\$ 143,710

- (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 \$48.6 million were pledged to secure certain borrowings and deposits at September 30, 2012. Of the pledged securities at September 30, 2012, approximately \$22.1 million were pledged for certain deposits, and approximately \$26.5 million were pledged for repurchase agreements.

At September 30, 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 September 30, 2012 and December 31, 2011, loans were as follows (in thousands):

	September 30, 2012	December 31, 2011
Commercial	\$ 4,038,955	\$ 3,275,150
Construction	649,375	422,026
Real estate	1,804,434	1,819,251
Consumer	19,975	24,822
Leases	74,207	61,792
Gross loans held for investment	6,586,946	5,603,041
Deferred income (net of direct origination costs)	(37,857)	(30,670)
Allowance for loan losses	(73,722)	(70,295)
Total loans held for investment, net	6,475,367	5,502,076
Loans held for sale	2,818,622	2,080,081
Total	\$ 9,293,989	\$ 7,582,157

*Commercial Loans and Leases.* Our commercial loan and lease 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 borrower's 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, non-performing 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 highly liquid and held by us for a short period, usually less than 30 days and more typically 10 to 20 days. 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 September 30, 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.

At September 30, 2012, we had a blanket floating lien based on certain real estate loans used as collateral for FHLB borrowings.

The reserve for loan losses is comprised of specific reserves for impaired loans and a general reserve for estimated 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

**Table of Contents**

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.

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 September 30, 2012 and December 31, 2011 (in thousands):

September 30, 2012

	Commercial	Construction	Real Estate	Consumer	Leases	Total
<b>Grade:</b>						
Pass	\$ 3,955,584	\$ 619,575	\$ 1,729,026	\$ 19,915	\$ 69,935	\$ 6,394,035
Special mention	35,360	5,969	17,619		830	59,778
Substandard-accruing	30,358	4,582	37,689		3,229	75,858
Non-accrual	17,653	19,249	20,100	60	213	57,275
<b>Total loans held for investment</b>	<b>\$ 4,038,955</b>	<b>\$ 649,375</b>	<b>\$ 1,804,434</b>	<b>\$ 19,975</b>	<b>\$ 74,207</b>	<b>\$ 6,586,946</b>

December 31, 2011

	Commercial	Construction	Real Estate	Consumer	Leases	Total
<b>Grade:</b>						
Pass	\$ 3,185,625	\$ 385,639	\$ 1,717,434	\$ 24,453	\$ 57,255	\$ 5,370,406
Special mention	30,872	5,064	32,413	50	3,952	72,351
Substandard-accruing	45,740	10,204	49,601	6	153	105,704
Non-accrual	12,913	21,119	19,803	313	432	54,580
<b>Total loans held for investment</b>	<b>\$ 3,275,150</b>	<b>\$ 422,026</b>	<b>\$ 1,819,251</b>	<b>\$ 24,822</b>	<b>\$ 61,792</b>	<b>\$ 5,603,041</b>

**Table of Contents**

The following table details activity in the reserve for loan losses by portfolio segment for the nine months ended September 30, 2012 and September 30, 2011. Allocation of a portion of the reserve to one category of loans does not preclude its availability to absorb losses in other categories.

September 30, 2012 (in thousands)	Commercial	Construction	Real Estate	Consumer	Leases	Unallocated	Total
Beginning balance	\$ 17,337	\$ 7,845	\$ 33,721	\$ 223	\$ 2,356	\$ 8,813	\$ 70,295
Provision for loan losses	4,575	3,258	(2,840)	6	417	602	6,018
Charge-offs	2,664		899	49	170		3,782
Recoveries	482	10	586	26	87		1,191
<b>Net charge-offs (recoveries)</b>	<b>2,182</b>	<b>(10)</b>	<b>313</b>	<b>23</b>	<b>83</b>		<b>2,591</b>
Ending balance	\$ 19,730	\$ 11,113	\$ 30,568	\$ 206	\$ 2,690	\$ 9,415	\$ 73,722
<b>Period end amount allocated to:</b>							
Loans individually evaluated for impairment	\$ 5,149	\$	\$ 775	\$ 18	\$ 42	\$	\$ 5,984
Loans collectively evaluated for impairment							
Ending balance	\$ 5,149	\$	\$ 775	\$ 18	\$ 42	\$	\$ 5,984
<b>September 30, 2011</b>							
(in thousands)	Commercial	Construction	Real Estate	Consumer	Leases	Unallocated	Total
Beginning balance	\$ 15,918	\$ 7,336	\$ 38,049	\$ 306	\$ 5,405	\$ 4,496	\$ 71,510
Provision for loan losses	11,289	3,024	(7,379)	3,616	7,135	4,438	22,123
Charge-offs	7,170		18,837	317	980		27,304
Recoveries	798	248	305	5	212		1,568
<b>Net charge-offs</b>	<b>6,372</b>	<b>(248)</b>	<b>18,532</b>	<b>312</b>	<b>768</b>		<b>25,736</b>
Ending balance	\$ 20,835	\$ 10,608	\$ 12,138	\$ 3,610	\$ 11,772	\$ 8,934	\$ 67,897
<b>Period end amount allocated to:</b>							
Loans individually evaluated for impairment	\$ 3,064	\$ 312	\$ 2,568	\$ 52	\$ 353	\$	\$ 6,349
Loans collectively evaluated for impairment							
Ending balance	\$ 3,064	\$ 312	\$ 2,568	\$ 52	\$ 353	\$	\$ 6,349

We have traditionally maintained an unallocated reserve component to allow for uncertainty in economic and other conditions affecting the quality of the loan portfolio. The unallocated portion of our loan loss reserve has increased since September 30, 2011. We believe the level of unallocated reserves at September 30, 2012 is warranted due to the ongoing weak economic environment which has produced more frequent losses, including those resulting from fraud by borrowers, that do not correlate to historical loss rates for specific product types or credit risk grades. Our methodology used to calculate the allowance considers historical losses, however, the historical loss rates for specific product types or credit risk grades may not fully incorporate the effects of continued weakness in the economy. In addition, a substantial portion of losses realized over the past several years were related to commercial real estate loans. Continuing uncertainty and illiquidity in the commercial real estate market has produced and continues to cause material changes in appraised values that can influence our impairment calculations on currently impaired loans and on pass-rated loans that may experience weakness if economic conditions and valuations do not stabilize.

**Table of Contents**

Generally we place loans on non-accrual when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectability is questionable, then cash payments are applied to principal. The table below summarizes our non-accrual loans by type and purpose as of September 30, 2012 (in thousands):

Commercial	
Business loans	\$ 17,653
Construction	
Market risk	19,249
Real estate	
Market risk	10,236
Commercial	6,374
Secured by 1-4 family	3,490
Consumer	60
Leases	213
<b>Total non-accrual loans</b>	<b>\$ 57,275</b>

As of September 30, 2012, non-accrual loans included in the table above included \$14.7 million related to loans that met the criteria for restructured.

**Table of Contents**

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. In accordance with *FASB ASC 310 Receivables*, we have also included all restructured loans in our impaired loan totals. The following tables detail our impaired loans, by portfolio class as of September 30, 2012 and December 31, 2011 (in thousands):

September 30, 2012

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>With no related allowance recorded:</b>					
Commercial					
Business loans	\$ 644	\$ 644	\$	\$ 649	\$
Construction					
Market risk	19,248	19,248		19,722	510
Real estate					
Market risk	7,385	7,385		5,079	
Commercial	6,374	6,374		6,375	
Secured by 1-4 family	1,424	1,424		1,436	
Consumer					
Leases					
Total impaired loans with no allowance recorded	\$ 35,075	\$ 35,075	\$	\$ 33,261	\$ 510
<b>With an allowance recorded:</b>					
Commercial					
Business loans	\$ 17,009	\$ 21,966	\$ 5,149	\$ 18,068	\$
Construction					
Real estate					
Market risk	11,997	11,997	563	14,883	
Commercial				25	
Secured by 1-4 family	2,066	2,066	212	2,382	
Consumer	60	110	18	199	
Leases	213	213	42	239	
Total impaired loans with an allowance recorded	\$ 31,345	\$ 36,352	\$ 5,984	\$ 35,796	\$
<b>Combined:</b>					
Commercial					
Business loans	\$ 17,653	\$ 22,610	\$ 5,149	\$ 18,717	\$
Construction					
Market risk	19,248	19,248		19,722	510
Real estate					
Market risk	19,382	19,382	563	19,962	
Commercial	6,374	6,374		6,400	
Secured by 1-4 family	3,490	3,490	212	3,818	
Consumer	60	110	18	199	
Leases	213	213	42	239	
Total impaired loans	\$ 66,420	\$ 71,427	\$ 5,984	\$ 69,057	\$ 510

**Table of Contents**

December 31, 2011

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>With no related allowance recorded:</b>					
Commercial					
Business loans	\$ 1,716	\$ 10,378	\$	\$ 1,697	\$
Construction					
Market risk	19,236	19,236		19,315	291
Real estate					
Market risk	5,711	11,217		7,064	
Commercial	4,575	4,575		5,111	
Secured by 1-4 family				899	
Consumer					
Leases					
Total impaired loans with no allowance recorded	\$ 31,238	\$ 45,406	\$	\$ 34,086	\$ 291
<b>With an allowance recorded:</b>					
Commercial					
Business loans	\$ 11,197	\$ 11,197	\$ 3,124	\$ 11,056	\$
Construction					
Market risk	1,883	1,882	298	1,916	
Real estate					
Market risk	30,533	34,275	1,131	19,146	
Commercial	1,809	1,809	271	730	
Secured by 1-4 family	2,279	2,279	330	1,465	
Consumer	313	313	52	310	
Leases	432	432	65	2,328	
Total impaired loans with an allowance recorded	\$ 48,446	\$ 52,187	\$ 5,271	\$ 36,951	\$
<b>Combined:</b>					
Commercial					
Business loans	\$ 12,913	\$ 21,575	\$ 3,124	\$ 12,753	\$
Construction					
Market risk	21,119	21,118	298	21,231	291
Real estate					
Market risk	36,244	45,492	1,131	26,210	
Commercial	6,384	6,384	271	5,841	
Secured by 1-4 family	2,279	2,279	330	2,364	
Consumer	313	313	52	310	
Leases	432	432	65	2,328	
Total impaired loans	\$ 79,684	\$ 97,593	\$ 5,271	\$ 71,037	\$ 291

**Table of Contents**

Average impaired loans outstanding during the nine months ended September 30, 2012 and 2011 totaled \$69.1 million and \$74.2 million, respectively.

The table below provides an age analysis of our past due loans that are still accruing as of September 30, 2012 (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days and Accruing <sup>(1)</sup>	Total Past Due	Current	Total
<b>Commercial</b>						
Business loans	\$ 16,654	\$ 2,261	\$ 2,864	\$ 21,779	\$ 3,001,668	\$ 3,023,447
<b>Energy</b>					997,855	997,855
<b>Construction</b>						
Market risk					626,223	626,223
Secured by 1-4 family	1,300			1,300	2,603	3,903
<b>Real estate</b>						
Market risk	22,957	4,960	758	28,675	1,396,666	1,425,341
<b>Commercial</b>					284,281	284,281
Secured by 1-4 family		925		925	73,787	74,712
<b>Consumer</b>	105			105	19,810	19,915
Leases	481			481	73,513	73,994
<b>Total loans held for investment</b>	<b>\$ 41,497</b>	<b>\$ 8,146</b>	<b>\$ 3,622</b>	<b>\$ 53,265</b>	<b>\$ 6,476,406</b>	<b>\$ 6,529,671</b>

(1) Loans past due 90 days and still accruing includes premium finance loans of \$2.7 million. These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

Restructured loans are loans on which, due to the borrower's financial difficulties, we have granted a concession that we would not otherwise consider for borrowers or similar credit quality. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of the two. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the maturity date at a contractual interest rate lower than the current rate for new debt with similar risk, or a reduction of the face amount of debt, or forgiveness of either principal or accrued interest. As of September 30, 2012, we have \$9.1 million in loans considered restructured that are not on nonaccrual. These loans have \$1.1 million in unfunded commitments. Of the nonaccrual loans at September 30, 2012, \$14.7 million met the criteria for restructured. These loans have no unfunded commitments. A loan continues to qualify as restructured until a consistent payment history or change in borrower's financial condition has been evidenced, generally no less than twelve months. Assuming that the restructuring agreement specifies an interest rate at the time of the restructuring that is greater than or equal to the rate that we are willing to accept for a new extension of credit with comparable risk, then the loan no longer has to be considered a restructuring if it is in compliance with modified terms in calendar years after the year of the restructure.

**Table of Contents**

The following tables summarize, for the nine months ended September 30, 2012 and 2011, loans that have been restructured during 2012 and 2011, respectively, (in thousands):

September 30, 2012

	Number of Contracts	Pre-Restructuring Outstanding Recorded Investment	Post- Restructuring Outstanding Recorded Investment
Commercial business loans	1	\$ 802	\$ 777
Real estate market risk	2	1,726	1,162
Real estate 1-4 family	1	1,424	1,424
Total new restructured loans in 2012	4	\$ 3,952	\$ 3,363

September 30, 2011

	Number of Contracts	Pre-Restructuring Outstanding Recorded Investment	Post- Restructuring Outstanding Recorded Investment
Commercial business loans	3	\$ 2,140	\$ 1,984
Construction market risk	1	2,620	1,915
Real estate market risk	9	43,374	37,569
Real estate 1-4 family	1	1,217	1,349
Total new restructured loans in 2011	14	\$ 49,351	\$ 42,817

The restructured loans generally include terms to reduce the interest rate and extend payment terms. We have not forgiven any principal on the above loans. At September 30, 2012, \$1.7 million of the above loans restructured in 2012 are on non-accrual. The restructuring of the loans did not have a significant impact on our allowance for loan losses at September 30, 2012.

The following tables provide information on how loans were modified as a TDR during the nine months ended September 30, 2012 and 2011 (in thousands):

	September 30,	
	2012	2011
Extended maturity	\$ 1,939	\$ 10,725
Adjusted payment schedule	1,424	26,144
Combination of maturity extension and payment schedule adjustment		4,011
Other		1,937
Total	\$ 3,363	\$ 42,817

The following table summarizes, as of September 30, 2012, loans that were restructured within the last 12 months that have subsequently defaulted (in thousands):

	Number of Contracts	Recorded Investment
Commercial - secured by real estate	1	\$ 875



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

Real estate - market risk	1	2,453
---------------------------	---	-------

The loans above were subsequently foreclosed and are included in the September 30, 2012 OREO balance.

**Table of Contents****(5) OREO AND VALUATION ALLOWANCE FOR LOSSES ON OREO**

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Beginning balance	\$ 27,882	\$ 27,285	\$ 34,077	\$ 42,261
Additions		12,661	3,397	19,254
Sales	(8,739)	(2,488)	(12,467)	(20,012)
Valuation allowance for OREO		(1,601)	(3,556)	(3,522)
Direct write-downs	(64)	(61)	(2,372)	(2,185)
Ending balance	\$ 19,079	\$ 35,796	\$ 19,079	\$ 35,796

**(6) FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK**

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit which involve varying degrees of credit risk in excess of the amount recognized in the consolidated balance sheets. The Bank's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation of the borrower.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit-worthiness on a case-by-case basis.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

The table below summarizes our financial instruments whose contract amounts represent credit risk at September 30, 2012 (in thousands):

Commitments to extend credit	\$ 2,263,389
Standby letters of credit	74,461

**(7) REGULATORY MATTERS**

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of September 30, 2012, that the Company and the Bank meet all

capital adequacy requirements to which they are subject.

**Table of Contents**

Financial institutions are categorized as well capitalized or adequately capitalized, based on minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the tables below. As shown below, the Company's capital ratios exceed the regulatory definition of well capitalized as of September 30, 2012 and 2011. As of June 30, 2012, the most recent notification from the OCC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There have been no conditions or events since the notification that management believes have changed the Bank's category. Based upon the information in its most recently filed call report, the Bank continues to meet the capital ratios necessary to be well capitalized under the regulatory framework for prompt corrective action and continues to meet the capital ratios necessary to be well capitalized under the regulatory framework for prompt corrective action.

	September 30,	
	2012	2011
Risk-based capital:		
Tier 1 capital	10.35%	9.67%
Total capital	12.55%	10.68%
Leverage	9.63%	9.77%

On August 1, 2012 we completed a sale of 2.3 million shares of our common stock in a public offering. Net proceeds from the sale totaled \$87.0 million. The additional equity is being used for general corporate purposes, including retirement of \$15.0 million of debt and additional capital to support continued loan growth at our bank.

On September 21, 2012, we issued \$111.0 million of subordinated notes. The notes mature in September 2042 and bear interest at a rate of 6.50% per annum, payable quarterly. The proceeds may be used for general corporate purposes including funding regulatory capital infusions into the Bank. The loan agreement contains customary financial covenants and restrictions.

**(8) STOCK-BASED COMPENSATION**

The fair value of our stock option and stock appreciation right (SAR) grants are estimated at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide the best single measure of the fair value of its employee stock options.

Stock-based compensation consists of SARs and RSUs were granted from 2006 through 2010.

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Stock-based compensation expense recognized:				
SARs	\$ 179	\$ 303	554	1,028
RSUs	916	1,312	4,094	4,774
Total compensation expense recognized	\$ 1,095	\$ 1,615	\$ 4,648	\$ 5,802

**Table of Contents**

	September 30, 2012	
(in thousands)	Options	SARs and RSUs
Unrecognized compensation expense related to unvested awards	\$	\$ 9,577
Weighted average period over which expense is expected to be recognized, in years		3.24

In connection with the 2010 Long-term Incentive Plan, the Company has issued cash-based performance units. A summary of the compensation cost for these units is as follows (in thousands):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Cash-based performance units	\$ 2,337	\$ 109	\$ 5,238	\$ 284

**(9) DISCONTINUED OPERATIONS**

Subsequent to the end of the first quarter of 2007, we and the purchaser of our residential mortgage loan division ( RML ) agreed to terminate and settle the contractual arrangements related to the sale of the division, which had been completed as of the end of the third quarter of 2006. Historical operating results of RML are reflected as discontinued operations in the financial statements.

During the three months ended September 30, 2012 and 2011, the loss from discontinued operations was \$34,000 and \$7,000, net of taxes, respectively. During the nine months ended September 30, 2012 and 2011, the loss from discontinued operations was \$31,000 and \$121,000, net of taxes, respectively. The 2012 and 2011 losses are primarily related to continuing legal and salary expenses incurred in dealing with the remaining loans and requests from investors related to the repurchase of previously sold loans. We still have approximately \$304,000 in loans held for sale from discontinued operations that are carried at the estimated market value at quarter-end, which is less than the original cost. We plan to sell these loans, but timing and price to be realized cannot be determined at this time due to market conditions. In addition, we continue to address requests from investors related to repurchasing loans previously sold. While the balances as of September 30, 2012 include a liability for exposure to additional contingencies, including risk of having to repurchase loans previously sold, we recognize that market conditions may result in additional exposure to loss and the extension of time necessary to complete the discontinued mortgage operation.

**(10) FAIR VALUE DISCLOSURES**

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. Fair value is defined under ASC 820 as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal market for the asset or liability in an orderly transaction between market participants on the measurement date.

We determine the fair market values of our financial instruments based on the fair value hierarchy as prescribed in ASC 820. The standard describes three levels of inputs that may be used to measure fair value as provided below.

- |         |  |
|---------|--|
| Level 1 | Quoted prices in active markets for identical assets or liabilities. Level 1 assets include U.S. Treasuries that are highly liquid and are actively traded in over-the-counter markets.  |
| Level 2 | Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets include U.S. government and agency mortgage-backed debt securities, corporate securities, municipal bonds, and Community Reinvestment Act funds. This category includes derivative assets and liabilities where values are obtained from independent pricing services. |

**Table of Contents**

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

Assets and liabilities measured at fair value at September 30, 2012 and December 31, 2011 are as follows (in thousands):

September 30, 2012

	Fair Value Measurements Using		
	Level 1	Level 2	Level 3
Available for sale securities: <sup>(1)</sup>			
Residential mortgage-backed securities	\$	\$ 68,354	\$
Corporate securities		5,150	
Municipals		26,063	
Equity securities		7,721	
Loans <sup>(2) (4)</sup>			10,671
OREO <sup>(3) (4)</sup>			19,079
Derivative asset <sup>(5)</sup>		29,031	
Derivative liability <sup>(5)</sup>		(29,031)	

December 31, 2011

Available for sale securities: <sup>(1)</sup>			
Residential mortgage-backed securities	\$	\$ 90,083	\$
Corporate securities		5,225	
Municipals		30,742	
Equity securities		7,660	
Other		10,000	
Loans <sup>(2) (4)</sup>			12,448
OREO <sup>(3) (4)</sup>			34,077
Derivative asset <sup>(5)</sup>		20,071	
Derivative liability <sup>(5)</sup>		(20,071)	

- (1) Securities are measured at fair value on a recurring basis, generally monthly.
- (2) Includes impaired loans that have been measured for impairment at the fair value of the loan's collateral.
- (3) OREO is transferred from loans to OREO at fair value less selling costs.
- (4) Fair value of loans and OREO is measured on a nonrecurring basis, generally annually or more often as warranted by market and economic conditions.
- (5) Derivative assets and liabilities are measured at fair value on a recurring basis, generally quarterly.

**Level 3 Valuations**

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

*Loans*

During the three and nine months ended September 30, 2012, certain impaired loans were reevaluated and reported at fair value through a specific valuation allowance allocation of the allowance for loan losses based upon the fair value of the underlying collateral. The \$10.7 million total above includes impaired loans at



**Table of Contents**

September 30, 2012 with a carrying value of \$12.1 million that were reduced by specific valuation allowance allocations totaling \$1.4 million for a total reported fair value of \$10.7 million based on collateral valuations utilizing Level 3 valuation inputs. Fair values were based on third party appraisals; however, based on the current economic conditions, comparative sales data typically used in the appraisals may be unavailable or more subjective due to the lack of real estate market activity.

*OREO*

Certain foreclosed assets, upon initial recognition, are valued based on third party appraisals less estimated selling costs. At September 30, 2012, OREO with a carrying value of \$23.8 million was reduced by specific valuation allowance allocations totaling \$4.7 million for a total reported fair value of \$19.1 million based on valuations utilizing Level 3 valuation inputs. Fair values are based on third party appraisals; however, based on the current economic conditions, comparative sales data typically used in the appraisals may be unavailable or more subjective due to the lack of real estate market activity.

**Fair Value of Financial Instruments**

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

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

	September 30, 2012		December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Cash and cash equivalents	\$ 149,191	\$ 149,191	\$ 101,258	\$ 101,258
Securities, available-for-sale	107,288	107,288	143,710	143,710
Loans held for sale	2,818,622	2,818,622	2,080,081	2,080,081
Loans held for sale from discontinued operations	304	304	393	393
Loans held for investment, net	6,475,367	6,480,374	5,502,076	5,506,899
Derivative asset	29,031	29,031	20,071	20,071
Deposits	6,717,579	6,718,017	5,556,257	5,557,062
Federal funds purchased	473,330	473,330	412,249	412,249
Borrowings	1,572,839	1,572,840	1,355,867	1,355,869
Subordinated notes	111,000	113,468		
Trust preferred subordinated debentures	113,406	113,406	113,406	113,406
Derivative liability	29,031	29,031	20,071	20,071

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

*Cash and cash equivalents*

The carrying amounts reported in the consolidated balance sheet for cash and cash equivalents approximate their fair value, which is characterized as a Level 1 asset in the fair value hierarchy.

*Securities*

The fair value of investment securities is based on prices obtained from independent pricing services which are based on quoted market prices for the same or similar securities, which is characterized as a Level 2 asset in the fair value hierarchy. We have obtained documentation from the primary pricing service we use about their processes and controls over pricing. In addition, on a quarterly basis we independently verify the prices that we receive from the service provider using two additional independent pricing sources. Any significant differences are investigated and resolved.





## **Table of Contents**

### *Loans, net*

Loans are characterized as Level 3 assets in the fair value hierarchy. For variable-rate loans that reprice frequently with no significant change in credit risk, fair values are generally based on carrying values. The fair value for all other loans is estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying amount of accrued interest approximates its fair value. The carrying amount of loans held for sale approximates fair value.

### *Derivatives*

The estimated fair value of the interest rate swaps and caps are obtained from independent pricing services, which is characterized as a Level 2 asset in the fair value hierarchy. On a quarterly basis, we independently verify the fair value using an additional independent pricing source.

### *Deposits*

Deposits are characterized as Level 3 assets in the fair value hierarchy. The carrying amounts for variable-rate money market accounts approximate their fair value. Fixed-term certificates of deposit fair values are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities.

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

The carrying value reported in the consolidated balance sheet for federal funds purchased and other borrowings approximates their fair value. The fair value of other borrowings and trust preferred subordinated debentures is estimated using a discounted cash flow calculation that applies interest rates currently being offered on similar borrowings, which is characterized as a Level 3 liability in the fair value hierarchy. The subordinated notes are publicly traded and are valued based on market prices, which is characterized as a Level 2 liability in the fair value hierarchy.

## **(11) DERIVATIVE FINANCIAL INSTRUMENTS**

The fair value of derivative positions outstanding is included in other assets and other liabilities in the accompanying consolidated balance sheets.

During 2012 and 2011, we entered into certain interest rate derivative positions that are not designated as hedging instruments. These derivative positions relate to transactions in which we enter into an interest rate swap, cap and/or floor with a customer while at the same time entering into an offsetting interest rate swap, cap and/or floor with another financial institution. In connection with each swap transaction, we agree to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a similar notional amount at a fixed interest rate. At the same time, we agree to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows our customer to effectively convert a variable rate loan to a fixed rate. Because we act as an intermediary for our customer, changes in the fair value of the underlying derivative contracts substantially offset each other and do not have a material impact on our results of operations.

**Table of Contents**

The notional amounts and estimated fair values of interest rate derivative positions outstanding at September 30, 2012 and 2011 are presented in the following tables (in thousands):

	September 30, 2012		September 30, 2011	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
<b>Non-hedging interest rate derivative:</b>				
Commercial loan/lease interest rate swaps	\$ 436,265	\$ 29,038	\$ 254,063	\$ 19,193
Commercial loan/lease interest rate swaps	(436,265)	(29,038)	(254,063)	(19,193)
Commercial loan/lease interest rate caps	(37,465)	(7)		
Commercial loan/lease interest rate caps	37,465	7		

The weighted-average receive and pay interest rates for interest rate swaps outstanding at September 30, 2012 were as follows:

	Weighted-Average	
	Interest Rate Received	Interest Rate Paid
Non-hedging interest rate swaps	4.94%	2.39%

The weighted-average strike rate for outstanding interest rate caps was 2.21% at September 30, 2012.

Our credit exposure on interest rate swaps and caps is limited to the net favorable value and interest payments of all swaps and caps by each counterparty. In such cases collateral may be required from the counterparties involved if the net value of the swaps and caps exceeds a nominal amount considered to be immaterial. Our credit exposure, net of any collateral pledged, relating to interest rate swaps and caps was approximately \$29.0 million at September 30, 2012, all of which relates to bank customers. Collateral levels are monitored and adjusted on a regular basis for changes in interest rate swap and cap values. At September 30, 2012, we had \$15.9 million in cash collateral pledged for these derivatives included in interest-bearing deposits.

**(12) STOCKHOLDERS EQUITY**

On August 1, 2012 we completed a sale of 2.3 million shares of our common stock in a public offering. Net proceeds from the sale totaled \$87.0 million. The additional equity is being used for general corporate purposes, including retirement of \$15.0 million of debt and additional capital to support continued loan growth at our bank.

**(13) LEGAL MATTERS**

We are aggressively defending against a \$65.4 million jury verdict that was rendered in August 2011, in rural southeastern Oklahoma. Post-trial motions were denied without comment in early July 2012, and an appeal has been filed in the Oklahoma Supreme Court.

The Oklahoma case was filed in May 2010 by one of the guarantors of a defaulted loan to an auto dealership in Hugo, Oklahoma, after we already had filed suit in Texas against the debtor and the three co-guarantors to recover the debt, and despite a forum selection clause in the guaranty requiring that any lawsuits be brought in Texas. The guarantor conceded he had signed the guaranty and that the guaranty was valid, but complained that he later had been defrauded because we had failed to notify him about on-going fraud at the dealership. We disputed that we had any such duty to him as guarantor under Oklahoma law, particularly since the guaranty expressly disclaimed such a duty and since he was a co-owner and salaried employee of the dealership. We repeatedly objected to the case proceeding in Oklahoma in view of the clause requiring any lawsuit to be brought in Texas, but these objections were rejected. We then obtained an injunction from the Texas court against the guarantor proceeding with the Oklahoma suit, but the guarantor nevertheless continued to trial in the Oklahoma suit in violation of that injunction.

Lacking much arguable economic loss, if any, the guarantor repeatedly emphasized to the jury in the Oklahoma case that we were claiming about \$6.7 million, plus accumulating interest, on the debt and guaranty in the Texas lawsuit, and that we were asking for those damages to be trebled because of RICO violations. The Oklahoma jury proceeded to award the guarantor a total of \$21.8 million in money damages, which was almost exactly three times his estimated prospective liability on his guaranty, and went on to award twice that amount in punitive damages.



---

## **Table of Contents**

Subsequent to the verdict in the Oklahoma case, the Texas Court of Appeals upheld the injunction and specifically ruled that the guaranty's forum selection clause required any claims by the guarantor to be brought in the Texas court.

We have been advised by counsel that we have numerous grounds to reverse the Oklahoma verdict entirely or substantially reduce the amount, such as the guarantor's pursuit of the Oklahoma case in violation of the forum selection clause in the guaranty and the Texas court's injunction, the absence of any alleged contractual or other legal duty to the guarantor, and the lack of proof of actual economic damages. In addition, we continued to pursue the Texas lawsuit over the guaranty, and on April 18, 2012, we received summary judgment ordering the guarantor to pay us approximately \$7 million on the debt, which could offset a portion of any arguable liability in the Oklahoma case.

In reaction to these post-trial developments, the guarantor has re-asserted the same claims that are the basis for his Oklahoma judgment as counterclaims in the Texas action. We have moved for summary judgment against the guarantor on these claims.

We believe that the foregoing orders and judgments, when finalized by the Texas trial court, would constitute final binding and immediately enforceable judgments which would constitute a legal bar to the Oklahoma judgment.

In light of these factors, we currently believe a materially negative outcome in this matter is not probable, despite the uncertainties inherent in litigation. We further have not been able to determine the amount or range of amounts, as likely for any liability. We thus have not established a reserve related to any potential exposure. The loss related to the loan was recognized in the second quarter of 2010 and we have no remaining balance sheet exposure on the principal balance of the loan.

### **(14) NEW ACCOUNTING PRONOUNCEMENTS**

*ASU 2011-04, Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04) amends Topic 820, Fair Value Measurements and Disclosures, to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards (IFRS). ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 is effective for annual periods beginning after December 15, 2011, and did not have a significant impact on our financial statements.

*ASU 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income* (ASU 2011-05) amends Topic 220, Comprehensive Income, to require that all non-owner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. ASU 2011-05 is effective for annual and interim periods beginning after December 15, 2011; however certain provisions related to the presentation of reclassification adjustments have been deferred by ASU 2011-12 *Comprehensive Income (Topic 820) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. ASU 2011-05 did not have a significant impact on our financial statements.

*ASU 2011-08, Intangibles Goodwill and Other (Topic 350) Testing Goodwill for Impairment* (ASU 2011-08) amends Topic 350, Intangibles Goodwill and Other, to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. ASU 2011-08 is effective of annual and interim impairment tests beginning after December 15, 2011, and did not have a significant impact on our financial statements.

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

Consolidated Daily Average Balances, Average Yields and Rates

(In thousands)

	For the three months ended September 30, 2012			For the three months ended September 30, 2011		
	Average Balance	Revenue/ Expense <sup>(1)</sup>	Yield/ Rate	Average Balance	Revenue/ Expense <sup>(1)</sup>	Yield/ Rate
<b>Assets</b>						
Securities taxable	\$ 84,583	\$ 881	4.14%	\$ 115,871	\$ 1,214	4.16%
Securities non-taxable <sup>(2)</sup>	25,717	376	5.82%	33,051	477	5.73%
Federal funds sold	9,360	2	0.09%	20,864	3	0.06%
Deposits in other banks	64,859	54	0.33%	36,495	44	0.48%
Loans held for sale	2,432,027	24,433	4.00%	1,191,375	13,340	4.44%
Loans	6,313,263	76,397	4.81%	5,219,496	68,352	5.20%
Less reserve for loan losses	72,373			66,215		
<b>Loans, net of reserve</b>	<b>8,672,917</b>	<b>100,830</b>	<b>4.63%</b>	<b>6,344,656</b>	<b>81,692</b>	<b>5.11%</b>
<b>Total earning assets</b>	<b>8,857,436</b>	<b>102,143</b>	<b>4.59%</b>	<b>6,550,937</b>	<b>83,430</b>	<b>5.05%</b>
Cash and other assets	399,428			333,563		
<b>Total assets</b>	<b>\$ 9,256,864</b>			<b>\$ 6,884,500</b>		
<b>Liabilities and Stockholders Equity</b>						
Transaction deposits	\$ 803,776	\$ 247	0.12%	\$ 412,203	\$ 52	0.05%
Savings deposits	2,922,852	2,185	0.30%	2,253,123	1,664	0.29%
Time deposits	491,783	576	0.47%	468,196	1,032	0.87%
Deposits in foreign branches	431,412	370	0.34%	588,221	443	0.30%
<b>Total interest bearing deposits</b>	<b>4,649,823</b>	<b>3,378</b>	<b>0.29%</b>	<b>3,721,743</b>	<b>3,191</b>	<b>0.34%</b>
Other borrowings	1,639,953	878	0.21%	894,073	240	0.11%
Subordinated notes	12,065	208	6.86%			
Trust preferred subordinated debentures	113,406	692	2.43%	113,406	634	2.22%
<b>Total interest bearing liabilities</b>	<b>6,415,247</b>	<b>5,156</b>	<b>0.32%</b>	<b>4,729,222</b>	<b>4,065</b>	<b>0.34%</b>
Demand deposits	2,010,694			1,525,087		
Other liabilities	80,810			53,233		
Stockholders equity	750,113			576,958		
<b>Total liabilities and stockholders equity</b>	<b>\$ 9,256,864</b>			<b>\$ 6,884,500</b>		
<b>Net interest income</b>		<b>\$ 96,987</b>			<b>\$ 79,365</b>	
<b>Net interest margin</b>			<b>4.36%</b>			<b>4.81%</b>
<b>Net interest spread</b>			<b>4.27%</b>			<b>4.71%</b>
<b>Additional information from discontinued operations:</b>						
Loans held for sale	\$ 384			\$ 396		

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

Borrowed funds	384		396	
Net interest income		\$ 5		\$ 8
Net interest margin - consolidated			4.36%	4.81%

- (1) The loan averages include loans on which the accrual of interest has been discontinued and are stated net of unearned income.
- (2) Taxable equivalent rates used where applicable.

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

Consolidated Daily Average Balances, Average Yields and Rates

(In thousands)

	For the nine months ended September 30, 2012			For the nine months ended September 30, 2011		
	Average Balance	Revenue/ Expense <sup>(1)</sup>	Yield/ Rate	Average Balance	Revenue/ Expense <sup>(1)</sup>	Yield/ Rate
<b>Assets</b>						
Securities taxable	\$ 95,031	\$ 2,870	4.03%	\$ 127,627	\$ 4,060	4.25%
Securities non-taxable <sup>(2)</sup>	27,009	1,178	5.83%	35,321	1,523	5.76%
Federal funds sold	8,100	7	0.12%	26,410	36	0.18%
Deposits in other banks	58,272	151	0.35%	129,669	306	0.32%
Loans held for sale	2,177,963	66,835	4.10%	913,410	31,608	4.63%
Loans	5,976,291	220,060	4.92%	4,945,863	191,633	5.18%
Less reserve for loan losses	71,474			68,115		
Loans, net of reserve	8,082,780	286,895	4.74%	5,791,158	223,241	5.15%
Total earning assets	8,271,192	291,101	4.70%	6,110,186	229,166	5.01%
Cash and other assets	391,464			312,464		
Total assets	\$ 8,662,656			\$ 6,422,650		
<b>Liabilities and Stockholders Equity</b>						
Transaction deposits	\$ 688,276	\$ 585	0.11%	\$ 377,998	\$ 162	0.06%
Savings deposits	2,708,406	6,375	0.31%	2,395,100	5,735	0.32%
Time deposits	566,788	2,327	0.55%	572,161	4,304	1.01%
Deposits in foreign branches	428,448	1,045	0.33%	461,038	1,278	0.37%
Total interest bearing deposits	4,391,918	10,332	0.31%	3,806,297	11,479	0.40%
Other borrowings	1,538,915	2,333	0.20%	431,661	459	0.14%
Subordinated notes	4,051	208	6.86%			
Trust preferred subordinated debentures	113,406	2,091	2.46%	113,406	1,905	2.25%
Total interest bearing liabilities	6,048,290	14,964	0.33%	4,351,364	13,843	0.43%
Demand deposits	1,859,069			1,466,456		
Other liabilities	76,145			47,074		
Stockholders equity	679,152			557,756		
Total liabilities and stockholders equity	\$ 8,662,656			\$ 6,422,650		
Net interest income		\$ 276,137			\$ 215,323	
Net interest margin			4.46%			4.71%
Net interest spread			4.37%			4.59%
<b>Additional information from discontinued operations:</b>						
Loans held for sale	\$ 388			\$ 433		



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

Borrowed funds	388	433
Net interest income	\$ 19	\$ 25
Net interest margin - consolidated	4.46%	4.71%

- (1) The loan averages include loans on which the accrual of interest has been discontinued and are stated net of unearned income.
- (2) Taxable equivalent rates used where applicable.

## **Table of Contents**

### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

#### ***Forward-Looking Statements***

Statements and financial analysis contained in this document that are not historical facts are forward looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 (the Act). In addition, certain statements may be contained in our future filings with SEC, in press releases, and in oral and written statements made by or with our approval that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Forward looking statements describe our future plans, strategies and expectations and are based on certain assumptions. Words such as believes, anticipates, expects, intends, targeted, continue, remain, should, may and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties, many of which are beyond our control that may cause actual results to differ materially from those in such statements. The important factors that could cause actual results to differ materially from the forward looking statements include, but are not limited to, the following:

- (1) Changes in interest rates and the relationship between rate indices, including LIBOR and Fed Funds
- (2) Changes in the levels of loan prepayments, which could affect the value of our loans or investment securities
- (3) Changes in general economic and business conditions in areas or markets where we compete
- (4) Competition from banks and other financial institutions for loans and customer deposits
- (5) The failure of assumptions underlying the establishment of and provisions made to the allowance for credit losses and differences in assumptions utilized by banking regulators which could have retroactive impact
- (6) The loss of senior management or operating personnel and the potential inability to hire qualified personnel at reasonable compensation levels
- (7) Changes in government regulations including changes as a result of the recent economic crisis. On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry. Many of the related regulations are still not written so the potential impact is still unknown
- (8) Claims and litigation, whether founded or unfounded, may result in significant financial liability if legal actions are not resolved in a manner favorable to us.

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

#### ***Results of Operations***

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

#### **Summary of Performance**

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

We reported net income of \$32.6 million, or \$0.80 per diluted common share, for the third quarter of 2012 compared to \$21.7 million, or \$0.56 per diluted common share, for the third quarter of 2011. Return on average equity was 17.27% and return on average assets was 1.40% for the third quarter of 2012, compared to 14.93% and 1.25%, respectively, for the third quarter of 2011. Net income for the nine months ended September 30,

**Table of Contents**

2012 totaled \$89.3 million, or \$2.25 per diluted common share, compared to \$50.4 million, or \$1.31 per diluted common share, for the same period in 2011. Return on average equity was 17.56% and return on average assets was 1.38% for the nine months ended September 30, 2012, compared to 12.07% and 1.05%, respectively, for the nine months ended September 30, 2011.

Net income increased \$10.9 million, or 50%, for the three months ended September 30, 2012 as compared to the same period in 2011. The \$10.9 million increase during the three months ended September 30, 2012, was primarily the result of a \$17.7 million increase in net interest income, a \$4.0 million decrease in the provision for credit losses and a \$2.9 million increase in non-interest income, offset by an \$7.3 million increase in non-interest expense and a \$6.4 million increase in income tax expense. The \$38.9 million increase during the nine months ended September 30, 2012 was primarily the result of a \$60.9 million increase in net interest income, a \$15.5 million decrease in the provision for credit losses and a \$7.0 million increase in non-interest income, offset by a \$22.0 million increase in non-interest expense and a \$22.5 million increase in income tax expense.

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

**Net Interest Income**

Net interest income was \$96.9 million for the third quarter of 2012, compared to \$79.2 million for the third quarter of 2011. The increase was due to an increase in average earning assets of \$2.3 billion as compared to the third quarter of 2011. The increase in average earning assets included a \$1.1 billion increase in average loans held for investment and a \$1.2 billion increase in loans held for sale, offset by a \$38.6 million decrease in average securities. For the quarter ended September 30, 2012, average net loans and securities represented 98% and 1%, respectively, of average earning assets compared to 97% and 2% in the same quarter of 2011.

Average interest bearing liabilities increased \$1.7 billion from the third quarter of 2011, which included a \$928.1 million increase in interest bearing deposits and a \$745.9 billion increase in other borrowings. The increase in average other borrowings was directly related to the growth in loans held for sale. Demand deposits increased from \$1.5 billion at September 30, 2011 to \$2.0 billion at September 30, 2012. The average cost of interest bearing deposits decreased from .34% for the quarter ended September 30, 2011 to .29% for the same period of 2012. The change in funding composition reduced the cost of deposits and borrowed funds to .28% in the third quarter of 2012 compared to .29% in the third quarter of 2011.

Net interest income was \$275.7 million for the nine months ended September 30, 2012, compared to \$214.8 million for the same period of 2011. The increase was due to an increase in average earning assets of \$2.1 billion as compared to the nine months ended September 30, 2011. The increase in average earning assets included a \$1.0 billion increase in average loans held for investment and a \$1.3 billion increase in loans held for sale, offset by a \$40.9 million decrease in average securities. For the nine months ended September 30, 2012, average net loans and securities represented 98% and 1%, respectively, of average earning assets compared to 95% and 3% in the same period of 2011.

Average interest bearing liabilities increased \$1.7 billion compared to the first nine months of 2011, which included a \$585.6 million increase in interest bearing deposits and a \$1.1 billion increase in other borrowings. The increase in average other borrowings was directly related to the growth in loans held for sale. Demand deposits increased from \$1.5 billion at September 30, 2011 to \$1.9 billion at September 30, 2012. The average cost of interest bearing deposits decreased from .40% for the nine months ended September 30, 2011 to .31% for the same period of 2012. The change in funding composition reduced the cost of deposits and borrowed funds to .29% for the nine months ended September 30, 2012 compared to .38% in the same period of 2011.

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

**Table of Contents**

	Three months ended September 30, 2012/2011			Nine months ended September 30, 2012/2011		
	Net Change	Change Due To Volume	Yield/Rate	Net Change	Change Due To <sup>(1)</sup> Volume	Yield/Rate
<b>Interest income:</b>						
Securities <sup>(2)</sup>	\$ (434)	\$ (437)	\$ 3	\$ (1,535)	\$ (1,392)	\$ (143)
Loans held for sale	11,093	13,808	(2,715)	35,227	43,836	(8,609)
Loans held for investment	8,045	13,961	(5,916)	28,427	40,211	(11,784)
Federal funds sold	(1)	(2)	1	(29)	(25)	(4)
Deposits in other banks	10	34	(24)	(155)	(168)	13
<b>Total</b>	<b>18,713</b>	<b>27,364</b>	<b>(8,651)</b>	<b>61,935</b>	<b>82,462</b>	<b>(20,527)</b>
Transaction deposits	195	49	146	423	133	290
Savings deposits	521	489	32	640	757	(117)
Time deposits	(456)	52	(508)	(1,977)	(41)	(1,936)
Deposits in foreign branches	(73)	(120)	47	(233)	(90)	(143)
Borrowed funds	904	200	704	2,268	1,179	1,089
<b>Total</b>	<b>1,091</b>	<b>670</b>	<b>421</b>	<b>1,121</b>	<b>1,938</b>	<b>(817)</b>
<b>Net interest income</b>	<b>\$ 17,622</b>	<b>\$ 26,694</b>	<b>\$ (9,072)</b>	<b>\$ 60,814</b>	<b>\$ 80,524</b>	<b>\$ (19,710)</b>

(1) Changes attributable to both volume and yield/rate are allocated to both volume and yield/rate on an equal basis.

(2) Taxable equivalent rates used where applicable.

Net interest margin from continuing operations, the ratio of net interest income to average earning assets from continuing operations, was 4.36% for the third quarter of 2012 compared to 4.81% for the third quarter of 2011. This 45 basis point decrease was a result of a decrease in interest income as a percent of earning assets offset by a reduction in funding costs. Total cost of funding, including demand deposits and stockholders equity decreased from .23% for the third quarter of 2011 to .22% for the third quarter of 2012.

**Non-interest Income**

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

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Service charges on deposit accounts	\$ 1,684	\$ 1,585	\$ 4,912	\$ 4,976
Trust fee income	1,216	1,091	3,562	3,111
Bank owned life insurance (BOLI) income	549	533	1,658	1,595
Brokered loan fees	4,839	2,849	12,618	7,927
Other	2,264	1,545	7,454	5,629
<b>Total non-interest income</b>	<b>\$ 10,552</b>	<b>\$ 7,603</b>	<b>\$ 30,204</b>	<b>\$ 23,238</b>

Non-interest income increased \$2.9 million during the three months ended September 30, 2012 compared to the same period of 2011. This increase is primarily related to an increase of \$2.0 million in brokered loan fees which relates to our mortgage warehouse lending business.

Non-interest income increased \$7.0 million during the nine months ended September 30, 2012 compared to the same period of 2011. This increase is primarily related to an increase of \$4.7 million in brokered loan fees which relates to our mortgage warehouse lending business and a \$1.9 million increase in other non-interest income, primarily due to swap fee income.

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

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 lines of business or expand existing lines of business. Any new product introduction or new market entry could place additional demands on capital and managerial resources.

**Table of Contents****Non-interest Expense**

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

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Salaries and employee benefits	\$ 31,009	\$ 25,596	\$ 90,258	\$ 73,877
Net occupancy expense	3,653	3,367	10,936	10,120
Marketing	3,472	2,455	9,469	7,311
Legal and professional	4,916	3,647	12,237	10,634
Communications and technology	2,885	2,210	8,088	7,141
FDIC insurance assessment	1,332	1,465	4,497	5,948
Allowance and other carrying costs for OREO	552	2,150	7,706	7,203
Other	5,702	5,296	16,579	15,614
<b>Total non-interest expense</b>	<b>\$ 53,521</b>	<b>\$ 46,186</b>	<b>\$ 159,770</b>	<b>\$ 137,848</b>

Non-interest expense for the third quarter of 2012 increased \$7.3 million, or 16%, to \$53.5 million from \$46.2 million in the second quarter of 2011. The increase is primarily attributable to a \$5.4 million increase in salaries and employee benefits, which was primarily due to general business growth and incentive expense directly related to our performance and the increase in the price of our common stock.

Marketing expense for the three months ended September 30, 2012 increased \$1.0 million, or 41%, compared to the same quarter in 2011, which was primarily due to general business growth and treasury management programs.

Legal and professional expense for the three months ended September 30, 2012 increased \$1.3 million, or 35%, compared to same quarter in 2011. Our legal and professional expense will continue to fluctuate from quarter to quarter and could increase in the future as we respond to continued regulatory changes, strategic initiatives, litigation and other developments.

For the three months ended September 30, 2012, allowance and other carrying costs for OREO decreased \$1.6 million, to \$552,000, \$64,000 of which related to deteriorating values of assets held in OREO. The \$64,000 valuation expense in the third quarter of 2012 related to direct write-downs of the OREO balance.

Non-interest expense for the nine months ended September 30, 2012 increased \$22.0 million, or 16%, to \$159.8 million from \$137.8 million compared to the same period in 2011. The increase is primarily attributable to an \$16.4 million increase in salaries and employee benefits, which was primarily due to general business growth and incentive expense directly related to our performance and the increase in the price of our common stock.

Marketing expense for the nine months ended September 30, 2012 increased \$2.2 million, or 30%, compared to the same quarter in 2011, which was primarily due to general business growth and treasury management programs.

Legal and professional expense for the nine months ended September 30, 2012 increased \$1.6 million, or 15%, compared to same quarter in 2011. Our legal and professional expense will continue to fluctuate from quarter to quarter and could increase in the future as we respond to continued regulatory changes, strategic initiatives, litigation and other developments.

FDIC insurance assessment expense for the nine months ended September 30, 2012 decreased by \$1.5 million from \$5.9 million in 2011 to \$4.5 million as a result of changes to the FDIC assessment method in 2011.

For the nine months ended September 30, 2012, allowance and other carrying costs for OREO increased \$503,000, to \$7.7 million, \$5.9 million of which related to deteriorating values of assets held in OREO. Of the \$5.9 million valuation expense in the first nine months of 2012, \$3.6 million related to increasing the valuation allowance and \$2.3 million related to direct write-downs of the OREO balance.





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

Total loans net of allowance for loan losses at September 30, 2012 increased \$1.7 billion from December 31, 2011 to \$9.3 billion. Combined commercial, construction loans and leases increased \$1.0 billion, offset by a combined decrease in real estate and consumer loans of \$19.7 million. Loans held for sale increased \$738.5 million from December 31, 2011 as a result of continued low mortgage rates.

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

	September 30, 2012	December 31, 2011
Commercial	\$ 4,038,955	\$ 3,275,150
Construction	649,375	422,026
Real estate	1,804,434	1,819,251
Consumer	19,975	24,822
Leases	74,207	61,792
Gross loans held for investment	6,586,946	5,603,041
Deferred income (net of direct origination costs)	(37,857)	(30,670)
Allowance for loan losses	(73,722)	(70,295)
Total loans held for investment, net	6,475,367	5,502,076
Loans held for sale	2,818,622	2,080,081
Total	\$ 9,293,989	\$ 7,582,157

We continue to lend primarily in Texas. As of September 30, 2012, a substantial majority of the principal amount of the loans held for investment in our portfolio was to businesses and successful professionals and entrepreneurs in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions in Texas. The risks created by these concentrations have been considered by management in the determination of the adequacy of the allowance for loan losses. Management believes the allowance for loan losses is adequate to cover estimated losses on loans at each balance sheet date.

We originate a substantial majority of all the loans held for investment. We also participate in syndicated loan relationships, both as a participant and as an agent. As of September 30, 2012, we have \$1.3 billion in syndicated loans, \$357.1 million of which we acted as agent. All syndicated loans, whether we act as agent or participant, are underwritten to the same standards as all other loans originated by us. In addition, as of September 30, 2012, \$18.1 million of our syndicated loans were on non-accrual, with \$17.8 million earning on a cash basis.

Loans held for sale relates to our mortgage warehouse lending operations where we invest in mortgage loan participations that are highly liquid and held by us for a short period, usually less than 30 days and more typically sold within 10 to 20 days. We purchase participations in mortgage loans from regional mortgage originators throughout the country. Volumes fluctuate based on the level of market demand in the product and the number of days between purchase and sale of the participated loans. If loans are not sold in accordance with the terms of the agreements, loans could be transferred to the loans held for investment portfolio at a lower of cost or fair value. The loans are then subject to normal loan review, grading and reserve allocation requirements. During 2012 and 2011, no loan participations have been transferred to loans held for investment and there has been no loss on sale or disposition of any loan participation.

**Summary of Loan Loss Experience**

The provision for credit losses is a charge to earnings to maintain the reserve for loan losses at a level consistent with management's assessment of the loan portfolio in light of current economic conditions and market trends. We recorded a provision of \$3.0 million during the third quarter of 2012 compared to \$7.0 million in the third quarter of 2011 and \$1.0 million in the second quarter of 2012. The amount of reserves and provision required to support the reserve generally increased in 2009 and 2010 as a result of credit deterioration in our loan portfolio driven by negative changes in national and regional economic conditions and



## Table of Contents

the impact of those conditions on the financial condition of borrowers and the values of assets, including real estate assets, pledged as collateral. However, in 2011 and continuing in 2012 we have experienced improvements in credit quality and seen levels of reserves and provision decrease. We do continue to maintain an unallocated reserve component to allow for continued uncertainty in economic and other conditions affecting the quality of the loan portfolio.

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. Even though portions of the allowance may be allocated to specific loans, the entire allowance is available for any credit that, in management's judgment, should be charged off.

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

The methodology used in the periodic review of reserve adequacy, which is performed at least quarterly, is designed to be dynamic and responsive to changes in portfolio credit quality. The changes are reflected in the general reserve and in specific reserves as the collectability of larger classified loans are 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. 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 combined reserve for credit losses, which includes a liability for losses on unfunded commitments, totaled \$77.2 million at September 30, 2012, \$72.8 million at December 31, 2011 and \$70.2 million at September 30, 2011. Due to the growth in loans, the total reserve percentage decreased to 1.18% at September 30, 2012 from 1.31% of loans held for investment at December 31, 2011 and decreased from 1.32% of loans held for investment at September 30, 2011. The total reserve percentage had increased in 2009 and 2010 as a result of the effects of national and regional economic conditions on borrowers and values of assets pledged as collateral. The combined reserve percentage is starting to trend down as we recognize losses on loans for which there were specific or general allocations of reserves and see improvement in our overall credit quality. The overall reserve for loan losses continues to result from consistent application of the loan loss reserve methodology as described above. At September 30, 2012, we believe the reserve is sufficient to cover all expected losses in the portfolio and has been derived from consistent application of the methodology described above. Should any of the factors considered by management in evaluating the adequacy of the allowance for loan losses change, our estimate of expected losses in the portfolio could also change, which would affect the level of future provisions for loan losses.

**Table of Contents**

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

	Nine months ended September 30, 2012	Nine months ended September 30, 2011	Year ended December 31, 2011
<b>Reserve for loan losses:</b>			
Beginning balance	\$ 70,295	\$ 71,510	\$ 71,510
<b>Loans charged-off:</b>			
Commercial	2,664	7,170	8,518
Real estate - term	899	18,837	21,275
Consumer	49	317	317
Equipment leases	170	980	1,218
<b>Total charge-offs</b>	<b>3,782</b>	<b>27,304</b>	<b>31,328</b>
<b>Recoveries:</b>			
Commercial	482	798	1,188
Real estate - construction	10	248	248
Real estate - term	586	305	350
Consumer	26	5	9
Equipment leases	87	212	383
<b>Total recoveries</b>	<b>1,191</b>	<b>1,568</b>	<b>2,178</b>
<b>Net charge-offs</b>	<b>2,591</b>	<b>25,736</b>	<b>29,150</b>
<b>Provision for loan losses</b>	<b>6,018</b>	<b>22,123</b>	<b>27,935</b>
<b>Ending balance</b>	<b>\$ 73,722</b>	<b>\$ 67,897</b>	<b>\$ 70,295</b>
<b>Reserve for off-balance sheet credit losses:</b>			
Beginning balance	\$ 2,462	\$ 1,897	\$ 1,897
Provision for off-balance sheet credit losses	982	377	565
<b>Ending balance</b>	<b>\$ 3,444</b>	<b>\$ 2,274</b>	<b>\$ 2,462</b>
<b>Total reserve for credit losses</b>	<b>\$ 77,166</b>	<b>\$ 70,171</b>	<b>\$ 72,757</b>
<b>Total provision for credit losses</b>	<b>\$ 7,000</b>	<b>\$ 22,500</b>	<b>\$ 28,500</b>
Reserve for loan losses to loans held for investment <sup>(2)</sup>	1.13%	1.28%	1.26%
Net charge-offs to average loans <sup>(1) (2)</sup>	0.06%	0.70%	0.58%
Total provision for credit losses to average loans <sup>(2)</sup>	0.24%	0.61%	0.56%
Recoveries to total charge-offs	31.49%	5.74%	6.95%
Reserve for off-balance sheet credit losses to off-balance sheet credit commitments	0.15%	0.13%	0.14%
Combined reserves for credit losses to loans held for investment <sup>(2)</sup>	1.18%	1.32%	1.31%
<b>Non-performing assets:</b>			
Non-accrual loans <sup>(5)</sup>	\$ 57,275	\$ 66,714	\$ 54,580
OREO <sup>(4)</sup>	19,079	35,796	34,077
Other repossessed assets		579	1,516
<b>Total</b>	<b>\$ 76,354</b>	<b>\$ 103,089</b>	<b>\$ 90,173</b>

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

Restructured loans	\$ 9,145	\$ 24,963	\$ 25,104
Loans past due 90 days and still accruing <sup>(3)</sup>	3,622	3,003	5,467
Reserve as a percent of non-performing loans	1.3x	1.0x	1.3x

- (1) Interim period ratios are annualized.
- (2) Excludes loans held for sale.
- (3) At September 30, 2012, December 31, 2011 and September 30, 2011, loans past due 90 days and still accruing includes premium finance loans of \$2.7 million, \$2.5 million and \$2.5 million, respectively. These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.
- (4) At September 30, 2012, December 31, 2011 and September 30, 2011, OREO balance is net of \$4.7 million, \$10.7 million and \$10.7 million valuation allowance, respectively.
- (5) As of September 30, 2012, December 31, 2011 and September 30, 2011, non-accrual loans included \$14.7 million, \$13.8 million and \$23.2 million, respectively, in loans that met the criteria for restructured.

**Table of Contents****Non-performing Assets**

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

	September 30, 2012	September 30, 2011	December 31, 2011
Non-accrual loans			
Commercial	\$ 17,653	\$ 12,674	\$ 12,913
Construction	19,249	21,288	21,119
Real estate	20,100	29,167	19,803
Consumer	60	309	313
Leases	213	3,276	432
<b>Total non-accrual loans</b>	<b>\$ 57,275</b>	<b>\$ 66,714</b>	<b>\$ 54,580</b>

The table below summarizes the non-accrual loans as segregated by loan type and type of property securing the credit as of September 30, 2012 (in thousands):

Non-accrual loans:	
Commercial	
Lines of credit secured by the following:	
Various single family residences and notes receivable	\$ 3,332
Assets of the borrowers	12,993
Other	1,328
<b>Total commercial</b>	<b>17,653</b>
Construction	
Secured by:	
Unimproved land and/or undeveloped residential lots	19,249
<b>Total construction</b>	<b>19,249</b>
Real estate	
Secured by:	
Commercial property	6,808
Unimproved land and/or undeveloped residential lots	8,023
Single family residences	2,174
Other	3,095
<b>Total real estate</b>	<b>20,100</b>
Consumer	60
Leases (commercial leases primarily secured by assets of the lessor)	213
<b>Total non-accrual loans</b>	<b>\$ 57,275</b>

Generally, we place loans on non-accrual when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectability is questionable, then cash payments are applied to principal. As of September 30, 2012, \$17.8 million of our non-accrual loans were earning on a cash basis.

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

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due (both principal and interest) according to the terms of the original loan agreement. All loans classified as TDRs are also considered impaired. 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.

At September 30, 2012, we had \$3.6 million in loans past due 90 days and still accruing interest. At September 30, 2012, \$2.7 million of the loans past due 90 days and still accruing are premium finance loans. These loans are primarily secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date.

**Table of Contents**

Restructured loans are loans on which, due to the borrower's financial difficulties, we have granted a concession that we would not otherwise consider. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of the two. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the maturity date at a contractual interest rate lower than the current rate for new debt with similar risk, or a reduction of the face amount of debt, or forgiveness of either principal or accrued interest. As of September 30, 2012, we have \$9.1 million in loans considered restructured that are not on nonaccrual. Of the nonaccrual loans at September 30, 2012, \$14.7 million met the criteria for restructured. A loan continues to qualify as restructured until a consistent payment history or change in borrower's financial condition has been evidenced, generally no less than twelve months. 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.

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which we have concerns about the borrower's ability to comply with repayment terms because of the borrower's potential financial difficulties. We monitor these loans closely and review their performance on a regular basis. At September 30, 2012, we did not have any potential problem loans compared to \$18.1 million at September 30, 2011, in loans of this type which were not included in either non-accrual or 90 days past due categories.

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

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Beginning balance	\$ 27,882	\$ 27,285	\$ 34,077	\$ 42,261
Additions		12,661	3,397	19,254
Sales	(8,739)	(2,488)	(12,467)	(20,012)
Valuation allowance for OREO		(1,601)	(3,556)	(3,522)
Direct write-downs	(64)	(61)	(2,372)	(2,185)
Ending balance	\$ 19,079	\$ 35,796	\$ 19,079	\$ 35,796

The following table summarizes the assets held in OREO at September 30, 2012 (in thousands):

Unimproved commercial real estate lots and land	\$ 4,594
Undeveloped land and residential lots	10,421
Multifamily lots and land	501
Single family residences	2,453
Other	1,110
Total OREO	\$ 19,079

When foreclosure occurs, fair value, which is generally based on appraised values, may result in partial charge-off of a loan upon taking property, and so long as property is retained, subsequent reductions in appraised values will result in valuation adjustment taken as non-interest expense. In addition, if the decline in value is believed to be permanent and not just driven by market conditions, a direct write-down to the OREO balance may be taken. We generally pursue sales of OREO when conditions warrant, but we may choose to hold certain properties for a longer term, which can result in additional exposure related to the appraised values during that holding period. During the nine months ended September 30, 2012 and September 30, 2011, we recorded \$5.9 million and \$5.7 million in valuation expense, respectively. Of the \$5.9 million recorded for the nine months ended September 30, 2012, \$3.6 million related to increases to the valuation allowance and \$2.3 million related to direct write-downs.



**Table of Contents****Liquidity and Capital Resources**

In general terms, liquidity is a measurement of our ability to meet our cash needs. Our objective in managing our liquidity is to maintain our ability to meet loan commitments, purchase securities or repay deposits and other liabilities in accordance with their terms, without an adverse impact on our current or future earnings. Our liquidity strategy is guided by policies, which are formulated and monitored by our senior management and our Balance Sheet Management Committee ( BSMC ), and which take into account the demonstrated 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, 2011 and for nine months ended September 30, 2012, our principal source of funding has been our customer deposits, supplemented by our short-term and long-term borrowings, primarily from federal funds purchased and Federal Home Loan Bank ( FHLB ) borrowings.

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

	September 30, 2012	September 30, 2011	December 31, 2011
Deposits from core customers	\$ 6,649.9	\$ 5,486.5	\$ 5,391.1
Deposits from core customers as a percent of total deposits	99.0%	100.0%	97.0%
Brokered deposits	\$ 67.7	\$	\$ 165.1
Brokered deposits as a percent of total deposits	1.0%	0.0%	3.0%
Average deposits from core customers <sup>(1)</sup>	\$ 6,113.7	\$ 5,272.8	\$ 5,344.2
Average deposits from core customers as a percent of total quarterly average deposits <sup>(1)</sup>	97.8%	100.0%	99.7%
Average brokered deposits <sup>(1)</sup>	\$ 137.3	\$	\$ 17.3
Average brokered deposits as a percent of total quarterly average deposits <sup>(1)</sup>	2.2%	0.0%	0.3%

(1) Annual averages presented for December 31, 2011.

We have access to sources of brokered deposits of not less than an additional \$3.4 billion. Customer deposits (total deposits minus brokered CDs) increased by \$1.2 billion from September 30, 2011 and increased \$1.3 billion from December 31, 2011.

**Table of Contents**

Additionally, we have borrowing sources available to supplement deposits and meet our funding needs. Such borrowings are generally used to fund our loans held for sale, due to their liquidity, short duration and interest spreads available. These borrowing sources typically include federal funds purchased from our downstream correspondent bank relationships (which consist of banks that are smaller than our bank) and from our upstream correspondent bank relationships (which consist of banks that are larger than our bank), customer repurchase agreements, treasury, tax and loan notes, and advances from the FHLB and the Federal Reserve. The following table summarizes our borrowings as of September 30, 2012 (in thousands):

Federal funds purchased	\$ 473,330
Customer repurchase agreements	22,788
FHLB borrowings	1,550,051
Subordinated notes	111,000
Trust preferred subordinated debentures	113,406
 Total borrowings	 \$ 2,270,575
 Maximum outstanding at any month-end during the year	 \$ 2,270,575

The following table summarizes our other borrowing capacities in excess of balances outstanding at September 30, 2012 (in thousands):

FHLB borrowing capacity relating to loans	\$ 747,549
FHLB borrowing capacity relating to securities	36,467
 Total FHLB borrowing capacity	 \$ 784,016
 Unused federal funds lines available from commercial banks	 \$ 511,500

Our equity capital averaged \$679.2 million for the nine months ended September 30, 2012, as compared to \$557.8 million for the same period in 2011. This increase reflects our retention of net earnings during this period. We have not paid any cash dividends on our common stock since we commenced operations and have no plans to do so in the near future.

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

On March 27, 2012 we entered into a loan agreement which provides for a non-revolving amortizing line of credit up to \$50 million that matures on March 27, 2014. This loan agreement was paid in full in August 2012.

During the second quarter of 2012, we filed an S-3 Registration Statement with the SEC which was effective June 25, 2012. The registration statement covers issuances of up to \$250.0 million of debt or equity securities. On August 1, 2012 we completed a sale of 2.3 million shares of our common stock in a public offering. Net proceeds from the sale totaled \$87.0 million. The additional equity is being used for general corporate purposes, including retirement of \$15.0 million of debt discussed above and additional capital to support continued loan growth at our bank.

On September 21, 2012, we issued \$111.0 million of subordinated notes. The notes mature in September 2042 and bear interest at a rate of 6.50% per annum, payable quarterly. The proceeds may be used for general corporate purposes including funding regulatory capital infusions into the Bank. The loan agreement contains customary financial covenants and restrictions.

**Table of Contents****Commitments and Contractual Obligations**

The following table presents significant fixed and determinable contractual obligations to third parties by payment date. Payments for borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts. As of September 30, 2012, our significant fixed and determinable contractual obligations to third parties were as follows (in thousands):

	Within One Year	After One but Within Three Years	After Three but Within Five Years	After Five Years	Total
Deposits without a stated maturity <sup>(1)</sup>	\$ 5,815,823	\$	\$	\$	\$ 5,815,823
Time deposits <sup>(1)</sup>	822,415	63,150	16,101	90	901,756
Federal funds purchased <sup>(1)</sup>	473,330				473,330
Customer repurchase agreements <sup>(1)</sup>	22,788				22,788
FHLB borrowings <sup>(1)</sup>	1,550,000		51		1,550,051
Operating lease obligations <sup>(1) (2)</sup>	9,951	10,089	28,134	40,022	88,196
Subordinated notes <sup>(1)</sup>				111,000	111,000
Trust preferred subordinated debentures <sup>(1)</sup>				113,406	113,406
<b>Total contractual obligations</b>	<b>\$ 8,694,307</b>	<b>\$ 73,239</b>	<b>\$ 44,286</b>	<b>\$ 264,518</b>	<b>\$ 9,076,350</b>

(1) Excludes interest.

(2) Non-balance sheet item.

**Critical Accounting Policies**

SEC guidance requires disclosure of critical accounting policies. The SEC defines critical accounting policies as those that are most important to the presentation of a company's financial condition and results, and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

We follow financial accounting and reporting policies that are in accordance with accounting principles generally accepted in the United States. The more significant of these policies are summarized in Note 1 to the consolidated financial statements. Not all these significant accounting policies require management to make difficult, subjective or complex judgments. However, the policy noted below could be deemed to meet the SEC's definition of critical accounting policies.

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

## **Table of Contents**

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is a broad term for the risk of economic loss due to adverse changes in the fair value of a financial instrument. These changes may be the result of various factors, including interest rates, foreign exchange rates, commodity prices, or equity prices. Additionally, the financial instruments subject to market risk can be classified either as held for trading purposes or held for other than trading.

We are subject to market risk primarily through the effect of changes in interest rates on our portfolio of assets held for purposes other than trading. The effect of other changes, such as foreign exchange rates, commodity prices, and/or equity prices do not pose significant market risk to us.

The responsibility for managing market risk rests with the BSMC, which operates under policy guidelines established by our board of directors. The negative acceptable variation in net interest revenue due to a 200 basis point increase or decrease in interest rates is generally limited by these guidelines to +/- 5%. These guidelines also establish maximum levels for short-term borrowings, short-term assets and public and brokered deposits. They also establish minimum levels for unpledged assets, among other things. Compliance with these guidelines is the ongoing responsibility of the BSMC, with exceptions reported to our board of directors on a quarterly basis.

### **Interest Rate Risk Management**

Our interest rate sensitivity is illustrated in the following table. The table reflects rate-sensitive positions as of September 30, 2012, and is not necessarily indicative of positions on other dates. The balances of interest rate sensitive assets and liabilities are presented in the periods in which they next reprice to market rates or mature and are aggregated to show the interest rate sensitivity gap. The mismatch between repricings or maturities within a time period is commonly referred to as the gap for that period. A positive gap (asset sensitive), where interest rate sensitive assets exceed interest rate sensitive liabilities, generally will result in the net interest margin increasing in a rising rate environment and decreasing in a falling rate environment. A negative gap (liability sensitive) will generally have the opposite results on the net interest margin. To reflect anticipated prepayments, certain asset and liability categories are shown in the table using estimated cash flows rather than contractual cash flows. The Company employs interest rate floors in certain variable rate loans to enhance the yield on those loans at times when market interest rates are extraordinarily low. The degree of asset sensitivity, spreads on loans and net interest margin may be reduced until rates increase by an amount sufficient to eliminate the effects of floors. The adverse effect of floors as market rates increase may also be offset by the positive gap, the extent to which rates on deposits and other funding sources lag increasing market rates and changes in composition of funding.

**Table of Contents****Interest Rate Sensitivity Gap Analysis****September 30, 2012**

(In thousands)

	0-3 mo Balance	4-12 mo Balance	1-3 yr Balance	3+ yr Balance	Total Balance
Securities <sup>(1)</sup>	\$ 21,614	\$ 33,806	\$ 28,475	\$ 23,393	\$ 107,288
Total variable loans	8,225,196	16,883	7,034	8,406	8,257,519
Total fixed loans	594,793	289,787	171,519	92,254	1,148,353
Total loans <sup>(2)</sup>	8,819,989	306,670	178,553	100,660	9,405,872
Total interest sensitive assets	\$ 8,841,603	\$ 340,476	\$ 207,028	\$ 124,053	\$ 9,513,160
Liabilities:					
Interest bearing customer deposits	\$ 4,133,440	\$	\$	\$	\$ 4,133,440
CDs & IRAs	150,967	171,884	63,150	16,191	402,192
Wholesale deposits	67,668				67,668
Total interest bearing deposits	4,352,075	171,884	63,150	16,191	4,603,300
Repurchase agreements, Federal funds purchased, FHLB borrowings	2,046,118		51		2,046,169
Subordinated notes				111,000	111,000
Trust preferred subordinated debentures				113,406	113,406
Total borrowings	2,046,118		51	224,406	2,270,575
Total interest sensitive liabilities	\$ 6,398,193	\$ 171,884	\$ 63,201	\$ 240,597	\$ 6,873,875
GAP	\$ 2,443,410	\$ 168,592	\$ 143,827	\$ (116,544)	\$
Cumulative GAP	2,443,410	2,612,002	2,755,829	2,639,285	2,639,285
Demand deposits					\$ 2,114,279
Stockholders' equity					802,406
Total					\$ 2,916,685

(1) Securities based on fair market value.

(2) Loans include loans held for sale and are stated at gross.

The table above sets forth the balances as of September 30, 2012 for interest bearing assets, interest bearing liabilities, and the total of non-interest bearing deposits and stockholders' equity. While a gap interest table is useful in analyzing interest rate sensitivity, an interest rate sensitivity simulation provides a better illustration of the sensitivity of earnings to changes in interest rates. Earnings are also affected by the effects of changing interest rates on the value of funding derived from demand deposits and stockholders' equity. We perform a sensitivity analysis to identify interest rate risk exposure on net interest income. We quantify and measure interest rate risk exposure using a model to dynamically simulate the effect of changes in net interest income relative to changes in interest rates and account balances over the next twelve months based on three interest rate scenarios. These are a most likely rate scenario and two shock test scenarios.

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

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

The two shock test scenarios assume a sustained parallel 200 basis point increase or decrease, respectively, in interest rates. As short-term rates continued to fall during 2009 and remained low through 2012, we could not assume interest rate decreases of any amount as the results of the decreasing rates scenario would not be meaningful. We will continue to evaluate these scenarios as interest rates change, until short-term rates rise above 3.0%.

**Table of Contents**

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

Anticipated Impact Over the Next Twelve Months  
as Compared to Most Likely Scenario  
200 bp Increase  
September 30, 2012

<b>Change in net interest income</b>	<b>\$55,175</b>
--------------------------------------	-----------------

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.

---

**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

Our management, including our chief executive officer and chief financial officer, have evaluated our disclosure controls and procedures as of September 30, 2012, and concluded that those disclosure controls and procedures are effective. There have been no changes in our internal controls or in other factors known to us that could materially affect these controls subsequent to their evaluation, nor any corrective actions with regard to significant deficiencies and material weaknesses. While we believe that our existing disclosure controls and procedures have been effective to accomplish these objectives, we intend to continue to examine, refine and formalize our disclosure controls and procedures and to monitor ongoing developments in this area.

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

We are aggressively defending against a \$65.4 million jury verdict that was rendered in August 2011, in rural southeastern Oklahoma. Post-trial motions were denied without comment in early July 2012, and an appeal has been filed in the Oklahoma Supreme Court.

The Oklahoma case was filed in May 2010 by one of the guarantors of a defaulted loan to an auto dealership in Hugo, Oklahoma, after we already had filed suit in Texas against the debtor and the three co-guarantors to recover the debt, and despite a forum selection clause in the guaranty requiring that any lawsuits be brought in Texas. The guarantor conceded he had signed the guaranty and that the guaranty was valid, but complained that he later had been defrauded because we had failed to notify him about on-going fraud at the dealership. We disputed that we had any such duty to him as guarantor under Oklahoma law, particularly since the guaranty expressly disclaimed such a duty and since he was a co-owner and salaried employee of the dealership. We repeatedly objected to the case proceeding in Oklahoma in view of the clause requiring any lawsuit to be brought in Texas, but these objections were rejected. We then obtained an injunction from the Texas court against the guarantor proceeding with the Oklahoma suit, but the guarantor nevertheless continued to trial in the Oklahoma suit in violation of that injunction.

Lacking much arguable economic loss, if any, the guarantor repeatedly emphasized to the jury in the Oklahoma case that we were claiming about \$6.7 million, plus accumulating interest, on the debt and guaranty in the Texas lawsuit, and that we were asking for those damages to be trebled because of RICO violations. The Oklahoma jury proceeded to award the guarantor a total of \$21.8 million in money damages, which was almost exactly three times his estimated prospective liability on his guaranty, and went on to award twice that amount in punitive damages.

Subsequent to the verdict in the Oklahoma case, the Texas Court of Appeals upheld the injunction and specifically ruled that the guaranty's forum selection clause required any claims by the guarantor to be brought in the Texas court.

We have been advised by counsel that we have numerous grounds to reverse the Oklahoma verdict entirely or substantially reduce the amount, such as the guarantor's pursuit of the Oklahoma case in violation of the forum selection clause in the guaranty and the Texas court's injunction, the absence of any alleged contractual or other legal duty to the guarantor, and the lack of proof of actual economic damages. In addition, we continued to pursue the Texas lawsuit over the guaranty, and on April 18, 2012, we received summary judgment ordering the guarantor to pay us approximately \$7 million on the debt, which could offset a portion of any arguable liability in the Oklahoma case.

In reaction to these post-trial developments, the guarantor has re-asserted the same claims that are the basis for his Oklahoma judgment as counterclaims in the Texas action. We have moved for summary judgment against the guarantor on these claims.

We believe that the foregoing orders and judgments, when finalized by the Texas trial court, would constitute final binding and immediately enforceable judgments which would constitute a legal bar to the Oklahoma judgment.

In light of these factors, we currently believe a materially negative outcome in this matter is not probable, despite the uncertainties inherent in litigation. We further have not been able to determine the amount or range of amounts, as likely for any liability. We thus have not established a reserve related to any potential exposure. The loss related to the loan was recognized in the second quarter of 2010 and we have no remaining balance sheet exposure on the principal balance of the loan.



## **Table of Contents**

### **ITEM 1A. RISK FACTORS**

There has not been any material change in the risk factors previously disclosed in the Company's 2011 Form 10-K for the fiscal year ended December 31, 2011. Additionally, the following risks associated with our industry were included in our prospectus supplement dated September 18, 2012.

*The earnings of financial services companies are significantly affected by general business and economic conditions.* As a financial services company, our operations and profitability are impacted by general business and economic conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, money supply, economic conditions in foreign markets, political issues, legislative and regulatory changes, fluctuation in both debt and equity capital markets, broad trends in industry and finance and the strength of the U.S. economy and the local economies in which we operate, all of which are beyond our control. Continued weakness or further deterioration in economic conditions could result in decreases in loan collateral values and increases in loan delinquencies, non-performing assets and losses on loans and other real estate acquired through foreclosure of loans. Industry conditions, competition and the performance of our bank could also result in a decrease in demand for our products and services, among other things, any of which could have a material adverse impact on our results of operations and financial condition.

*We are subject to extensive government regulation and supervision.* We are subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders or debtholders. Federal regulation is also designed to cause the banking system to support governmental policies that may not be beneficial to our bank. These regulations affect our lending practices, capital structure, investment practices, accounting, financial reporting, dividend policy, operations and growth, among other things. These regulations also impose obligations to maintain appropriate policies, procedures and controls, among other things, to detect, prevent and report money laundering and terrorist financing and to verify the identities of our customer. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect us in substantial and unpredictable ways. The changes in regulation and requirements imposed on financial institutions, such as the Dodd-Frank Act and Basel III accords, could subject us to additional costs, impose requirements for additional capital, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Over a year after the adoption of the Dodd-Frank Act, there are still many related regulations that have not been written, so the effects of those are unknown at this time. In addition, from time to time we receive inquiries from our regulators regarding, among other things, lending practices, reserve methodology, interest rate and operational risk management, regulatory and financial accounting practices and policies and related matters. Any change to our practices or policies requested or required by our regulators, or any changes in interpretation of regulatory policy applicable to our businesses, may have a material adverse effect on our business, results of operations, financial condition, credit quality or regulatory capital.

We expend substantial effort and incur costs to improve our systems, controls, accounting, operations, information security, compliance, audit capabilities, staffing and training in order to satisfy regulatory requirements, but the regulatory authorities may determine that such efforts are insufficient. Failure to comply with relevant laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. In addition, the FDIC has imposed higher general and special assessments on deposits based on general industry conditions and as a result of changes in specific programs, and there is no restriction on the amount by which the FDIC may increase deposit assessments in the future. Any increase in FDIC assessments could affect our earnings to a significant degree, and the industry may be subject to additional assessments, fees or taxes.

Furthermore, Sarbanes-Oxley, and the related rules and regulations promulgated by the SEC and Financial Industry Regulatory Authority (FINRA) that are applicable to us, have increased the scope, complexity and cost of corporate governance, reporting and disclosure practices. As a result, we have experienced, and may continue to experience, greater compliance costs.

**Table of Contents**

**ITEM 5. EXHIBITS**

(a) Exhibits

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

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

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

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

101 The following materials from Texas Capital Bancshares, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Income, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TEXAS CAPITAL BANCSHARES, INC.

Date: October 25, 2012

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

**Table of Contents**

**EXHIBIT INDEX**

Exhibit  
Number

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
- 101 The following materials from Texas Capital Bancshares, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Income, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements \*\*\*

\*\*\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under these sections.