TEXAS CAPITAL BANCSHARES INC/TX
Form S-3/A
July 31, 2003

As filed with the Securities and Exchange Commission on July 31, 2003

Registration No. 333-97915

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 3
to the

Form S-3

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

Texas Capital Bancshares, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**6022**	**75-2679109**
(State or Other Jurisdiction of Incorporation or Organization	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification Number)*

2100 McKinney Avenue, Suite 900

Dallas, Texas 75201
(214) 932-6600
(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant s Principal Executive Offices)

Joseph M. Grant, Chief Executive Officer
2100 McKinney Avenue, Suite 900
Dallas, Texas 75201
(214) 932-6600
(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent for Service)

Copies of all communications, including communications sent to agent for service, should be sent to:

Fred S. Stovall
Patton Boggs LLP
2001 Ross Avenue, Suite 3000
Dallas, Texas 75201
Tel. (214) 758-1500

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Simpson Thacher & Bartlett LLP
425 Lexington Avenue
New York, New York 10017
Tel. (212) 455-2000

Approximate date of commencement of proposed sale to public: As soon as practicable on or after the effective date of this Registration Statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. o

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Shares to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price Per Share	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee(3)
Common Stock, $0.01 par value per share	6,900,000	$12.00	$82,800,000	$7,618

(1) Includes shares of common stock which may be purchased by the underwriters to cover over-allotments, if any.
(2) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(a) of the Securities Act of 1933, as amended.
(3) A registration fee of $6,900 was paid upon the initial filing of the Form S-3 on August 9, 2002 and a supplemental fee of $718 was paid upon the filing of Amendment No. 1 on September 17, 2002.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Subject to Completion, dated July 31, 2003

PROSPECTUS

6,000,000 Shares

Common Stock

This is our initial public offering of our common stock. We are offering 3,000,000 shares of our common stock and the selling stockholders named in this prospectus are offering 3,000,000 shares of our common stock. No public market for our common stock currently exists. We will not receive any proceeds from the sale of our shares by the selling stockholders.

Our common stock has been approved for listing on the Nasdaq National Market under the symbol TCBI, subject to official notice of issuance. We anticipate that the initial public offering price will be between $10.00 and $12.00 per share.

Investing in our common stock involves risks. See Risk Factors beginning on page 10.

	Per Share	Total
Public offering price		
Underwriting discounts and commissions		
Proceeds, before expenses, to Texas Capital Bancshares		
Proceeds, before expenses, to the selling stockholders		

We and certain of the selling stockholders have granted the underwriters a 30-day option to purchase up to 900,000 additional shares to cover over-allotments.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

These securities are not deposits or savings accounts and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

Lehman Brothers, on behalf of the underwriters, expects to deliver the shares on or about , 2003.

LEHMAN BROTHERS

U.S. BANCORP PIPER JAFFRAY

SUNTRUST ROBINSON HUMPHREY

SANDLER O NEILL & PARTNERS, L.P.

, 2003

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ABOUT THIS PROSPECTUS

You should rely only on the information contained in this document or any other document to which we refer you. We have not authorized anyone to provide you with information that is different. This document may only be used where it is legal to sell these securities. The information contained in this document is current only as of its date, regardless of the time of delivery of this prospectus or of any sales of shares of common stock.

Unless otherwise indicated, the information in this prospectus:

- assumes an initial public offering price of $11.00 per share (the midpoint of the range set forth on the cover page of this prospectus); and
- reflects the conversion of the 1,057,142 shares of preferred stock outstanding as of July 31, 2003 into 2,114,284 shares of common stock, which we expect will automatically occur upon the consummation of the offering.

PROSPECTUS SUMMARY

This summary highlights selected information about us and the offering that is contained elsewhere in this prospectus. You should read this summary together with the entire prospectus, including the more detailed information in our consolidated financial statements and related notes appearing elsewhere in this prospectus, as well as the other documents to which we refer you. Except as otherwise indicated by the context, references in this prospectus to we, our, the issuer or TCBI are to the combined business of Texas Capital Bancshares, Inc. and its wholly-owned subsidiary, Texas Capital Bank, N.A.

THE COMPANY

Through our bank, Texas Capital Bank, we provide a wide range of banking services, primarily to the middle market business and high net worth individual segments of the Texas economy. Since we commenced operations in December 1998, our bank has demonstrated substantial growth in assets, deposits and profitability. As of June 30, 2003, we had approximately $2.0 billion in assets, $1.3 billion in total loans, $1.3 billion in deposits and $132 million in stockholders equity. We currently operate eight banking centers in our core markets, which are the greater Dallas/ Fort Worth, Austin and San Antonio metropolitan areas. We anticipate opening a new banking center to support and expand our operations in the Houston metropolitan area in September 2003. In addition, we also operate BankDirect, an Internet banking division of our bank, to attract consumer deposits for funding purposes and to provide our BankDirect customers with access to banking services on a 24 hours-a-day/ 7 days-a-week basis.

Background

In March 1998, our founders organized TCBI to serve as a new holding company for an independent bank oriented to the needs of the Texas marketplace. Our founders have extensive Texas banking experience and strong community and business relationships in our core markets. Based on their assessment of the Texas banking environment, our founders determined that middle market businesses (which we generally define as businesses with annual revenues between $5 million and $250 million) and high net worth individuals (which we generally define as individuals with net worth in excess of $1 million) were not being well-served by the banks that emerged from the Texas banking crisis of the late 1980s. They concluded that there was an opportunity to reestablish an independent, Texas-headquartered, -managed and -focused bank with sufficient capital and other resources and expertise to serve these clients.

We commenced banking operations under the Texas Capital Bank name in December 1998. Our predecessor bank, Resource Bank N.A., had commenced limited operations in October 1997. At the time of our acquisition of Resource Bank, we raised approximately $80 million in initial equity capital in a private offering, which we believe is the largest amount of start-up capital ever raised by a national bank. We believed this capital was necessary to service our target markets, particularly by allowing us to originate and retain loans of a size and type that would appeal to our targeted market segment. We also began recruiting a team of senior executives with extensive experience in the Texas banking industry and expanding our operations in our targeted core markets. We also focused on developing a broader range of funding sources, including raising deposits through BankDirect and attracting cost-effective, stable deposits from our commercial banking customers.

We have grown substantially in both asset size and profitability since our formation. Our assets increased at annual rates of 357%, 122%, 28% and 54% in 1999, 2000, 2001 and 2002, respectively. Our total loans increased at annual rates of 1,952%, 176%, 44% and 24% in 1999, 2000, 2001 and 2002, respectively. Over the same period, our operating results have improved from a net loss of $9.3 million and $16.5 million in 1999 and 2000, respectively, reflecting in large part our start-up and expansion costs, to profits of $5.8 million and $7.3 million in 2001 and 2002, respectively, and $6.9 million for the first six months of 2003. The growth in our profitability is based largely on our success in developing a portfolio with an increasing amount of higher yielding commercial loans to local businesses and individuals, while managing our funding costs and non-interest expenses.

The Texas Market

We believe that a key factor in our ability to achieve our business strategy and financial goals and to create stockholder value is the attractiveness of the Texas market. We believe the Texas market has favorable demographic and economic characteristics. In addition, we believe that the changes in the Texas banking market since the late 1980s have created an underserved market of Texas-based middle market businesses and high net worth individuals that we can successfully target.

Texas is the second most populous state in the country with an estimated population in 2002 of approximately 21.6 million. In terms of population, Texas is expected to be among the ten fastest growing states in the U.S. over the period from 2002 to 2007, and the third fastest growing state of the ten most populous states over that period. In addition, average 2002 per capita income of $27,069 in our target markets (the five largest metropolitan markets in the state of Texas) was above the U.S. average and is expected to grow faster than any of the ten largest metropolitan statistical areas in the U.S. (excluding Dallas and Houston, which are two of our target markets and are among the ten largest metropolitan statistical areas in the U.S.) for the period 2002 to 2007. The Texas banking markets have grown over the past five years, with statewide deposits increasing from $194.3 billion in 1997 to $256.6 billion in 2002. The Texas economy has become substantially less dependent upon energy-related businesses than it was prior to the energy industry crisis of the late 1980s and includes a greater diversification among industries such as services, technology and manufacturing. Accordingly, we expect that the local Texas markets will grow faster than most in the U.S. with less volatility than experienced in the past, providing opportunities for above-average growth and potential profitability for us. Although current estimates of future economic and demographic data may indicate a favorable trend, there is no assurance that the actual results will follow these trends, especially as the Texas market may be subject to unexpected economic downturns.

The Texas banking market is currently characterized by the dominance of large out-of-state banking organizations that entered the state following the economic crisis that affected Texas during the 1980s. Today, Texas five largest banking organizations by deposits are headquartered outside of Texas and approximately 55% of the total deposits in the state are controlled by out-of-state organizations. We believe that many middle market companies and high net worth individuals are interested in banking with a company headquartered in, and with decision-making authority based in, Texas and with established Texas bankers who have the expertise to act as trusted advisors. These customers are attractive to us because we believe that, if we serve them properly, we will be able to establish long-term relationships and provide multiple products to them, enhancing our overall profitability. Our banking centers have been built around experienced bankers with lending expertise in the specific industries found in their market areas, allowing for responsive, personalized service.

Our Management

We have assembled an executive management team with extensive experience in the Texas banking industry.

Joseph M. (Jody) Grant (64) Mr. Grant has been our Chairman of the Board and Chief Executive Officer since we commenced operations in 1998. In addition, he currently serves as the Chairman of the Board of our bank. Prior to co-founding our company, Mr. Grant served as Executive Vice President, Chief Financial Officer and a member of the board of directors of Electronic Data Systems Corporation from 1990 to March 1998. From 1986 to 1989, Mr. Grant had served as the Chairman and Chief Executive Officer of Texas American Bancshares, Inc.

George F. Jones, Jr. (59) Mr. Jones has served as the Chief Executive Officer and President of our bank since its inception in December 1998. Mr. Jones was also a founder of Resource Bank, our predecessor bank. From 1993 until 1995, Mr. Jones served as an Executive Vice President of Comerica Bank, which acquired NorthPark National Bank in 1993. From 1986 until Comerica s acquisition of NorthPark in 1993, Mr. Jones served as either NorthPark s President or President and Chief Executive Officer.

C. Keith Cargill (50) Mr. Cargill has served as an Executive Vice President and the Chief Lending Officer of our bank since its inception in December 1998. Mr. Cargill has more than 20 years of banking experience. He began his banking career at Texas American Bank in 1977, where he was the manager of the national corporate lending division of the flagship bank in Fort Worth. In 1985, Mr. Cargill became President and Chief Executive Officer of Texas American Bank/ Riverside, Ft. Worth. In 1989, Mr. Cargill joined NorthPark National Bank as an Executive Vice President and Chief Lending Officer. When NorthPark was acquired by Comerica Bank in 1993, Mr. Cargill joined Comerica as Senior Vice President and middle market banking manager.

In addition to these three executive officers, we have attracted a number of other experienced Texas bankers to help build and grow our company. It is an integral component of our ongoing strategy to attract high quality, experienced bankers with long track records of serving middle market and private banking clientele in our targeted banking markets in Texas.

Chief Financial Officer

In July 2003, Peter B. Bartholow agreed to become our Executive Vice President and Chief Financial Officer. We expect that he will begin serving in that capacity on October 6, 2003. Mr. Bartholow most recently served as managing director of Hat Creek Partners, a Dallas, Texas venture capital firm. Prior to joining Hat Creek Partners, he served as a consultant to, and prior to that, as Vice President, Corporate Finance of, Electronic Data Systems, Inc.

Strategy

Our main objective is to take advantage of expansion opportunities while operating efficiently, providing individualized customer service and maximizing profitability. To achieve this, we seek to implement the following strategies:

- Target the attractive middle market business and high net worth individual market segments;
- Focus our business development efforts on the key major metropolitan markets in Texas;
- Grow our loan and deposit base in our existing markets by hiring additional experienced Texas bankers and opening select, strategically-located banking centers;
- Improve our financial performance through the efficient management of our infrastructure and capital base;
- Continue to use BankDirect as a way to diversify our funding sources by attracting retail deposits on a nationwide basis; and
- Expand our geographic reach and business mix by hiring qualified local bankers, establishing select banking locations and completing selective acquisitions in new markets.

Expansion in Houston Market

In September 2003, we anticipate that we will open a new banking center in Houston. We believe this new banking center will allow us to significantly expand our current operations in Houston. To assist our expansion in Houston, we have also hired four senior, experienced bankers who we believe will significantly expand our relationships in the energy and real estate sectors of the Houston marketplace. In addition, we intend to hire sufficient support personnel to offer a complete range of banking services.

THE OFFERING

Common stock offered by us	3,000,000 shares
Common stock offered by the selling stockholders	3,000,000 shares
Total shares of common stock offered	6,000,000 shares
Common stock outstanding after the offering	24,426,449 shares
Use of proceeds received by us	General corporate purposes, including to finance the growth of our business. A portion of the proceeds may be used for acquisitions or for the opening of select banking locations, although currently we have no understandings, agreements or definitive plans with respect to any acquisitions or openings of banking locations, other than the anticipated opening of our banking center in Houston in September 2003. We will not receive any proceeds from the shares sold by our selling stockholders.
Nasdaq National Market trading symbol	TCBI

Unless otherwise indicated, the share information in the table above and in this prospectus excludes up to 900,000 shares that may be purchased by the underwriters from us and certain of the selling stockholders to cover over-allotments.

The outstanding share information is based upon 21,426,449 shares of our common stock that were outstanding as of July 31, 2003, as adjusted for the conversion of the 1,057,142 shares of preferred stock outstanding as of July 31, 2003 into 2,114,284 shares of common stock, which we expect will automatically occur upon the consummation of the offering. Unless otherwise indicated, information contained in this prospectus regarding the number of outstanding shares of common stock does not include or reflect the following:

- 2,368,888 shares of common stock issuable upon the exercise of outstanding stock options as of June 30, 2003; and
- an aggregate of 129,861 shares of common stock reserved for future issuance as of June 30, 2003 under our 1999 Omnibus Stock Plan and 2000 Employee Stock Purchase Plan.

OUR CORPORATE INFORMATION

We are incorporated under the laws of Delaware. Our corporate headquarters is located at 2100 McKinney Avenue, Suite 900, Dallas, Texas 75201. Our telephone number is (214) 932-6600. Our web site addresses are www.texascapitalbank.com and www.bankdirect.com. The information on our web sites does not constitute part of this prospectus.

SUMMARY CONSOLIDATED FINANCIAL INFORMATION

The following table provides our summary consolidated financial data for the periods ended and as of the dates indicated. You should read the summary consolidated financial data set forth below in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and with our consolidated financial statements and related notes appearing elsewhere in this prospectus.

	At or for the Six Months Ended June 30,		At or for the Year Ended December 31,		
	2003	2002	2002	2001	2000
	(Unaudited)	(In thousands, except per share, average share and percentage data)			
Consolidated Statement of Operations Data(1)					
Interest income	$ 41,499	$ 32,013	$ 70,142	$ 70,594	$ 55,769
Interest expense	17,093	12,405	27,896	35,539	32,930
Net interest income	24,406	19,608	42,246	35,055	22,839
Provision for loan losses	2,850	1,979	5,629	5,762	6,135
Net interest income after provision for loan losses	21,556	17,629	36,617	29,293	16,704
Non-interest income	6,145	3,656	8,625	5,983	1,957
Non-interest expense	26,279	16,780	35,370	29,432	35,158
Income (loss) before taxes	1,422	4,505	9,872	5,844	(16,497)
Income tax expense (benefit)	(5,466)	1,128	2,529		
Net income (loss)	6,888(2)	3,377(2)	7,343	5,844	(16,497)
Consolidated Balance Sheet Data(1)					
Total assets	2,003,198	1,260,774	1,793,282	1,164,779	908,428
Loans	1,251,794	944,731	1,122,506	903,979	629,109
Securities available for sale	649,522	270,085	553,169	206,365	184,952
Securities held to maturity					28,366
Deposits	1,340,322	980,297	1,196,535	886,077	794,857
Federal funds purchased	156,194	52,087	83,629	76,699	11,525
Other borrowings	346,773	102,442	365,831	86,899	7,061
Long-term debt	20,000		10,000		
Stockholders equity	132,168	118,043	124,976	106,359	86,197
Other Financial Data					
Income (loss) per share:					
Basic	$ 0.33(2)	$ 0.15	$ 0.33(2)	$ 0.31	$ (0.95)
Diluted	0.32(2)	0.15	0.32(2)	0.30	(0.95)
Tangible book value per share(3)	6.11	5.48	5.80	5.08	4.46
Book value per share(3)	6.18	5.55	5.87	5.15	4.54
Weighted average shares:					
Basic	19,202,699	19,135,782	19,145,255	18,957,652	17,436,628
Diluted	21,554,892	19,338,906	19,344,874	19,177,204	17,436,628
Selected Financial Ratios:					
Performance Ratios(6)					
Return on average assets	0.74%	0.56%	0.54%	0.58%	(2.42)%
Return on average equity	10.87%	6.02%	6.27%	6.44%	(20.02)%
Net interest margin	2.81%	3.47%	3.28%	3.62%	3.51%
Efficiency ratio	86.02%(4)	72.13%	69.53%(4)	71.72%	141.79%
Non-interest expense to average assets	2.81%(5)	2.79%	2.59%(5)	2.90%	5.15%

Asset Quality Ratios(6):					
Net charge-offs to average loans	0.02%	0.56%	0.38%	0.26%	
Allowance for loan losses to total loans	1.38%	1.28%	1.30%	1.39%	1.42%
Allowance for loan losses to non-performing and renegotiated loans	136.12%	178.88%	499.42%	110.23%	1,557.69%
Non-performing and renegotiated loans to total loans	1.01%	0.72%	.26%	1.26%	.09%
Capital and Liquidity Ratios					
Total capital ratio	11.50%	11.99%	11.32%	11.73%	10.98%
Tier 1 capital ratio	10.27%	10.83%	10.16%	10.48%	9.94%
Tier 1 leverage ratio	7.43%	9.27%	7.66%	9.46%	9.62%
Average equity/average assets	6.78%	9.34%	8.57%	8.93%	12.07%
Tangible equity/assets	6.52%	9.24%	6.89%	9.00%	9.31%
Average net loans/average deposits	92.91%	96.08%	96.31%	95.54%	72.92%

(1) The consolidated statement of operations data and consolidated balance sheet data presented above for the six month period ended June 30, 2002 and for the three most recent fiscal years ended December 31 have been derived from our audited consolidated financial statements, which have been audited by Ernst & Young LLP, independent auditors. The historical results are not necessarily indicative of the results to be expected in any future period. The unaudited operating results for the six month period ended June 30, 2003 are not necessarily indicative of the results to be achieved for the full year. Interim results reflect all adjustments necessary for a fair statement of the results of operations and balances for the interim periods presented. Such adjustments are of a normal recurring nature.

(2) During the six months ended June 30, 2003, net income included the impact of reversing our deferred tax asset valuation allowance of $5.9 million, $6.3 million in penalties related to unwinding repurchase agreements prior to maturity and approximately $250,000 in separation expense related to the resignation of a senior officer. For the six months ended June 30, 2003, income per share excluding the impact of reversing the valuation allowance, unwinding penalties and separation expense would have been $0.25, on a basic basis, and $0.25, on a diluted basis. During the year ended December 31, 2002, net income included $1.2 million in IPO expenses recognized as our offering was postponed. For the year ended December 31, 2002, income per share excluding these IPO expenses would have been $0.37, on a basic basis, and $0.36, on a diluted basis. Income per share excluding the impact of reversing the valuation allowance, unwinding penalties and separation expense for the six months ended June 30, 2003 and income per share excluding IPO expenses for the year ended December 31, 2002 are non-GAAP financial measures. See below for an explanation of why we believe these non-GAAP financial measures are useful to management and investors and a reconciliation of these non-GAAP financial measures to income per share, which is the most directly comparable financial measure presented in accordance with GAAP.

(3) Amounts for December 31, 2001 are adjusted to reflect the conversion of 753,301 shares of preferred stock outstanding on such date into 1,506,602 shares of common stock, assuming automatic conversion of the preferred stock. Amounts for June 30, 2002, December 31, 2002 and June 30, 2003 are adjusted to reflect the conversion of 1,057,142 shares of preferred stock outstanding on such date into 2,114,284 shares of common stock, assuming automatic conversion of the preferred stock.

(4) Represents non-interest expense divided by the sum of net interest income and non-interest income for the periods shown. During the six months ended June 30, 2003, non-interest expense included $6.3 million in penalties related to unwinding repurchase agreements prior to maturity and approximately $250,000 in separation expense related to the resignation of a senior officer. For the six months ended June 30, 2003, the efficiency ratio excluding the unwinding penalties and separation expense would have been 64.70%. During the year ended December 31, 2002, non-interest expense included $1.2 million in IPO expenses recognized as our offering was postponed. For the year ended December 31, 2002, the efficiency ratio excluding the IPO expenses would have been 67.19%. The efficiency ratio excluding unwinding penalties and separation expense for the six months ended June 30, 2003 and the efficiency ratio excluding IPO expenses for the year ended December 31, 2002 are non-GAAP financial measures. See below for an explanation of why we believe these non-GAAP financial measures are useful to management and investors and a reconciliation of these non-GAAP financial measures to the efficiency ratio, which is the most directly comparable financial measure presented in accordance with GAAP.

(5) During the six months ended June 30, 2003, the ratio of non-interest expense to average assets included $6.3 million in penalties related to unwinding repurchase agreements prior to maturity and approximately $250,000 in separation expense related to the resignation of a senior officer. For the six months ended June 30, 2003, the annualized ratio of non-interest expense to average assets excluding the unwinding penalties and separation expense would have been 2.11%. During the year ended December 31, 2002, the ratio of non-interest expense to average assets included $1.2 million in IPO expenses recognized as our offering was postponed. For the year ended December 31, 2002, the ratio of non-interest expense to average assets excluding the IPO expenses would have been 2.50%. The ratio of non-interest expense to average assets excluding unwinding penalties and separation expense for the six months ended June 30, 2003 and the ratio of non-interest expense to average assets excluding IPO expenses for the year ended December 31, 2002 are non-GAAP financial measures. See below for an explanation of why we believe these non-GAAP financial measures are useful to management and investors and a reconciliation of these non-GAAP financial measures to the ratio of non-interest expense to average assets, which is the most directly comparable financial measure presented in accordance with GAAP.

(6) Interim period ratios are annualized.

* Not meaningful.

Non-GAAP Financial Measures

The footnotes to the Summary Consolidated Financial Information presented above, the footnotes to the Selected Consolidated Financial Data, and portions of Management s Discussion and Analysis of Financial Condition and Results of Operations include non-GAAP financial measures. These non-GAAP financial measures are:

for the six months ended June 30, 2003:

income per share (basic and diluted) excluding the impact of reversing the valuation allowance, unwinding penalties and separation expense;

efficiency ratio excluding unwinding penalties and separation expense; and

ratio of non-interest expense to average assets excluding unwinding penalties and separation expense;

for the year ended December 31, 2002:

income per share (basic and diluted) excluding IPO expenses;

efficiency ratio excluding IPO expenses; and

ratio of non-interest expense to average assets excluding IPO expenses.

The impact of reversing the valuation allowance reflects the reversal of our deferred tax asset valuation allowance of $5.9 million. The unwinding penalties reflect $6.3 million in penalties related to unwinding repurchase agreements prior to maturity. The separation expense reflects approximately $250,000 in separation expense related to the resignation of a senior officer. The IPO expenses reflect $1.2 million in IPO expenses recognized as our offering was postponed.

Management believes that these non-GAAP financial measures are useful to investors and to management because they provide additional information that more closely reflects our intrinsic operating performance and growth. Reversal of the entire valuation allowance was based on our assessment of our ability to generate earnings to allow the deferred tax assets to be realized which is supported by our current earnings trends. We unwound certain repurchase agreements, incurring the unwinding penalties, in order to take advantage of historical lows in interest rates, which had decreased on similar repurchase agreements by approximately 1.4% since the time we entered into the original repurchase agreements. Although we have experienced employee separations in the past, this was the first separation with an executive who had entered into an employee agreement with us. We currently have only three other employees with employment agreements. Since we have not had any reversals of valuation allowances, unwinding penalties or separation expenses related to employees who have employment agreements in our operating history, and because expenses related to the initial public offering will not recur once the offering is completed, we believe that these non-GAAP financial measures are useful to investors and to management to understand the development of our income per share results, efficiency ratio and ratio of non-interest expense to average assets since our founding and to help in comparing our intrinsic operating performance in different periods. Management also uses these measures internally to evaluate our performance and manage our operations. These measurements should not be regarded as a replacement for corresponding GAAP measures.

The following tables reconcile each of the non-GAAP financial measures described above to the most directly comparable financial measure presented in accordance with GAAP.

Reconciliation of GAAP to income per share, excluding the impact of reversing the valuation allowance, unwinding penalties, separation expense and to income per share excluding IPO expenses.

	Six Months Ended June 30, 2003	Year Ended December 31, 2002
	(Unaudited)	
	(In thousands except share data)	
Net income	$ 6,888	$ 7,343
Repurchase agreement unwinding penalties	6,262	
Executive separation	250	
Tax effect of repurchase agreement unwinding penalties and separation costs	(2,120)	
Impact of reversing deferred tax asset valuation allowance	(5,929)	
IPO expenses		1,190
Tax effect of IPO expenses		(417)
Income excluding the impact of reversing the valuation allowance, unwinding penalties, and separation expense (for six months ended June 30, 2003), and income excluding IPO expenses (for year ended December 31, 2002)	5,351	8,116
Preferred stock dividends	(550)	(1,097)
Numerator used to calculate basic income per share excluding the impact of reversing the valuation allowance, unwinding penalties, and separation expense (for six months ended June 30, 2003) and numerator for basic income for share excluding IPO expenses (for year ended December 31, 2002)	4,801	7,019
Effect of dilutive securities (*)	550	
Numerator used to calculate diluted income per share excluding the impact of reversing the valuation allowance, unwinding penalties, and separation expense (for six months ended June 30, 2003) and numerator for diluted income per share excluding IPO expenses (for year ended December 31, 2002)	$ 5,351	$ 7,019
Denominator used for GAAP and basic income per share excluding the impact of reversing the valuation allowance, unwinding penalties, and separation expense (for six months ended June 30, 2003) and denominator for GAAP and basic income per share excluding IPO expenses (for year ended December 31, 2002)	19,202,699	19,145,255
Denominator used for GAAP and diluted income per share excluding the impact of reversing the valuation allowance, unwinding penalties, and separation expense (for six months ended June 30, 2003) and denominator for GAAP and diluted income per share excluding IPO expenses (for year ended December 31, 2002)	21,554,892	19,344,874
Basic income per share excluding the impact of reversing the valuation allowance, unwinding penalties, and separation expense (for six months ended June 30, 2003) and basic income per share excluding IPO expenses (for year ended December 31, 2002)	$ .25	$ .37
Diluted income per share excluding the impact of reversing the valuation allowance, unwinding penalties, and separation expense (for six months ended June 30, 2003) and diluted income per share excluding IPO expenses (for year ended December 31, 2002)	$ .25	$ .36

* Effects of Series A convertible preferred stock are anti-dilutive in 2002 and are not included.

Reconciliation of GAAP to Efficiency Ratio and Ratio of Non-interest Expense to Average Assets excluding Unwinding Penalties and Separation Expense, and Efficiency Ratio and Ratio of Non-interest Expense to Average Assets excluding IPO expenses.

	Six Months Ended June 30, 2003	Year Ended December 31, 2002
	(Unaudited)	
	(In thousands)	
Non-interest expense	$ 26,279	$ 35,370
Repurchase agreement unwinding penalties	(6,262)	
Executive separation	(250)	
IPO expenses		(1,190)
Numerator used to calculate efficiency ratio excluding unwinding penalties and separation expense and ratio of non-interest expense to average assets excluding unwinding penalties and separation expense (for six months ended June 30, 2003) and numerator for efficiency ratio excluding IPO expenses and ratio of non-interest expense to average assets excluding IPO expenses (for year ended December 31, 2002)	$ 19,767	$ 34,180
Denominator used for GAAP and efficiency ratio excluding unwinding penalties and separation expense (for six months ended June 30, 2003) and denominator used for GAAP and efficiency ratio excluding IPO expenses (for year ended December 31, 2002)		
Net interest income	$ 24,406	$ 42,246
Non-interest income	6,145	8,625
	$ 30,551	$ 50,871
Efficiency ratio excluding unwinding penalties and separation expense (for six months ended June 30, 2003) and efficiency ratio excluding IPO expenses (for year ended December 31, 2002)	64.70%	67.19%
Denominator used for GAAP and ratio of non-interest expense to average assets excluding unwinding penalties and separation expense (for six months ended June 30, 2003 (annualized)) and denominator used for GAAP and ratio of non-interest expense to average assets excluding IPO expenses (for year ended December 31, 2002)		
Average assets	$ 1,886,142	$ 1,365,722
Ratio of Non-interest expense to average assets excluding unwinding penalties and separation expense (for six months ended June 30, 2003 (annualized)) and ratio of non-interest expense to average assets excluding IPO expenses (for year ended December 31, 2002)	2.11%	2.50%

RISK FACTORS

Before you invest in our common stock, you should understand the high degree of risk involved. You should consider carefully the following risks and other information in this prospectus, including our financial statements and related notes, before you decide to purchase shares of our common stock. The following risks and uncertainties are not the only ones we face. There may be additional risks that we do not currently know of or that we currently deem immaterial based on the information available to us. If any of these risks actually occur, our business, financial condition and operating results could be adversely affected. As a result, the trading price of our common stock could decline, perhaps significantly and you could lose part or all of your investment.

Risks Related to Our Business

Our business strategy includes significant growth plans, and if we fail to manage our growth effectively as we pursue our expansion strategy, it could negatively affect our operations

We intend to develop our business by pursuing a significant growth strategy. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in significant growth stages of development. In order to execute our growth strategy successfully, we must, among other things:

- identify and expand into suitable markets;
- build our customer base;
- maintain credit quality;
- attract sufficient deposits to fund our anticipated loan growth;
- attract and retain qualified bank management in each of our targeted markets;
- identify and pursue suitable opportunities for opening new banking locations; and
- maintain adequate regulatory capital.

Failure to manage our growth effectively could have a material adverse effect on our business, future prospects, financial condition or results of operations, and could adversely affect our ability to successfully implement our business strategy.

We have a history of net operating losses

Although we have generated operating profits for each fiscal quarter since March 2001, we incurred significant losses during our initial years of operations and cannot guarantee that we will be able to sustain profitability. Our losses were attributable in large part to expenses incurred in forming our business, establishing our operations and growing our business, which were funded with equity capital. We cannot assure you that our revenues will continue to be sufficient to cover our expenses or that capital will be available to us on satisfactory terms, or at all, to fund any shortfall between these costs and revenues. Consequently, if we are unable to generate profits on a consistent basis, our ability to compete effectively could be adversely affected.

We have a limited operating history and as a result our financial performance to date may not be a reliable indicator of whether our business strategy will be successful

We did not commence significant operations with our current management and begin implementing our current strategy until December 1998, and our operations prior to that date were very limited. We have a very limited historical basis upon which to rely for gauging our business performance under normalized operations. Our prospects are subject to the risks and uncertainties frequently encountered by companies in their early stages of development, including the risk that we will not be able to implement our business plan or that our business plan will prove to be unprofitable. Accordingly, our financial performance to date may not be

representative of our long-term future performance or indicative of whether our business strategy will be successful.

We may not be able to find suitable acquisition candidates

We intend to make acquisitions that will complement or expand our business. However, we believe that there are a limited number of banks that will meet our acquisition criteria and, consequently, we cannot assure you that we will be able to identify suitable candidates for acquisitions. In addition, even if suitable candidates are identified, we expect to compete with other potential bidders for such businesses, many of which may have greater financial resources than we have. Our failure to find suitable acquisition candidates, or successfully bid against other competitors for acquisitions, could adversely affect our ability to successfully implement our business strategy.

We may be unable to manage our growth due to acquisitions, which could have an adverse effect on our financial condition or results of operations

We believe that a portion of our growth will come from acquisitions of banks and other financial institutions. Such acquisitions involve risks of changes in results of operations or cash flows, unforeseen liabilities relating to the acquired institution or arising out of the acquisition, asset quality problems of the acquired entity and other conditions not within our control, such as adverse personnel relations, loss of customers because of change of identity, deterioration in local economic conditions and other risks affecting the acquired institution. In addition, the process of integrating acquired entities will divert significant management time and resources. We cannot assure you that we will be able to integrate successfully or operate profitably any financial institutions we may acquire. We may experience disruption and incur unexpected expenses in integrating acquisitions. There can be no assurance that any such acquisitions will enhance our business, results of operations, cash flows or financial condition, and such acquisitions may have an adverse effect on our results of operations, particularly during periods in which the acquisitions are being integrated into our operations.

We are dependent upon key personnel

Our success depends to a significant extent upon the performance of certain key employees, the loss of whom could have an adverse effect on our business. Our key employees include Joseph M. Grant, our Chairman of the Board of Directors and Chief Executive Officer, George F. Jones, Jr., the President and Chief Executive Officer of our bank, and C. Keith Cargill, our bank s Executive Vice President and Chief Lending Officer. Although we have entered into employment agreements with these employees, we cannot assure you that we will be successful in retaining these key employees.

Our operations are significantly affected by interest rate levels

Our profitability is dependent to a large extent on our net interest income, which is the difference between interest income we earn as a result of interest paid to us on loans and investments and interest we pay to third parties such as our depositors and those from whom we borrow funds. Like most financial institutions, we are affected by changes in general interest rate levels, which are currently at relatively low levels, and by other economic factors beyond our control. Interest rate risk can result from mismatches between the dollar amount of repricing or maturing assets and liabilities and from mismatches in the timing and rate at which our assets and liabilities reprice. Although we have implemented strategies which we believe reduce the potential effects of changes in interest rates on our results of operations, these strategies may not always be successful. In addition, any substantial and prolonged increase in market interest rates could reduce our customers desire to borrow money from us or adversely affect their ability to repay their outstanding loans by increasing their credit costs since most of our loans have adjustable interest rates that reset periodically. Any of these events could adversely affect our results of operations or financial condition.

We must effectively manage our credit risk

There are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks resulting from changes in economic and industry conditions, risks inherent in dealing with individual borrowers and risks resulting from uncertainties as to the future value of collateral. The risk of nonpayment of loans is inherent in commercial banking. Although we attempt to minimize our credit risk by carefully monitoring the concentration of our loans within specific industries and through prudent loan application approval procedures, we cannot assure you that such monitoring and approval procedures will reduce these lending risks. Moreover, as we expand our operations into new geographic markets, our credit administration and loan underwriting policies will need to be adapted to the local lending and economic environments of these new markets. We cannot assure you that our credit administration personnel, policies and procedures will adequately adapt to any new geographic markets.

There are material risks involved in commercial lending that could adversely affect our business

We generally invest a greater proportion of our assets in commercial loans than other banking institutions of our size, which typically invest a greater proportion of their assets in loans secured by single-family residences. Commercial loans generally involve a higher degree of credit risk than residential mortgage loans due, in part, to their larger average size and generally less readily-marketable collateral. Due to their size and the nature of their collateral, losses incurred on a small number of commercial loans could have a material adverse impact on our financial condition and results of operations. In addition, unlike residential mortgage loans, commercial loans generally depend on the cash flow of the borrower s business to service the debt. Furthermore, a significant portion of our loans is dependent for repayment largely on the liquidation of assets securing the loan, such as inventory and accounts receivable. These loans carry incrementally higher risk, since their repayment is often dependent solely on the financial performance of the borrower s business. Our business plan calls for continued efforts to increase our assets invested in commercial loans. An increase in non-performing loans could cause operating losses, impaired liquidity and the erosion of our capital, and could have a material adverse effect on our business, financial condition or results of operations.

If the value of real estate in our core Texas markets were to decline materially, a significant portion of our loan portfolio could become under-collateralized, which would have a material adverse effect on us

The market value of real estate, particularly real estate held for investment, can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. If the value of the real estate serving as collateral for our loan portfolio were to decline materially, a significant part of our loan portfolio could become under-collateralized. As of June 30, 2003, approximately 41% of the collateral for the loans in our portfolio consisted of real estate. Of the real estate that collateralizes the loans in our portfolio, approximately one-third of the properties are real estate owned and occupied by businesses to which we have extended loans and the remaining two-thirds is real estate held for investment by the borrower. If the loans that are collateralized by real estate become troubled during a time when market conditions are declining or have declined, then we may not be able to realize the amount of security that we anticipated at the time of originating the loan, which could have a material adverse effect on our provision for loan losses and our operating results and financial condition.

We may be responsible for environmental claims and other related costs of property we acquire through foreclosure, which could adversely affect our profitability

A significant portion of our loan portfolio is secured by real property. In the course of our business, we may acquire properties that secure loans as a result of foreclosure. There is a risk that hazardous or toxic waste could be found on such properties. In such event, we could be held responsible for the cost of cleaning up or removing such waste, and such cost could significantly exceed the value of the underlying properties and adversely affect our profitability. To date, we have not been required to perform any investigation or clean up activities with respect to, nor have we been subject to any environmental claims on, any loans held in our loan portfolio or other properties we acquired. Although we have a policy that requires us to perform an environmental review before initiating any foreclosure action on real property, there can be no assurance that this will be sufficient to detect all potential environmental hazards.

Our financial condition and results of operations would be adversely affected if our allowance for loan losses is not sufficient to absorb actual losses

Experience in the banking industry indicates that a portion of our loans will become delinquent, some of which may only be partially repaid or may never be repaid at all. Despite our underwriting criteria, we experience losses for reasons beyond our control, such as general economic conditions. Although we believe that our allowance for loan losses is maintained at a level adequate to absorb any inherent losses in our loan portfolio, these estimates of loan losses are inherently subjective and their accuracy depends on the outcome of future events. We may need to make significant and unanticipated increases in our loss allowances in the future, which would materially affect our results of operations in that period.

Bank regulators may require us to increase our allowance for loan losses, which could have a negative effect on our financial condition and results of operations

Federal regulators, as an integral part of their respective supervisory functions, periodically review our allowance for loan losses. The regulatory agencies may require us to increase our provision for loan losses or to recognize further loan charge-offs based upon their judgments, which may be different from ours. Any increase in the allowance for loan losses required by these regulatory agencies could have a negative effect on our financial condition and results of operations.

Lack of seasoning of our loan portfolio may increase the risk of credit defaults in the future

Most of the loans in our loan portfolio were originated within the past four years, and approximately 49% were originated within the past 18 months. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process referred to as seasoning. As a result, a portfolio of older loans will usually behave more predictably than a newer portfolio. Because our loan portfolio is relatively new, the current level of delinquencies and defaults may not be representative of the level that will prevail when the portfolio becomes more seasoned, which is likely to be somewhat higher than current levels.

Until our portfolio becomes more seasoned, we must rely in part on the historical loan loss experience of other financial institutions and the experience of our management in determining our allowance for loan losses, and this may not be comparable to our loan portfolio

Because most of our loans in our loan portfolio were originated relatively recently, our loan portfolio does not provide an adequate history of loan losses for our management to rely upon in establishing our allowance for loan losses. We therefore rely to a significant extent upon other financial institutions histories of loan losses and their allowance for loan losses, as well as our management s estimates based on their experience in the banking industry, when determining our allowance for loan losses. There is no assurance that the history of loan losses and the reserving policies of other financial institutions and our management s judgment will result in reserving policies that will be adequate for our business and operations or applicable to our loan portfolio.

Our business faces unpredictable economic conditions

General economic conditions impact the banking industry. The credit quality of our loan portfolio necessarily reflects, among other things, the general economic conditions in the areas in which we conduct our business. Our continued financial success depends somewhat on factors beyond our control, including:

- national and local economic conditions;
- the supply and demand for investable funds;

interest rates; and

federal, state and local laws affecting these matters.

Any substantial deterioration in any of the foregoing conditions could have a material adverse effect on our financial condition and results of operations, which would likely adversely affect the market price of our common stock. Further, with the exception of our BankDirect customers which comprised 19% of our total deposits as of June 30, 2003, our bank s customer base is primarily commercial in nature, and our bank does not have a significant branch network or retail deposit base. In periods of economic downturn, business and commercial deposits may tend to be more volatile than traditional retail consumer deposits and, therefore, during these periods our financial condition and results of operations could be adversely affected to a greater degree than those competitors that have a larger retail customer base.

Our business is concentrated in Texas and a downturn in the economy of Texas may adversely affect our business

Substantially all of our business is located in Texas. As a result, our financial condition and results of operations may be affected by changes in the Texas economy. A prolonged period of economic recession or other adverse economic conditions in Texas may result in an increase in nonpayment of loans and a decrease in collateral value.

We compete with many larger financial institutions which have substantially greater financial resources than we have

Competition among financial institutions in Texas is intense. We compete with other bank holding companies, state and national commercial banks, savings and loan associations, consumer finance companies, credit unions, securities brokerages, insurance companies, mortgage banking companies, money market mutual funds, asset-based non-bank lenders and other financial institutions. Many of these competitors have substantially greater financial resources, lending limits and larger branch networks than we do, and are able to offer a broader range of products and services than we can. Failure to compete effectively for deposit, loan and other banking customers in our markets could cause us to lose market share, slow our growth rate and may have an adverse effect on our financial condition and results of operations.

Our future profitability depends, to a significant extent, upon revenue we receive from our middle market business customers and their ability to meet their loan obligations

At June 30, 2003, a substantial majority of our loan portfolio was comprised of loans to our middle market business customers. For the six month period ended June 30, 2003, a significant portion of our total interest and non-interest income was derived from middle market business customers. We expect that our future profitability will depend, to a significant extent, upon revenue we receive from middle market business customers, and their ability to continue to meet existing loan obligations. As a result, adverse economic conditions or other factors adversely affecting this market segment may have a greater adverse effect on us than on other financial institutions that have a more diversified customer base.

We compete in an industry that continually experiences technological change, and we may have fewer resources than many of our competitors to continue to invest in technological improvements

The financial services industry is undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. In addition to improving the ability to serve customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

System failure or breaches of our network security could subject us to increased operating costs as well as litigation and other liabilities

The computer systems and network infrastructure we use could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from fire, power loss, telecommunications failure or a similar catastrophic event. Any damage or failure that causes an interruption in our operations could have an adverse effect on our financial condition and results of operations. In addition, our operations are dependent upon our ability to protect the computer systems and network infrastructure utilized by us against damage from physical break-ins, security breaches and other disruptive problems caused by the Internet or other users. Such computer break-ins and other disruptions would jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us and deter potential customers. Although we, with the help of third-party service providers, intend to continue to implement security technology and establish operational procedures to prevent such damage, there can be no assurance that these security measures will be successful. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms we and our third-party service providers use to protect customer transaction data. A failure of such security measures could have an adverse effect on our financial condition and results of operations.

Our success in the Internet banking market will largely depend on our ability to implement services competitive with similar services offered by other financial institutions

The success of our Internet banking products and services will depend in large part on our ability to implement and maintain the appropriate technology. This includes our ability to provide services competitive with banks that are already using the Internet. If we are unable to implement and maintain the appropriate technology efficiently, it could affect our results of operations and our ability to compete with financial institutions.

Our success in attracting and retaining retail consumer deposits depends on our ability to offer competitive rates and services

As of June 30, 2003, approximately 19% of our total deposits came from retail consumer customers through BankDirect, our Internet banking facility. The market for Internet banking is extremely competitive and allows retail consumer customers to access financial products and compare interest rates from numerous financial institutions located across the U.S. As a result, Internet retail consumers are more sensitive to interest rate levels than retail consumers who bank at a branch office. Our future success in retaining and attracting retail consumer customers depends, in part, on our ability to offer competitive rates and services.

We could be adversely affected by changes in the regulation of the Internet

Our ability to conduct, and the cost of conducting, business may also be adversely affected by a number of legislative and regulatory proposals concerning the Internet, which are currently under consideration by federal, state, local and foreign governmental organizations. These proposals include, but are not limited to, the following matters:

- on-line content;
- user privacy;
- taxation;
- access charges;
- liability for third-party activities; and
- regulatory and supervisory authority.

Moreover, it is uncertain how existing laws relating to these issues will be applied to the Internet. The adoption of new laws or the application of existing laws could decrease the growth in the use of the Internet, which could in turn decrease the demand for our services, increase our cost of doing business or otherwise have an adverse effect on our business, financial condition and results of operations. Furthermore, government restrictions on Internet content could slow the growth of Internet use and decrease acceptance of the Internet as a communications and commercial medium and thereby have an adverse effect on our financial condition and results of operations.

Risks Related to Our Industry

We are subject to significant government regulation

We operate in a highly regulated environment and are subject to supervision and regulation by a number of governmental regulatory agencies, including the Federal Reserve System, or Federal Reserve, the Office of the Comptroller of the Currency, or OCC, and the Federal Deposit Insurance Corporation, or FDIC. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of stockholders, govern a comprehensive range of matters relating to ownership and control of our shares, our acquisition of other companies and businesses, permissible activities for us to engage in, maintenance of adequate capital levels and other aspects of our operations. The bank regulatory agencies possess broad authority to prevent or remedy unsafe or unsound practices or violations of law. In addition, future legislation and government policy, including with respect to bank deregulation and interstate expansion, could adversely affect the banking industry as a whole, including our results of operations. For example, new legislation or regulation may limit the manner in which we may conduct our business, including our ability to offer new products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads.

Recent legislation will change the way financial institutions conduct their business; we cannot predict the effect it will have upon us

The Gramm-Leach-Bliley Financial Modernization Act was signed into law on November 12, 1999. Among other things, the Modernization Act repeals restrictions on banks affiliating with securities firms and insurance companies. It also permits bank holding companies that become financial holding companies to engage in additional financial activities, including insurance and securities underwriting and agency activities, merchant banking and insurance company portfolio investment activities. The Modernization Act may have the result of increasing the competition we face from larger banks and other companies. It is not possible to predict the full effect that the Modernization Act will have on us.

Risks Related to an Investment in Our Common Stock

Our offering price may not be indicative of the fair market value of the common stock, and the future trading price of our stock may fluctuate

The public offering price may not indicate the market price for the common stock after this offering. We expect to determine the public offering price based on a variety of factors, including:

- prevailing market conditions;
- our historical performance and capital structure;
- estimates of our business potential and earnings prospects;
- an overall assessment of our management; and
- the consideration of these factors in relation to market valuation of companies in related businesses.

The offering price and aggregate number of shares being offered will be determined through our negotiations with the underwriters. No assurance can be given that you will be able to resell your shares at a price equal to or greater than the offering price or that the offering price will necessarily indicate the fair market value of our common stock.

The market price of our common stock may also be subject to significant fluctuations in response to our future operating results and other factors, including market conditions. In recent years, the stock market has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performances and prospects of individual companies.

If a market for our common stock does not develop, you may not be able to sell your shares at or above the offering price

Prior to this offering, a public market for our common stock did not exist. Although our common stock has been approved for listing on the Nasdaq National Market, subject to official notice of issuance, there can be no assurance that an active trading market will develop or that purchasers of our common stock will be able to resell their common stock at prices equal to or greater than the initial public offering price. The development of a public market having the desirable characteristics of depth, liquidity and orderliness depends upon the presence of a sufficient number of willing buyers and sellers at any given time, over which neither we nor any market maker has any control. Accordingly, there can be no assurance that an established and liquid market for the common stock will develop or be maintained.

Future sales of our common stock could depress the price of our common stock

Sales of a substantial number of shares of our common stock in the public market by our stockholders after this offering, or the perception that these sales are likely to occur, could cause the market price of our common stock to decline. Upon completion of this offering, we will have 24,426,449 outstanding shares of our common stock. Of these shares, approximately 11.4 million shares, including the shares sold in this offering, may be traded, without restriction, in the public market immediately after this offering is completed. Upon the expiration of lock-up agreements entered into by our directors, officers, the selling stockholders and certain other significant stockholders in connection with the offering, which will occur 180 days from the date of this prospectus, approximately 13.0 million additional shares will be eligible for sale in the public market, subject, in the case of our affiliates, to the volume restrictions of Rule 144.

As a new investor, you will incur substantial book value dilution as a result of this offering and future equity issuances could result in further dilution, which could cause our stock price to decline

The initial public offering price is substantially higher than the current net tangible book value of our outstanding common stock. As a result, investors purchasing common stock in this offering will incur immediate dilution of $4.34 per share. This dilution is due in large part to earlier investors in our company having paid substantially less than the initial public offering price when they purchased their shares. The exercise of outstanding options and future equity issuances, including any additional shares issued in connection with acquisitions, could result in further dilution to investors.

Our existing management will maintain significant control over us following the offering

Immediately following this offering, our current executive officers and directors will beneficially own approximately 14.8% of the outstanding shares of our common stock, or approximately 13.9% if the underwriters exercise their over-allotment option in full. These percentages may increase to the extent that the executive officers and directors elect to purchase shares in connection with this offering. Accordingly, our current executive officers and directors will be able to influence, to a significant extent, the outcome of all matters required to be submitted to our stockholders for approval (including decisions relating to the election of directors), the determination of day-to-day corporate and management policies and other significant corporate activities.

We have not historically paid, and do not presently intend to pay, cash dividends

We have not paid any cash dividends on our common stock to date and do not intend to pay cash dividends on our common stock in the foreseeable future. We intend to retain earnings to finance operations and the expansion of our business. Therefore, any gains from your investment in our common stock must come from an increase in its market price.

We will be restricted in our ability to pay dividends to our stockholders

We are a holding company with no independent sources of revenue and would likely rely upon cash dividends and other payments from our bank to fund the payment of future cash dividends, if any, to our stockholders. Payment of dividends by the bank to us would be subject to the prior approval of the OCC if the total of all dividends declared by the bank in any calendar year exceeds the sum of the bank s net profits for that year and its retained net profits for the preceding two calendar years, less any required transfers to surplus. In addition, federal law also prohibits a national bank from paying dividends if it is, or such dividend payments would cause it to become, undercapitalized. At June 30, 2003, our bank was prohibited by these laws from paying any dividends to us without the OCC s prior approval. If the bank is restricted from paying cash dividends to us, we would likely not be able to pay cash dividends to our stockholders.

Anti-takeover provisions of our certificate of incorporation, bylaws and Delaware law may make it more difficult for you to receive a change in control premium

Certain provisions of our certificate of incorporation and bylaws could make a merger, tender offer or proxy contest more difficult, even if such events were perceived by many of our stockholders as beneficial to their interests. These provisions include advance notice for nominations of directors and stockholders proposals. In addition, our certificate of incorporation authorizes the issuance of blank check preferred stock with such designations, rights and preferences as may be determined from time to time by our board of directors. Accordingly, our board of directors is empowered, without stockholder approval (unless otherwise required by the rules of any stock exchange on which our common stock is then listed), to issue preferred stock with dividend, liquidation, conversion, voting or other rights which could adversely affect the voting power or other rights of the holders of our common stock. In the event of such issuance, the preferred stock could be utilized, under certain circumstances, as a method of discouraging, delaying or preventing a change in control. Although we have no present intention to issue any shares of our preferred stock, there can be no assurance that we will not do so in the future. In addition, as a Delaware corporation, we are subject to Section 203 of the Delaware General Corporation Law which, in general, prevents an interested stockholder, defined generally as a person owning 15% or more of a corporation s outstanding voting stock, from engaging in a business combination with our company for three years following the date that person became an interested stockholder unless certain specified conditions are satisfied.

There are substantial regulatory limitations on changes of control

With certain limited exceptions, federal regulations prohibit a person or company or a group of persons deemed to be acting in concert from, directly or indirectly, acquiring more than 10% (5% if the acquiror is a bank holding company) of any class of our voting stock or obtaining the ability to control in any manner the election of a majority of our directors or otherwise direct the management or policies of our company without prior notice or application to and the approval of the Federal Reserve. Accordingly, prospective investors need to be aware of and comply with these requirements, if applicable, in connection with any purchase of shares of our common stock in this offering.

We have broad discretion to use the proceeds of this offering

We expect to use the net proceeds from this offering for the broadening of business lines, potential acquisitions in the financial and financial services industries and other general corporate purposes. Accordingly, we will have broad discretion as to the application of such proceeds. You will not have an opportunity to evaluate the economic, financial or other information on which we base our decisions on how to use these net proceeds. Our failure to use these funds effectively could have an adverse effect on our financial condition and results of operations.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This prospectus includes forward-looking statements based on our current expectations, assumptions, estimates and projections about our business and our industry. They include, but are not limited to, statements relating to:

- future revenues, expenses and profitability; and

- the future development and expected growth of our business.

You can identify forward-looking statements by the use of words such as may, should, will, could, estimates, predicts, potential, aims, anticipates, believes, plans, expects, future and intends and similar expressions. This information does not guarantee future perfo and is subject to risks, uncertainties and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. In evaluating forward-looking statements, you should carefully consider the risks and uncertainties described in Risk Factors and elsewhere in this prospectus. The forward-looking statements reflect our view only as of the date of this prospectus, and we do not assume any obligation to update or correct these forward-looking statements except to the extent we are required to do so by applicable law. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements and risk factors contained throughout this prospectus.

USE OF PROCEEDS

Assuming a public offering price of $11.00 per share (the midpoint of the range set forth on the cover page of this prospectus), we expect to receive net proceeds of approximately $30.2 million from this offering after deducting the underwriting discount and estimated offering expenses. We will not receive any proceeds from shares of our common stock sold by the selling stockholders in this offering.

We intend to use the net proceeds for general corporate purposes, including to finance the growth of our business. We may also use a portion of the proceeds for acquisitions or for the opening of select banking locations. However, we have no present understanding, agreement or definitive plans relating to any specific acquisitions or openings of any banking locations, other than the anticipated opening of our banking center in Houston in September 2003.

The principal purposes of this offering are to raise capital, create a public market for our common stock, enhance our ability to acquire other businesses, products and technologies and facilitate future access to public securities markets.

We have not yet determined the amount of net proceeds to be used specifically for each of the foregoing purposes mentioned above. Accordingly, our management will have significant flexibility in applying the net proceeds of the offering. Pending their use as described above, we may invest the net proceeds of this offering in interest-bearing investment-grade instruments or bank deposits.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our common stock. We do not anticipate paying any cash dividends on our common stock in the foreseeable future. We currently intend to retain future earnings, if any, to finance operations and the expansion of our business.

In addition, we are a holding company and our principal source of funds to pay dividends, if any, in the future and make other payments will be the payment of dividends by our bank to us. As a national bank, our bank is subject to various restrictions under federal law on its ability to pay dividends and make other distributions and payments to us. These are described under Regulation and Supervision.

Any future determination to pay cash dividends will be at the discretion of our board of directors and will be dependent upon our financial condition, operating results, capital requirements, federal banking regulations, Delaware law, and other factors that our board of directors deems relevant.

CAPITALIZATION

The following table presents our capitalization as of June 30, 2003. Our capitalization is presented:

on an actual basis (which does not reflect the conversion of the 1,057,142 shares of preferred stock into shares of common stock); and

on a pro forma basis to reflect:

our receipt of the estimated net proceeds of approximately $30.2 million from the sale of 3,000,000 shares of common stock by us in this offering at an estimated initial public offering price of $11.00 per share (the midpoint of the range set forth on the cover page of this prospectus), after deducting the estimated underwriting discounts and commissions, and estimated offering expenses;

the conversion of the 1,057,142 shares of preferred stock outstanding into 2,114,284 shares of common stock, which we expect will automatically occur upon the consummation of the offering; and

the conversion of a sufficient number of shares of Series A-1 Nonvoting common stock, all of which is held by one of our stockholders, into an equal number of shares of voting common stock so that, after the offering, the holder s beneficial ownership of voting common stock equals 4.9% of the outstanding shares of voting common stock.

You should read this table in conjunction with the consolidated financial statements and related notes that are included in this prospectus.

	As of June 30, 2003	
	Actual	Pro Forma
	(In thousands, except share data)	
Liabilities		
Deposits		
Non-interest bearing	$ 330,015	$ 330,015
Interest bearing	1,010,307	1,010,307
Total deposits	1,340,322	1,340,322
Accrued interest payable	3,393	3,393
Other liabilities	4,348	4,348
Federal funds purchased	156,194	156,294
Repurchase agreements	293,272	293,172
Other borrowings	53,501	53,501
Long-term debt	20,000	20,000
Total liabilities	1,871,030	1,871,030
Stockholders equity:		
Preferred stock, $.01 par value		
Authorized shares 10,000,000		
Issued shares 1,057,142 convertible preferred stock, nonvoting, $.01 par value, 6% (actual); 0 (pro forma)	11	
Common stock, $.01 par value:		
Authorized shares 100,000,000		
Voting common stock:		
Issued shares 18,577,704 (actual); 24,056,863 (pro forma)	185	241
Series A-1 non-voting common stock, $.01 par value:		
Issued shares 691,733 (actual); 326,858 (pro forma)	7	3
Additional paid-in capital	131,801	161,954
Accumulated deficit	(6,459)	(6,459)
Treasury stock (shares at cost: 97,246 (actual); 97,246 (pro forma))	(668)	(668)
Deferred compensation	573	573
Accumulated other comprehensive income	6,718	6,718

Total stockholders equity	132,168	162,362
Total capitalization	$2,003,198	$2,033,392

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the selected consolidated financial data presented below in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the related notes appearing elsewhere in this prospectus.

We formed our wholly-owned subsidiary bank through the acquisition of Resource Bank, N.A. on December 18, 1998. Our bank s financial statements include the operations of our bank from December 18, 1998. The operations of Resource Bank, N.A. prior to December 18, 1998 are shown separately as predecessor financial statements.

	At or for the Six Months Ended June 30,		At or for the Year Ended December 31,				March 1, 1998 (Inception) through December 31,
	2003	**2002**	**2002**	**2001**	**2000**	**1999**	**1998**
	(Unaudited)						
	(In thousands, except per share, average share and percentage data)						
Consolidated Statement of Operations(1)							
Interest income	$ 41,499	$ 32,013	$ 70,142	$ 70,594	$ 55,769	$ 14,414	$ 213
Interest expense	17,093	12,405	27,896	35,539	32,930	6,166	32
Net interest income	24,406	19,608	42,246	35,055	22,839	8,248	181
Provision for loan losses	2,850	1,979	5,629	5,762	6,135	2,687	1
Net interest income after provision for loan losses	21,556	17,629	36,617	29,293	16,704	5,561	180
Non-interest income	6,145	3,656	8,625	5,983	1,957	358	4
Non-interest expense	26,279	16,780	35,370	29,432	35,158	15,217	923
Income (loss) before taxes	1,422	4,505	9,872	5,844	(16,497)	(9,298)	(739)
Income tax expense (benefit)	(5,466)	1,128	2,529				
Net income (loss)	6,888(2)	3,377(2)	7,343	5,844	(16,497)	(9,298)	(739)
Consolidated Balance Sheet Data(1)							
Total assets	2,003,198	1,260,774	1,793,282	1,164,779	908,428	408,579	89,311
Loans	1,251,794	944,731	1,122,506	903,979	629,109	227,600	11,092
Securities available for sale	649,522	270,085	553,169	206,365	184,952	164,409	3,171
Securities held to maturity					28,366		
Deposits	1,340,322	980,297	1,196,535	886,077	794,857	287,068	16,018
Federal funds purchased	156,194	52,087	83,629	76,699	11,525		
Other borrowings	346,773	102,442	365,831	86,899	7,061	46,267	
Long-term debt	20,000		10,000				
Stockholders equity	132,168	118,043	124,976	106,359	86,197	72,912	73,186
Other Financial Data							
Income (loss) per share:							
Basic	$ 0.33(2)	$ 0.15	$ 0.33(2)	$ 0.31	$ (0.95)	$ (0.61)	$ *
Diluted	0.32(2)	0.15	0.32(2)	0.30	(0.95)	(0.61)	*
Tangible book value per share(3)	6.11	5.48	5.80	5.08	4.46	4.67	5.37
Book value per share(3)	6.18	5.55	5.87	5.15	4.54	4.79	5.51

Weighted average shares:							
Basic	19,202,699	19,135,782	19,145,255	18,957,652	17,436,628	15,132,496	*
Diluted	21,554,892	19,338,906	19,344,874	19,177,204	17,436,628	15,132,496	*
Selected Financial Ratios:							
Performance Ratios(6)							
Return on average assets	0.74%	0.56%	0.54%	0.58%	(2.42)%	(4.45)%	(5.83)%(7)
Return on average equity	10.87%	6.02%	6.27%	6.44%	(20.02)%	(12.13)%	(12.52)%(7)
Net interest margin	2.81%	3.47%	3.28%	3.62%	3.51%	4.12%	5.65%(7)
Efficiency ratio	86.02%(4)	72.13%	69.53%(4)	71.72%	141.79%	176.82%	205.18%(7)
Non-interest expense to average assets	2.81%(5)	2.79%	2.59%(5)	2.90%	5.15%	7.28%	10.64%(7)
Asset Quality Ratios(6):							
Net charge-offs to average loans	0.02%	0.56%	0.38%	0.26%		0.01%	
Allowance for loan losses to total loans	1.38%	1.28%	1.30%	1.39%	1.42%	1.22%	0.90%
Allowance for loan losses to non-performing and renegotiated loans	136.12%	178.88%	499.42%	110.23%	1,557.69%		666.67%
Non-performing and renegotiated loans to total loans	1.01%	0.72%	.26%	1.26%	0.09%		0.14%

	At or for the Six Months Ended June 30,		At or for the Year Ended December 31,				March 1, 1998 (Inception) through December 31,
	2003	2002	2002	2001	2000	1999	1998
	(Unaudited)						
	(In thousands, except per share, average share and percentage data)						
Capital and Liquidity Ratios							
Total capital ratio	11.50%	11.99%	11.32%	11.73%	10.98%	23.84%	267.01%
Tier 1 capital ratio	10.27%	10.83%	10.16%	10.48%	9.94%	22.98%	266.64%
Tier 1 leverage ratio	7.43%	9.27%	7.66%	9.46%	9.62%	21.32%	397.86%
Average equity/average assets	6.78%	9.34%	8.57%	8.93%	12.07%	36.67%	46.58%(7)
Tangible equity/assets	6.52%	9.24%	6.89%	9.00%	9.31%	17.42%	79.85%
Average loans/average deposits	92.91%	96.08%	96.31%	95.54%	72.92%	81.12%	68.36%(7)

(1) The consolidated statement of operations data and consolidated balance sheet data presented above for the six month period ended June 30, 2002 and for the four most recent fiscal years ended December 31 have been derived from our audited consolidated financial statements, which have been audited by Ernst & Young LLP, independent auditors. The historical results are not necessarily indicative of the results to be expected in any future period. The unaudited operating results for the six month period ended June 30, 2003 are not necessarily indicative of the results to be achieved for the full year. Interim results reflect all adjustments necessary for a fair statement of the results of operations and balances for the interim periods presented. Such adjustments are of a normal recurring nature.

(2) During the six months ended June 30, 2003, net income included the impact of reversing our deferred tax asset valuation allowance of $5.9 million, $6.3 million in penalties related to unwinding repurchase agreements prior to maturity and approximately $250,000 in separation expense related to the resignation of a senior officer. For the six months ended June 30, 2003, income per share excluding the impact of reversing the valuation allowance, unwinding penalties and separation expense would have been $0.25, on a basic basis, and $0.25, on a diluted basis. During the year ended December 31, 2002, net income included $1.2 million in IPO expenses recognized as our offering was postponed. For the year ended December 31, 2002, income per share excluding these IPO expenses would have been $0.37, on a basic basis, and $0.36, on a diluted basis. Income per share excluding the impact of reversing the valuation allowance, unwinding penalties and separation expense for the six months ended June 30, 2003 and income per share excluding IPO expenses for the year ended December 31, 2002 are non-GAAP financial measures. See discussion of non-GAAP financial measures on page 7 and reconciliation of GAAP to non-GAAP measures beginning on page 8.

(3) Amounts for December 31, 2001 are adjusted to reflect the conversion of 753,301 shares of preferred stock outstanding on such date into 1,506,602 shares of common stock, assuming automatic conversion of the preferred stock. Amounts for June 30, 2002, December 31, 2002 and June 30, 2003 are adjusted to reflect the conversion of 1,057,142 shares of preferred stock outstanding on such date into 2,114,284 shares of common stock, assuming automatic conversion of the preferred stock.

(4) Represents non-interest expense divided by the sum of net interest income and non-interest income for the periods shown. During the six months ended June 30, 2003, non-interest expense included $6.3 million in penalties related to unwinding repurchase agreements prior to maturity and approximately $250,000 in separation expense related to the resignation of a senior officer. For the six months ended June 30, 2003, the efficiency ratio excluding the penalties and separation expense would have been 64.70%. During the year ended December 31, 2002, non-interest expense included $1.2 million in IPO expenses recognized as our offering was postponed. For the year ended December 31, 2002, the efficiency ratio excluding the IPO expenses would have been 67.19%. The efficiency ratio excluding unwinding penalties and separation expense for the six months ended June 30, 2003 and the efficiency ratio excluding IPO expenses for the year ended December 31, 2002 are non-GAAP financial measures. See discussion of non-GAAP financial measures on page 7 and reconciliation of GAAP to non-GAAP measures beginning on page 8.

(5) During the six months ended June 30, 2003, the non-interest expense to average assets ratio included $6.3 million in penalties related to unwinding repurchase agreements prior to maturity and approximately $250,000 in separation expense related to the resignation of a senior officer. For the six months ended June 30, 2003, the annualized ratio of non-interest expense to average assets excluding the penalties and separation expense would have been 2.11%. During the year ended December 31, 2002, the non-interest expense to average assets ratio included $1.2 million in IPO expenses recognized as our offering was postponed. For the year ended December 31, 2002, the ratio of non-interest expense to average assets excluding the IPO expenses would have been 2.50%. The ratio of non-interest expense to average assets excluding unwinding penalties and separation expense for the six months ended June 30, 2003 and the ratio of non-interest expense to average assets excluding IPO expenses for the year ended December 31, 2002 are non-GAAP financial measures. See discussion of

non-GAAP financial measures on page 7 and reconciliation of GAAP to non-GAAP measures beginning on page 8.

(6) Interim period ratios are annualized.

(7) Percentage is calculated using the combined results of Resource Bank and TCBI for 1998.

* Not meaningful.

Non-GAAP Financial Measures

The footnotes to the Selected Consolidated Financial Information presented above include non-GAAP financial measures. See discussion of non-GAAP financial measures on page 7 and reconciliation of GAAP to non-GAAP measures beginning on page 8.

Predecessor Financial Statements

	Resource Bank	
	January 1 through December 18, 1998	October 3, 1997 (Inception) through December 31, 1997
	(In thousands)	
Selected Operating Data		
Interest income	$ 1,097	$ 86
Interest expense	377	10
Net interest income	720	76
Provision for loan losses	69	30
Net interest income after provision for loan losses	651	46
Non-interest income	60	3
Non-interest expense	1,057	271
Loss before taxes	(346)	(222)
Income tax expense		
Net loss	(346)	(222)
Selected Balance Sheet Data		
Total assets	19,605	8,060
Loans	11,102	1,532
Securities available for sale	3,175	
Deposits	15,166	3,386
Federal funds purchased		
Other borrowings		
Stockholders equity	4,292	4,638

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview of Our Operating Results

Our bank was formed through the acquisition of Resource Bank, N.A., which itself had been organized in 1997. Upon completion of our $80 million private equity offering and acquisition of our predecessor bank, we commenced operations in December 1998. The amount of capital we raised, which we believe is the largest amount of start-up capital ever raised for a national bank, was intended to support a significant level of near-term growth and permit us to originate and retain loans of a size and type that our targeted customers, middle market businesses and high net worth individuals, would find attractive. Our large initial capitalization has resulted in reduced levels of return on equity to date. However, as we build our loan and investment portfolio we expect our return on equity to increase to normalized levels.

An important aspect of our growth strategy is the ability to service and effectively manage a large number of loans and deposit accounts in multiple markets in Texas. Accordingly, we created an operations infrastructure sufficient to support state-wide lending and banking operations. We believe that our existing infrastructure will allow us to grow our business over the next two to three years both geographically and with respect to the size and number of loan and deposit accounts without substantial additional capital expenditures.

During 1999 and 2000, we established a total of seven banking centers in key metropolitan markets in Texas. We also invested resources in hiring experienced bankers, which required a significant period of time for both recruiting and transitioning them from their previous employers. In conjunction with our roll-out of operations in 1999, we undertook a significant advertising and marketing campaign to increase brand name recognition of the traditional banking activities of our bank and of BankDirect, particularly in the Dallas/ Fort Worth business community. Once we had achieved our initial goals, we were able to significantly reduce our advertising expenses (from $2.3 million (which excludes approximately $1.9 million in expenses attributable to American Airlines AAdvantage® minimum mile requirements and co-branded advertising) in 2000 to $278,000 in 2001) and place more emphasis on targeted marketing to, and relationship-building efforts with, selected business groups, charities and communities. As we enter new market areas, we intend to evaluate the efficiency of selected advertising to brand our name and increase our recognition in those markets.

Our historical financial results reflect the development of our company in its early stages, notably in connection with initial start-up costs and the raising and retention of excess capital to fund our planned growth. In 1999 and 2000, we incurred significant non-interest expenses for the start-up and infrastructure costs described above, while revenue items gradually increased as we began to source and originate loans and other earning assets. In 2001, 2002 and the first half of 2003, we achieved improved levels of profitability as these costs have been spread over a larger asset base.

Our historical results also reflect the evolving role of BankDirect, the Internet banking division of our bank, in our business. When we launched BankDirect in 1999, we aimed to quickly establish a significant market position and establish a significant deposit base with which to fund our growth. Accordingly, we committed substantial resources to advertising for BankDirect and offered its deposit products at very attractive rates. Our efforts were successful, and BankDirect grew to account for approximately $369.7 million in deposits by the end of 2000, providing much of the liquidity we required to increase our lending activities during 2000. By early 2001, however, deposits at our traditional bank had grown to an amount sufficient to fund a much larger portion of our ongoing lending activities. As a result, we decided to reorient the focus of BankDirect towards higher balance depositors to reduce our management requirements and expenses. To this end, we restructured the account fees charged by BankDirect and lowered the rates on deposit products. This reorientation toward customers with higher deposit balances allowed us to significantly reduce our expenses related to BankDirect (from $6.8 million in 2000 (which excludes approximately $1.9 million in expenses attributable to American Airlines AAdvantage® minimum mile requirements and co-branded advertising) to $3.0 million in 2001, a decrease of over 56%), while substantially increasing the average balance held in our BankDirect accounts and lowering the total number of accounts serviced by BankDirect. As of June 30, 2003, BankDirect provided a significant, but not primary, source of funding for us, accounting for approximately 19% of our deposits.

Our operating results have improved significantly over the past several years as we moved into full operations. The table below shows the annual growth rate of our net interest income, net income, assets, loans and deposits:

	At or for December 31, 2002	Annual Growth Rate(1)	At or for December 31, 2001	Annual Growth Rate(1)	At or for December 31, 2000	Annual Growth Rate(1)	At or for December 31, 1999	Annual Growth Rate(1)
				(In thousands)				
Net interest income	$ 42,246	21%	$ 35,055	53%	$ 22,839	177%	$ 8,248	815%
Net income (loss)	7,343	26%	5,844	135%	(16,497)	*	(9,298)	*
Assets	1,793,282	54%	1,164,779	28%	908,428	122%	408,579	357%
Loans	1,122,506	24%	903,979	44%	629,109	176%	227,600	1,952%
Deposits	1,196,535	35%	886,077	11%	794,857	177%	287,068	1,692%

(1) The annual growth rate with respect to period data is the percentage growth of the item in the period shown compared to the most recently completed prior period. For purposes of calculating the 1999 annual growth rate, results of our bank and Resource Bank, our predecessor bank, for 1998 have been combined. The annual growth rate with respect to data as of a particular date is the percentage growth of the item at the date shown compared to the most recent prior date.

* Not meaningful.

The growth in our profitability is based on several key factors:

we have successfully grown our asset base significantly each year;

we have been able to maintain stable and diverse funding sources, resulting in increased net interest income from 2000 onward, despite a falling interest rate environment and the fact that most of our loans have floating interest rates;

the growth in our asset base has resulted in annual growth of 815%, 177%, 53% and 21% in our principal earnings source, net interest income, in 1999, 2000, 2001 and 2002, respectively; and

since the completion of our initial advertising and marketing campaigns and the reorientation of BankDirect, we have been able to tightly control non-interest expenses; this has contributed to a substantial improvement of our efficiency ratio from 176.8% in 1999 to 69.5% in 2002.

Six Months Ended June 30, 2003 Compared to the Six Months Ended June 30, 2002

We recorded net income of $6.9 million for the six months ended June 30, 2003 compared to $3.4 million for the same period in 2002. Diluted income per common share was $0.32 for 2003 and $0.15 for the same period in 2002. Returns on average assets and average equity were 0.74% and 10.87%, respectively, for the six months ended June 30, 2003, compared to 0.56% and 6.02%, respectively, for the same period in 2002.

The increase in net income for the six months ended June 30, 2003 over the same period of 2002 was primarily due to an increase in net interest income and non-interest income and the impact of reversing the deferred tax valuation allowance of $5.9 million, offset by an increase in non-interest expense. Net interest income increased by $4.8 million, or 24.5%, to $24.4 million for the six months ended June 30, 2003 compared to $19.6 million for the same period in 2002. The increase in net interest income was primarily due to an increase of $613.7 million in average earning assets, offset by a 66 basis point decrease in the net interest margin. Non-interest expense for the six months ended June 30, 2003 included approximately $250,000 in separation expense related to the resignation of a senior officer and $6.3 million in penalties related to unwinding repurchase agreements in June 2003 prior to maturity to lower funding costs. We unwound approximately $139 million of repurchase agreements and entered into new repurchase agreements with respect to a significant portion of that amount, with the remainder replaced with overnight funds. We expect that a significant portion of these overnight funds will be replaced with deposits when we complete our planned acquisition of the outstanding deposit accounts of Bluebonnet Savings Bank FSB, which is expected to occur in August 2003. See Business Acquisition of Bluebonnet Savings Deposits. The impact on net interest income of these transactions was not material for the six-month period ended June 30, 2003, as these transactions occurred in June. Assuming a flat interest rate environment, we expect that these transactions will significantly lower our cost of funding through the remainder of 2003 and in 2004.

Excluding the impact of reversing the valuation allowance, unwinding penalties and separation expense, diluted income per share would have been $0.25. Income per share excluding the impact of reversing the valuation allowance, unwinding penalties and separation expense is a non-GAAP financial measure. Please see the discussion of non-GAAP financial measures beginning on page 7 for an explanation of why we believe this non-GAAP financial measure is useful to management and investors and the table beginning on page 8 for a reconciliation of diluted income per share excluding impact of reversing the valuation allowance, unwinding penalties and separation expense to diluted income per share, which is the most directly comparable financial measure presented in accordance with GAAP.

Non-interest income increased by $2.4 million, or 68.1%, during the six month period ended June 30, 2003 to $6.1 million, compared to $3.7 million during the same period in 2002. The increase was in part due to an overall increase in non-interest bearing deposits for 2003, which resulted in more service charges on deposit accounts. Also, our trust income increased by $95,000 to $587,000 during the six month period ended June 30, 2003 compared to $492,000 for the same period in 2002, due to continued growth in trust assets. During the six month period ended June 30, 2003, we had a gain on sale of securities of $686,000 due to our ability to realize substantial profits from sales of fixed-rate debt securities as a result of rapid declines in overall interest rates. Mortgage warehouse fees increased by $448,000 to $703,000 during the six month period ended June 30, 2003 from $255,000 in the same period in 2002. Also, we had bank owned life insurance (BOLI) income of $842,000 during the six month period ended June 30, 2003.

Non-interest expense increased by $9.5 million, or 56.6%, to $26.3 million during the six months ended June 30, 2003 compared to $16.8 million during the same period in 2002. This increase is primarily due to the incurrence of $6.3 million in penalties related to unwinding repurchase agreements prior to maturity in order to take advantage of historical lows in interest rates, which had decreased on similar repurchase agreements by approximately 1.4% since the time we entered into the original repurchase agreements. Salaries and employee benefits increased by $2.9 million due in part to an increase in total full-time employees from 201 at June 30, 2002 to 237 at June 30, 2003. The increase in salaries and employee benefits also included separation expenses of approximately $250,000 related to the resignation of a senior officer. In addition, we experienced losses related to forged checks of approximately $278,000 in the first half of 2003. We have taken steps to attempt to reduce these types of losses in the future. Occupancy expense decreased by $167,000 to $2.4 million during the six months ended June 30, 2003 compared to the same period in 2002 primarily related to a decrease in depreciation as many of our fixed assets are becoming fully depreciated. Advertising expense decreased $170,000 to $392,000 during the six months ended June 30, 2003 from $562,000 during the same period in 2002.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

We recorded net income of $7.3 million for 2002 compared to $5.8 million for 2001. Diluted income per common share was $0.32 for 2002 and $0.30 for 2001. Returns on average assets and average equity were 0.54% and 6.27%, respectively, for 2002 compared to 0.58% and 6.44%, respectively, for 2001.

The increase in net income for 2002 was due to an increase in both net interest income and non-interest income partially offset by an increase in non-interest expenses. Net interest income increased by $7.2 million, or 20.5%, to $42.3 million for 2002 compared to $35.1 million for 2001. The increase in net interest income was primarily due to an increase of $319.5 million in average earning assets, offset by a 34 basis point decrease in the net interest margin. Non-interest expense included $1.2 million of IPO expenses recognized as our offering was postponed in October 2002 due to unfavorable market conditions. Excluding the IPO expenses, diluted income per share would have been $0.36. Income per share excluding IPO expenses is a non-GAAP financial measure. Please see discussion of non-GAAP financial measures beginning on page 7 for an explanation of why we believe this non-GAAP financial measure is useful to management and investors and the table beginning on page 8 for a reconciliation of diluted income per share excluding IPO expenses to diluted income per share, which is the most directly comparable financial measure presented in accordance with GAAP.

Non-interest income increased by $2.6 million in 2002 to $8.6 million, compared to $6.0 million in 2001. The increase was in part due to an overall increase in deposits for 2002, which resulted in more service charges on deposit accounts. Also, our trust income increased by $161,000, to $987,000 for 2002 compared to $826,000 for 2001, due to continued growth in trust assets. Mortgage warehouse fees increased by $402,000 to $693,000 for 2002 from $291,000 in 2001. Income from bank owned life insurance, or BOLI, policies that we purchased during 2002 totaled $660,000. Gain on sale of securities in 2002 was $1.4 million compared to $1.9 million in 2001.

Non-interest expense increased by $6.0 million in 2002 to $35.4 million compared to $29.4 million in 2001. The increase was due, in part, to an increase in total full-time employees from 198 at December 31, 2001 to 215 at December 31, 2002. IPO expenses of $1.2 million were recognized as our offering was postponed in October 2002 due to unfavorable market conditions. Advertising expenses increased to $1.2 million in 2002 compared to $278,000 in 2001. 2002 advertising expenses included direct marketing and branding for the traditional banking activities of our bank of $586,000 and for BankDirect of $12,000, as well as American Airlines AAdvantage® minimum mile requirements of $630,000 and co-branded advertising with American Airlines AAdvantage® of $8,000. BankDirect has been a member of American Airlines AAdvantage® travel benefits program since May 2000, offering AAdvantage awards to AAdvantage® members who open and maintain accounts with BankDirect. We did not purchase any miles in 2001 because the miles that we were contractually required to purchase in 2000 were sufficient to cover our mileage rewards to customers in 2001.

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

We recorded net income of $5.8 million for 2001 compared to a net loss of $16.5 million for 2000. Diluted income (loss) per common share was $0.30 for 2001 and $(0.95) for 2000. Returns on average assets and average equity were 0.58% and 6.44%, respectively, for 2001 compared to (2.42)% and (20.02)%, respectively, for 2000.

The increase in net income for 2001 was due to an increase in both net interest income and non-interest income and a substantial decrease in non-interest expenses. Net interest income increased by $12.2 million, or 53.5%, to $35.1 million for 2001 compared to $22.8 million for 2000. The increase in net interest income was primarily due to an increase of $317.0 million in average earning assets, combined with an 11 basis point increase in the net interest margin.

Non-interest income increased by $4.0 million in 2001 to $6.0 million, compared to $2.0 million in 2000. The increase was in part due to an overall increase in deposits for 2001, which resulted in more service charges on deposit accounts. Also, our trust income increased by $252,000, to $826,000 for 2001 compared to $574,000 for 2000, due to continued growth in trust assets. Mortgage warehouse fees increased by $287,000 to $291,000 in 2001 from $4,000 in 2000. Other non-interest income increased by $234,000 in 2001 to $1.1 million from $873,000 in 2000, primarily related to letter of credit fees, investment fees, rental income, and gain on sale of leases. Gain on sale of securities in 2001 was $1.9 million compared to $19,000 in 2000, due to our ability to realize substantial profits from sales of fixed-rate debt securities as a result of rapid declines in overall interest rates.

Non-interest expense decreased by $5.8 million in 2001 to $29.4 million compared to $35.2 million in 2000. The decrease was due, in part, to a reduction in total full-time employees from 234 at December 31, 2000 to 198 at December 31, 2001. 75% of this decrease in full-time employees from 2000 to 2001 was attributable to a reduction in BankDirect employees from 40 to 13. Also, we reduced advertising expenses to $278,000 in 2001 compared to $4.2 million in 2000. 2000 advertising expenses included direct marketing and branding for the traditional banking activities of our bank of $724,000 and for BankDirect of $1.6 million, as well as American Airlines AAdvantage® minimum mile requirements of $1.1 million and co-branded advertising with American Airlines AAdvantage® of $752,000. BankDirect has been a member of the American Airlines AAdvantage® travel benefits program since May 2000, offering AAdvantage® awards to AAdvantage® members who open and maintain accounts with BankDirect. We did not purchase any miles in 2001 because the miles that we were contractually required to purchase in 2000 were sufficient to cover our mileage rewards to customers in 2001. Also, a reduction in other non-interest expense was due to the accrual in 2000 of a $1.8 million contingent liability related to an agreement to provide merchant card processing for a customer who ceased operations and filed for bankruptcy in December 2000. Approximately $300,000 of this liability was reversed in 2001.

Net Interest Income

Net interest income was $24.4 million for the six months ended June 30, 2003 compared to $19.6 million for the same period of 2002. The increase was primarily due to an increase in average earning assets of $613.7 million for the six months ended June 30, 2003 compared to the same period in 2002. The increase in average earning assets from the six months ended June 30, 2002 included a $270.3 million increase in average net loans, which represented 65.5% of average earning assets for the six months ended June 30, 2003 compared to 77.0% for the same period in 2002. The decrease reflected management s decision to tighten lending standards during 2002 pending clearer signs of improvement in the U.S. economy. While we continue to apply conservative lending standards, loan growth in the second quarter of 2003 continued as net loans increased to $1.23 billion. Securities increased to 33.3% of average earning assets for the six months ended June 30, 2003 compared to 21.1% for the same period in 2002. We used additional securities in 2003 to increase our earnings by taking advantage of market spreads between returns on assets and the cost of funding these assets.

Average interest bearing liabilities increased $560.2 million for the six months ended June 30, 2003 compared to the same period in 2002, due, in part, to a $226.2 million increase in interest bearing deposits and a $319.5 million increase in other borrowings. Average borrowings were 26.3% of average total assets for the six months ended June 30, 2003 compared to 14.6% for the same period in 2002. The increase in average borrowings was primarily related to an increase in federal funds purchased and securities sold under repurchase agreements, and was used to supplement deposits in funding loan growth and securities purchases. The average cost of interest bearing liabilities decreased from 2.62% for the six months ended June 30, 2002 to 2.27% for the same period in 2003, reflecting the continuing decline in market interest rates and a $95.9 million increase in non-interest bearing deposits.

Net interest income was $42.3 million for the year ended December 31, 2002 compared to $35.1 million for the same period of 2001. The increase was primarily due to an increase in average earning assets of $319.5 million for 2002 as compared to 2001. The increase in average earning assets from 2002 included a $176.2 million increase in average net loans, which represented 74.0% of average earning assets for the year ended December 31, 2002 compared to 80.3% for 2001. The decrease reflected management s decision to tighten lending standards during 2002 pending clearer signs of improvement in the U.S. economy. Securities increased to 24.8% of average earning assets in 2002 compared to 18.2% in 2001.

Average interest bearing liabilities increased $268.0 million in 2002 compared to 2001, due, in part, to a $120.7 million increase in interest bearing deposits and a $146.2 million increase in other borrowings. Average borrowings were 18.2% of average total assets for 2002 compared to 10.1% in 2001. The increase in average borrowings was primarily related to an increase in federal funds purchased and securities sold under repurchase agreements, and was used to supplement deposits in funding loan growth and securities purchases. The average cost of interest bearing liabilities decreased from 4.35% for the year ended December 31, 2001 to 2.57% in 2002, reflecting the continuing decline in market interest rates and a $55.8 million increase in non-interest bearing deposits.

Net interest income increased by $12.2 million, or 53.5%, in 2001 to $35.1 million compared to $22.8 million in 2000. The increase in net interest income was primarily due to a significant increase in average earning assets. Average earning assets increased by $317.0 million during 2001, primarily due to continued growth in our lending portfolio. Additionally, the mix of earning assets improved during 2001. Average loans, which generally have higher yields than other types of earning assets, increased to 80.3% of average earning assets in 2001 compared to 64.5% of average earning assets in 2000.

Average interest bearing liabilities also increased by $269.9 million during 2001 compared to 2000. Of this amount, interest bearing deposits increased $186.6 million and borrowings increased $83.3 million. Average borrowings were 10.1% of average total assets for 2001 compared to 2.9% for 2000. The increase in borrowings was used to supplement deposits in funding the growth in loans. The average cost of interest bearing liabilities decreased in 2001 to 4.35% from 6.02% in 2000. The decrease was mainly due to the overall decline in market interest rates, as well as the additional lowering of rates on BankDirect deposits and a $51.0 million increase in non-interest bearing deposits.

Volume/ Rate Analysis

	Six Months Ended June 30,			Years Ended December 31,					
	2003/2002			2002/2001			2001/2000		
		Change Due to(1)			Change Due to(1)			Change Due to(1)	
	Change	Volume	Yield/Rate	Change	Volume	Yield/Rate	Change	Volume	Yield/Rate
					(In thousands)				
Interest income:									
Securities	$4,180	$ 9,231	$(5,051)	$ 4,724	$ 8,740	$ (4,016)	$ (2,848)	$ (1,811)	$ (1,037)
Loans	5,351	7,755	(2,404)	(4,849)	13,464	(18,313)	18,954	34,432	(15,478)
Federal funds sold	(49)	4	(53)	(337)	7	(344)	(1,198)	(846)	(352)
Deposits in other banks	4	15	(11)	10	11	(1)	(83)	1	(84)
	9,486	17,005	(7,519)	(452)	22,222	(22,674)	14,825	31,776	(16,951)
Interest expense:									
Transaction deposits	(10)	60	(70)	(414)	255	(669)	383	584	(201)
Savings deposits	168	552	(384)	(7,214)	(452)	(6,762)	(2,621)	4,497	(7,118)
Time deposits	788	2,612	(1,824)	(2,908)	6,558	(9,466)	2,294	5,734	(3,440)
Borrowed funds	3,742	4,487	(745)	2,893	5,416	(2,523)	2,553	5,218	(2,665)
	4,688	7,711	(3,023)	(7,643)	11,777	(19,420)	2,609	16,033	(13,424)
Net interest income	$4,798	$ 9,294	$(4,496)	$ 7,191	$10,445	$ (3,254)	$12,216	$15,743	$ (3,527)

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

Net interest margin, the ratio of net interest income to average earning assets, decreased from 3.47% for the six months ended June 30, 2002 to 2.81% for the same period in 2003. This decrease was due primarily to the falling rate environment in which our balance sheet was asset sensitive, which means we had more loans repricing than deposits over the year. In addition, a larger portion of our assets were invested in securities, which generally have a lower yield than loans. The cost of interest bearing liabilities decreased by 35 basis points during the six months ended June 30, 2003, primarily due to overall lower market interest rates, and an increase in non-interest bearing deposits.

Net interest margin decreased from 3.62% in 2001 to 3.28% in 2002. This decrease was due primarily to the falling rate environment in which our balance sheet was asset sensitive, which means we had more loans repricing than deposits over the year. The cost of interest bearing liabilities decreased by 178 basis points in 2002, primarily due to overall lower market interest rates, and an increase in non-interest bearing deposits.

Net interest margin increased from 3.51% in 2000 to 3.62% in 2001. This increase was due primarily to lower cost of funds and continued strong asset yields in a falling rate environment. The cost of interest bearing liabilities decreased by 167 basis points in 2001, primarily due to lower interest rates offered as a result of a reorientation of BankDirect, overall lower market interest rates, and an increase in non-interest bearing deposits.

Consolidated Daily Average Balances, Average Yields and Rates

	Six Months Ended June 30,					
	2003			2002		
	Average Balance	Revenue/ Expense(1)	Yield/ Rate	Average Balance	Revenue/ Expense(1)	Yield/ Rate
	(In thousands, except percentage data)					
Assets						
Taxable securities	$ 583,384	$ 10,685	3.69%	$ 241,165	$ 6,505	5.44%
Federal funds sold	21,262	130	1.23%	20,850	179	1.73%
Deposits in other banks	951	7	1.48%	161	3	3.76%
Loans	1,163,993	30,677	5.31%	891,126	25,326	5.73%
Less reserve for loan losses	15,525			12,919		
Loans, net	1,148,468	30,677	5.39%	878,207	25,326	5.82%
Total earning assets	1,754,065	41,499	4.77%	1,140,383	32,013	5.66%
Cash and other assets	132,077			70,312		
Total assets	$ 1,886,142			$ 1,210,695		
Liabilities and Stockholders Equity						
Transaction deposits	$ 61,038	$ 233	0.77%	$ 49,007	$ 243	1.00%
Savings deposits	394,404	3,269	1.67%	334,780	3,101	1.87%
Time deposits	550,114	7,477	2.74%	395,618	6,689	3.41%
Total interest bearing deposits	1,005,556	10,979	2.20%	779,405	10,033	2.60%
Other borrowings	496,061	5,734	2.33%	176,578	2,372	2.71%
Long-term debt	14,530	380	5.27%			
Total interest bearing liabilities	1,516,147	17,093	2.27%	955,983	12,405	2.62%
Demand deposits	230,497			134,597		
Other liabilities	11,702			7,012		
Stockholders equity	127,796			113,103		
Total liabilities and stockholders equity	$ 1,886,142			$ 1,210,695		
Net interest income		$ 24,406			$ 19,608	
Net interest income to average earning assets (net interest margin)			2.81%			3.47%
Net interest spread			2.50%			3.04%

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

	Year Ended December 31,								
	2002			2001			2000		
	Average Balance	Revenue/ Expense(1)	Yield/ Rate	Average Balance	Revenue/ Expense(1)	Yield/ Rate	Average Balance	Revenue/ Expense(1)(2)	Yield/ Rate
	(In thousands, except percentage data)								
Assets									
Taxable securities	$ 318,864	$15,484	4.86%	$ 175,945	$10,760	6.12%	$202,955	$13,608	6.70%
Federal funds sold	14,874	243	1.63%	14,688	580	3.95%	28,025	1,778	6.34%
Deposits in other banks	558	28	5.02%	351	18	5.13%	348	101	29.02%
Loans	966,964	54,387	5.62%	787,879	59,236	7.52%	424,782	40,282	9.48%
Less reserve for loan losses	13,226			10,335			4,619		
Loans, net	953,738	54,387	5.70%	777,544	59,236	7.62%	420,163	40,282	9.59%
Total earning assets	1,288,034	70,142	5.45%	968,528	70,594	7.29%	651,491	55,769	8.56%
Cash and other assets	77,688			47,789			31,023		
Total assets	$1,365,722			$1,016,317			$682,514		
Liabilities and Stockholders Equity									
Transaction deposits	$ 52,155	$ 491	0.94%	$ 40,673	$ 905	2.23%	$ 19,198	$ 522	2.72%
Savings deposits	349,128	6,671	1.91%	360,865	13,885	3.85%	283,594	16,506	5.82%
Time deposits	433,731	14,061	3.24%	312,826	16,969	5.42%	224,933	14,675	6.52%
Total interest bearing deposits	835,014	21,223	2.54%	714,364	31,759	4.45%	527,725	31,703	6.01%
Other borrowings	249,000	6,608	2.65%	102,840	3,780	3.68%	19,579	1,227	6.27%
Long-term debt	1,178	65	5.52%						
Total interest bearing liabilities	1,085,192	27,896	2.57%	817,204	35,539	4.35%	547,304	32,930	6.02%
Demand deposits	155,298			99,471			48,483		
Other liabilities	8,138			8,878			4,326		
Stockholders equity	117,094			90,764			82,401		
Total liabilities and stockholders equity	$1,365,722			$1,016,317			$682,514		
Net interest income		$42,246			$35,055			$22,839	
Net interest income to earning assets (net interest margin)			3.28%			3.62%			3.51%
Net interest spread			2.88%			2.94%			2.54%

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

(2) Revenue from deposits in other banks includes interest earned on capital while held in an escrow account, which was established in connection with our private equity offering.

Non-Interest Income

	Six Months Ended June 30,		Year Ended December 31,		
	2003	2002	2002	2001	2000
	(Unaudited)				
	(In thousands)				
Service charges on deposit accounts	$1,740	$1,345	$2,772	$1,857	$ 487
Trust fee income	587	492	987	826	574
Gains on sale of securities	686		1,375	1,902	19
Cash processing fees	973	993	993		
Bank owned life insurance (BOLI) income	842		660		
Mortgage warehouse fees	703	255	693	291	4
Other	614	571	1,145	1,107	873
Total non-interest income	$6,145	$3,656	$8,625	$5,983	$1,957

Non-interest income increased $2.4 million, or 68.1%, in the six months ended June 30, 2003 compared to the same period in 2002. Service charges on deposit accounts increased $395,000 for the six months ended June 30, 2003 as compared to the same period in 2002. This increase was due to the significant increase in non-interest deposits, which resulted in a higher volume of transactions. Trust fee income increased $95,000 due to continued growth of trust assets during the six month period ended June 30, 2003. During the six month period ended June 30, 2003, we had gains on sale of securities of $686,000 due to our ability to realize substantial profits from sales of fixed-rate debt securities as a result of rapid declines in overall interest rates. Cash processing fees totaled $973,000 for the six months ended June 30, 2003, which is comparable to the same period in 2002. These fees were related to a special project that occurred during the first quarters of 2003 and 2002 and will not be recurring in future quarters of 2003. We had BOLI income of $842,000 during the first six months of 2003. Our BOLI investment originated in August 2002. The current policy provides life insurance for 25 executives, naming us as beneficiary. Mortgage warehouse fees increased by $448,000.

Non-interest income increased $2.6 million, or 44.2%, in the year ended December 31, 2002 as compared to 2001. Service charges on deposit accounts increased $915,000 for the year ended December 31, 2002 as compared to 2001. This increase was due to the significant increase in deposits, which resulted in a higher volume of transactions. Trust fee income increased $161,000 due to continued growth of trust assets during 2002. Cash processing fees totaled $993,000 for the year ended December 31, 2002. These fees were related to a special project that occurred during the first quarter of 2002. Mortgage warehouse fees increased by $402,000 to $693,000 for 2002 from $291,000 in 2001. Income from bank owned life insurance, or BOLI, policies that we purchased during 2002 totaled $660,000.

Non-interest income for the year ended December 31, 2001 increased $4.0 million, or 205.7%, to $6.0 million compared with $2.0 million in 2000. Service charges on deposit accounts increased $1.4 million, or 281.3%, in 2001 as compared to 2000 due to the large increase in total deposits, which resulted in a higher volume of transactions. Service charges on deposit accounts contributed 31.0% of our non-interest income for 2001 compared to 24.9% of our non-interest income in 2000. Trust fee income increased by $252,000 in 2001 compared to 2000, while contributing 13.8% of non-interest income for 2001 compared to 29.3% for 2000. Mortgage warehouse fees increased $287,000 for 2001 to $291,000 from $4,000 in 2000. Other non-interest income increased by $234,000, or 26.8%, compared to 2000 due to letter of credit fees, investment fees, rental income and gain on sale of leases. Gain on sale of securities increased in 2001 to $1.9 million compared to $19,000 in 2000.

While management expects continued growth in non-interest income, the future rate of growth could be affected by increased competition from nationwide and regional financial institutions. In order to achieve continued growth in non-interest income, we may need to introduce new products or enter into new markets.

Any new product introduction or new market entry would likely place additional demands on capital and managerial resources.

Non-Interest Expense

	Six Months Ended June 30,		Year Ended December 31,		
	2003	2002	2002	2001	2000
	(Unaudited)				
			(In thousands)		
Salaries and employee benefits	$11,236	$ 8,329	$16,757	$15,033	$15,330
Net occupancy expense	2,386	2,553	5,001	4,795	4,122
Advertising and affinity payments	392	562	1,236	278	4,182
Legal and professional	1,509	1,451	3,038	1,898	2,823
Communications and data processing	1,456	1,400	2,839	2,930	1,804
Franchise taxes	74	47	108	120	145
IPO expenses			1,190		
Repurchase agreement penalties	6,262				
Other(1)	2,964	2,438	5,201	4,378	6,752
Total non-interest expense	$26,279	$16,780	$35,370	$29,432	$35,158

(1) Other expense includes such items as courier expenses, regulatory assessments, business development expenses, due from bank charges, and other general operating expenses, none of which account for 1% or more of total interest income and non-interest income.

Non-interest expense for the six months ended June 30, 2003 increased $9.5 million, or 56.6%, compared to the same period of 2002. This increase included $6.3 million in penalties related to our restructuring of the maturities and pricing of our repurchase agreements in June 2003 in order to take advantage of historical lows in interest rates, which had decreased on similar repurchase agreements by approximately 1.4% since the time we entered into the original repurchase agreements. We unwound approximately $139 million in repurchase agreements prior to their maturities and entered into new repurchase agreements with respect to a significant portion of that amount, with the remainder replaced with overnight funds. We expect that a significant portion of these overnight funds will be replaced with deposits when we complete our planned acquisition of the outstanding deposit accounts of Bluebonnet Savings Bank FSB, which is expected to occur in August 2003. See Business Acquisition of Bluebonnet Savings Deposits. Salaries and employee benefits increased by $2.9 million or 34.9%. Total full time employees increased from 201 at June 30, 2002 to 237 at June 30, 2003. Also included in salaries and benefits for the six months ended June 30, 2003, is $250,000 in separation costs related to the resignation of a senior officer. In addition, we experienced losses related to forged checks of approximately $278,000 in the first half of 2003. We have taken steps to attempt to reduce these types of losses in the future.

Net occupancy expense for the six months ended June 30, 2003 decreased by $167,000, or 6.5%, mainly due to a decrease in depreciation as many of our fixed assets are becoming fully depreciated.

Advertising expense for the six months ended June 30, 2003 decreased $170,000, or 30.2%, compared to 2002. Advertising expense for the six months ended June 30, 2003 included $62,000 of direct marketing and branding, including print ads for the traditional bank, and $330,000 for the purchase of miles related to the American Airlines AAdvantage® program compared to direct marketing and branding of $289,000 and $273,000 for the purchases of American Airlines miles during the same period in 2002. Our direct marketing may increase as we seek to further develop our brand, reach more of our target customers and expand in our target markets. Legal and professional expenses increased $58,000 or 4.0%, mainly related to continued legal expenses incurred with our non-performing loans and leases. Communications and data processing expense for the six months ended June 30, 2003 increased $56,000, or 4.0%, due to growth in our loan and deposit base and increased staff.

Non-interest expense for the year ended December 31, 2002 increased $6.0 million, or 20.2%, compared to the same period of 2001. Salaries and employee benefits increased by $1.7 million, or 11.5%, which accounts for 29.0% of the increase in non-interest expense. Total full time employees increased from 198 at December 31, 2001 to 215 at December 31, 2002.

Net occupancy expense for the year ended December 31, 2002 increased by $206,000, or 4.3%, mainly related to the relocation of our operations center in the last quarter of 2001.

Advertising expense for the year ended December 31, 2002 increased $958,000, or 344.6%, compared to 2001. Advertising expense for the year ended December 31, 2002 included $586,000 of direct marketing and branding, including print ads for the traditional bank and $12,000 for BankDirect, $630,000 for the purchase of miles related to the American Airlines AAdvantage® program and $8,000 of co-branded advertising with American Airlines. We did not purchase any miles in 2001 because the miles that we were contractually required to purchase in 2000 were sufficient to cover our mileage rewards to customers for 2001. Since 2002, we purchased miles as we utilized them. Legal and professional expenses increased $1.1 million or 60.1%, mainly related to legal expenses incurred with our non-performing loans and leases. Communications and data processing expense for the year ended December 31, 2002 decreased $91,000, or 3.1%, due to some increased efficiencies in our communications costs. IPO expenses of $1.2 million were recognized as our offering was postponed in October 2002 due to unfavorable market conditions.

Non-interest expense totaled $29.4 million for 2001 compared to $35.2 million in 2000, a decrease of $5.8 million, or 16.3%. Approximately $297,000, or 5.2%, of this decrease in 2001 compared to 2000 was related to salary and employee benefits. Total full time employees decreased from 234 at December 31, 2000 to 198 at December 31, 2001. The decrease was due to our realignment of staffing levels during the second quarter of 2001. Most of this decrease was due to a reduction in BankDirect employees from 40 to 13, relating to our decision to reorient the focus of BankDirect toward higher-balance depositors.

Net occupancy expense for 2001 increased $673,000 or 16.3%. The increase was primarily due to our use of all of our primary locations for the entire year, as well as the relocation of our operations center in the last quarter of the year.

Advertising expense for 2001 totaled $278,000 compared to $4.2 million in 2000. Advertising expense in 2000 included direct marketing with print and online ads, branding for the traditional bank and BankDirect, and minimum miles and co-branding related to the American Airlines AAdvantage® program. Legal and professional expense for 2001 totaled $1.9 million compared to $2.8 million in 2000. This decrease is partially due to costs incurred in 2000 related to obtaining final regulatory approval for the formation of a state chartered savings bank in connection with a possible restructuring of our operations (which we decided not to pursue), and an investment banking fee related to BankDirect. Legal and professional expenses for 2000 also included a $150,000 accrual related to legal expenses associated with the contingent liability related to the merchant card processing arrangement, which is discussed below. Communications and data processing expenses increased to $2.9 million in 2001, as compared to $1.8 million in 2000. This increase is due to the strong growth in our loans and non-interest bearing deposits, which created significantly more transactions to be processed. Included in other expenses in 2000 was a $1.8 million contingent liability related to an agreement to provide merchant card processing for a customer who ceased operations and filed for bankruptcy in December 2000. Other expenses in 2001 include a reversal of approximately $300,000 of the $1.8 million contingent liability, as the actual losses were less than the original amount accrued.

Income Taxes

We had a gross deferred tax asset of $7.8 million at June 30, 2003 (unaudited). In 2003, as a result of our reassessment of our ability to generate sufficient earnings to allow the utilization of our deferred tax assets, we believe it is more likely than not that the deferred tax assets will be realized. Accordingly, in compliance with Statement of Financial Accounting Standards No. 109, we reversed the valuation allowance and certain related tax reserves during the period.

At December 31, 2002, we had a net deferred tax asset of $2.2 million, and a valuation allowance of $5.4 million. In assessing the need for a valuation allowance at December 31, 2002, we did not assume future taxable income would be generated due to our limited operating history and uncertainty regarding the timing of certain future deductions. The effective tax rate in 2002 reflected the use of certain net operating loss carryforwards from prior years.

No tax was provided in 2000 and 2001 due to tax losses which were generated and used during those years. Deferred tax assets at December 31, 2001 were fully offset by a valuation allowance.

Lines of Business

We operate two principal lines of business under our bank the traditional bank and BankDirect, an Internet-only bank that is operated as a division of our bank. BankDirect, which provides a complete line of consumer deposit services but offers no credit products, has been a net provider of funds, and the traditional bank has been a net user of funds. In order to provide a consistent measure of the net interest margin for BankDirect, we use a multiple pool funds transfer rate to calculate credit for funds provided. This method takes into consideration the current market conditions during the reporting period.

During the launch of BankDirect in 1999, we incurred approximately $1.9 million in start-up expenses. In 2000, we committed significant resources to advertising and marketing for BankDirect, including approximately $1.9 million spent on AAdvantage® miles and co-branded advertising with American Airlines AAdvantage®. As a result, our non-interest expense related to BankDirect increased to approximately $8.7 million in 2000.

In February 2001, we reoriented BankDirect towards higher balance depositors and restructured the account fees charged by BankDirect. As a result, we reduced our non-interest expense related to BankDirect to $3.0 million for 2001 from $8.7 million in 2000. In addition, our higher fees resulted in an increase in non-interest income for 2001 to approximately $300,000 from approximately $30,000 in 2000. The historical results below illustrate the evolving role and focus of BankDirect in our business. As management s approach to evaluating the operating performance of BankDirect changes, management will continue to assess the appropriate reporting of BankDirect as a separate segment.

The Traditional Bank

	Six Months Ended June 30,		Year Ended December 31,		
	2003	2002	2002	2001	2000
	(Unaudited)				
	(In thousands, except percentage data)				
Net interest income	$ 24,970	$ 18,798	$ 41,299	$ 34,344	$ 20,860
Provision for loan losses	2,850	1,979	5,629	5,762	6,135
Non-interest income	6,063	3,583	8,490	5,671	1,927
Non-interest expense	24,490	15,068	30,466	25,431	24,288
Pre-tax income (loss)	$ 3,693	$ 5,334	$ 13,694	$ 8,822	$ (7,636)
Average assets	$ 1,885,175	$ 1,210,787	$ 1,365,377	$ 1,016,301	$ 682,497
Total assets	2,002,767	1,260,258	1,792,395	1,164,763	908,412

BankDirect

	Six Months Ended June 30,		Year Ended December 31,		
	2003	2002	2002	2001	2000
	(Unaudited)				
	(In thousands)				
Net interest income	$ (184)	$ 810	$ 1,012	$ 711	$ 1,901
Non-interest income	82	73	135	312	30
Non-interest expense	975	1,289	2,515	2,985	8,692
Pre-tax income (loss)	$ (1,077)	$ (406)	$ (1,368)	$ (1,962)	$ (6,761)

Loan Portfolio. Our loan portfolio has grown at an annual rate of 176%, 44% and 24% in 2000, 2001 and 2002, respectively, reflecting the build-up of our lending operations. Our business plan focuses primarily on lending to middle market businesses and high net worth individuals, and accordingly, commercial and real estate loans have comprised a majority of our loan portfolio since we commenced operations, increasing from 48.4% of total loans at December 31, 1998 to 67.8% of total loans at June 30, 2003. Construction loans have decreased from 41.1% of the portfolio at December 31, 1998 to 17.0% of the portfolio at June 30, 2003. Consumer loans have decreased from 10.5% of the portfolio at December 31, 1998 to 1.6% of the portfolio at June 30, 2003. Loans held for sale, which are principally residential mortgage loans being warehoused for sale (typically within 30 days), fluctuate based on the level of market demand in the product.

We originate substantially all of the loans held in our portfolio, except in certain instances we have purchased individual leases and lease pools (primarily commercial and industrial equipment and vehicles), as well as select loan participations and USDA government guaranteed loans.

The following summarizes our loan portfolios by major category as of the dates indicated:

	At June 30,		At December 31,				
	2003	2002	2002	2001	2000	1999	1998

	(Unaudited)						
				(In thousands)			
Commercial	$ 550,359	$452,133	$ 509,505	$402,302	$325,774	$152,749	$ 2,227
Construction	212,722	170,271	172,451	180,115	83,931	11,565	4,554
Real estate	298,061	238,901	282,703	218,192	164,873	51,779	3,142
Consumer	19,564	21,436	24,195	25,054	36,092	10,865	1,169
Leases	13,912	24,164	17,546	34,552	17,093	642	
Loans held for sale	157,176	37,826	116,106	43,764	1,346		
Total	$1,251,794	$944,731	$1,122,506	$903,979	$629,109	$227,600	$11,092

We continue to lend primarily in Texas. As of June 30, 2003, a substantial majority of the principal amount of the loans in our portfolio was to businesses and individuals in Texas. As of June 30, 2003, approximately 77% of our total loans originated out of our Dallas banking centers. This geographic concentration subjects the loan portfolio to the general economic conditions in Texas. Within the loan portfolio, loans to the services industry were $445.2 million, or 35.6%, of total loans at June 30, 2003. Other notable concentrations include $244.4 million in personal/household loans (which includes loans to certain high net worth individuals for commercial purposes and mortgage loans held for sale, in addition to consumer loans), $141.7 million in petrochemical and mining loans, and $134.1 million to the contracting industry. 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.

Loan Maturity and Interest Rate Sensitivity on June 30, 2003 (Unaudited)

		Remaining Maturities		
	Total	Within 1 Year	1-5 Years	After 5 Years
		(In thousands)		
Loan maturity:				
Commercial	$550,359	$317,132	$181,409	$51,818
Construction	212,722	101,112	104,785	6,825
Total	$763,081	$418,244	$286,194	$58,643
Interest rate sensitivity for loans with:				
Predetermined interest rates	$ 34,860	$ 5,949	$ 22,940	$ 5,971
Floating or adjustable interest rates	728,221	412,295	263,254	52,672
Total	$763,081	$418,244	$286,194	$58,643

Summary of Loan Loss Experience

The provision for loan losses is a charge to earnings to maintain the reserve for loan losses at a level consistent with management s assessment of the loan portfolio in light of current economic conditions and market trends. We recorded a provision of $2.9 million for the six months ended June 30, 2003, $5.6 million for the year ended December 31, 2002, $5.8 million for 2001 and $6.1 million for 2000. These provisions were made to reflect management s assessment of the risk of loan losses specifically including the significant growth in outstanding loans during each of these periods.

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 specific loans. We regularly evaluate our reserve for loan losses to maintain an adequate level to absorb loan losses inherent in the loan portfolio. 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. All loans rated doubtful and all commitments rated substandard that are at least $1,000,000 are specifically reviewed for impairment as appropriate. A reserve is recorded on impaired loans when the carrying amount of the loan exceeds the discounted cash flows using the loan s initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. We consider all loans graded substandard or worse to be potential problem loans. As of June 30, 2003, there were $12.3 million in loans rated substandard or worse that are not included as non-accrual or 90 days past due and still accruing. As of December 31, 2002, there were $11.8 million in loans rated substandard or worse that are not included as non-accrual or 90 days past due and still accruing. For purposes of determining the general reserve, the portfolio is segregated by product types to recognize differing risk profiles among categories, and then further segregated by credit grades. Credit grades are assigned to all loans greater than $50,000. Each credit grade is assigned a risk factor, or reserve allocation percentage. These risk factors are multiplied by the outstanding principal balance and risk-weighted by product type to calculate the required reserve. A similar process is employed to calculate that portion of the required reserve assigned to unfunded loan commitments.

The reserve allocation percentages assigned to each credit grade have been developed based on an analysis of our historical loss rates and loss rates at selected peer banks, adjusted for certain qualitative factors, and on our management s experience. Qualitative adjustments for such things as national and local economic conditions, market interest rates, changes in credit policies and lending standards, and changes in the trend and severity of problem loans can cause the estimation of future losses to differ from past experience. The unallocated portion of the general reserve, which takes into account industry comparable reserve ratios, serves to compensate for additional areas of uncertainty. In addition, the reserve considers the results of reviews performed by independent third party reviewers as reflected in their confirmations of assigned credit grades within the portfolio.

The methodology used in the periodic review of reserve adequacy, which is performed at least quarterly, is designed to be dynamic and responsive to changes in portfolio credit quality and anticipated future credit losses. The changes are reflected in both the general reserve and in specific reserves as the collectibility of larger classified loans is regularly recalculated with new information. As our portfolio matures, historical loss ratios are being closely monitored. Eventually, our reserve adequacy analysis will rely more on our loss history and less on the experience of peer banks. Currently, the review of reserve adequacy is performed by executive management and presented to our board of directors for their review, consideration and ratification on a quarterly basis.

The reserve for loan losses, which is available to absorb losses inherent in the loan portfolio, totaled $17.3 million at June 30, 2003, $14.5 million at December 31, 2002, $12.6 million at December 31, 2001 and $8.9 million at December 31, 2000. This represents 1.38%, 1.30%, 1.39% and 1.42% of total loans at June 30, 2003 and December 31, 2002, 2001 and 2000, respectively.

The table below presents a summary of our loan loss experience for the past five years.

Summary of Loan Loss Experience

	Texas Capital Bancshares							Resource Bank
	Six Months Ended June 30,		Year Ended December 31,				Inception (March 1, 1998) through December 31,	January 1, 1998 through December 18,
	2003	2002	2002	2001	2000	1999	1998	1998
	(Unaudited)							
	(In thousands, except percentage and multiple data)							
Beginning balance	$14,538	$12,598	$12,598	$ 8,910	$ 2,775	$ 100	$	$ 30
Loans charged-off:								
Commercial	17	2,000	2,096	1,418				
Consumer	2	6	11			12		
Leases	250	485	1,740	656				
Total	269	2,491	3,847	2,074		12		
Recoveries:								
Commercial	78		42					
Consumer		10						
Leases	77		116					
	155	10	158					
Net charge-offs	114	2,481	3,689	2,074		12		
Provision for loan losses	2,850	1,979	5,629	5,762	6,135	2,687	1	69
Additions due to acquisition of Resource Bank							99	
Ending balance	$17,274	$12,096	$14,538	$12,598	$ 8,910	$2,775	$ 100	$ 99
Allowance for loan losses to loans outstanding at period-end	1.38%	1.28%	1.30%	1.39%	1.42%	1.22%	.90%	0.89%
Net charge-offs to average loans(1)	.02%	.56%	.38%	.26%		.01%		
Provision for loan losses to average loans(1)	.49%	.45%	.58%	.73%	1.44%	2.73%	1.03%(3)	1.03%(3)
Recoveries to gross charge-offs	57.62%	.40%	4.11%					
Reserve as a multiple of net charge-offs	151.5x	4.9x	3.9x	6.1x		231.3x		
Non-performing and renegotiated loans:								
Loans past due (90 days)	$ 1,145	$	$ 135	$ 384	$	$	$ 15	$
Non-accrual(2)	11,545	6,762	2,776	6,032	572			
Renegotiated				5,013				

Total	$12,690	$ 6,762	$ 2,911	$11,429	$ 572	$	$ 15	$
Allowance as a percent of non- performing and renegotiated loans	136.12%	178.88%	499.42%	110.23%	1,557.69%		666.67%	

(1) Interim period ratios are annualized.

(2) The accrual of interest on loans is discontinued when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectibility is questionable, then cash payments are applied to principal. If these loans had been current throughout their terms, interest and fees on loans would have increased by approximately $167,000, $202,000 and $771,000 for the six months ended June 30, 2003 and 2002 and the year ended December 31, 2002, respectively.

(3) Percentage is calculated using the combined results of Resource Bank and TCBI for 1998.

Loan Loss Reserve Allocation

	June 30, 2003		December 31,									
			2002		2001		2000		1999		1998	
	Reserve	% of Loans	Reserve	% of Loans	Reserve	% of Loans	Reserve	% of Loans	Reserve	% of Loans	Reserve	% of Loans
	(In thousands, except percentage data)											
Loan category:												
Commercial	$ 6,018	44%	$ 4,818	45%	$ 7,549	45%	$ 3,136	52%	$ 1,428	67%	$	20%
Construction	2,277	17	2,008	15	1,004	20	498	13	174	5		41
Real estate	3,465	36	3,193	36	1,738	29	2,250	26	499	23		28
Consumer	99	2	114	2	116	2	144	6	187	5		11
Leases	681	1	706	2	623	4	384	3				
Unallocated	4,734		3,699		1,568		2,498		487		100	
Total	$ 17,274	100%	$ 14,538	100%	$ 12,598	100%	$ 8,910	100%	$ 2,775	100%	$ 100	100%

Non-Performing Assets

Non-performing assets include non-accrual loans and leases, accruing loans 90 or more days past due, restructured loans, and other repossessed assets. We had non-accrual loans and leases of $11,545,000, with reserves of $3,021,000, at June 30, 2003, non-accrual loans and leases of $2,776,000, with reserves of $832,000, at December 31, 2002, non-accrual loans and leases of $6,032,000, with reserves of $1,213,000, at December 31, 2001, a non-accrual lease of $572,000, with a specific reserve of $277,000, at December 31, 2000 and no non-accrual loans or leases at December 31, 1999 and 1998. The increase in non-accrual loans from December 31, 2002 to June 30, 2003 included a $3.5 million loan relationship that was restructured in 2001. Although the loan continues to pay as agreed, it has been returned to non-accrual status due to weaker financial results of the borrower. Additionally, a $3.9 million loan relationship, where payment default is not anticipated in the near future, was placed on non-accrual due to uncertain future cash flow capacity of the borrower. At June 30, 2003, our non-accrual loans and leases consisted of $4,344,000 in commercial loans, $3,991,000 in construction loans, $1,351,000 in real estate loans, $113,000 in consumer loans and $1,746,000 in leases. At December 31, 2002, our non-accrual loans and leases consisted of $641,000 in commercial loans, $1,367,000 in real estate loans, $26,000 in consumer loans and $742,000 in leases. At December 31, 2001, our non-accrual loans and leases consisted of $5,767,000 in commercial loans and $265,000 in leases. At June 30, 2003 and December 31, 2002 and 2001, we had $1,145,00, $135,000 and $384,000, respectively, in accruing loans past due 90 days or more. At June 30, 2003, $1,095,000 of the accruing loans past due 90 days or more are 100% government guaranteed. We had one loan relationship in the amount of $5,013,000 that was restructured and returned to accrual status during 2001. The restructuring included a charge-off and a principal reduction from the borrower. Interest income recorded on impaired loans during the six months ended June 30, 2003 and the year ended December 31, 2002 was approximately $60,000 and $64,000, respectively. Additional interest income that would have been recorded if the loans had been current during the six months ended June 30, 2003 and the year ended December 31, 2002 totaled $167,000 and $771,000, respectively. At June 30, 2003 and December 31, 2002, we had $87,000 and $181,000, respectively, in other repossessed assets.

Generally, we place loans on non-accrual when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due.

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

Securities Portfolio

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. Amortization of premiums or accretion of discounts on mortgage-backed securities is periodically adjusted for estimated prepayments.

During the six months ended June 30, 2003, we maintained an average securities portfolio of $583.4 million compared to an average portfolio of $241.2 million for the same period in 2002. We used additional securities in 2003 to increase our earnings by taking advantage of market spreads between returns on assets and the cost of funding these assets. The June 30, 2003 portfolio was primarily comprised of mortgage-backed securities. The mortgage-backed securities in our portfolio at June 30, 2003 consisted primarily of government agency mortgage-backed securities.

Our unrealized gain on the securities portfolio value increased from a gain of $10.0 million, which represented 1.8% of the amortized cost, at December 31, 2002, to a gain of $10.3 million, which represented 1.6% of the amortized cost, at June 30, 2003.

During the year ended December 31, 2002, we maintained an average securities portfolio of $318.9 million compared to an average portfolio of $176.0 million for the same period in 2001. We used additional securities in 2002 to increase our earnings by taking advantage of market spreads between returns on assets and the cost of funding these assets. The December 31, 2002 portfolio was primarily comprised of mortgage-backed securities. The mortgage-backed securities in our portfolio at December 31, 2002 consisted solely of government agency mortgage-backed securities.

Our unrealized gain on the securities portfolio value increased from a loss of $507,000, which represented 0.25% of the amortized cost, at December 31, 2001, to a gain of $10.0 million, which represented 1.8% of the amortized cost, at December 31, 2002.

During 2001, we maintained an average securities portfolio of $176.0 million compared to an average portfolio of $203.0 million in 2000. The average securities portfolio was not increased in 2001 due to the strong growth in our loans. The December 31, 2001 portfolio was comprised primarily of mortgage-backed securities. The mortgage-backed securities in our portfolio at December 31, 2001 consisted primarily of government agency mortgage-backed securities.

Our unrealized loss on the securities portfolio value increased slightly from $482,000, which represented 0.23% of the amortized cost, at December 31, 2000, to $507,000, which represented 0.25% of the amortized cost, at December 31, 2001.

The average expected life of the mortgage-backed securities was 2.5 years at June 30, 2003, 2.4 years at December 31, 2002 and 4.7 years at December 31, 2001. The effect of possible changes in interest rates on our earnings and equity is discussed under Interest Rate Risk Management.

The following presents the amortized cost and fair values of the securities portfolio at June 30, 2003 and December 31, 2002, 2001 and 2000.

Securities Portfolio

	At June 30, 2003 (Unaudited)	
	Amortized Cost	Fair Value
	(In thousands)	
Available-for-sale:		
U.S. Treasuries	$ 3,792	$ 3,793
Mortgage-backed securities	618,214	628,519
Other debt securities	4,994	4,994
Equity securities(1)	12,188	12,216
Total available-for-sale	$639,188	$649,522

	At December 31,					
	2002		2001		2000	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
			(In thousands)			
Available-for-sale:						
U.S. Treasuries	$ 3,291	$ 3,291	$ 1,298	$ 1,297	$	$
U.S. Government Agency					71,488	70,847
Mortgage-backed securities	530,271	540,280	199,060	198,571	76,957	77,088
Other debt securities					31,726	31,755
Equity securities(1)	9,590	9,598	6,514	6,497	5,262	5,262
Total available-for-sale	543,152	553,169	206,872	206,365	185,433	184,952
Held-to-maturity:						
Other debt securities					28,366	28,539
Total held-to-maturity					28,366	28,539
Total securities	$543,152	$553,169	$206,872	$206,365	$213,799	$213,491

(1) Equity securities consist of Federal Reserve Bank stock, Federal Home Loan Bank stock, and Community Reinvestment Act funds.

The amortized cost and estimated fair value of securities are presented below by contractual maturity:

	At June 30, 2003 (Unaudited)				
	Less Than One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	Total
	(In thousands, except percentage data)				
Available-for-sale:					

U.S. Treasuries:					
Amortized cost	$3,792	$	$	$	$ 3,792
Estimated fair value	$3,793	$	$	$	$ 3,793
Weighted average yield	.891%				.891%
Mortgage-backed securities:(1)					
Amortized cost		837	65,342	552,035	618,214
Estimated fair value		859	66,024	561,636	628,519
Weighted average yield		5.813%	4.254%	4.607%	4.576%
Other debt:					
Amortized cost				4,994	4,994
Estimated fair value				4,994	4,994
Weighted average yield				7.390%	7.390%
Equity securities:					
Amortized cost					12,188
Estimated fair value					12,216
Total available-for-sale securities:					
Amortized cost					$639,188
Estimated fair value					$649,522

(1) Actual maturities may differ significantly from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties. The average expected life of the mortgage-backed securities was 2.5 years at June 30, 2003.

Deposits

We compete for deposits by offering a broad range of products and services to our customers. While this includes offering competitive interest rates and fees, the primary means of competing for deposits is convenience and service to our customers. However, our strategy to provide service and convenience to customers does not include a large branch network. Not including our planned banking center in Houston, scheduled to open in September 2003, our bank offers eight banking centers, courier services, and online banking. BankDirect, the Internet division of our bank, serves its customers on a 24 hours-a-day/ 7 days-a-week basis solely through Internet banking.

Average deposits for the six months ended June 30, 2003 increased $322.1 million compared to the same period of 2002. Demand deposits, interest bearing transaction accounts, savings, and time deposits increased by $95.9 million, $12.0 million, $59.6 million, and $154.5 million, respectively, during the six months ended June 30, 2003 as compared to the same period of 2002. The average cost of deposits decreased in 2003 mainly due to lower market interest rates.

Average deposits for the year ended December 31, 2002 increased $176.5 million compared to the same period of 2001. Demand deposits, interest bearing transaction accounts, and time deposits increased by $55.8 million, $11.5 million, and $120.9 million, respectively, during the year ended December 31, 2002 as compared to the same period of 2001. Savings accounts decreased by $11.7 million. The average cost of deposits decreased in 2002 mainly due to lower market interest rates.

Average deposits for 2001 increased $237.6 million compared to 2000. Demand deposits, interest bearing transaction accounts, savings, and time deposits increased by $51.0 million, $21.5 million, $77.3 million and $87.9 million, respectively, in 2001 compared to 2000. The average cost of deposits decreased in 2001 mainly due to lower market interest rates and BankDirect s reorientation toward higher deposit customers and its restructuring of account fees.

Deposit Analysis

	Average Balances				
	Six Months Ended June 30,		Year Ended December 31,		
	2003	2002	2002	2001	2000
	(Unaudited)				
	(In thousands)				
Non-interest bearing	$ 230,497	$134,597	$155,298	$ 99,471	$ 48,483
Interest bearing transaction	61,038	49,007	52,155	40,673	19,198
Savings	394,404	334,780	349,128	360,865	283,594
Time deposits	550,114	395,618	433,731	312,826	224,933
Total average deposits	$1,236,053	$914,002	$990,312	$813,835	$576,208

As with our loan portfolio, most of our deposits are from businesses and individuals in Texas, and particularly the Dallas metropolitan area. As of June 30, 2003, approximately 84% of our total deposits originated out of our Dallas banking centers. Uninsured deposits at June 30, 2003 were 64% of total deposits compared to 57% of total deposits at December 31, 2002, 47% of total deposits at December 31, 2001 and 36% of total deposits at December 31, 2000. Uninsured deposits as used in this presentation for 2001 and 2000 was based on a simple analysis of account balances over and under $100,000 and does not reflect combined ownership and other account styling that would determine insurance based on FDIC regulations. The presentation for 2003 and 2002 does reflect combined ownership, but does not reflect all of the account styling that would determine insurance based on FDIC regulations.

At June 30, 2003 and December 31, 2002, approximately 9% of our total deposits were comprised of a number of short-term maturity deposits from a single municipal entity. We use these funds to increase our net interest income from excess securities that we pledge as collateral for these deposits.

Maturity of Domestic CDs and Other Time Deposits in Amounts of $100,000 or More

	June 30, 2003	December 31, 2002	December 31, 2001	December 31, 2000
	(Unaudited)	(In thousands)		
Months to maturity:				
3 or less	$187,059	$174,518	$143,264	$ 51,579
Over 3 through 6	11,558	47,041	20,854	28,588
Over 6 through 12	98,943	28,905	29,491	28,739
Over 12	123,754	174,715	32,486	7,431
Total	$421,314	$425,179	$226,095	$116,337

Liquidity and Capital Resources

In general terms, liquidity is a measurement of our ability to meet our cash needs. Our objective in managing our liquidity is to maintain our ability to meet loan commitments, purchase securities or repay deposits and other liabilities in accordance with their terms, without an adverse impact on our current or future earnings. Our liquidity strategy is guided by policies, which are formulated and monitored by our senior management and our bank s balance sheet committee, and which take into account the marketability of assets, the sources and stability of funding and the level of unfunded commitments. We regularly evaluate all of our various funding sources with an emphasis on accessibility, stability, reliability and cost-effectiveness. For the year ended December 31, 2002 and the six months ended June 30, 2003, our principal source of funding has been our customer deposits, supplemented by our short-term and long-term borrowings, primarily from securities sold under repurchase agreements and federal funds purchased from our downstream correspondent bank relationships (which consist of banks that are considered to be smaller than our bank).

Since early 2001, our liquidity needs have primarily been fulfilled through growth in our traditional bank customer and stockholder deposits. Our goal is to obtain as much of our funding as possible from deposits of these customers and stockholders, which as of June 30, 2003, comprised $952.7 million, or 71.1%, of total deposits, compared to $810.3 million, or 67.7%, of total deposits, at December 31, 2002. These traditional deposits are generated principally through development of long-term relationships with customers and stockholders.

In addition to deposits from our traditional bank customers and stockholders, we also have access to incremental consumer deposits through BankDirect, our Internet banking facility, and through brokered retail certificates of deposit, or CDs. As of June 30, 2003, BankDirect deposits comprised $252.6 million, or 18.8%, of total deposits, and brokered retail CDs comprised $135.0 million, or 10.1%, of total deposits. Our dependence on Internet deposits and retail brokered CDs is limited by our internal funding guidelines, which as of June 30, 2003, limited borrowing from these sources to 15-25% and 10-20%, respectively, of total deposits.

Additionally, we have borrowing sources available to supplement deposits and meet our funding needs. These borrowing sources include federal funds purchased from our downstream correspondent bank relationships and from our upstream correspondent bank relationships (which consist of banks that are considered to be larger than our bank), securities sold under repurchase agreements, treasury, tax and loan notes, and advances from the Federal Home Loan Bank, or FHLB. As of June 30, 2003, our borrowings consisted of a total of $279.6 million of securities sold under repurchase agreements, $111.2 million of downstream federal funds purchased, $45.0 million of upstream federal funds purchased, $13.7 million from customer repurchase agreements, $50.0 million of FHLB borrowings and $3.5 million of treasury, tax and loan notes. Credit availability from the FHLB is based on our bank s financial and operating condition and borrowing collateral we hold with the FHLB. At June 30, 2003, borrowings from the FHLB consisted of approximately $50.0 million of overnight advances bearing interest at 1.4%. Our unused FHLB borrowing capacity at June 30, 2003 was approximately $386.0 million. As of June 30, 2003, we had unused upstream federal fund lines available from commercial banks of approximately $52.8 million. During the six months ended June 30, 2003, our average borrowings from these sources were $496.1 million or 26.3% of average assets, which is well within our internal funding guidelines, which limit our dependence on borrowing sources to 25-30% of total assets. In prior periods, our internal funding guidelines limited our dependence on borrowing sources to 20-25% of total assets. In 2002, we increased this internal guideline in order to implement management s strategy of increasing the investment securities portfolio funded by term repurchase agreements. In June 2003, we unwound approximately $139 million of these term repurchase agreements and replaced a significant portion of that amount with new securities repurchase agreements subject to lower interest rates, with the remainder replaced with overnight funds. We expect that a significant portion of these overnight funds will be replaced with deposits when we complete our planned acquisition of the outstanding deposit accounts of Bluebonnet Savings Bank FSB, which is expected to occur in August 2003. See Business Acquisition of Bluebonnet Savings Deposits. The maximum amount of other borrowings outstanding at any month-end during the six months ended June 30, 2003 was $516.2 million, or 27.2% of total assets.

On November 19, 2002, our subsidiary Texas Capital Bancshares Statutory Trust I issued $10,000,000 of its Floating Rate Capital Securities Cumulative Trust Preferred Securities (the 2002 Trust Preferred) in a private offering. On April 10, 2003, our subsidiary Texas Capital Bancshares Statutory Trust II issued $10,000,000 of its Floating Rate Capital Securities Cumulative Trust Preferred Securities (the 2003 Trust Preferred) in a private offering. Proceeds of the 2002 Trust Preferred and the 2003 Trust Preferred were invested in related series of our Floating Rate Junior Subordinated Deferrable Interest Securities (the Subordinated Debentures). After deducting underwriters compensation and other expenses of the offerings, the net proceeds were available to us to increase capital and for general corporate purposes, including use in investment and lending activities.

The interest rate on the Subordinated Debentures issued in connection with the 2002 Trust Preferred adjusts every three months and is currently 4.45%. The interest rate on the Subordinated Debentures issued in connection with the 2003 Trust Preferred adjusts every three months and is currently 4.54%. Interest payments on the Subordinated Debentures are deductible for federal income tax purposes. The payment by us of the principal and interest on the Subordinated Debentures is subordinated and junior in light of payment to the prior payment in full of all of our senior indebtedness, whether outstanding at this time or incurred in the future.

The 2002 Trust Preferred and the related Subordinated Debentures mature in November 2032 and the 2003 Trust Preferred and the related Subordinated Debentures mature in April 2033. The 2002 Trust Preferred, the 2003 Trust Preferred and the related Subordinated Debentures also may be redeemed prior to maturity if certain events occur.

As of June 30, 2003, our contractual obligations and commercial commitments, other than deposit liabilities, were as follows (Unaudited):

	Within One Year	After One But Within Three Years	After Three But Within Five Years	After Five Years	Total
			(In thousands)		
Federal funds purchased	$156,194	$	$	$	$156,194
Securities sold under repurchase agreements	103,808	175,800			279,608
Customer repurchase agreements	13,664				13,664
Treasury, tax and loan notes	3,501				3,501
FHLB borrowings	50,000				50,000
Operating lease obligations	2,649	8,184	5,156	2,925	18,914
Long-term debt				20,000	20,000
Total contractual obligations	$329,816	$183,984	$5,156	$22,925	$541,881

The contractual amount of our financial instruments with off-balance sheet risk expiring by period at June 30, 2003 is presented below (Unaudited):

	Within One Year	After One But Within Three Years	After Three But Within Five Years	After Five Years	Total
			(In thousands)		
Commitments to extend credit	$244,660	$94,171	$17,470	$4,911	$361,212
Standby letters of credit	17,120	2,960			20,080
Total contractual obligations	$261,780	$97,131	$17,470	$4,911	$381,292

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

Our equity capital averaged $127.8 million for the six months ended June 30, 2003 as compared to $113.1 million for the same period in 2002.

Our equity capital averaged $117.1 million for the year ended December 31, 2002 as compared to $90.8 million in 2001 and $82.4 million in 2000. These increases reflect our retention of net earnings during these periods. We have not paid any cash dividends on our common stock since we commenced operations and have no plans to do so in the future.

Our pro forma, actual and minimum required capital amounts and actual ratios are as follows:

	Regulatory Capital Adequacy									
					December 31,					
	Pro Forma(1) (as of June 30, 2003)		June 30, 2003		2002		2001		2000	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(In thousands, except percentage data)									
Total capital (to risk-weighted assets):										
Company										
Actual	$191,435	13.65%	$161,241	11.50%	$141,688	11.32%	$117,921	11.73%	$93,968	10.98%
To be well-capitalized	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Minimum required	112,160	8.00%	112,160	8.00%	100,160	8.00%	80,431	8.00%	68,448	8.00%
Excess above well-capitalized	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Excess above minimum	79,275	5.65%	49,081	3.50%	41,528	3.32%	37,490	3.73%	25,520	2.98%
Bank										
Actual	N/A	N/A	$151,630	10.82%	$128,696	10.29%	$114,551	11.39%	$82,925	9.69%
To be well-capitalized	N/A	N/A	140,095	10.00%	125,111	10.00%	100,538	10.00%	85,558	10.00%
Minimum required	N/A	N/A	112,076	8.00%	100,089	8.00%	80,430	8.00%	68,446	8.00%
Excess above well-capitalized	N/A	N/A	11,535	0.82%	3,585	.29%	14,013	1.39%	(2,633)	(0.31%)

Excess above minimum	N/A	N/A	39,554	2.82%	28,607	2.29%	34,121	3.39%	14,479	1.69%

Regulatory Capital Adequacy

	Pro Forma(1) (as of June 30, 2003)		June 30, 2003		December 31, 2002		December 31, 2001		December 31, 2000	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(In thousands, except percentage data)									
Tier 1 capital (to risk-weighted assets):										
Company										
Actual	$174,148	12.42%	$143,954	10.27%	$127,146	10.16%	$105,353	10.48%	$85,058	9.94%
To be well-capitalized	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Minimum required	56,080	4.00%	56,080	4.00%	50,080	4.00%	40,216	4.00%	34,224	4.00%
Excess above well-capitalized	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Excess above minimum	118,068	8.42%	87,874	6.27%	77,066	6.16%	65,137	6.48%	50,834	5.94%
Bank										
Actual	N/A	N/A	$134,344	9.59%	$114,154	9.12%	$101,983	10.14%	$74,015	8.65%
To be well-capitalized	N/A	N/A	84,057	6.00%	75,066	6.00%	60,323	6.00%	51,335	6.00%
Minimum required	N/A	N/A	56,038	4.00%	50,044	4.00%	40,215	4.00%	34,223	4.00%
Excess above well-capitalized	N/A	N/A	50,287	3.59%	39,088	3.12%	41,660	4.14%	22,680	2.65%
Excess above minimum	N/A	N/A	78,306	5.59%	64,110	5.12%	61,768	6.14%	39,792	4.65%
Tier 1 capital (to average assets):										
Company										
Actual	$174,148	8.98%	$143,954	7.43%	$127,146	7.66%	$105,353	9.46%	$85,058	9.62%
To be well-capitalized	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Minimum required	77,531	4.00%	77,531	4.00%	66,400	4.00%	44,545	4.00%	35,367	4.00%
Excess above well-capitalized	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Excess above minimum	96,617	4.98%	66,423	3.43%	60,746	3.66%	60,808	5.46%	49,691	5.62%
Bank										
Actual	N/A	N/A	$134,344	6.93%	$114,154	6.88%	$101,983	9.16%	$74,015	8.37%
To be well-capitalized	N/A	N/A	96,861	5.00%	82,949	5.00%	55,681	5.00%	44,208	5.00%
Minimum required	N/A	N/A	77,489	4.00%	66,359	4.00%	44,544	4.00%	35,366	4.00%
Excess above well-capitalized	N/A	N/A	37,483	1.93%	31,205	1.88%	46,302	4.16%	29,807	3.37%
Excess above minimum	N/A	N/A	56,855	2.93%	47,795	2.88%	57,439	5.16%	38,649	4.37%

(1) Pro forma amounts assume the issuance of all shares pursuant to this prospectus for estimated net proceeds of approximately $30.2 million. Pro forma amounts do not reflect any contribution of the net proceeds to our bank. See Use of Proceeds.

Critical Accounting Policies

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

We follow financial accounting and reporting policies that are in accordance with generally accepted accounting principles. 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 policies noted below could be deemed to meet the SEC s definition of critical accounting policies.

Management considers the policies related to the allowance for loan losses as the most critical to the financial statement presentation. The total allowance for loan losses includes activity related to allowances calculated in accordance with Statement of Financial Accounting Standards (SFAS) No. 114, *Accounting by Creditors for Impairment of a Loan,* and SFAS No. 5, *Accounting for Contingencies.* The allowance for loan losses is established through a provision for loan losses 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.

Management considers the policies related to income taxes to be critical to the financial statement presentation. 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.

We had a gross deferred tax asset of $7.8 million at June 30, 2003 (unaudited). In 2003, as a result of a reassessment of our ability to generate sufficient earnings to allow the utilization of our deferred tax assets, we believe it is more likely than not that the deferred tax assets will be realized. Accordingly, in compliance with SFAS No. 109, we reversed the valuation allowance and certain related tax reserves during the period.

New Accounting Standards

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

We have tested goodwill for impairment using the two-step process prescribed in SFAS 142. The first step is a screen for potential impairment, while the second step measures the amount of the impairment, if any. We performed the first of the required impairment tests of goodwill and indefinite lived intangible assets as of January 1, 2002 in the first quarter of 2002 and an annual assessment as of October 1, 2002, and, in each case, no impairment was noted. We will test for impairment again on October 1, 2003. We have no reason to believe that there will be an impairment charge in 2003.

For comparative purposes, the prior period results shown below have been adjusted to reflect the impact the change in accounting would have had if it had been adopted for the periods shown.

	For the Six Months Ended June 30,		For the Year Ended December 31,		
	2003	2002	2002	2001	2000
	(Unaudited)				
	(In thousands, except per share data)				
Net income (loss):					
As reported	$6,888	$3,377	$7,343	$5,844	$(16,497)
Amortization expense				125	125
Net income (loss) without amortization expense	$6,888	$3,377	$7,343	$5,969	$(16,372)
Basic income (loss) per share:					
As reported	$ 0.33	$ 0.15	$ 0.33	$ 0.31	$ (0.95)
Excluding amortization expense	$ 0.33	$ 0.15	$ 0.33	$ 0.31	$ (0.94)
Diluted income (loss) per share:					
As reported	$ 0.32	$ 0.15	$ 0.32	$ 0.30	$ (0.95)
Excluding amortization expense	$ 0.32	$ 0.15	$ 0.32	$ 0.31	$ (0.94)

Financial Accounting Standards Board Interpretation (FIN) No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others an Interpretation of FASB Statements No. 5, 57 and 107 and Rescission of FASB Interpretation No. 34.* FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002, and were adopted in our financial statements for the year ended December 31, 2002. Implementation of the remaining provisions of FIN 45 during the first half of 2003 did not have a significant impact on our financial statements.

FIN No. 46 *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51.* FIN 46 establishes accounting guidance for consolidation of variable interest entities (VIE) that function to support the activities of the primary beneficiary. The primary beneficiary of a VIE entity is the entity that absorbs a majority of the VIE s expected losses, receives a majority of the VIE s expected residual returns, or both, as a result of ownership, controlling interest, contractual relationship or other business relationship with a VIE. Prior to the implementation of FIN 46, VIEs were generally consolidated by an enterprise when the enterprise had a controlling financial interest through ownership of a majority of voting interest in the entity. The provisions of FIN 46 were effective immediately for all arrangements entered into after January 31, 2003, and are otherwise effective at the beginning of the first interim period beginning after June 15, 2003. Texas Capital Bancshares Statutory Trust II was formed subsequent to January 31, 2003 for the purpose of issuing $10 million of Trust Preferred Securities (See Note 8 to the consolidated financial statements) and accordingly is currently subject to the requirements of FIN 46. Texas Capital Bancshares Statutory Trust I was formed prior to January 31, 2003 to issue $10 million of Trust Preferred Securities (See Note 8 to the consolidated financial statements) and will be subject to FIN 46 in the third quarter of 2003. We currently believe the continued consolidation of Texas Capital Bancshares Statutory Trust II is appropriate under FIN 46. However, the application of FIN 46 to this type of trust is an emerging issue and a possible unintended consequence of FIN 46 is the deconsolidation of these trusts. The deconsolidation of Texas Capital Bancshares Statutory Trust I & II would not have a material effect on our consolidated balance sheet or our consolidated statement of operations. In July 2003, the Board of Governors of the Federal Reserve System issued a supervisory letter instructing bank holding companies to continue to include the trust preferred securities in their Tier I capital for regulatory capital purposes until notice is given to the contrary. The Federal Reserve intends to review the regulatory implications of any accounting treatment changes and, if necessary or warranted, provide further appropriate guidance. There can be no assurance that the Federal Reserve will continue to allow institutions to include trust preferred securities in Tier I capital for regulatory capital purposes. As of June 30, 2003, assuming we were not allowed to include the $20 million in trust preferred securities issued by Texas Capital Bancshares Statutory Trust I and Texas Capital Bancshares Statutory Trust II in Tier 1 capital, the Corporation would still exceed the regulatory required minimums for capital adequacy purposes (see Note 13 to the consolidated financial statements).

SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities.* SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS 133, Accounting for Derivative Instruments and Hedging Activities. The amendments (i) reflect decisions of the Derivatives Implementation Group; (ii) reflect decisions made by the Financial Accounting Standards Board in conjunction with other projects dealing with financial instruments; and (iii) address implementation issues related to the application of the definition of a derivative. SFAS 149 also modifies various other existing pronouncements to conform with the changes made to SFAS 133. SFAS 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003, with all provisions applied prospectively. Adoption of SFAS 149 on July 1, 2003 did not have a significant impact on our financial statements.

SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity.* SFAS 150 establishes standards for how an issuer classifies, measures and discloses in its financial statements certain financial instruments with characteristics of both liabilities and equity. SFAS 150 requires that an issuer classify financial instruments that are within its scope as a liability, in most circumstances. Such financial instruments include (i) financial instruments that are issued in the form of shares that are mandatorily redeemable; (ii) financial instruments that embody an obligation to repurchase the issuer s equity shares, or are indexed to such an obligation, and that require the issuer to settle the obligation by transferring assets; (iii) financial instruments that embody an obligation that the issuer may settle by issuing a variable number of its equity shares if, at inception, the monetary value of the obligation is predominately based on a fixed amount, variations in something other than the fair value of the issuer s equity shares or variations inversely related to changes in the fair value of the issuer s equity shares; and (iv) certain freestanding financial instruments. SFAS 150 is effective for contracts entered into or modified after May 31, 2003, and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of SFAS 150 on July 1, 2003 did not have a significant impact on our financial statements.

Quantitative and Qualitative Disclosure 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 and/or equity prices.

We are subject to market risk primarily through the effect of changes in interest rates on our portfolio of assets. 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 Balance Sheet Management Committee, which operates under policy guidelines established by our board of directors. The negative acceptable variation in net interest income due to a 200 basis point increase or decrease in interest rates is generally limited by these guidelines to +/-10%. These guidelines also establish maximum levels for short-term borrowings, short-term assets and brokered deposits. They also establish minimum levels for unpledged assets, among other things. Compliance with these guidelines is the ongoing responsibility of the Balance Sheet Management Committee, with exceptions reported to our board of directors on a quarterly basis.

Interest Rate Risk Management

We perform a sensitivity analysis to identify interest rate risk exposure on net interest income. We quantify and measure interest rate exposure using a model to dynamically simulate the effect of changes in net interest income relative to changes in interest rates over the next twelve months based on three interest rate scenarios. These are a most likely rate scenario and two shock test scenarios.

The most likely rate scenario is based on the consensus forecast of future interest rates published by independent sources. These forecasts incorporate future spot rates and relevant spreads of instruments that are actively traded in the open market. The Federal Reserve s Federal Funds target affects short-term borrowing; the prime lending rate and the London Interbank Offering Rate are the basis for most of our variable-rate loan pricing.

The 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 standard shock test scenarios assume a sustained parallel 200 basis point increase or decrease in interest rates. As short term rates have continued to fall since 2001 we could not assume interest rate changes of 200 basis points as the results of the decreasing rates scenario would be negative rates. Therefore, our shock test scenarios with respect to decreases in rates now assume a decrease of 100 basis points in the current interest rate environment. In prior periods, we had assumed 150 basis point increases and decreases in our modeling scenarios. We will continue to evaluate these scenarios as interest rates change, until short term rates rise above 2.00%.

Our interest rate risk exposure model incorporates assumptions regarding the level of interest rate or changes in outstanding balances 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:

	Anticipated Impact Over the Next Twelve Months as Compared to Most Likely Scenario			
	200 bp Increase June 30, 2003	100 bp Decrease June 30, 2003	150 bp Increase June 30, 2002	150 bp Decrease June 30, 2002
	(In thousands)			
Change in net interest income	$ 10,626	$ (6,814)	$ 4,477	$ (6,250)

	Anticipated Impact Over the Next Twelve Months as Compared to Most Likely Scenario			
	200 bp Increase December 31, 2002	100 bp Decrease December 31, 2002	150 bp Increase December 31, 2001	150 bp Decrease December 31, 2001
	(In thousands)			
Change in net interest income	$ 8,172	$ (5,397)	$ 3,246	$ (3,811)

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

The simulations used to manage market risk are based on numerous assumptions regarding the effect of changes in interest rates on the timing and extent of repricing characteristics, future cash flows, and customer behavior. These assumptions are inherently uncertain and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and management strategies, among other factors.

We expect our balance sheet will continue to be asset sensitive over the next twelve months, which means that we will have more assets repricing than liabilities over this period. This is largely due to the concentration of our assets in variable rate (rather than fixed rate) loans. If, as we expect will occur, interest rates rise in 2004, this asset-sensitivity will tend to result in an increase in our interest margin, all other factors being equal. In the event of a rising rate environment, management may choose to fund investment securities purchased with term liabilities/deposits to lock in a return. Investment securities are generally held in the available-for-sale category so that gains and losses can be realized as appropriate. At certain times, we use the held-to-maturity category if we are not planning to sell these securities before maturity.

As of June 30, 2003, the bank sourced approximately 19% of its total deposits from retail consumer deposit customers through BankDirect, our Internet banking facility. These retail consumer deposits may be more interest rate sensitive than our other deposits as a result of the extremely competitive Internet banking market.

BUSINESS

Background

We were organized in March 1998 to serve as the holding company for an independent bank managed by Texans and oriented to the needs of the Texas marketplace. Our principal founders, Joseph M. Jody Grant, George F. Jones, Jr. and C. Keith Cargill, had extensive experience with the large independent Texas banks prevalent in Texas before the collapse of the independent Texas banking industry in the late 1980s. Each of our founders has over 20 years of Texas banking experience and strong community and business relationships. Based on their experience and assessment of the Texas banking environment, our founders determined that middle market businesses and high net worth individuals were not being well served by the smaller community banks and out-of-state nationwide banks that emerged to dominate the Texas banking industry after the collapse of the large independent Texas banks. As a result, they agreed that these underserved markets provided an opportunity to re-establish a large independent bank focused on the needs of the Texas marketplace.

Our founders decided that the most efficient method of building an independent bank was to acquire an existing bank and substantially increase the equity capitalization of the bank through private equity financing. The acquisition of an existing bank was attractive because it would enable us to avoid the substantial delay involved in chartering a new national or state bank, an exhaustive process which can take over a year to complete. Our predecessor bank, Resource Bank, N.A., headquartered in Dallas, had completed the chartering process and commenced operations in October 1997. Because our founders determined that it would serve as an excellent foundation for the independent Texas bank they envisioned, we acquired Resource Bank in December 1998.

Our founders also concluded that substantial equity capital was needed to enable us to compete effectively with the subsidiary banks of nationwide banking conglomerates such as NationsBank (now known as Bank of America), Chase Manhattan (now JP Morgan Chase), Bank One and Wells Fargo that had aggressively entered the Texas market. Accordingly, in June 1998, we commenced a private offering of our common stock and were successful in raising approximately $80.0 million upon completion of the offering.

Growth History

We have grown substantially in both size and profitability since our formation. The table below sets forth data regarding the growth of key areas of our business from December 1998 through June 2003.

	At June 30,		At December 31,				
	2003	2002	2002	2001	2000	1999	1998
	(Unaudited)						
			(In thousands)				
Loans	$1,251,794	$ 944,731	$1,122,506	$ 903,979	$629,109	$227,600	$11,092
Assets	2,003,198	1,260,774	1,793,282	1,164,779	908,428	408,579	89,311
Deposits	1,340,322	980,297	1,196,535	886,077	794,857	287,068	16,018
Stockholders equity	132,168	118,043	124,976	106,359	86,197	72,912	73,186

The following table provides information about the growth of our loan portfolio by type of loan from December 1998 to June 2003.

	At June 30,		At December 31,				
	2003	2002	2002	2001	2000	1999	1998
	(Unaudited)						
			(In thousands)				
Commercial loans	$550,359	$452,133	$509,505	$402,302	$325,774	$152,749	$2,227
Total real estate loans	510,783	409,172	455,154	398,307	248,804	63,344	7,696
Construction loans	212,722	170,271	172,451	180,115	83,931	11,565	4,554
Permanent real estate loans	298,061	238,901	282,703	218,192	164,873	51,779	3,142
Equipment leases	13,912	24,164	17,546	34,552	17,093	642	

Consumer loans	19,564	21,436	24,195	25,054	36,092	10,865	1,169

Our Senior Management

Our senior management team has over 75 years of combined experience in the banking industry. The banking experience of each of our senior managers is set forth below:

Joseph M. Jody Grant is our Chairman and Chief Executive Officer. Mr. Grant has served in these positions since our formation in 1998. Mr. Grant has been involved in banking for most of his 40 year business career. Mr. Grant began his banking career with Citibank in New York City in 1961. After receiving a Ph.D. degree in 1970 in finance and economics from The University of Texas at Austin, Mr. Grant joined Texas Commerce Bank, Houston as Senior Vice President and Economist. At Texas Commerce Bank, Mr. Grant led the effort that formed Texas Commerce Bancshares. He was the architect of the expansion strategy of the company and a key member of the team that was responsible for the company s first 35 acquisitions (Texas Commerce Bancshares was subsequently acquired by Chemical Bank, New York, and is now known as Chase Bank, Texas, a subsidiary of JP Morgan Chase). In 1975, Mr. Grant joined Texas American Bancshares, Inc. as President of its lead bank, Texas American Bank/ Fort Worth. In 1982, he was named Chairman and Chief Executive Officer of Texas American Bank/ Fort Worth and in 1986 he was named Chairman and Chief Executive Officer of Texas American Bancshares, Inc., then the sixth largest bank holding company in Texas. During his tenure at Texas American Bancshares, Mr. Grant was involved in all aspects of the company s operations and served on its board of directors until leaving the company in 1990. He served as Electronic Data Systems Executive Vice President and Chief Financial Officer, and as a member of its board of directors, from November 1990 until March 1998, when he founded our company. Mr. Grant is the author of two books: The Development of State Chartered Banking in Texas (Bureau of Business Research, The University of Texas at Austin, 1978) and The Great Texas Banking Crash: An Insider s Account (University of Texas Press, 1996). Mr. Grant received the 2001 Community Banker of the Year award from the American Banker, the daily newspaper of the financial services industry. In addition, in 2002, Mr. Grant was awarded the Ernst & Young regional Entrepreneur of the Year award for the Northern Texas/ Arkansas/ Oklahoma region in the financial services category.

George F. Jones, Jr. is the President and Chief Executive Officer of our bank. Mr. Jones has served as President and Chief Executive Officer of our bank since its inception in December 1998. Mr. Jones has been a banker for virtually all of his 35 year business career. In 1967, he began his banking career at Mercantile National Bank in Dallas, where he became Vice President and Manager of Financial Institutions. Mr. Jones joined Texas American Bank/ Dallas in 1980, and served as President and Chief Executive Officer from 1982 to 1986. In 1986, Mr. Jones joined NorthPark National Bank in Dallas as President and Chief Executive Officer, and served as President of NorthPark National Corporation, the parent company of NorthPark National Bank. In 1993, NorthPark National Bank, one of the largest independent banks in Texas at that time, sold its business operations to Comerica Bank Texas, a subsidiary company of Comerica, Inc., a $30 billion bank holding company headquartered in Detroit, Michigan. Mr. Jones joined Comerica as Executive Vice President and Manager of Corporate Banking where he supervised a commercial loan portfolio of nearly $1 billion. In 1995, he left Comerica Bank Texas to devote his full time to the acquisition of a commercial finance division of a Fortune 500 company. In March 1995, Mr. Jones co-founded Mack Financial Group, Inc., a financial investment company, and served as its Vice President, until 1997, when Mr. Jones became an organizer, stockholder, and Chairman of the Board of Directors of Resource Bank, our predecessor bank.

C. Keith Cargill is our bank s Chief Lending Officer. Mr. Cargill has served as an Executive Vice President and the Chief Lending Officer of our bank since its inception in December 1998. Mr. Cargill has more than 20 years of banking experience. He began his banking career at Texas American Bank in 1977, where he was the manager of the national corporate lending division of the flagship bank in Fort Worth. In 1985, Mr. Cargill became President and Chief Executive Officer of Texas American Bank/ Riverside, Ft. Worth. In 1989, Mr. Cargill joined NorthPark National Bank as an Executive Vice President and Chief Lending Officer. When NorthPark sold its business operations to Comerica Bank in 1993, Mr. Cargill joined Comerica as Senior Vice President and middle market banking manager. In March 1995, Mr. Cargill co-founded Mack Financial Group, Inc., a financial investment company, and served as its Executive

Operating Officer. Since 1995, he has served as President of Cargill Lakes, Inc., a privately owned venture capital investment company.

Chief Financial Officer

In July 2003, Peter B. Bartholow agreed to become our Executive Vice President and Chief Financial Officer. We expect that he will begin serving in that capacity on October 6, 2003. Before agreeing to join us, Mr. Bartholow had served as a Managing Director with Hat Creek Partners, a Dallas, Texas venture capital firm, since January 1999. Before his service with Hat Creek Partners, he was engaged as a consultant by Electronic Data Systems, Inc. from September 1998 to December 1999. From September 1995 to August 1998, Mr. Bartholow served as Vice President, Corporate Finance of Electronic Data Systems. Prior to joining Electronic Data Systems, he served as Executive Vice President and Chief Financial Officer of First USA Bank. In 1972, Mr. Bartholow received a Master of Business Administration degree from the University of Texas.

The Texas Market

Prior to the late 1980s, the Texas marketplace had historically been served by independent Texas banks. In 1986, all ten of the largest banks with operations in Texas were headquartered in Texas. Bankers often spent their entire careers working in Texas-based banks in a single community. As a result, their knowledge of the community was based on years of experience providing banking services to businesses and prominent individuals. The business and personal relationships of these bankers within the community often spanned many years. The banking crisis of the late 1980s changed the Texas banking industry dramatically. The collapse of the Texas energy industry spurred by the precipitous decline in the price of oil beginning in 1986, combined with the collapse of the Texas real estate market, caused virtually every bank and thrift in Texas to experience severe financial difficulty as the value of the collateral for their real estate and energy loans plummeted.

By 1993, nine of the ten largest commercial banks in Texas had been closed by federal regulators or sold to out-of-state bank conglomerates, due in significant part to these difficulties. A number of large independent Texas banks became branches of out-of-state nationwide banks. It is our perception that these nationwide banks focused their Texas operations more on retail consumer banking clients and large commercial clients with revenues over $250 million and reduced their emphasis on the established banking relationships with middle market businesses and high net worth individuals that had been built over years of experience by the bankers of the independent Texas banks. Many of these experienced bankers with established relationships in their communities left the banking industry, joined smaller community banks and thrifts or the nationwide, out-of state banks that had entered the Texas market following the economic crisis of the 1980s. Today, Texas five largest banking organizations by deposits are headquartered outside of Texas and approximately 55% of total deposits in the state are controlled by out-of-state organizations. We believe that many middle market companies and high net worth individuals are interested in banking with a company headquartered in, and with decision-making authority based in, Texas and with established Texas bankers who have the expertise to act as trusted advisors to the customer with regard to its banking needs. Our banking centers, which are serviced by experienced bankers with lending expertise in the specific industries found in their market areas and established community ties, can offer these customers responsive, personalized service. We believe that, if we service these customers properly, we will be able to establish long-term relationships and provide multiple products to our customers, thereby enhancing our profitability.

We believe that the Texas economy presents an attractive opportunity to build an independent bank managed by Texans and oriented to the needs of the Texas economic marketplace. The population of Texas in 2002 was estimated at 21.6 million, making it the second most populous state in the country. From 1990 to 2002, the population of Texas grew by approximately 4.6 million, representing a 27.2% increase. Approximately 85.2% of the residents of Texas live in metropolitan areas and population growth in metropolitan areas accounted for approximately 91% of the increase in population from 1990 to 2000. In terms of population, Texas is expected to be among the ten fastest growing states in the U.S. over the period from 2002 to 2007, and the third fastest growing state of the ten most populous states over that period. In addition, average 2002 per capita income of $27,069 in our target markets (the five largest metropolitan markets in the state of Texas) was above the U.S. average and is expected to grow faster than any of the ten largest metropolitan statistical areas in the U.S. excluding Dallas and Houston, (which are two of our target markets and are among the ten largest metropolitan statistical areas in the U.S.) for the period 2002 to 2007. The Texas banking markets have grown over the past five years, with statewide deposits increasing from $194.3 billion in 1997 to $256.6 billion in 2002. The Texas economy has diversified substantially from its energy-driven economy of the 1970s and 1980s to include a greater diversification among industries such as services, technology and manufacturing. Accordingly, we expect that the local Texas markets will grow faster than most in the U.S. with less volatility than experienced in the past, providing opportunities for above-average growth and potential profitability for us. Although current estimates of future economic and demographic data may indicate a favorable trend, there is no assurance that the actual results will follow those trends, especially as the Texas market may be subject to unexpected economic downturns.

Business Strategy

Utilizing the strong business and community ties of our management and their extensive banking experience, our strategy is to build an independent bank that focuses primarily on middle market business customers and high net worth individual customers in each of the major metropolitan markets of Texas. To achieve this, we seek to implement the following strategies:

- Target the attractive middle market business and high net worth individual market segments;
- Focus our business development efforts on the key major metropolitan markets in Texas;
- Grow our loan and deposit base in our existing markets by hiring additional experienced Texas bankers and opening select, strategically-located banking centers;
- Improve our financial performance through the efficient management of our infrastructure and capital base, which includes:
  - leveraging our existing infrastructure to support a larger volume of business;
  - tight internal approval processes for capital and operating expenses; and
  - extensive use of outsourcing to provide cost-effective operational support with service levels consistent with large-bank operations;
- Continue to use BankDirect as a way to diversify our funding sources by attracting retail deposits on a nationwide basis; and
- Expand our geographic reach and business mix by hiring qualified local bankers, establishing select banking locations and completing selective acquisitions in new markets.

We aim to achieve a return on equity of 14-16%, a ratio of net charge-offs to total loans of less than 0.30%, and an efficiency ratio of 50-55%. Our goal is to increase loans by approximately 15-25% per year and deposits by approximately 15-30% per year, over the next two to three years. However, we have not achieved these benchmarks and we cannot assure you that we will be successful in meeting our goals.

Target the attractive middle market business and high net worth individual market segments.

Our business strategy concentrates on business customers with annual revenues between $5 million and $250 million, commonly referred to as middle market businesses, and high net worth individual customers, which we generally define as individuals with net worth in excess of $1 million. We believe these core customers are currently underserved in Texas. It is our perception that the Texas operations of the large nationwide banks generally do not emphasize middle market businesses or high net worth individuals, preferring instead to focus on retail consumer banking clients and large commercial clients with revenues over $250 million. Smaller community banks, savings and loans, and credit unions tend to focus on residential mortgage loans, consumer loans and retail deposit accounts. Virtually all of the large independent Texas banks that historically served middle market businesses and high net worth individuals failed or were purchased by large nationwide banks during the Texas banking crisis of the late 1980s. As a result of these market developments, we believe we can operate successfully by focusing on middle market businesses and high net worth individuals. These customers generally have the size and sophistication to demand customized products and services, which we believe our bankers are well-equipped to understand and respond to due to their experience and personal relationships with their clients. We believe that a significant amount of the growth we have experienced has been due to our concentration on this underserved segment of the marketplace. By continuing our focus on these customers, we expect to continue to grow in our current market areas and to compete successfully as we enter new metropolitan market areas.

Focus our business development efforts on the key metropolitan markets in Texas.

The established relationships of our bankers tend to be centered on the large metropolitan areas that were the core business markets of the large independent Texas banks before the collapse of the Texas banking industry. In addition, these metropolitan areas offer high concentrations of our core middle market business and high net worth individual customers. We also believe the diverse nature of the middle market business communities in large Texas metropolitan markets provides us with a broad, diverse customer base that will allow us to spread our lending risks throughout a number of different borrowers and industries. As a result, we intend to focus our development efforts on these market areas. We believe that, as a result of our focus on middle market businesses and high net worth individuals and the existing relationships of our bankers with these core customers, we have a competitive advantage in the major metropolitan market areas that will enable us to compete successfully in these markets.

Grow our loan and deposit base in our existing markets by hiring additional experienced bankers and opening select strategically located banking centers.

We believe that the experience and personal relationships of our bankers provide a competitive advantage and are a critical factor in our ability to grow our business. The personal relationships of our bankers increase our opportunities to market our products and services to existing customers and obtain new customers, particularly among our core middle market business and high net worth individual customers in our markets. We believe that the experience of our bankers allows them to better appreciate and anticipate the needs and demands of our customers. We provide our bankers with substantial latitude regarding their customers and, as much as possible, we attempt to allow local bankers to resolve issues that arise. This reinforces the relationship between our banker and the customers and enables us to better benefit from our bankers knowledge of the customers, their industry and their community. We intend to continue to hire bankers with extensive banking, community and personal relationships, particularly in market areas where we do not have an established presence. We also intend to use the knowledge and experience of our bankers in our market areas to identify potential new lending relationships. By leveraging the experience and relationships of our bankers, we believe we will be able to broaden our relationships with our existing customers, establish new customer relationships and establish a banking presence in new market areas and industries.

Improve our financial performance through the efficient management of our infrastructure and capital base, which includes:

leveraging our existing infrastructure to support a larger volume of business

We have made significant investments in our infrastructure in order to centralize many of our critical operations, such as credit policy, finance, data processing and loan application processing. We believe that our existing infrastructure can accommodate substantial additional growth without substantial additional capital expenditures. We also believe that the centralization of our administrative operations enables us to maximize efficiency through economies of scale without jeopardizing the personal relationships of our bankers with their customers.

tight internal approval processes for capital and operating expenses

We maintain stringent cost control practices and policies to increase the efficiency of our operations. A significant part of the annual bonuses we pay our managers is based on the extent to which they are successful in containing expenses and increasing efficiency. In addition, all salary increases and capital expenditures in excess of $25,000 are reviewed by a committee comprised of our senior management. Capital expenditures in excess of $10,000 must be approved by our chief financial officer.

extensive use of outsourcing to provide cost-effective operational support with service levels consistent with large-bank operations

We use outside service providers where they can increase the efficiency of our operations. Currently, our loan documentation, data processing and bank operations, and almost all our internal, regulatory and audit examinations, are provided by outside service providers. We intend to continue to review our operations to determine where we can contain costs by using third party service providers.

Continue to use BankDirect as a way to diversify our funding sources by attracting deposits on a nationwide basis.

We currently use BankDirect as a source of retail deposits to fund our lending activities. We believe our repositioning of BankDirect in February 2001 resulted in our depositors holding substantially higher balances in their accounts. We intend to continue to use BankDirect to attract attractive depositors that retain higher balances in their accounts.

Expand our geographic reach and business mix by hiring qualified bankers, establishing select banking locations and completing selective acquisitions.

We intend to expand our business by hiring experienced bankers in our current market areas and in new market areas. We believe that hiring bankers in our current market areas will augment our business by providing us with access to established relationships with potential new customers and industries in our current market areas. In addition, hiring experienced bankers in other markets can enable us to enter new market areas with an established presence and existing relationships in that market area. Selective acquisitions of other banks or the addition of select banking locations can also allow us to expand and grow our business. Acquisitions of banks that have lower ratios of loans to deposits than us can also allow us to significantly increase our net deposits, increasing our ability to make loans to our core customers. Expanding our banking network into an underserved area may also allow us to increase our deposits and fund our lending activities. Although we do not have any current commitments with respect to acquisitions or additional banking locations other than the anticipated opening of our banking center in Houston in September 2003, we believe that acquisitions and the establishment of select banking locations are potentially available in our existing market areas and in new market areas and we intend to pursue such opportunities in the future.

Expansion in Houston Market

As part of the continuing development of our business strategy, we expect to open a new banking center in Houston in September 2003. We believe this new banking center will allow us to significantly expand our current operations in the Houston metropolitan area. Houston is the largest metropolitan area in Texas and the seventh largest metropolitan statistical area in the U.S. To assist our expansion in Houston, we have also hired four senior, experienced bankers who we believe will significantly expand our relationships in the energy and real estate sectors of the Houston marketplace. In addition, we intend to hire sufficient support personnel to offer a complete range of banking services. As of June 30, 2003, we have originated approximately $20.7 million in loans and $1.0 million in deposits in the Houston metropolitan area.

Acquisition of Bluebonnet Savings Deposits

In July 2003, we agreed to acquire the outstanding deposit accounts of Bluebonnet Savings Bank FSB, a federal savings bank located in Dallas, Texas. As consideration for accepting these accounts, we will be paid $275,000 by Bluebonnet Savings. Pursuant to the deposit acquisition, we will acquire an aggregate balance of approximately $100 million comprised of certificates of deposit and money market deposit accounts. These accounts are currently held by approximately 2,500 customers. In connection with the acquisition, we also hired three senior Bluebonnet Savings bankers to provide continuity of customer service and relationship management with respect to these accounts. We anticipate that the acquisition of these accounts will close in August 2003.

Products and Services

We offer a variety of loan, deposit account and other financial products and services to our customers. At June 30, 2003, we maintained approximately 16,100 deposit accounts and 2,900 loan accounts. At June 30, 2003, approximately $1.0 billion of our outstanding loans, representing approximately 81% of our funded loans, were made to business customers.

Business Customers. We offer a full range of products and services oriented to the needs of our business customers, including:

- commercial loans for working capital and to finance internal growth, acquisitions and leveraged buyouts;
- permanent real estate and construction loans;
- equipment leasing;
- cash management services;
- trust and escrow services;
- letters of credit; and
- business insurance products.

Individual Customers. We also provide complete banking services for our individual customers, including:

- personal trust and wealth management services;
- certificates of deposit;
- interest-bearing and non-interest bearing checking accounts with optional features such as Visa® debit/ ATM cards and overdraft protection;
- traditional savings accounts;
- consumer loans, both secured and unsecured;
- mortgages and home equity loans;
- branded Visa® credit card accounts, including gold-status accounts; and
- personal insurance products.

Lending Activities

We target our lending to middle market businesses and high net worth individuals that meet our credit standards. The credit standards are set by our standing Credit Policy Committee with the assistance of our Chief Credit Officer, who is charged with ensuring that credit standards are met by loans in our portfolio. Our Credit Policy Committee is comprised of senior bank officers including the President of our bank, our Chief Lending Officer and our Chief Credit Officer. Our credit standards for commercial borrowers reference numerous criteria with respect to the borrower, including historical and projected financial information, strength of management, acceptable collateral and associated advance rates, and market conditions and trends in the borrower s industry. In addition, prospective loans are also analyzed based on current industry concentrations in our loan portfolio to prevent an unacceptable concentration of loans in any particular industry. We believe our credit standards are similar to the standards generally employed by large nationwide banks in the markets we serve. We believe that we differentiate our bank from its competitors by focusing on

and aggressively marketing to our core customers and accommodating, to the extent permitted by our credit standards, their individual needs.

We generally extend variable rate loans in which the interest rate fluctuates with a predetermined indicator such as the U.S. prime rate or the London Inter-Bank Offered Rate. Our use of variable rate loans is designed to reduce our exposure to risks associated with interest rate fluctuations since the rates of interest earned will automatically reflect such fluctuations. As of June 30, 2003, approximately 92% of the loans by outstanding principal balance in our portfolio were variable rate loans.

Commercial Loans. Our commercial loan portfolio is comprised of lines of credit for working capital and term loans to finance equipment and other business assets. Our lines of credit for working capital generally are renewed on an annual basis and our term loans generally have terms of two to five years. Our lines of credit and term loans typically have floating interest rates. Commercial loans can contain risk factors unique to the business of each customer. In order to mitigate these risks and better serve our customers, we seek to gain an understanding of the business of each customer and the reliability of their cash flow, so that we can place appropriate value on collateral taken and structure the loan to maintain collateral values at appropriate levels. In analyzing credit risk, we generally focus on the business experience of our borrowers management. We prefer to lend to borrowers with an established track record of loan repayment and predictable growth and cash flow. Our energy production loans are usually collateralized with proven reserves and have amortization schedules that extend for one-half of the projected life plus one year of the proven reserves. We also rely on the experience of our bankers and their relationships with our customers to aid our understanding of the customer and its business. Our lines of credit typically are limited to a percentage of the value of the assets securing the line. Lines of credit typically are reviewed annually and are supported by accounts receivable, inventory and equipment. Depending on the risk profile of the borrower, we may require periodic aging of receivables, as well as borrowing base certificates representing current levels of inventory, equipment, and accounts receivables. Our term loans are typically also secured by the assets of our clients businesses. Commercial borrowers are required to provide updated personal and corporate financial statements at least annually. At June 30, 2003, funded commercial loans totaled approximately $550.4 million, approximately 44.0% of our total funded loans.

Permanent Real Estate Loans. Approximately one-half of our permanent real estate loan portfolio is comprised of loans secured by commercial properties occupied by the borrower. We also provide temporary financing for commercial and residential property. Our permanent real estate loans generally have terms of five to seven years. We generally avoid long-term loans for commercial real estate held for investment. Our permanent real estate loans have both floating and fixed rates. Depending on the financial situation of the borrower, we may require periodic appraisals of the property to verify the ongoing quality of our collateral. At June 30, 2003, funded permanent real estate loans totaled approximately $298.1 million, approximately 23.8% of our total funded loans.

Construction Loans. Our construction loan portfolio consists primarily of single-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. We closely monitor the status of each construction loan and the underlying project throughout its term. These loans typically have floating rates and commitment fees. Typically, we require full investment of the borrower s equity in construction projects prior to releasing our funds. Generally, we do not allow our borrowers to recoup their equity from the sale proceeds of finished units until we have recovered our funds on the overall project. We use a title company to disburse periodic draws from the construction loan to attempt to avoid title problems at the end of the project. At June 30, 2003, funded construction real estate loans totaled approximately $212.7 million, approximately 17.0% of our total funded loans.

Equipment Leases. We provide equipment financing in the form of capital and operating leases. Our lease financings generally have terms of three to five years. The leases are secured by the equipment purchased with the lease financing. Interest rates are generally fixed and based on the actual depreciation of the collateral equipment. At June 30, 2003, funded equipment lease financings totaled approximately $13.9 million, approximately 1.1% of our total funded loans.

Letters of Credit. We issue standby or performance letters of credit, and can service the international needs of our clients through correspondent banks. At June 30, 2003, our commitments under letters of credit totaled approximately $20.1 million.

Consumer Loans. Our consumer loan portfolio consists of personal lines of credit and loans to acquire personal assets such as automobiles and boats. Our personal lines of credit generally have terms of one year and our term loans generally have terms of three to five years. Our lines of credit typically have floating interest rates. We generally require assets as collateral for consumer loans, but if the financial situation of the customer is sufficient, we will grant unsecured lines of credit. We also examine the personal liquidity of our individual borrowers, in some cases requiring agreements to maintain a minimum level of liquidity, to insure that the borrower has sufficient liquidity to repay the loan. Due to low levels of profitability, interest rate risks and collateral risks, we do not consider secured consumer loans, such as automobile loans, a core part of our business. Our rates are generally substantially higher than the rates offered by other providers of these loans. At June 30, 2003, funded consumer loans totaled approximately $19.6 million, approximately 1.6% of our total funded loans. Of these funded consumer loans, approximately $4.0 million are not secured by specific collateral or are unsecured, representing approximately 20.4% of our total funded consumer loans.

We infrequently make consumer residential real estate loans consisting primarily of first and second mortgage loans for residential properties. These loans are made to high net worth individuals as part of our private client services and will not be part of our mortgage origination services discussed below. We do not retain long-term, fixed rate residential real estate loans in our portfolio due to interest rate and collateral risks and low levels of profitability. We do not consider consumer residential real estate loans a core part of our business. Our rates are generally substantially higher than the rates offered by other providers of these loans.

We maintain a diversified loan portfolio and do not focus on any particular industry or group of related industries. Credit policies and underwriting guidelines are tailored to address the unique risks associated with each industry represented in the portfolio. The table below sets forth information regarding the distribution of our funded loans among various industries at June 30, 2003.

	Funded Loans	
	Amount	Percent of Total
	(Unaudited) (Dollars in thousands)	
Agriculture	$ 10,765	.9%
Contracting	134,145	10.7
Government	11,241	.9
Manufacturing	73,016	5.8
Personal/household	244,427	19.5
Petrochemical and mining	141,650	11.3
Retail	31,540	2.5
Services	445,247	35.6
Wholesale	77,269	6.2
Investors and investment management companies	82,494	6.6
Total	$ 1,251,794	100.0%

Loans extended to borrowers within the contracting industry are composed largely of loans to land subdividers and developers and to both heavy construction and general commercial contractors. Many of these loans are secured by real estate properties, the development of which is being funded by our bank s financing. Loans extended to borrowers within the petrochemical and mining industries are predominantly loans to finance the exploration and production of petroleum and natural gas. These loans are generally secured by proven petroleum and natural gas reserves. Personal/household loans include loans to certain high net worth individuals for commercial purposes and mortgage loans held for sale, in addition to consumer loans. Loans extended to borrowers within the services industries include loans to