TENNECO INC
Form 10-Q
November 06, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended September 30, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission file number 1-12387

TENNECO INC.

(Exact name of registrant as specified in its charter)

Delaware	**76-0515284**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
500 North Field Drive, Lake Forest, Illinois	**60045**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (847) 482-5000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date.

Common Stock, par value $0.01 per share: 60,220,472 shares outstanding as of October 31, 2012.

Table of Contents

TABLE OF CONTENTS

* No response to this item is included herein for the reason that it is inapplicable or the answer to such item is negative.

Table of Contents

CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Quarterly Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 concerning, among other things, our prospects and business strategies. These forward-looking statements are included in various sections of this report, including the section entitled Outlook appearing in Item 2 of this report. The words may, will, believe, should, could, plan, ex anticipate, estimate, and similar expressions (and variations thereof), identify these forward-looking statements. Although we believe that the expectations reflected in these forward-looking statements are based on reasonable assumptions, these expectations may not prove to be correct. Because these forward-looking statements are also subject to risks and uncertainties, actual results may differ materially from the expectations expressed in the forward-looking statements. Important factors that could cause actual results to differ materially from the expectations reflected in the forward-looking statements include:

- general economic, business and market conditions;
- our ability to source and procure needed materials, components and other products and services in accordance with customer demand and at competitive prices;
- changes in capital availability or costs, including increases in our cost of borrowing (i.e., interest rate increases), the amount of our debt, our ability to access capital markets at favorable rates, and the credit ratings of our debt;
- changes in consumer demand, prices and our ability to have our products included on top selling vehicles, including any shifts in consumer preferences away from light trucks, which tend to be higher margin products for our customers and us, to other lower margin vehicles, for which we may or may not have supply arrangements;
- changes in consumer demand for our automotive, commercial or aftermarket products, or changes in automotive and commercial vehicle manufacturers production rates and their actual and forecasted requirements for our products, due to difficult economic conditions, such as the significant production cuts by automotive manufacturers during 2008 and 2009, as well as any future reduction in demand for our products due to the sovereign debt crisis in Europe;
- the overall highly competitive nature of the automobile and commercial vehicle parts industries, and any resultant inability to realize the sales represented by our awarded book of business (which is based on anticipated pricing and volumes over the life of the applicable program);
- the loss of any of our large original equipment manufacturer (OEM) customers (on whom we depend for a substantial portion of our revenues), or the loss of market shares by these customers if we are unable to achieve increased sales to other OEMs or any change in customer demand due to delays in the adoption or enforcement of worldwide emissions regulations;
- industrywide strikes, labor disruptions at our facilities or any labor or other economic disruptions at any of our significant customers or suppliers or any of our customers other suppliers (such as the 2008 strike at American Axle, which disrupted our supply of products for significant General Motors (GM) platforms);
- increases in the costs of raw materials, including our ability to successfully reduce the impact of any such cost increases through materials substitutions, cost reduction initiatives, customer recovery and other methods;

the negative impact of higher fuel prices on transportation and logistics costs, raw material costs and discretionary purchases of vehicles or aftermarket products;

the cyclical nature of the global vehicle industry, including the performance of the global aftermarket sector and the impact of vehicle parts longer product lives;

our ability to successfully execute cash management, restructuring and other cost reduction plans and to realize anticipated benefits from these plans;

costs related to product warranties and other customer satisfaction actions;

the impact of consolidation among vehicle parts suppliers and customers on our ability to compete;

changes in distribution channels or competitive conditions in the markets and countries where we operate, including the impact of changes in distribution channels for aftermarket products on our ability to increase or maintain aftermarket sales;

the cost and outcome of existing and any future claims or legal proceedings, including, but not limited to, claims or proceedings against us or our customers relating to product performance, product safety or intellectual property rights;

economic, exchange rate and political conditions in the countries where we operate or sell our products;

customer acceptance of new products;

new technologies that reduce the demand for certain of our products or otherwise render them obsolete;

our ability to realize our business strategy of improving operating performance;

our ability to successfully integrate any acquisitions that we complete and effectively manage our joint ventures and other third-party relationships;

changes by the Financial Accounting Standards Board or the Securities and Exchange Commission of authoritative generally accepted accounting principles or policies;

changes in accounting estimates and assumptions, including changes based on additional information;

any changes by the International Organization for Standardization (ISO) or other such committees in their certification protocols for processes and products, which may have the effect of delaying or hindering our ability to bring new products to market;

the impact of changes in and compliance with laws and regulations, including: environmental laws and regulations, which may result in our incurrence of environmental liabilities in excess of the amount reserved; and any changes to the timing of the funding requirements for our pension and other postretirement benefit liabilities;

the potential impairment in the carrying value of our long-lived assets and goodwill or our deferred tax assets;

potential volatility in our effective tax rate;

natural disasters, such as the 2011 earthquake in Japan and flooding in Thailand, and any resultant disruptions in the supply or production of goods or services to us or by us or in demand by our customers;

acts of war and/or terrorism, as well as actions taken or to be taken by the United States and other governments as a result of further acts or threats of terrorism, and the impact of these acts on economic, financial and social conditions in the countries where we operate; and

the timing and occurrence (or non-occurrence) of other transactions, events and circumstances which may be beyond our control.

The risks included here are not exhaustive. Refer to Part I, Item 1A Risk Factors in our annual report on Form 10-K for the year ended December 31, 2011, for further discussion regarding our exposure to risks. Additionally, new risk factors emerge from time to time and it is not possible for us to predict all such risk factors, nor to assess the impact such risk factors might have on our business or the extent to which any factor or combination of factors may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

Table of Contents

PART I.

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Tenneco Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Tenneco Inc. and consolidated subsidiaries as of September 30, 2012, and the related condensed consolidated statements of income, comprehensive income, and cash flows for the three-month and nine-month periods ended September 30, 2012 and 2011, and changes in shareholders equity for the nine-month periods ended September 30, 2012 and 2011. These interim financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2011, and the related consolidated statements of income (loss), cash flows, changes in shareholders equity and comprehensive income for the year then ended (not presented herein), and in our report dated February 24, 2012, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2011, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP
Chicago, Illinois
November 6, 2012

The Report of Independent Registered Public Accounting Firm included above is not a report or part of a Registration Statement prepared or certified by an independent accountant within the meaning of Sections 7 and 11 of the Securities Act of 1933, and the accountants Section 11 liability does not extend to such report.

Table of Contents

TENNECO INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(Millions Except Share and Per Share Amounts)			
Revenues				
Net sales and operating revenues	$ 1,778	$ 1,773	$ 5,610	$ 5,421
Costs and expenses				
Cost of sales (exclusive of depreciation and amortization shown below)	1,494	1,492	4,696	4,523
Goodwill impairment charge		11		11
Engineering, research, and development	28	32	94	102
Selling, general, and administrative	94	101	321	328
Depreciation and amortization of other intangibles	49	51	148	156
	1,665	1,687	5,259	5,120
Other expense				
Loss on sale of receivables	(1)	(1)	(3)	(4)
Other	(1)	(1)	(4)	(6)
	(2)	(2)	(7)	(10)
Earnings before interest expense, income taxes, and noncontrolling interests	111	84	344	291
Interest expense (net of interest capitalized of $1 million for both three months ended September 30, 2012 and 2011, respectively, and $3 million for both nine months ended September 30, 2012 and 2011, respectively)	21	27	84	81
Earnings before income taxes and noncontrolling interests	90	57	260	210
Income tax (benefit) expense	(42)	21	(3)	65
Net income	132	36	263	145
Less: Net income attributable to noncontrolling interests	7	6	21	18
Net income attributable to Tenneco Inc.	$ 125	$ 30	$ 242	$ 127
Earnings per share				
Weighted average shares of common stock outstanding				
Basic	59,766,097	59,793,866	59,983,310	59,866,717

Diluted	60,949,632	61,541,476	61,266,124	61,802,403
Basic earnings per share of common stock	$ 2.09	$ 0.51	$ 4.04	$ 2.12
Diluted earnings per share of common stock	$ 2.05	$ 0.49	$ 3.95	$ 2.06

The accompanying notes to the condensed consolidated financial statements are an integral

part of these condensed consolidated statements of income.

Table of Contents

TENNECO INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

	Three Months Ended September 30, 2012					
	Tenneco Inc.		Noncontrolling Interests		Total	
	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)
	(Millions)					
Net Income		$ 125		$ 7		$ 132
Accumulated Other Comprehensive Income (Loss)						
Cumulative Translation Adjustment						
Balance July 1	$ (47)		$ 4		$ (43)	
Translation of foreign currency statements	14	14			14	14
Balance September 30	(33)		4		(29)	
Additional Liability for Pension and Postretirement Benefits						
Balance July 1	(344)				(344)	
Additional Liability for Pension and Postretirement Benefits, net of tax	3	3			3	3
Balance September 30	(341)				(341)	
Balance September 30	$ (374)		$ 4		$ (370)	
Other Comprehensive Income		17				17
Comprehensive Income		$ 142		$ 7		$ 149

The accompanying notes to the condensed consolidated financial statements are an integral

part of these condensed consolidated statements of comprehensive income.

Table of Contents

TENNECO INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

	Three Months Ended September 30, 2011					
	Tenneco Inc.		Noncontrolling Interests		Total	
	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)
	(Millions)					
Net Income		$ 30		$ 6		$ 36
Accumulated Other Comprehensive Income (Loss)						
Cumulative Translation Adjustment						
Balance July 1	$ 59		$ 5		$ 64	
Translation of foreign currency statements	(82)	(82)	(1)	(1)	(83)	(83)
Balance September 30	(23)		4		(19)	
Additional Liability for Pension and Postretirement Benefits						
Balance July 1	(246)				(246)	
Additional Liability for Pension and Postretirement Benefits, net of tax	4	4			4	4
Balance September 30	(242)				(242)	
Balance September 30	$ (265)		$ 4		$ (261)	
Other Comprehensive Loss		(78)		(1)		(79)
Comprehensive Income (Loss)		$ (48)		$ 5		$ (43)

The accompanying notes to the condensed consolidated financial statements are an integral

part of these condensed consolidated statements of comprehensive income.

Table of Contents

TENNECO INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Nine Months Ended September 30, 2012					
	Tenneco Inc.		Noncontrolling Interests		Total	
	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)
	(Millions)					
Net Income		$ 242		$ 21		$ 263
Accumulated Other Comprehensive Income (Loss)						
Cumulative Translation Adjustment						
Balance January 1	$ (30)		$ 4		$ (26)	
Translation of foreign currency statements	(3)	(3)			(3)	(3)
Balance September 30	(33)		4		(29)	
Additional Liability for Pension and Postretirement Benefits						
Balance January 1	(352)				(352)	
Additional Liability for Pension and Postretirement Benefits, net of tax	11	11			11	11
Balance September 30	(341)				(341)	
Balance September 30	$ (374)		$ 4		$ (370)	
Other Comprehensive Income		8				8
Comprehensive Income		$ 250		$ 21		$ 271

The accompanying notes to the condensed consolidated financial statements are an integral part of these condensed consolidated statements of comprehensive income.

Table of Contents

TENNECO INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Nine Months Ended September 30, 2011					
	Tenneco Inc.		Noncontrolling Interests		Total	
	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)
	(Millions)					
Net Income		$ 127		$ 18		$ 145
Accumulated Other Comprehensive Income						
Cumulative Translation Adjustment						
Balance January 1	$ 8		$ 5		$ 13	
Translation of foreign currency statements	(31)	(31)	(1)	(1)	(32)	(32)
Balance September 30	(23)		4		(19)	
Additional Liability for Pension and Postretirement Benefits						
Balance January 1	(250)				(250)	
Additional Liability for Pension and Postretirement Benefits, net of tax	8	8			8	8
Balance September 30	(242)				(242)	
Balance September 30	$ (265)		$ 4		$ (261)	
Other Comprehensive Loss		(23)		(1)		(24)
Comprehensive Income		$ 104		$ 17		$ 121

The accompanying notes to the condensed consolidated financial statements are an integral

part of these condensed consolidated statements of comprehensive income.

Table of Contents

TENNECO INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2012	December 31, 2011
	(Millions)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 207	$ 214
Receivables		
Customer notes and accounts, net	1,098	936
Other	33	44
Inventories		
Finished goods	256	244
Work in process	217	181
Raw materials	147	121
Materials and supplies	52	46
Deferred income taxes	70	40
Prepayments and other	193	153
Total current assets	2,273	1,979
Other assets:		
Long-term receivables, net	4	10
Goodwill	73	74
Intangibles, net	37	32
Deferred income taxes	122	92
Other	105	103
	341	311
Plant, property, and equipment, at cost	3,282	3,153
Less Accumulated depreciation and amortization	(2,194)	(2,106)
	1,088	1,047
Total Assets	$ 3,702	$ 3,337
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Short-term debt (including current maturities of long-term debt)	$ 134	$ 66
Trade payables	1,188	1,171
Accrued taxes	57	44
Accrued interest	14	13
Accrued liabilities	245	226
Other	43	50
Total current liabilities	1,681	1,570
Long-term debt	1,211	1,158
Deferred income taxes	41	51
Postretirement benefits	350	385
Deferred credits and other liabilities	122	118
Commitments and contingencies		

Total liabilities	3,405	3,282
Redeemable noncontrolling interests	13	12
Tenneco Inc. Shareholders equity:		
Common stock	1	1
Premium on common stock and other capital surplus	3,026	3,016
Accumulated other comprehensive loss	(374)	(382)
Retained earnings (accumulated deficit)	(2,137)	(2,379)
	516	256
Less Shares held as treasury stock, at cost	274	256
Total Tenneco Inc. shareholders equity	242	
Noncontrolling interests	42	43
Total equity	284	43
Total liabilities, redeemable noncontrolling interests and equity	$ 3,702	$ 3,337

The accompanying notes to the condensed consolidated financial statements are an integral

part of these condensed consolidated balance sheets.

Table of Contents

TENNECO INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
		(Millions)		
Operating Activities				
Net income	$ 132	$ 36	$ 263	$ 145
Adjustments to reconcile net income to cash provided by operating activities				
Goodwill impairment charge		11		11
Depreciation and amortization of other intangibles	49	51	148	156
Deferred income taxes	(87)	2	(94)	(3)
Stock-based compensation	2	2	9	6
Loss on sale of assets	1	2	3	3
Changes in components of working capital				
(Increase) decrease in receivables	55	(24)	(157)	(314)
(Increase) decrease in inventories	2	(25)	(81)	(85)
(Increase) decrease in prepayments and other current assets	(1)	6	(40)	(18)
Increase (decrease) in payables	(50)	25	36	159
Increase (decrease) in accrued taxes	19	(7)	37	(7)
Increase in accrued interest	5	9	1	9
Increase (decrease) in other current liabilities		(2)	15	15
Changes in long-term assets	7	1	16	(2)
Changes in long-term liabilities	(13)	(10)	(35)	(31)
Other	4	3	5	
Net cash provided by operating activities	125	80	126	44
Investing Activities				
Proceeds from the sale of assets	1		2	4
Cash payments for plant, property, and equipment	(70)	(50)	(195)	(145)
Cash payments for software related intangible assets	(3)	(4)	(10)	(10)
Cash payments for net assets purchased	(7)		(7)	
Net cash used by investing activities	(79)	(54)	(210)	(151)
Financing Activities				
Retirement of long-term debt	(3)		(406)	(23)
Issuance of long-term debt		1	250	5
Debt issuance cost of long-term debt			(13)	(1)
Purchase of common stock under the share repurchase program		(5)	(18)	(16)
Increase (decrease) in bank overdrafts	2	(5)	2	3
Net increase (decrease) in revolver borrowings and short-term debt excluding current maturities of long-term debt	(19)	20	217	108
Net increase (decrease) in short-term borrowings secured by accounts receivable			60	
Capital contribution from noncontrolling interest partner	4		5	1
Purchase of additional noncontrolling equity interest		(4)		(4)
Distributions to noncontrolling interest partners	(9)	(10)	(27)	(20)
Net cash provided (used) by financing activities	(25)	(3)	70	53

Effect of foreign exchange rate changes on cash and cash equivalents	5	(21)	7	(16)
Increase (decrease) in cash and cash equivalents	26	2	(7)	(70)
Cash and cash equivalents, July 1 and January 1, respectively	181	161	214	233
Cash and cash equivalents, September 30 (Note)	$ 207	$ 163	$ 207	$ 163
Supplemental Cash Flow Information				
Cash paid during the period for interest	$ 16	$ 18	$ 75	$ 71
Cash paid during the period for income taxes (net of refunds)	18	25	54	58
Non-cash Investing and Financing Activities				
Period end balance of trade payables for plant, property, and equipment	$ 25	$ 23	$ 25	$ 23

Note: Cash and cash equivalents include highly liquid investments with a maturity of three months or less at the date of purchase.

The accompanying notes to the condensed consolidated financial statements are an integral

part of these condensed consolidated statements of cash flows.

Table of Contents

TENNECO INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(Unaudited)

	Nine Months Ended September 30,			
	2012		2011	
	Shares	Amount	Shares	Amount
	(Millions Except Share Amounts)			
Inc. lders:				
n Stock				
January 1	62,101,335	$ 1	61,541,760	$ 1
rsuant to benefit	149,497		52,394	
tions exercised	232,258		323,039	
September 30	62,483,090	1	61,917,193	1
n on Common d Other Capital				
January 1		3,016		3,008
of additional olling equity				

ction deposits	$ 106,602	$ 1,182	1.11%	$ 108,459	$ 1,080	1.00%	$ 96,911	$ 652	.6
s deposits	755,817	32,218	4.26%	647,039	17,295	2.67%	558,479	7,690	1.3
eposits	640,369	30,175	4.71%	545,603	19,014	3.48%	512,852	13,375	2.6
ts in foreign es	707,423	35,925	5.08%	360,142	12,639	3.51%	85,133	1,520	1.7
nterest bearing s	2,210,211	99,500	4.50%	1,661,243	50,028	3.01%	1,253,375	23,237	1.8
orrowings	308,578	14,685	4.76%	447,623	13,443	3.00%	607,270	11,632	1.9
erm debt	74,526	5,439	7.30%	26,694	1,858	6.96%	20,620	1,096	5.3
nterest bearing es	2,593,315	119,624	4.61%	2,135,560	65,329	3.06%	1,881,265	35,965	1.9
d deposits	462,279			410,213			298,430		
abilities	20,536			13,178			10,052		
olders equity	229,715			204,537			182,182		
abilities and olders equity	$ 3,305,845			$ 2,763,488			$ 2,371,929		

erest income		$ 118,835		$ 95,067		$ 72,325	
erest margin			3.84%		3.66%		3.2
erest spread			3.10%		3.12%		2.9

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

able equivalent rates used where applicable.

nal information from discontinued operations:

ıeld for sale scontinued ons	$ 22,922			$ 29,557			$ 5,025		
ed funds	22,922			29,557			5,025		
erest income		$ 5,939			$ 7,441			$ 2,879	
erest margin dated			4.01%			3.91%			3.3

25

Table of Contents

Non-interest Income

(in thousands)	Year Ended December 31 2006	2005	2004
Service charges on deposit accounts	$ 3,306	$ 3,223	$ 3,370
Trust fee income	3,790	2,739	1,932
Cash processing fees			587
Bank Owned Life Insurance (BOLI) income	1,134	1,136	1,288
Brokered loan fees	2,029	1,759	996
Insurance commissions	4,158	1,047	444
Equipment rental income	3,908	236	86
Other(1)	2,517	2,415	1,494
Total non-interest income	$ 20,842	$ 12,555	$ 10,197

(1) Other income includes such items as letter of credit fees, rental income, investment in subsidiary income, and other general operating income, none of which account for 1% or more of total interest income and non-interest income.

Non-interest income increased by $8.2 million, or 65.1%, during the year ended December 31, 2006 to $20.8 million, compared to $12.6 million during the same period in 2005. The increase was primarily due to an increase in equipment rental income, which increased $3.7 million to $3.9 million for the year ended December 31, 2006, compared to $236,000 for the same period in 2005 related to expansion of our operating lease portfolio. Also, insurance commission income increased $3.2 million to $4.2 million for the year ended December 31, 2006, compared to $1.0 million for the same period in 2005 due to increased focus on the insurance business. Trust income increased by $1.1 million to $3.8 million during the year ended December 31, 2006 compared to $2.7 million for the same period in 2005 due to continued growth in trust assets. Brokered loan fees increased $270,000 to $2.0 million for the year ended December 31, 2006, compared to $1.8 million for the same period in 2005.

Non-interest income increased by $2.4 million, or 23.5%, during the year ended December 31, 2005 to $12.6 million, compared to $10.2 million during the same period in 2004. The increase was primarily due to an increase in trust income, which increased by $807,000 to $2.7 million during the year ended December 31, 2005, compared to $1.9 million for the same period in 2004 due to continued growth in trust assets. Brokered loan fees increased $763,000 to $1.8 million for the year ended December 31, 2005, compared to $996,000 for the same period in 2004. Insurance commission income increased $603,000 to $1.0 million for the year ended December 2005, compared to $444,000 for the same period in 2004 due to increased focus on the insurance business. Offsetting these increases was a decrease in cash processing fees. Cash processing fees were $587,000 lower in 2005 compared to 2004. These fees were related to a special project that occurred in the first quarter of 2003 and 2004. Also, there was a decrease in BOLI income related to an annual adjustment in earning rates.

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

Table of Contents

Non-interest Expense

(in thousands)	Year Ended December 31 2006	2005	2004
Salaries and employee benefits	$ 53,130	$ 38,896	$ 29,270
Net occupancy expense	8,184	6,056	5,062
Leased equipment depreciation	3,097	194	39
Marketing	3,161	2,974	2,491
Legal and professional	6,576	5,166	3,141
Communications and data processing	3,192	2,900	3,158
Franchise taxes	281	273	246
Other(1)	12,873	9,667	6,974
Total non-interest expense	$ 90,494	$ 66,126	$ 50,381

(1) Other expense includes such items as courier expenses, regulatory assessments, 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 year ended December 31, 2006 increased $24.4 million compared to the same period of 2005. This increase is due primarily to a $14.2 million increase in salaries and employee benefits, of which $2.8 million relates to FAS 123R. The remaining increase in salaries and employee benefits resulted from an increase in commissions and incentives for insurance lines of business, the total number of employees related to the addition of the premium finance business and general business growth.

Occupancy expense increased by $2.1 million to $8.2 million during the year ended December 31, 2006 compared to the same period in 2005 and is related to our general business growth. Leased equipment depreciation increased $2.9 million to $3.1 million during the year ended December 31, 2006, from $194,000 in 2005 related to expansion of our operating lease portfolio.

Marketing expense for the year ended December 31, 2006, increased $187,000, or 6.3%, compared to 2005. Marketing expense for the year ended December 31, 2006 included $216,000 of direct marketing and promotions and $1.9 million in business development compared to direct marketing and promotions of $195,000 and business development of $1.5 million during 2005. Marketing expense for the year ended December 31, 2006 also included $1.1 million for the purchase of miles related to the American Airlines AAdvantage®program compared to $1.3 million during 2005. 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 $1.4 million, or 26.9%, mainly related to growth and increased cost of compliance with laws and regulations. Communications and data processing expense for the year ended December 31, 2006 increased $292,000, or 10.1% as a result of growth and some improvements in technology.

Non-interest expense for the year ended December 31, 2005 increased $15.7 million, or 31.2%, compared to the same period of 2004. This increase is due primarily to a $9.6 million increase in salaries and employee benefits. The increase in salaries and employee benefits resulted from an increase in the total number of employees related to general business growth, additional staffing for the Houston office, addition of the premium finance business, increased focus on the insurance business and increased incentive compensation reflective of our performance.

Occupancy expense increased by $994,000 to $6.1 million during the year ended December 31, 2005 compared to the same period in 2004 and is related to our continued growth in our Houston office and the premium finance business.

Marketing expense for the year ended December 31, 2005 increased $483,000, or 19.4%, compared to 2004. Marketing expense for the year ended December 31, 2005 included $195,000 of direct marketing and promotions and $1.5 million in business development compared to direct marketing and promotions of

Table of Contents

$117,000 and business development of $1.2 million during 2004. Marketing expense for the year ended December 31, 2005 also included $1.3 million for the purchase of miles related to the American Airlines Aadvantage® program compared to $1.2 million during 2004.

Legal and professional expenses increased $2.0 million, or 64.5%, mainly related to growth, creation of BankDirect Capital Finance (BDCF) and increased cost of compliance with laws and regulations. Communications and data processing expense for the year ended December 31, 2005 decreased $258,000, or 8.2%.

Consolidated Interim Financial Information (Unaudited)

	2006 Selected Quarterly Financial Data			
(in thousands except per share data)	**Fourth**	**Third**	**Second**	**First**
Interest income	$ 66,576	$ 62,848	$ 57,434	$ 50,666
Interest expense	34,657	32,747	28,421	23,799
Net interest income	31,919	30,101	29,013	26,867
Provision for loan losses	1,000	750	2,250	
Net interest income after provision for loan losses	30,919	29,351	26,763	26,867
Non-interest income	6,343	5,406	4,675	4,418
Non-interest expense	25,070	22,563	21,968	20,893
Income from continuing operations before income taxes	12,192	12,194	9,470	10,392
Income tax expense	4,134	4,157	3,230	3,543
Income from continuing operations	8,058	8,037	6,240	6,849
Income (loss) from discontinued operations (after-tax)	12	(167)	101	(206)
Net income	$ 8,070	$ 7,870	$ 6,341	$ 6,643
Basic earnings per share:				
Income from continuing operations	$ .31	$ .31	$ .24	$ .27
Net income	$ .31	$ .30	$ .24	$ .26
Diluted earnings per share:				
Income from continuing operations	$ .31	$ .30	$ .24	$ .26
Net income	$ .31	$ .30	$ .24	$ .25
Average shares:				
Basic	26,047,000	25,998,000	25,907,000	25,825,000
Diluted	26,374,000	26,412,000	26,525,000	26,568,000

Table of Contents

(in thousands except per share data)	2005 Selected Quarterly Financial Data Fourth	Third	Second	First
Interest income	$ 46,815	$ 42,806	$ 37,173	$ 32,665
Interest expense	20,494	17,933	14,517	12,385
Net interest income	26,321	24,873	22,656	20,280
Provision for loan losses				
Net interest income after provision for loan losses	26,321	24,873	22,656	20,280
Non-interest income	3,845	3,559	2,751	2,400
Non-interest expense	18,844	17,144	15,381	14,757
Income from continuing operations before income taxes	11,322	11,288	10,026	7,923
Income tax expense	3,833	3,843	3,414	2,693
Income from continuing operations	7,489	7,445	6,612	5,230
Income (loss) from discontinued operations (after-tax)	256	139	(25)	46
Net income	$ 7,745	$ 7,584	$ 6,587	$ 5,276
Basic earnings per share:				
Income from continuing operations	$ .29	$ .29	$ .26	$ .20
Net income	$ .30	$ .30	$ .26	$ .21
Diluted earnings per share:				
Income from continuing operations	$ .28	$ .28	$ .25	$ .20
Net income	$ .29	$ .28	$ .25	$ .20
Average shares:				
Basic	25,726,000	25,650,000	25,578,000	25,522,000
Diluted	26,737,000	26,676,000	26,543,000	26,623,000

Analysis of Financial Condition

Loan Portfolio

Our loan portfolio has grown at an annual rate of 27%, 30% and 37% in 2004, 2005 and 2006, 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, comprising 72% of total loans at December 31, 2006. Construction loans have increased from 15% of the portfolio at December 31, 2002 to 18% of the portfolio at December 31, 2006. Consumer loans have decreased from 2% of the portfolio at December 31, 2002 to 1% of the portfolio at December 31, 2006. Loans held for sale, which relates to our mortgage warehouse operations and are principally 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 select loan participations and syndications, which are underwritten independently by us prior to purchase, and certain and USDA and SBA government guaranteed loans that we purchase on the secondary market.

Table of Contents

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

	December 31				
(in thousands)	**2006**	**2005**	**2004**	**2003**	**2002**
Commercial	$ 1,602,577	$ 1,182,734	$ 818,156	$ 608,542	$ 509,505
Construction	538,586	387,163	328,074	256,134	172,451
Real estate	530,377	478,634	397,029	339,069	282,703
Consumer	21,113	19,962	15,562	16,564	24,195
Equipment leases	45,280	16,337	9,556	13,152	17,546
Loans held for sale	215,858	72,383	91,585	77,978	116,106
Total	$ 2,953,791	$ 2,157,213	$ 1,659,962	$ 1,311,439	$ 1,122,506

We continue to lend primarily in Texas. As of December 31, 2006, a substantial majority of the principal amount of the loans in our portfolio was to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions in Texas. Within the loan portfolio, loans to the services industry were $1.1 billion, or 36%, of total loans at December 31, 2006. Other notable concentrations include $370.8 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), $456.3 million to the contracting construction and real estate development industry, $274.2 million in petrochemical and mining loans and $340.4 million in investors and investment management company loans. 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 December 31, 2006

		Remaining Maturities of Selected Loans		
(in thousands)	**Total**	**Within 1 Year**	**1-5 Years**	**After 5 Years**
Loan maturity:				
Commercial	$ 1,602,577	$ 841,469	$ 688,650	$ 72,458
Construction	538,586	236,050	282,982	19,554
Total	$ 2,141,163	$ 1,077,519	$ 971,632	$ 92,012
Interest rate sensitivity for selected loans with:				
Predetermined interest rates	$ 312,511	$ 191,327	$ 99,910	$ 21,274
Floating or adjustable interest rates	1,828,652	886,192	871,722	70,738
Total	$ 2,141,163	$ 1,077,519	$ 971,632	$ 92,012

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 $4.0 million for the year ended December 31, 2006, no provision for 2005, and $1.7 million for 2004.

The reserve for loan losses is comprised of specific reserves for impaired loans and an estimate of losses inherent in the portfolio at the balance sheet date, but not yet identified with specified loans. We regularly evaluate our reserve for loan losses to maintain an adequate level to absorb estimated loan losses inherent in the loan portfolio. Factors contributing to the determination of specific reserves include the credit worthiness of the borrower, changes in the value of pledged collateral, and general economic conditions. All loan commitments rated substandard or worse and greater than $1,000,000 are specifically reviewed for impairment. For loans deemed to be impaired, a specific allocation is assigned based on the losses expected to be realized from those loans. For purposes of determining the general reserve, the portfolio is segregated by product types to recognize differing risk profiles among categories, and then further segregated by credit grades. Credit grades are assigned to all loans 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. Even though portions of the allowance may be allocated to specific loans, the entire allowance is available for any credit that, in management s judgment, should be charged off.

The reserve allocation percentages assigned to each credit grade have been developed based on an analysis that focuses primarily on our historical loss rates, but does include some review of historical loss rates at selected peer banks, adjusted for certain qualitative factors. Qualitative adjustments for such things as general economic conditions, changes in credit policies and lending standards, and changes in the trend and severity of problem loans, can cause the estimation of future losses to differ from past experience. In addition, the reserve considers the results of reviews performed by independent third party reviewers as reflected in their confirmations of assigned credit grades within the portfolio. The portion of the allowance that is not derived by the allowance allocation percentages compensates for the uncertainty and complexity in estimating loan and lease losses including factors and conditions that may not be fully reflected in the determination and application of the allowance allocation percentages. We evaluate many factors and conditions in determining the unallocated portion of the allowance, including the economic and business conditions affecting key lending areas, credit quality trends and general growth in the portfolio. The Company s allowance for loan and lease losses exceeds its cumulative historical net charge-off experience for the last five years. The allowance, which has declined as a percent of total loans, is considered adequate and appropriate, given management s assessment of potential losses within the portfolio as of the evaluation date, the significant growth in the loan and lease portfolio, current economic conditions in the Company s market areas and other factors.

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

The reserve for loan losses, which is available to absorb losses inherent in the loan portfolio, totaled $21.0 million at December 31, 2006, $18.9 million at December 31, 2005 and $18.7 million at December 31, 2004. The reserve percentage decreased to 0.77% at year-end 2006 from 0.91% and 1.20% of loans held for investment at December 31, 2005 and 2004, respectively, despite an overall increase in the total reserve. At December 31, 2006, we believe the reserve is sufficient to cover all reasonably expected losses in the portfolio and has been derived from consistent application of the methodology described above.

Table of Contents

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

Summary of Loan Loss Experience

	Year ended December 31				
(in thousands, except percentage and multiple data)	**2006**	**2005**	**2004**	**2003**	**2002**
Beginning balance	$ 18,897	$ 18,698	$ 17,727	$ 14,538	$ 12,598
Loans charged-off:					
Commercial	2,525	410	258	50	2,096
Real estate		28		402	
Consumer	3	93	157	5	11
Equipment leases	76	66	939	618	1,740
Total	2,604	597	1,354	1,075	3,847
Recoveries:					
Commercial	462	569	148	78	42
Consumer	1	2			
Equipment leases	247	225	489	161	116
	710	796	637	239	158
Net charge-offs (recoveries)	1,894	(199)	717	836	3,689
Provision for loan losses	4,000		1,688	4,025	5,629
Ending balance	$ 21,003	$ 18,897	$ 18,698	$ 17,727	$ 14,538
Reserve to loans held for investment(2)	.77%	.91%	1.20%	1.44%	1.45%
Net charge-offs (recoveries) to average loans(2)	.08%	(.01)%	.05%	.08%	.40%
Provision for loan losses to average loans(2)	.17%	.00%	.12%	.37%	.61%
Recoveries to gross charge-offs	27.27%	133.33%	47.05%	22.23%	4.11%
Reserve as a multiple of net charge-offs	11.1x	N/M	26.1x	21.2x	3.9x
Non-performing and renegotiated loans:					
Non-accrual(1)	$ 9,088	$ 5,657	$ 5,850	$ 10,217	$ 2,776
Loans past due (90 days)(3)	2,142	2,795	209	7	135
Total	$ 11,230	$ 8,452	$ 6,059	$ 10,224	$ 2,911
Other real estate owned	$ 882	$ 158	$ 180	$ 64	$ 181
Reserve to non-performing loans	1.9x	2.2x	3.1x	1.7x	5.0x

(1) 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 $518,000, $121,000 and $168,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

(2) Excludes loans held for sale.

(3) At December 31, 2006, loans past due 90 days and still accruing include premium finance loans of $1.5 million (69% of total). These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date. The total also includes $571,000 of loans fully guaranteed by the U.S. Department of Agriculture.

Table of Contents

Loan Loss Reserve Allocation

	December 31									
n thousands, except	**2006**		**2005**		**2004**		**2003**		**2002**	
ercentage data)	**Reserve**	**% of Loans**	**Reserve**	**% of Loans**	**Reserve**	**% of Loans**	**Reserve**	**% of Loans**	**Reserve**	**% of Loans**
oan category:										
ommercial	$ 9,932	54%	$ 9,996	53%	$ 6,829	48%	$ 6,376	46%	$ 4,818	45%
onstruction	4,081	18	2,346	18	2,701	19	2,608	20	2,008	15
eal estate(1)	2,910	25	3,095	27	2,136	31	2,113	32	3,193	36
onsumer	589	1	115	1	371	1	93	1	114	2
quipment leases	482	2	395	1	457	1	932	1	706	2
nallocated	3,009		2,950		6,204		5,605		3,699	
otal	$ 21,003	100%	$ 18,897	100%	$ 18,698	100%	$ 17,727	100%	$ 14,538	100%

(1) Includes loans held for sale.

Non-performing Assets

Non-performing assets include non-accrual loans and equipment leases, accruing loans 90 or more days past due, restructured loans, and other repossessed assets. The table below summarizes our non-accrual loans by type:

	Year Ended December 31		
(in thousands)	**2006**	**2005**	**2004**
Non-accrual loans:(1)			
Commercial	$ 5,587	$ 4,931	$ 687
Construction		61	4,371
Real estate	3,417	464	403
Consumer	63	51	126
Equipment leases	21	150	263
Total non-accrual loans	$ 9,088	$ 5,657	$ 5,850
Reserves on non-accrual loans	$ 2,082	$ 1,116	$ 1,278
Loans past due (90 days)(2)	$ 2,142	$ 2,795	$ 209
Other repossessed assets:			
Other real estate owned	882		
Other repossessed assets	135	158	180

Total other repossessed assets	1,017	158	180
Total non-performing assets	$ 12,247	$ 8,610	$ 6,239

(1) 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 $518,000, $121,000 and $168,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

(2) At December 31, 2006, loans past due 90 days and still accruing includes premium finance loans of $1.5 million (69% of total). These loans are generally secured by obligations of insurance carriers to refund premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date. The total also includes $571,000 of loans fully guaranteed by the U.S. Department of Agriculture.

We did not recognize any interest income on impaired loans during 2006 and 2005, compared to $232,000 in 2004. Additional interest income that would have been recorded if the loans had been current during the years ended December 31, 2006, 2005 and 2004 totaled $518,000, $121,000 and $168,000, respectively.

Generally, we place loans on non-accrual when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectibility is questionable, then cash payments are applied to principal. As of December 31, 2006, approximately $50,000 of our non-accrual loans were earning on a cash basis.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due (both principal and interest) according to the terms of the 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 year ended December 31, 2006, we maintained an average securities portfolio of $574.0 million compared to an average portfolio of $712.4 million for the same period in 2005. The December 31, 2006 portfolio was primarily comprised of mortgage-backed securities. The mortgage-backed securities in our portfolio at December 31, 2006 primarily consisted of government agency mortgage-backed securities.

Our unrealized gain on the securities portfolio value increased from a loss of $12.5 million, which represented 1.94% of the amortized cost, at December 31, 2005, to a loss of $8.0 million, which represented 1.49% of the amortized cost, at December 31, 2006. The Company does not believe these unrealized losses are other than temporary as (1) the Company has the ability and intent to hold the investments to maturity, or a period of time sufficient to allow for a recovery in market value; (2) it is not probable that the Company will be unable to collect the amounts contractually due; and (3) no decision to dispose of the investments were made prior to the balance sheet date. The unrealized losses noted are interest rate related due to rising rates at December 31, 2006 in relation to previous rates in 2005. The Company has not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities.

During the year ended December 31, 2005, we maintained an average securities portfolio of $712.4 million compared to an average portfolio of $784.4 million for the same period in 2004. The December 31, 2005 portfolio was primarily comprised of mortgage-backed securities. The mortgage-backed securities in our portfolio at December 31, 2005 primarily consisted of government agency mortgage-backed securities.

Our unrealized gain on the securities portfolio value decreased from a gain of $4.0 million, which represented .50% of the amortized cost, at December 31, 2004, to a loss of $12.5 million, which represented 1.94% of the amortized cost, at December 31, 2005. The Company does not believe these unrealized losses are other than temporary as (1) the Company has the ability and intent to hold the investments to maturity, or a period of time sufficient to allow for a recovery in market value; (2) it is not probable that the Company will be unable to collect the amounts contractually due; and (3) no decision to dispose of the investments were made prior to the balance sheet date. The unrealized losses noted are interest rate related due to rising rates at December 31, 2005 in relation to previous rates in 2004. The Company has not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities.

Table of Contents

The average expected life of the mortgage-backed securities was 3.3 years at December 31, 2006 and 3.7 years at December 31, 2005. 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 December 31, 2006, 2005 and 2004.

	At December 31					
	2006		2005		2004	
(in thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Available-for-sale:						
U.S. Treasuries	$ 4,572	$ 4,565	$ 2,589	$ 2,587	$ 1,896	$ 1,895
Mortgage-backed securities	435,918	428,501	533,374	522,499	690,775	694,543
Corporate securities	35,581	35,155	45,896	45,207	46,272	46,630
Municipals	48,560	48,484	48,642	47,846	48,721	48,644
Equity securities(1)	15,468	15,348	12,449	12,343	12,891	12,832
Total available-for-sale securities	$ 540,099	$ 532,053	$ 642,950	$ 630,482	$ 800,555	$ 804,544

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

Table of Contents

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

	At December 31, 2006				
(in thousands, except percentage data)	**Less Than One Year**	**After One Through Five Years**	**After Five Through Ten Years**	**After Ten Years**	**Total**
Available-for-sale:					
U.S. Treasuries:					
Amortized cost	$ 4,572	$	$	$	$ 4,572
Estimated fair value	$ 4,565	$	$	$	$ 4,565
Weighted average yield	4.900%				4.900%
Mortgage-backed securities:(1)					
Amortized cost		90,866	73,820	271,232	435,918
Estimated fair value		89,016	72,766	266,719	428,501
Weighted average yield		4.303%	4.675%	4.723%	4.627%
Corporate securities:					
Amortized cost	10,433	20,148	5,000		35,581
Estimated fair value	10,266	19,827	5,062		35,155
Weighted average yield	3.747%	3.950%	7.375%		4.374%
Municipals:(2)					
Amortized cost		10,602	28,955	9,003	48,560
Estimated fair value		10,463	28,952	9,069	48,484
Weighted average yield		6.637%	8.175%	8.866%	7.969%
Equity securities:					
Amortized cost	15,468				15,468
Estimated fair value	15,348				15,348
Total available-for-sale securities:					
Amortized cost					$ 540,099
Estimated fair value					$ 532,053

(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 3.3 years at December 31, 2006.

(2) Yields have been adjusted to a tax equivalent basis assuming a 35% federal tax rate.

The following table discloses, as of December 31, 2006 and 2005, our investment securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months (in thousands):

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
December 31, 2006						
U.S. Treasuries	$ 4,565	$ (7)	$	$	$ 4,565	$ (7)
Mortgage-backed securities	689	(1)	361,191	(8,171)	361,880	(8,172)
Corporate securities			30,093	(488)	30,093	(488)
Municipals	1,746	(5)	25,004	(255)	26,750	(260)
Equity securities			3,386	(120)	3,386	(120)
	$ 7,000	$ (13)	$ 419,674	$ (9,034)	$ 426,674	$ (9,047)
December 31, 2005						
U.S. Treasuries	$ 2,587	$ (2)	$	$	$ 2,587	$ (2)
Mortgage-backed securities	280,855	(5,914)	157,199	(5,888)	438,054	(11,802)
Corporate securities	30,025	(671)	10,073	(128)	40,098	(799)
Municipals	35,525	(562)	8,959	(256)	44,484	(818)
Equity securities	999	(7)	1,401	(99)	2,400	(106)
	$ 349,991	$ (7,156)	$ 177,632	$ (6,371)	$ 527,623	$ (13,527)

We believe the investment securities in the table above are within ranges customary for the banking industry. At December 31, 2006, the number of investment positions in this unrealized loss position totals 115. We do not believe these unrealized losses are other than temporary as (1) we have the ability and intent to hold the investments to maturity, or a period of time sufficient to allow for a recovery in market value; (2) it is not probable that we will be unable to collect the amounts contractually due; and (3) no decision to dispose of the investments were made prior to the balance sheet date. The unrealized losses noted are interest rate related due to rising rates in 2006 in relation to previous rates in 2005. We have not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities.

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. Our bank offers nine 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 year ended December 31, 2006 increased $601.0 million compared to the same period of 2005. Average demand deposits, savings, and time deposits increased by $52.1 million, $108.8 million, and $442.0 million, respectively, while average interest bearing transaction accounts decreased $1.9 million during the year ended December 31, 2006 as compared to the same period of 2005. The average cost of deposits increased in 2006 mainly due to higher market interest rates.

Average deposits for the year ended December 31, 2005 increased $519.7 million compared to the same period of 2004. Average demand deposits, interest bearing transaction accounts, savings, and time deposits increased by $111.8 million, $11.5 million, $88.6 million, and $307.8 million, respectively, during the year ended December 31, 2005 as compared to the same period of 2004. The average cost of deposits increased in 2005 mainly due to higher market interest rates.

Deposit Analysis

(in thousands)	Average Balances 2006	2005	2004
Non-interest bearing	$ 462,279	$ 410,213	$ 298,430
Interest bearing transaction	106,602	108,459	96,911
Savings	755,817	647,039	558,479
Time deposits	640,369	545,603	512,852
Deposits in foreign branches	707,423	360,142	85,133
Total average deposits	$ 2,672,490	$ 2,071,456	$ 1,551,805

As with our loan portfolio, most of our deposits are from businesses and individuals in Texas, particularly the Dallas metropolitan area. As of December 31, 2006, approximately 73% of our deposits originated out of our Dallas metropolitan banking centers. Uninsured deposits at December 31, 2006 were 54% of total deposits, compared to 56% of total deposits at December 31, 2005 and 62% of total deposits at December 31, 2004. The presentation for 2006, 2005 and 2004 does reflect combined ownership, but does not reflect all of the account styling that would determine insurance based on FDIC regulations.

At December 31, 2006, approximately 4% 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.

At December 31, 2006, we had $880.4 million in interest bearing time deposits of $100,000 or more in foreign branches related to our Cayman Islands branch.

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

(in thousands)	December 31 2006	2005	2004
Months to maturity:			
3 or less	$ 234,898	$ 298,134	$ 174,392
Over 3 through 6	48,307	24,224	33,229
Over 6 through 12	169,513	89,481	56,943
Over 12	82,484	96,341	137,325
Total	$ 535,202	$ 508,180	$ 401,889

Liquidity and Capital Resources

In general terms, liquidity is a measurement of our ability to meet our cash needs. Our objective in managing our liquidity is to maintain our ability to meet loan commitments, purchase securities or repay deposits and other liabilities in accordance with their terms, without an adverse impact on our current or future earnings. Our liquidity strategy is guided by policies, which are formulated and monitored by our senior management and our Balance Sheet Management Committee (BSMC), and which take into account the marketability of assets, the sources and stability of funding and the level of unfunded commitments. We regularly evaluate all of our various funding sources with an emphasis on accessibility, stability, reliability and cost-effectiveness. For the years ended December 31, 2005 and 2006, 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) and Federal Home Loan Bank (FHLB) borrowings.

Since early 2001, our liquidity needs have primarily been fulfilled through growth in our core customer deposits. Our goal is to obtain as much of our funding as possible from deposits of these core customers, which as of December 31, 2006, comprised $3,063.4 million, or 99.8%, of total deposits, compared to $2,388.7 million, or 95.7%, of total deposits, at December 31, 2005. These deposits are generated principally through development of long-term relationships with customers and stockholders and our retail network which is mainly through BankDirect.

In addition to deposits from our core customers, we also have access to incremental deposits through brokered retail certificates of deposit, or CDs. As of December 31, 2006, brokered retail CDs comprised $5.9 million, or 0.2%, of total deposits. Our dependence on retail brokered CDs is limited by our internal funding guidelines, which as of December 31, 2006, limited borrowing from these sources to 15% 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 (which consist of banks that are smaller than our bank) and from our upstream correspondent bank relationships (which consist of banks that are larger than our bank), securities sold under repurchase agreements, treasury, tax and loan notes, and advances from the FHLB. As of December 31, 2006, our borrowings consisted of a total of $29.4 million of securities sold under repurchase agreements, $166.0 million of downstream federal funds purchased, $14.0 million from customer repurchase agreements and $2.2 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 December 31, 2006, we had no borrowings from the FHLB. FHLB borrowings are collateralized by eligible securities and loans. Our unused FHLB borrowing capacity at December 31, 2006 was approximately $781.0 million, of which $546.0 million relates to loans and $235.0 million relates to securities. As of December 31, 2006, we had unused upstream federal fund lines available from commercial banks of approximately $379.5 million. During the year ended December 31, 2006, our average borrowings from these sources were $308.6 million, of which $100.3 million related to securities sold under repurchase agreements. The maximum amount of borrowed funds outstanding at any month-end during the year ended December 31, 2006 was $442.0 million, of which $103.6 million related to securities sold under repurchase agreements.

On October 6, 2005, Texas Capital Statutory Trust III issued $25,000,000 of its Fixed/Floating Rate Capital Securities (the Capital Securities) in a private offering. Proceeds of the Capital Securities, together with the proceeds from the sale by the Trust of its Common Securities to the Company, were invested in a related series of our Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures (the Debentures). After deducting underwriter s compensation and other expenses of the offering, the net proceeds were available to the Company to increase capital and for general corporate purposes, including use in investment and lending activities.

The interest rate on the Debentures issued in connection with the 2005 Trust Preferred is a fixed rate of 6.19% for five years through December 15, 2010. 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 Capital Securities and the Debentures each mature in October 2035; however, the Capital Securities and the Debentures may be redeemed at the option of the Company on fixed quarterly dates beginning on December 15, 2010.

On April 28, 2006, Texas Capital Statutory Trust IV issued $25,774,000 of its Floating Rate Capital Securities (the 2006-1 Trust Preferred Securities) in a private offering. Proceeds of the 2006-1 Trust Preferred Securities were invested in Floating Rate Junior Subordinated Deferrable Interest Debentures (the 2006-1 Subordinated Debentures) of the Company due 2036. After deducting underwriter s compensation and other expenses of the offering, the net proceeds were available to the Company to increase capital and for general corporate purposes, including use in investment and lending activities. Interest payments on the 2006-1 Subordinated Debentures are deductible for federal income tax purposes.

Interest rate on the 2006-1 Subordinated Debentures is a floating rate that resets quarterly to 1.60% above the three-month LIBOR rate. Interest payments on the 2006-1 Subordinated Debentures are deductible for

Table of Contents

federal income tax purposes. The payment by us of the principal and interest on the 2006-1 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 2006-1 Trust Preferred Securities and the 2006-1 Subordinated Debentures each mature in June 2036; however, the 2006-1 Trust Preferred Securities and the 2006-1 Subordinated Debentures may be redeemed at the option of the Company on fixed quarterly dates beginning on June 15, 2011.

On September 29, 2006, Texas Capital Statutory Trust V issued $41,238,000 of its Floating Rate Capital Securities (the 2006-2 Trust Preferred Securities) in a private offering. Proceeds of the 2006-2 Trust Preferred Securities were invested in Floating Rate Junior Subordinated Deferrable Interest Debentures (the 2006-2 Subordinated Debentures) of the Company due 2036. After deducting underwriter s compensation and other expenses of the offering, the net proceeds were available to the Company to increase capital and for general corporate purposes, including use in investment and lending activities. Interest payments on the 2006-2 Subordinated Debentures are deductible for federal income tax purposes.

Interest rate on the 2006-2 Subordinated Debentures is a floating rate that resets quarterly to 1.71% above the three-month LIBOR rate. Interest payments on the 2006-2 Subordinated Debentures are deductible for federal income tax purposes. The payment by us of the principal and interest on the 2006-2 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 2006-2 Trust Preferred Securities and the 2006-2 Subordinated Debentures each mature in September 2036; however, the 2006-2 Trust Preferred Securities and the 2006-2 Subordinated Debentures may be redeemed at the option of the Company on fixed quarterly dates beginning on December 31, 2011.

Our equity capital averaged $229.7 million for the year ended December 31, 2006 as compared to $204.5 million in 2005 and $182.2 million in 2004. 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 actual and minimum required capital amounts and actual ratios are as follows:

	Regulatory Capital Adequacy			
	December 31, 2006		**December 31, 2005**	
(in thousands, except percentage data)	**Amount**	**Ratio**	**Amount**	**Ratio**
Total capital (to risk-weighted assets):				
Company				
Actual	$ 375,096	11.16%	$ 275,695	10.83%
Minimum required	268,786	8.00%	203,701	8.00%
Excess above minimum	106,310	3.16%	71,994	2.83%
Bank				
Actual	339,336	10.10%	258,327	10.15%
To be well-capitalized	335,847	10.00%	254,431	10.00%
Minimum required	268,678	8.00%	203,544	8.00%
Excess above well-capitalized	3,489	0.10%	3,896	0.15%
Excess above minimum	70,658	2.10%	54,783	2.15%

Tier 1 capital (to risk-weighted assets):						
Company						
Actual	$	325,093	9.68%	$	256,798	10.09%
Minimum required		134,393	4.00%		101,851	4.00%
Excess above minimum		190,700	5.68%		154,947	6.09%

Table of Contents

(in thousands, except percentage data)	Regulatory Capital Adequacy December 31, 2006 Amount	Ratio	December 31, 2005 Amount	Ratio
Bank				
Actual	$ 318,333	9.48%	$ 239,430	9.41%
To be well-capitalized	201,508	6.00%	152,658	6.00%
Minimum required	134,339	4.00%	101,772	4.00%
Excess above well-capitalized	116,825	3.48%	86,772	3.41%
Excess above minimum	183,994	5.48%	137,658	5.41%
Tier 1 capital (to average assets):				
Company				
Actual	$ 325,093	9.18%	$ 256,798	8.68%
Minimum required	141,595	4.00%	118,296	4.00%
Excess above minimum	183,498	5.18%	138,502	4.68%
Bank				
Actual	$ 318,333	9.00%	$ 239,430	8.10%
To be well-capitalized	176,926	5.00%	147,775	5.00%
Minimum required	141,541	4.00%	118,220	4.00%
Excess above well-capitalized	141,407	4.00%	91,655	3.10%
Excess above minimum	176,792	5.00%	121,210	4.10%

The following table presents, as of December 31, 2006, significant fixed and determinable contractual obligations to third parties by payment date. Further discussion of the nature of each obligation is included in the referenced note to the consolidated financial statements.

(in thousands)	Note Reference	Within One Year	After One But Within Three Years	After Three But Within Five Years	After Five Years	Total
Deposits without a stated maturity(a)	6	$ 1,556,548	$	$	$	$ 1,556,548
Time deposits(a)	6	1,384,829	105,363	22,529	61	1,512,782
Federal funds purchased	7	165,955				165,955
Securities sold under repurchase agreements(a)	7	29,400				29,400
Customer repurchase agreements(a)	7	13,959				13,959
Treasury, tax and loan notes(a)	7	2,245				2,245
	16	5,747	13,664	9,450	35,951	64,812

Operating lease obligations										
Long-term debt(a)	7, 8							113,406		113,406
Total contractual obligations		$	3,158,683	$	119,027	$	31,979	$ 149,418	$	3,459,107

(a) Excludes interest.

Off-Balance Sheet Arrangements

The contractual amount of our financial instruments with off-balance sheet risk expiring by period at December 31, 2006 is presented below:

(in thousands)	Within One Year	After One But Within Three Years	After Three But Within Five Years	After Five Years	Total
Commitments to extend credit	$ 553,293	$ 427,179	$ 77,810	$ 12,591	$ 1,070,873
Standby and commercial letters of credit	45,868	12,105	230		58,203
Total financial instruments with off-balance sheet risk	$ 599,161	$ 439,284	$ 78,040	$ 12,591	$ 1,129,076

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.

Critical Accounting Policies

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

We follow financial accounting and reporting policies that are in accordance with accounting principles generally accepted in the United States. The more significant of these policies are summarized in Note 1 to the consolidated financial statements. Not all these significant accounting policies require management to make difficult, subjective, or complex judgments. However, the 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.

New Accounting Standards

See Note 19 New Accounting Standards in the accompanying notes to consolidated financial statements included elsewhere in this report for details of recently issued accounting pronouncements and their expected impact on our financial statements.

ITEM 7A. ***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, or equity prices. Additionally, the financial instruments subject to market risk can be classified either as held for trading purposes or held for other than trading.

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

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

Interest Rate Risk Management

Our interest rate sensitivity is illustrated in the following table. The table reflects rate-sensitive positions as of December 31, 2006, and is not necessarily indicative of positions on other dates. The balances of interest rate sensitive assets and liabilities are presented in the periods in which they next reprice to market rates or mature and are aggregated to show the interest rate sensitivity gap. The mismatch between repricings or maturities within a time period is commonly referred to as the gap for that period. A positive gap (asset sensitive), where interest rate sensitive assets exceed interest rate sensitive liabilities, generally will result in the net interest margin increasing in a rising rate environment and decreasing in a falling rate environment. A negative gap (liability sensitive) will generally have the opposite results on the net interest margin. To reflect anticipated prepayments, certain asset and liability categories are shown in the table using estimated cash flows rather than contractual cash flows.

Table of Contents

Interest Rate Sensitivity Gap Analysis
December 31, 2006

(in thousands)	0-3 Mo Balance	4-12 Mo Balance	1-3 Yr Balance	3+ Yr Balance	Total Balance
Securities(1)	$ 23,406	$ 74,188	$ 155,659	$ 278,800	$ 532,053
Total variable loans	2,402,768	17,226	639	1,152	2,421,785
Total fixed loans	168,084	100,705	154,023	109,194	532,006
Total loans(2)	2,570,852	117,931	154,662	110,346	2,953,791
Total interest sensitive assets	$ 2,594,258	$ 192,119	$ 310,321	$ 389,146	$ 3,485,844
Liabilities:					
Interest bearing customer deposits	$ 1,927,062	$	$	$	$ 1,927,062
CDs & IRAs	257,214	242,326	100,298	22,590	622,428
Wholesale deposits	100	745	5,065		5,910
Total interest-bearing deposits	2,184,376	243,071	105,363	22,590	2,555,400
Repo, FF, FHLB borrowings	182,159	29,400			211,559
Trust preferred				113,406	113,406
Total borrowing	182,159	29,400		113,406	324,965
Total interest sensitive liabilities	$ 2,366,535	$ 272,471	$ 105,363	$ 135,996	$ 2,880,365
GAP	$ 227,723	$ (80,352)	$ 204,958	$ 253,150	$
Cumulative GAP	227,723	147,371	352,329	605,479	605,479
Demand deposits					$ 513,930
Stockholders equity					250,668
Total					$ 764,598

(1) Securities based on fair market value.

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

The table above sets forth the balances as of December 31, 2006 for interest bearing assets, interest bearing liabilities, and the total of non-interest bearing deposits and stockholders equity. While a gap interest table is useful in analyzing interest rate sensitivity, an interest rate sensitivity simulation provides a better illustration of the sensitivity of earnings to changes in interest rates. Earnings are also affected by the effects of changing interest rates on the value of funding derived from demand deposits and stockholders equity. We perform a sensitivity analysis to identify interest rate risk exposure on net interest income. We quantify and measure interest rate risk exposure using a model to dynamically simulate the effect of changes in net interest income relative to changes in interest rates and account balances over the next twelve months based on three interest rate scenarios. These are a most likely rate scenario and two shock test scenarios.

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

Table of Contents

The two shock test scenarios assume a sustained parallel 200 basis point increase or decrease, respectively, in interest rates.

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

	Anticipated Impact Over the Next Twelve Months as Compared to Most Likely Scenario			
(in thousands)	**200 bp Increase December 31, 2006**	**200 bp Decrease December 31, 2006**	**200 bp Increase December 31, 2005**	**200 bp Decrease December 31, 2005**
Change in net interest income	$ 7,546	$ (7,767)	$ 6,794	$ (6,700)

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

ITEM 8. *FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA*

Index to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of
Texas Capital Bancshares, Inc.

We have audited the accompanying consolidated balance sheets of Texas Capital Bancshares, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Texas Capital Bancshares, Inc. at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the financial statements, effective January 1, 2006, Texas Capital Bancshares, Inc. adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment, to account for stock-based compensation.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Texas Capital Bancshares, Inc. s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2007, expressed an unqualified opinion thereon.

Dallas, Texas
February 27, 2007

Table of Contents

Texas Capital Bancshares, Inc.

Consolidated Balance Sheets

(in thousands except share data)	December 31 2006	2005
ASSETS		
Cash and due from banks	$ 93,716	$ 137,840
Securities, available-for-sale	532,053	630,482
Loans held for sale	215,858	72,383
Loans held for sale from discontinued operations		38,795
Loans held for investment, net	2,701,094	2,057,064
Premises and equipment, net	33,818	21,632
Accrued interest receivable and other assets	85,821	71,395
Goodwill and other intangible assets, net	12,989	12,634
Total assets	$ 3,675,349	$ 3,042,225
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Non-interest bearing	$ 513,930	$ 512,294
Interest bearing	1,670,956	1,436,111
Interest bearing in foreign branches	884,444	546,774
	3,069,330	2,495,179
Accrued interest payable	5,781	4,778
Other liabilities	21,758	14,630
Federal funds purchased	165,955	103,497
Repurchase agreements	43,359	108,357
Other borrowings	2,245	53,867
Long-term debt	113,406	46,394
Total liabilities	3,421,834	2,826,702
Stockholders equity:		
Common stock, $.01 par value:		
Authorized shares 100,000,000 Issued shares 26,065,124 and 25,771,718 at December 31, 2006 and 2005, respectively	261	258
Additional paid-in capital	182,321	176,131
Retained earnings	76,163	47,239
Treasury stock (shares at cost: 84,274 at December 31, 2006 and 2005)	(573)	(573)
Deferred compensation	573	573
Accumulated other comprehensive loss	(5,230)	(8,105)
Total stockholders equity	253,515	215,523
Total liabilities and stockholders equity	$ 3,675,349	$ 3,042,225

See accompanying notes.

Texas Capital Bancshares, Inc.

Consolidated Statements of Operations

(in thousands except share data)	Year Ended December 31 2006	2005	2004
Interest income:			
Interest and fees on loans	$ 211,092	$ 127,989	$ 75,550
Securities	26,311	30,712	32,200
Federal funds sold	65	611	65
Deposits in other banks	56	147	13
Total interest income	237,524	159,459	107,828
Interest expense:			
Deposits	99,500	50,028	23,237
Federal funds purchased	8,198	3,588	1,620
Repurchase agreements	4,016	8,978	9,538
Other borrowings	2,471	877	474
Long-term debt	5,439	1,858	1,096
Total interest expense	119,624	65,329	35,965
Net interest income	117,900	94,130	71,863
Provision for loan losses	4,000		1,688
Net interest income after provision for loan losses	113,900	94,130	70,175
Non-interest income:			
Service charges on deposit accounts	3,306	3,223	3,370
Trust fee income	3,790	2,739	1,932
Cash processing fees			587
Bank owned life insurance (BOLI) income	1,134	1,136	1,288
Brokered loan fees	2,029	1,759	996
Insurance commissions	4,158	1,047	444
Equipment rental income	3,908	236	86
Other	2,517	2,415	1,494
Total non-interest income	20,842	12,555	10,197
Non-interest expense:			
Salaries and employee benefits	53,130	38,896	29,270
Net occupancy expense	8,184	6,056	5,062
Leased equipment depreciation	3,097	194	39
Marketing	3,161	2,974	2,491
Legal and professional	6,576	5,166	3,141
Communications and data processing	3,192	2,900	3,158
Franchise taxes	281	273	246
Other	12,873	9,667	6,974
Total non-interest expense	90,494	66,126	50,381
Income from continuing operations before income taxes	44,248	40,559	29,991
Income tax expense	15,064	13,783	10,006

Income from continuing operations		29,184		26,776		19,985
Income (loss) from discontinued operations (after-tax)		(260)		416		(425)
Net income	$	28,924	$	27,192	$	19,560
Basic earnings per share:						
Income from continuing operations	$	1.12	$	1.05	$	.79
Net income	$	1.11	$	1.06	$	.77
Diluted earnings per share:						
Income from continuing operations	$	1.10	$	1.00	$	.76
Net income	$	1.09	$	1.02	$	.75

See accompanying notes.

Table of Contents

Texas Capital Bancshares, Inc.

Consolidated Statements of Stockholders Equity

	Common Stock		Series A-1 Non-Voting Common Stock		Additional Paid-in	Retained	Treasury Stock		Deferred	Accumulated Other Comprehensive Income
share data)	**Shares**	**Amount**	**Shares**	**Amount**	**Capital**	**Earnings**	**Shares**	**Amount**	**Compensation**	**(Loss)**
r 31, 2003	24,715,607	$ 247	293,918	$ 3	$ 167,751	$ 487	(84,274)	$ (573)	$ 573	$ 3,268
me:										
						19,560				
gain (loss) securities,), net of nt of $363										(675)
income exercise of										
					1,411					
k	452,077	5			3,218					
	293,918	3	(293,918)	(3)						
r 31, 2004	25,461,602	255			172,380	20,047	(84,274)	(573)	573	2,593
me:										
						27,192				
gain (loss) securities, 9										(10,698)
income exercise of										
					1,424					
k	310,116	3			2,327					
r 31, 2005	25,771,718	258			176,131	47,239	(84,274)	(573)	573	(8,105)
me:										
						28,924				
gain (loss) securities, 7										2,875
income exercise of										
					1,431					

sation										
n earnings					2,847					
k	293,406	3			1,912					
r 31, 2006	26,065,124	$ 261	$		$ 182,321	$ 76,163	(84,274)	$ (573)	$ 573	$ (5,230)

See accompanying notes.

Table of Contents

Texas Capital Bancshares, Inc.

Consolidated Statements of Cash Flows

(in thousands)	Year Ended December 31 2006	2005	2004
Operating activities			
Net income	$ 28,924	$ 27,192	$ 19,560
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Provision for loan losses	4,000		1,688
Deferred tax benefit	(1,433)	(302)	(300)
Depreciation and amortization	5,842	1,851	1,487
Amortization and accretion on securities	961	2,340	4,393
Bank owned life insurance (BOLI) income	(1,134)	(1,136)	(1,251)
Stock-based compensation expense	2,847		
Tax benefit from stock option exercises	1,431	1,424	1,411
Excess tax benefits from stock-based compensation arrangements	(4,090)		
Originations of loans held for sale	(3,114,210)	(1,480,531)	(1,498,132)
Proceeds from sales of loans held for sale	2,987,579	1,486,078	1,438,085
Changes in operating assets and liabilities:			
Accrued interest receivable and other assets	(11,725)	(12,670)	(5,737)
Accrued interest payable and other liabilities	6,583	14,778	1,039
Net cash provided by (used in) operating activities of continuing operations	(94,425)	39,024	(37,757)
Net cash provided by operating activities of discontinued operations	15,023	2,946	21,578
Net cash provided by (used in) operating activities	(79,402)	41,970	(16,179)
Investing activities			
Purchases of available-for-sale securities	(16,946)	(17,437)	(239,067)
Maturities and calls of available-for-sale securities	22,071	17,252	14,002
Principal payments received on securities	96,766	155,449	190,427
Net increase in loans	(639,395)	(526,205)	(336,462)
Purchase of premises and equipment, net	(19,212)	(3,571)	(985)
Cash paid for acquisition		(11,307)	
Net cash used in investing activities of continuing operations	(556,716)	(385,819)	(372,085)
Net cash used in investing activities of discontinued operations		(153)	(114)
Net cash used in investing activities	(556,716)	(385,972)	(372,199)
Financing activities			
Net increase in checking, money market and savings accounts	204,352	245,178	269,325
Net increase in certificates of deposit	369,799	460,114	75,532
Sale of common stock	1,915	2,330	3,223
Issuance of long-term debt	66,000	25,000	
Net other borrowings	(116,620)	(319,289)	14,720

Excess tax benefits from stock-based compensation arrangements		4,090				
Net federal funds purchased		62,458		(9,981)		34,517
Net cash provided by financing activities of continuing operations		591,994		403,352		397,317
Net cash provided by financing activities of discontinued operations						
Net cash provided by financing activities		591,994		403,352		397,317
Net increase (decrease) in cash and cash equivalents		(44,124)		59,350		8,939
Cash and cash equivalents, beginning of year		137,840		78,490		69,551
Cash and cash equivalents, end of year	$	93,716	$	137,840	$	78,490
Supplemental disclosures of cash flow information:						
Cash paid during the year for interest	$	119,564	$	64,857	$	36,093
Cash paid during the year for income taxes		14,912		12,999		10,250
Non-cash transactions:						
Transfers from loans/leases to other repossessed assets		955		68		418
Transfers from loans/leases to premises and equipment		1,703		126		302

See accompanying notes.

51

1. Operations and Summary of Significant Accounting Policies

Organization and Nature of Business

Texas Capital Bancshares, Inc. (Texas Capital Bancshares or the Company), a Delaware bank holding company, was incorporated in November 1996 and commenced operations in March 1998. The consolidated financial statements of the Company include the accounts of Texas Capital Bancshares, Inc. and its wholly owned subsidiary, Texas Capital Bank, National Association (the Bank). The Bank was formed on December 18, 1998 through the acquisition of Resource Bank, National Association (Resource Bank). All significant intercompany accounts and transactions have been eliminated upon consolidation.

All business is conducted through the Bank and its subsidiaries. The Bank currently provides commercial banking services to its customers in Texas. The Bank concentrates on middle market commercial and high net worth customers.

Certain reclassifications have been made to the 2005 and 2004 consolidated financial statements to conform to the 2006 presentation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

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

Securities

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

Trading Account

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

Held-to-Maturity and Available-for-Sale

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

Available-for-sale securities are stated at fair value, with the unrealized gains and losses reported in a separate component of accumulated other comprehensive income, net of tax. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity, or in the case of mortgage-backed securities, over the estimated life of the security. Such amortization and accretion is included in interest income from securities. Realized gains and losses and declines in value judged to be other-than-temporary are included in gain (loss) on sale of securities. The cost of securities sold is based on the specific identification method.

All securities are available-for-sale as of December 31, 2006.

Loans

Loans (which include equipment leases) are either secured or unsecured based on the type of loan and the financial condition of the borrower. Repayment is generally expected from cash flows of borrowers. The Company is exposed to risk of loss on loans which may arise from any number of factors including problems within the respective industry of the borrower or from local economic conditions. Access to collateral, in the event of borrower default, is reasonably assured through adherence to applicable lending laws and through sound lending standards and credit review procedures.

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

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

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

The Company originates and purchases participations in mortgage loans primarily for sale in the secondary market. Accordingly, these loans are classified as held for sale and are carried at the lower of cost or fair value, determined on an aggregate basis.

Allowance for Loan Losses

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

Repossessed Assets

Repossessed assets, which are included in other assets on the balance sheet, consist of collateral that has been repossessed. Collateral that has been repossessed is recorded at the lower of fair value less selling costs or the book value of the loan or lease prior to repossession. Writedowns are provided for subsequent declines in value and are recorded in other non-interest expense.

Other Real Estate Owned

Other real estate owned, which is included in other assets on the balance sheet, consists of real estate that has been foreclosed. Real estate that has been foreclosed is recorded at the lower of fair value less selling costs or the book value of the loan or lease prior to foreclosure. Writedowns are provided for subsequent declines in value and are recorded in other non-interest expense.

Table of Contents

Premises and Equipment

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

Marketing, Website Development Costs, and Software

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

Goodwill and Other Intangible Assets

Intangible assets are acquired assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. The Company s intangible assets relate primarily to customer relationships. Intangible assets with definite useful lives are amortized on an accelerated basis over their estimated life. Intangible assets are tested for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value. See Note 4 Goodwill and Intangible Assets.

As of January 1, 2002, the Company ceased amortizing goodwill in connection with the adoption of Statements of Financial Accounting Standards No. 141, *Business Combinations* (Statement 141), and No. 142, *Goodwill and Other Intangible Assets* (Statement 142). Statement 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives. Statement 142 requires that these assets be reviewed for impairment at least annually. Intangible assets with finite lives will continue to be amortized over their estimated useful lives. Additionally, Statement 142 requires that goodwill included in the carrying value of equity method investments no longer be amortized. The Company tests impairment on an annual basis, or an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of the underlying unit below its carrying value. See Note 4 Goodwill and Intangible Assets.

Segment Reporting

The Company has determined that all of its lending divisions and subsidiaries meet the aggregation criteria of SFAS No. 131 Segment Disclosures and Related Information, since all offer similar products and services, operate with similar processes, and have similar customers.

Stock-based Compensation

On January 1, 2006, the Company changed its accounting policy related to stock-based compensation in connection with the adoption of Statement of Financial Accounting Standards (SFAS) No. 123, Share-Based Payment (Revised 2004) (SFAS 123R). Prior to adoption, the Company accounted for stock plans under the recognition and measurement principles of APB Opinion 25, Accounting for Stock Issued to Employees , and related interpretations. No stock-based compensation was reflected in net income, as all option grants had an exercise price equal to the market value of the underlying common stock on the date of the grant. SFAS 123R eliminates the ability to account for stock-based compensation using APB 25 and requires that such transactions be recognized as compensation expense in the statement of operations based on their fair values on the measurement date, which is the date of the grant. The Company transitioned to fair value based accounting for stock-based compensation using a modified version of prospective application (modified prospective application). Under modified prospective application, as it is applicable to the Company, SFAS 123R applies to new awards and to awards modified, repurchased or cancelled after January 1, 2006. Additionally, compensation expense for the portion of awards for which the requisite period has not been rendered (generally referring to nonvested awards) that are outstanding as of January 1, 2006 will be recognized as the remaining requisite service is rendered during and after the period of adoption of SFAS 123R. The compensation expense for the earlier awards is based on the same method and on the same grant date fair values previously determined for the pro forma disclosures required for all companies that did not previously adopt the fair value accounting method for stock-based compensation.

SFAS 123R requires pro forma disclosures of net income and earnings per share for all periods prior to the adoption of the fair value accounting method for stock-based compensation. The pro forma disclosures presented in Note 10 Employee Benefits use the fair value method of SFAS 123 to measure compensation expense for stock-based compensation for years prior to 2006.

Accumulated Other Comprehensive Income (Loss)

Unrealized gains or losses on the Company s available-for-sale securities (after applicable income tax expense or benefit) are included in accumulated other comprehensive income (loss).

Income Taxes

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

Basic and Diluted Earnings Per Common Share

Basic earnings per common share is based on net income divided by the weighted-average number of common shares outstanding during the period excluding non-vested stock. Diluted earnings per common share include the dilutive effect of stock options and non-vested stock awards granted using the treasury stock method. A reconciliation of the weighted-average shares used in calculating basic earnings per common share and the weighted average common shares used in calculating diluted earnings per common share for the reported periods is provided in Note 14 Earnings Per Share.

Fair Values of Financial Instruments

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

Table of Contents

2. Securities

The following is a summary of securities:

	December 31, 2006			
(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Securities:				
U.S. Treasuries	$ 4,572	$	$ (7)	$ 4,565
Mortgage-backed securities	435,918	755	(8,172)	428,501
Corporate securities	35,581	62	(488)	35,155
Municipals	48,560	184	(260)	48,484
Equity securities(1)	15,468		(120)	15,348
	$ 540,099	$ 1,001	$ (9,047)	$ 532,053

	December 31, 2005			
(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-Sale Securities:				
U.S. Treasuries	$ 2,589	$	$ (2)	$ 2,587
Mortgage-backed securities	533,374	927	(11,802)	522,499
Corporate securities	45,896	110	(799)	45,207
Municipals	48,642	22	(818)	47,846
Equity securities(1)	12,449		(106)	12,343
	$ 642,950	$ 1,059	$ (13,527)	$ 630,482

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

Table of Contents

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

	At December 31, 2006				
(in thousands, except percentage data)	**Less Than One Year**	**After One Through Five Years**	**After Five Through Ten Years**	**After Ten Years**	**Total**
Available-for-sale:					
U.S. Treasuries:					
Amortized cost	$ 4,572	$	$	$	$ 4,572
Estimated fair value	$ 4,565	$	$	$	$ 4,565
Weighted average yield	4.900%				4.900%
Mortgage-backed securities:(1)					
Amortized cost		90,866	73,820	271,232	435,918
Estimated fair value		89,016	72,766	266,719	428,501
Weighted average yield		4.303%	4.675%	4.723%	4.627%
Corporate securities:					
Amortized cost	10,433	20,148	5,000		35,581
Estimated fair value	10,266	19,827	5,062		35,155
Weighted average yield	3.747%	3.950%	7.375%		4.374%
Municipals:(2)					
Amortized cost		10,602	28,955	9,003	48,560
Estimated fair value		10,463	28,952	9,069	48,484
Weighted average yield		6.637%	8.175%	8.866%	7.969%
Equity securities:					
Amortized cost	15,468				15,468
Estimated fair value	15,348				15,348
Total available-for-sale securities:					
Amortized cost					$ 540,099
Estimated fair value					$ 532,053

(1) Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties.

(2) Yields have been adjusted to a tax equivalent basis assuming a 35% federal tax rate.

Securities with carrying values of approximately $249,160,000 and $327,091,000 were pledged to secure certain borrowings and deposits at December 31, 2006 and 2005, respectively. See Note 7 for discussion of securities securing borrowings. Of the pledged securities at December 31, 2006 and 2005, approximately $186,006,000 and $173,189,000, respectively, were pledged for certain deposits.

Table of Contents

The following tables disclose, as of December 31, 2006 and 2005, the Company s investment securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months (in thousands):

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
December 31, 2006						
U.S. Treasuries	$ 4,565	$ (7)	$	$	$ 4,565	$ (7)
Mortgage-backed securities	689	(1)	361,191	(8,171)	361,880	(8,172)
Corporate securities			30,093	(488)	30,093	(488)
Municipals	1,746	(5)	25,004	(255)	26,750	(260)
Equity securities			3,386	(120)	3,386	(120)
	$ 7,000	$ (13)	$ 419,674	$ (9,034)	$ 426,674	$ (9,047)
December 31, 2005						
U.S. Treasuries	$ 2,587	$ (2)	$	$	$ 2,587	$ (2)
Mortgage-backed securities	280,855	(5,914)	157,199	(5,888)	438,054	(11,802)
Corporate securities	30,025	(671)	10,073	(128)	40,098	(799)
Municipals	35,525	(562)	8,959	(256)	44,484	(818)
Equity securities	999	(7)	1,401	(99)	2,400	(106)
	$ 349,991	$ (7,156)	$ 177,632	$ (6,371)	$ 527,623	$ (13,527)

The Company believes the investment securities in the table above are within ranges customary for the banking industry. At December 31, 2006, the number of investment positions in this unrealized loss position totals 115. The Company does not believe these unrealized losses are other than temporary as (1) the Company has the ability and intent to hold the investments to maturity, or a period of time sufficient to allow for a recovery in market value; (2) it is not probable that the Company will be unable to collect the amounts contractually due; and (3) no decision was made to dispose of the investments were made prior to the balance sheet date. The unrealized losses noted are interest rate related due to rising rates at December 31, 2006 in relation to previous rates in 2005. The Company has not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities.

3. Loans and Allowance for Loan Losses

Loans are summarized by category as follows (in thousands):

	December 31	
	2006	2005
Commercial	$ 1,602,577	$ 1,182,734
Construction	538,586	387,163
Real estate	530,377	478,634
Consumer	21,113	19,962

Equipment leases	45,280	16,337
Loans held for sale	215,858	72,383
	2,953,791	2,157,213
Deferred income (net of direct origination costs)	(15,836)	(8,869)
Allowance for loan losses	(21,003)	(18,897)
Loans, net	$ 2,916,952	$ 2,129,447

The majority of the loan portfolio is comprised of loans to businesses and individuals in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions within this area. Within the loan portfolio, loans to the services industry were $1.1 billion, or 35.7% of total loans, at December 31, 2006. Other notable segments include personal/household (which includes loans to certain high net worth individuals for commercial purposes and mortgage loans held for sale, in addition to consumer loans) of $370.8 million, contracting construction and real estate development industry loans of $456.3 million, petrochemical and mining of $274.2 million and $340.4 million in investors and investment management company loans at December 31, 2006. 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.

The changes in the allowance for loan losses are summarized as follows (in thousands):

	Year Ended December 31		
	2006	**2005**	**2004**
Balance, beginning of year	$ 18,897	$ 18,698	$ 17,727
Provision for loan losses	4,000		1,688
Loans charged off	(2,604)	(597)	(1,354)
Recoveries	710	796	637
Balance, end of year	$ 21,003	$ 18,897	$ 18,698

Non-performing loans and leases and related reserves at December 2006, 2005 and 2004 are summarized as follows:

	Year Ended December 31		
(in thousands)	**2006**	**2005**	**2004**
Non-accrual loans:(1)			
Commercial	$ 5,587	$ 4,931	$ 687
Construction		61	4,371
Real estate	3,417	464	403
Consumer	63	51	126
Equipment leases	21	150	263
Total non-accrual loans	9,088	5,657	5,850
Loans past due (90 days)(2)	2,142	2,795	209
Other repossessed assets:			
Other real estate owned	882		
Other repossessed assets	135	158	180
Total other repossessed assets	1,017	158	180
Total non-performing assets	$ 12,247	$ 8,610	$ 6,239
Reserves on non-accrual loans	$ 2,082	$ 1,116	$ 1,278

(1) 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 $518,000, $121,000 and $168,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

(2) At December 31, 2006, loans past due 90 days and still accruing includes premium finance loans of $1.5 million (69% of total). These loans are generally secured by obligations of insurance carriers to refund

premiums on cancelled insurance policies. The refund of premiums from the insurance carriers can take 180 days or longer from the cancellation date. The total also includes $571,000 of loans fully guaranteed by the U.S. Department of Agriculture.

We did not recognize any interest income on non-accrual loans during 2006 and 2005, compared to $232,000 in 2004. Additional interest income that would have been recorded if the loans had been current during the years ended December 31, 2006, 2005 and 2004 totaled $518,000, $121,000 and $168,000, respectively. Average impaired loans outstanding during the years ended December 31, 2006, 2005 and 2004 totaled $6,082,000, $4,726,000 and $7,252,000, respectively.

Generally, we place loans on non-accrual when there is a clear indication that the borrower s cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining unpaid principal amount of the loan is deemed to be fully collectible. If collectibility is questionable, then cash payments are applied to principal. As of December 31, 2006, approximately $50,000 of our non-accrual loans were earning on a cash basis.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due (both principal and interest) according to the terms of the 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.

During the normal course of business, the Company and subsidiary may enter into transactions with related parties, including their officers, employees, directors, significant stockholders and their related affiliates. It is the Company s policy that all such transactions are on substantially the same terms as those prevailing at the time for comparable transactions with third parties. Loans to related parties, including officers and directors, were approximately $4,656,000 and $14,069,000 at December 31, 2006 and 2005, respectively. During the years ended December 31, 2006 and 2005, total advances were approximately $8,393,000 and $22,900,000 and total paydowns were $17,807,000 and $14,156,000, respectively.

4. Goodwill and Other Intangible Assets

Goodwill totaled $9.8 million (net of $374,000 of accumulated amortization) at December 31, 2006 and $9.3 million (net of $374,000 of accumulated amortization) at December 31, 2005. During 2006, the Company recorded goodwill totaling $486,000 related to the purchase of insurance books of business. During 2005, the Company recorded $5.1 million of goodwill in connection with the purchase of a premium finance marketing company, with additional payment up to $4 million, over 3 years, which may increase this goodwill amount. Also during 2005, the Company recorded $2.7 million of goodwill in connection with the purchase of an insurance agency and insurance books of business.

During 2006, the Company recorded customer relationship intangibles totaling $506,000 in connection with the acquisitions of insurance books of business. During 2005, the Company recorded a customer base intangible totaling $1.6 million related to the July 2005 purchase of a portfolio and loan account services of a premium finance loan customer base. Also in 2005, the Company recorded customer relationship intangibles totaling $1.7 million related to the purchase of insurance customer relationships.

Goodwill and other intangible assets at December 31, 2006 and December 31, 2005 are summarized as follows (in thousands):

	Gross Goodwill and Intangible Assets	Accumulated Amortization	Net Goodwill and Intangible Assets
December 31, 2006			
Goodwill	$ 10,202	$ (374)	$ 9,828
Insurance customer relationships	2,489	(714)	1,775
Loan customer base	1,622	(236)	1,386
	$ 14,313	$ (1,324)	$ 12,989
December 31, 2005			
Goodwill	$ 9,716	$ (374)	$ 9,342
Insurance customer relationships	1,983	(239)	1,744
Loan customer base	1,622	(74)	1,548
	$ 13,321	$ (687)	$ 12,634

Other intangible assets are amortized over their estimated lives, which range from 2 to 10 years. Amortization expense related to intangible assets totaled $637,000 in 2006, $169,000 in 2005 and none in 2004. The estimated aggregate future amortization expense for intangible assets remaining as of December 31, 2006 is as follows:

2007	$ 649
2008	414
2009	392
2010	390
2011	390
Thereafter	926
	$ 3,161

5. Premises and Equipment

Premises and equipment at December 31, 2006 and 2005 are summarized as follows:

(in thousands)	December 31 2006	2005
Premises	$ 5,876	$ 6,049
Furniture and equipment	12,758	10,882
Rental equipment	30,241	15,304
	48,875	32,235

Accumulated depreciation	(15,057)	(10,603)
	$ 33,818	$ 21,632

Depreciation expense was approximately $5,206,000, $1,816,000 and $1,555,000 in 2006, 2005 and 2004, respectively.

6. Deposits

The scheduled maturities of interest bearing time deposits are as follows at December 31, 2006 (in thousands):

2007	$ 1,384,830
2008	28,887
2009	76,476
2010	11,038
2011	11,490
2012 and after	61
	$ 1,512,782

At December 31, 2006 and 2005, the Bank had approximately $38,000,000 and $50,000,000, respectively, in deposits from related parties, including directors, stockholders, and their related affiliates.

At December 31, 2006 and 2005, interest bearing time deposits, including deposits in foreign branches, of $100,000 or more were approximately $1,418,181,000 and $1,053,599,000, respectively.

7. Borrowing Arrangements

Borrowings at December 31, 2006 consist of $29.4 million of securities sold under repurchase agreements with a weighted average rate of 3.41%, $14.0 million of customer repurchase agreements, and $2.2 million of treasury, tax and loan notes. Securities sold under repurchase are with one counterparty, Salomon Smith Barney and have a weighted average maturity of six months. At December 31, 2006, we had no borrowings from the FHLB. FHLB borrowings are collateralized by eligible securities and loans. Our unused FHLB borrowing capacity at December 31, 2006 was approximately $781.0 million, of which $546.0 million relates to loans and $235.0 million relates to securities. There were $63.2 million of securities pledged for customer repurchase agreements and securities sold under repurchase agreements and $9.5 million pledged for treasury, tax and loan notes. During the year ended December 31, 2006, our average borrowings from these sources were $308.6 million, of which $100.3 million related to securities sold under repurchase agreements. The maximum amount of borrowed funds outstanding at any month-end during the year ended December 31, 2006 was $442.0 million, of which $103.6 million related to securities sold under repurchase agreements.

The Bank had $166.0 million of downstream federal funds purchased outstanding with a rate of 5.275% at December 31, 2006. The Bank had unused upstream federal fund lines available from commercial banks at December 31, 2006 of approximately $379.5 million. Generally, these federal fund borrowings are overnight, but not to exceed seven days.

As of December 31, 2006, our borrowings were as follows (in thousands)

	Within One Year	After One but Within	After Three but Within	After Five Years	Total

		Three Years	**Five Years**		
Federal funds purchased(1)	$ 165,955	$	$	$	$ 165,955
Securities sold under repurchase agreements(1)	29,400				29,400
Customer repurchase agreements(1)	13,959				13,959
Treasury, tax and loan notes(1)	2,245				2,245
Long-term debt(1)				113,406	113,406
Total borrowings	$ 211,559	$	$	$ 113,406	$ 324,965

(1) Excludes interest.

Borrowings at December 31, 2005 consist of $99.7 million of securities sold under repurchase agreements with a weighted average rate of 3.20%, $8.7 million of customer repurchase agreements, and $3.9 million of treasury, tax and loan notes. Securities sold under repurchase are with two significant counterparties which are Salomon Smith Barney at $85.4 million and Credit Suisse First Boston at $14.3 million. The weighted average maturities of the Salomon and Credit Suisse repurchase agreements are nine months and two months, respectively. At December 31, 2005, $50.0 million of our borrowings consisted of borrowings from the FHLB. There were $153.9 million of securities pledged for customer repurchase agreements and securities sold under repurchase agreements and $4.4 million pledged for treasury, tax and loan notes. During the year ended December 31, 2005, our average borrowings from these sources were $477.2 million, of which $315.6 million related to securities sold under repurchase agreements. The maximum amount of borrowed funds outstanding at any month-end during the year ended December 31, 2005 was $610.3 million, of which $354.2 million related to securities sold under repurchase agreements.

The Bank had $103.5 million of downstream federal funds purchased outstanding with a rate of 4.325% at December 31, 2005. The Bank had unused upstream federal fund lines available from commercial banks at December 31, 2005 of approximately $280.5 million. Generally, these federal fund borrowings are overnight, but not to exceed seven days.

Borrowings at December 31, 2004 consist of $463.9 million of securities sold under repurchase agreements with a weighted average rate of 2.33%, $14.3 million of customer repurchase agreements, and $3.3 million of treasury, tax and loan notes. Securities sold under repurchase are with two significant counterparties which are Salomon Smith Barney at $435.4 million and Credit Suisse First Boston at $28.5 million. The weighted average maturities of the Salomon and Suisse repurchase agreements are seven months and eight months, respectively. At December 31, 2004, none of our borrowings consisted of borrowings from the FHLB. Our unused FHLB borrowing capacity at December 31, 2004 was approximately $245.0 million. There were $524.3 million of securities pledged for customer repurchase agreements and securities sold under repurchase agreements and $3.4 million pledged for treasury, tax and loan notes. During the year ended December 31, 2004, our average borrowings from these sources were $612.3 million, of which $458.9 million related to securities sold under repurchase agreements. The maximum amount of borrowed funds outstanding at any month-end during the year ended December 31, 2004 was $653.2 million, of which $478.6 million related to securities sold under repurchase agreements.

The Bank had $113.5 million of downstream federal funds purchased outstanding with a rate of 2.325% at December 31, 2004. The Bank had unused upstream federal fund lines available from commercial banks at December 31, 2004 of approximately $138.6 million. Generally, these federal fund borrowings are overnight, but not to exceed seven days.

8. Long-term Debt

On September 29, 2006, Texas Capital Statutory Trust V issued $41,238,000 of its Floating Rate Capital Securities (the 2006-2 Trust Preferred Securities) in a private offering. Proceeds of the 2006-2 Trust Preferred Securities were invested in Floating Rate Junior Subordinated Deferrable Interest Debentures (the 2006-2 Subordinated Debentures) of the Company. The interest rate on the 2006-2 Trust Preferred Subordinated Debentures is a floating rate that resets quarterly to 1.71% above the three-month LIBOR rate. After deducting underwriter s compensation and other expenses of the offering, the net proceeds were available to the Company to increase capital and for general corporate purposes, including use in investment and lending activities. Interest payments on the 2006-2 Subordinated Debentures are deductible for federal income tax purposes.

The 2006-2 Trust Preferred Securities and the 2006-2 Subordinated Debentures each mature in September 2036; however, the 2006-2 Trust Preferred Securities and the 2006-2 Subordinated Debentures may be redeemed at the option of the Company on fixed quarterly dates beginning on December 31, 2011. The 2006-2 Trust Preferred and the 2006-2 Subordinated Debentures also may be redeemed prior to maturity if certain events occur. The 2006-2 Trust Preferred is subject to mandatory redemption, in whole or in part, upon repayment of the 2006-2 Subordinated Debentures at maturity or their earlier redemption. The

Company also has the right, if certain conditions are met, to defer payment of interest on the 2006-2 Subordinated Debentures, which would result in a deferral of dividend payments on the 2006-2 Trust Preferred, at any time or from time to time for a period not to exceed 20 consecutive quarters in a deferral period. The payment by the Company of the principal and interest on the 2006-2 Subordinated Debentures is subordinated and junior in right of payment to the prior payment in full of all senior indebtedness of the Company, whether outstanding at this time or incurred in the future.

The Company and Texas Capital Statutory Trust V believe that, taken together, the obligations of the Company under the Trust Preferred Guarantee Agreement, the Amended and Restated Trust Agreement, the Subordinated Debentures, the Indenture and the Agreement as to Expenses and Liabilities, entered into in connection with the offering of the 2006-2 Trust Preferred and the 2006-2 Subordinated Debentures, in the aggregate constitute a full and unconditional guarantee by the Company of the obligations of Texas Capital Statutory Trust V under the 2006 Trust Preferred.

Texas Capital Statutory Trust V is a Delaware business trust created for the purpose of issuing the 2006-2 Trust Preferred and purchasing the 2006-2 Subordinated Debentures, which are its sole assets. The Company owns all of the outstanding common securities, liquidation value $1,000 per share, of Texas Capital Statutory Trust V.

On April 28, 2006, Texas Capital Statutory Trust IV issued $25,774,000 of its Floating Rate Capital Securities (the 2006-1 Trust Preferred Securities) in a private offering. Proceeds of the 2006-1 Trust Preferred Securities were invested in Floating Rate Junior Subordinated Deferrable Interest Debentures (the 2006-1 Subordinated Debentures) of the Company. The interest rate on the 2006-1 Trust Preferred Subordinated Debentures is a floating rate that resets quarterly to 1.60% above the three-month LIBOR rate. After deducting underwriter s compensation and other expenses of the offering, the net proceeds were available to the Company to increase capital and for general corporate purposes, including use in investment and lending activities. Interest payments on the 2006-1 Subordinated Debentures are deductible for federal income tax purposes.

The 2006-1 Trust Preferred Securities and the 2006-1 Subordinated Debentures each mature in June 2036; however, the 2006-1 Trust Preferred Securities and the 2006-1 Subordinated Debentures may be redeemed at the option of the Company on fixed quarterly dates beginning on June 15, 2011. The 2006-1 Trust Preferred and the 2006-1 Subordinated Debentures also may be redeemed prior to maturity if certain events occur. The 2006-1 Trust Preferred is subject to mandatory redemption, in whole or in part, upon repayment of the 2006-1 Subordinated Debentures at maturity or their earlier redemption. The Company also has the right, if certain conditions are met, to defer payment of interest on the 2006-1 Subordinated Debentures, which would result in a deferral of dividend payments on the 2006-1 Trust Preferred, at any time or from time to time for a period not to exceed 20 consecutive quarters in a deferral period. The payment by the Company of the principal and interest on the 2006-1 Subordinated Debentures is subordinated and junior in right of payment to the prior payment in full of all senior indebtedness of the Company, whether outstanding at this time or incurred in the future.

The Company and Texas Capital Statutory Trust IV believe that, taken together, the obligations of the Company under the Trust Preferred Guarantee Agreement, the Amended and Restated Trust Agreement, the Subordinated Debentures, the Indenture and the Agreement as to Expenses and Liabilities, entered into in connection with the offering of the 2006-1 Trust Preferred and the 2006-1 Subordinated Debentures, in the aggregate constitute a full and unconditional guarantee by the Company of the obligations of Texas Capital Statutory Trust IV under the 2006 Trust Preferred.

Texas Capital Statutory Trust IV is a Delaware business trust created for the purpose of issuing the 2006-1 Trust Preferred and purchasing the 2006-1 Subordinated Debentures, which are its sole assets. The Company owns all of the outstanding common securities, liquidation value $1,000 per share, of Texas Capital Statutory Trust IV.

On October 6, 2005, Texas Capital Statutory Trust III issued $25,774,000 of its Fixed/Floating Rate Capital Securities (the 2005 Trust Preferred) in a private offering. Proceeds of the 2005 Trust Preferred were invested in Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures (the 2005 Subordinated Debentures) of the Company. Interest rate on the 2005 Trust Preferred Subordinated Debentures is a fixed rate of 6.19% for five years through December 15, 2010, and a floating rate of interest for the remaining 25 years that resets quarterly to 1.51% above the three month LIBOR rate. After deducting underwriter s compensation and other expenses of the offering, the net proceeds were available to the Company to increase capital and for general corporate purposes, including use in investment and lending activities. Interest payments on the Subordinated Debentures are deductible for federal income tax purposes.

The 2005 Trust Preferred and the 2005 Subordinated Debentures each mature in December 2035. If certain conditions are met, the maturity dates of the 2005 Trust Preferred and the 2005 Subordinated Debentures may be shortened to a date not earlier than December 2010. The 2005 Trust Preferred and the 2005 Subordinated Debentures also may be redeemed prior to maturity if certain events occur. The 2005 Trust Preferred is subject to mandatory redemption, in whole or in part, upon repayment of the 2005 Subordinated Debentures at maturity or their earlier redemption. The Company also has the right, if certain conditions are met, to defer payment of interest on the 2005 Subordinated Debentures, which would result in a deferral of dividend payments on the 2005 Trust Preferred, at any time or from time to time for a period not to exceed 20 consecutive quarters in a deferral period. The payment by the Company of the principal and interest on the 2005 Subordinated Debentures is subordinated and junior in right of payment to the prior payment in full of all senior indebtedness of the Company, whether outstanding at this time or incurred in the future.

The Company and Texas Capital Statutory Trust III believe that, taken together, the obligations of the Company under the Trust Preferred Guarantee Agreement, the Amended and Restated Trust Agreement, the Subordinated Debentures, the Indenture and the Agreement as to Expenses and Liabilities, entered into in connection with the offering of the 2005 Trust Preferred and the Subordinated Debentures, in the aggregate constitute a full and unconditional guarantee by the Company of the obligations of Texas Capital Statutory Trust III under the 2005 Trust Preferred.

Texas Capital Statutory Trust III is a Delaware business trust created for the purpose of issuing the 2005 Trust Preferred and purchasing the Subordinated Debentures, which are its sole assets. The Company owns all of the outstanding common securities, liquidation value $1,000 per share, of Texas Capital Statutory Trust III.

On April 10, 2003, Texas Capital Statutory Trust II issued $10,310,000 of its Floating Rate Capital Securities Cumulative Trust Preferred Securities (the 2003 Trust Preferred) in a private offering. Proceeds of the 2003 Trust Preferred were invested in the Floating Rate Junior Subordinated Deferrable Interest Securities (the 2003 Subordinated Debentures) of the Company. Interest rate on the 2003 Trust Preferred Subordinated Debentures is three month LIBOR plus 3.25%. After deducting underwriter s compensation and other expenses of the offering, the net proceeds were available to the Company to increase capital and for general corporate purposes, including use in investment and lending activities. Interest payments on the Subordinated Debentures are deductible for federal income tax purposes.

The 2003 Trust Preferred and the 2003 Subordinated Debentures each mature in April 2033. If certain conditions are met, the maturity dates of the 2003 Trust Preferred and the Subordinated Debentures may be shortened to a date not earlier than April 10, 2008. The 2003 Trust Preferred and the 2003 Subordinated Debentures also may be redeemed prior to maturity if certain events occur. The 2003 Trust Preferred is subject to mandatory redemption, in whole or in part, upon repayment of the 2003 Subordinated Debentures at maturity or their earlier redemption. The Company also has the right, if certain conditions are met, to defer payment of interest on the 2003 Subordinated Debentures, which would result in a deferral of dividend payments on the 2003 Trust Preferred, at any time or from time to time for a period not to exceed 20 consecutive quarters in a deferral period. The payment by the Company of the principal and interest on the 2003 Subordinated Debentures is subordinated and junior in right of payment to the prior payment in full of all senior indebtedness of the Company, whether outstanding at this time or incurred in the future.

The Company and Texas Capital Statutory Trust II believe that, taken together, the obligations of the Company under the Trust Preferred Guarantee Agreement, the Amended and Restated Trust Agreement, the

2003 Subordinated Debentures, the Indenture and the Agreement as to Expenses and Liabilities, entered into in connection with the offering of the 2003 Trust Preferred and the 2003 Subordinated Debentures, in the aggregate constitute a full and unconditional guarantee by the Company of the obligations of Texas Capital Statutory Trust II under the 2003 Trust Preferred.

Texas Capital Statutory Trust II is a Connecticut business trust created for the purpose of issuing the 2003 Trust Preferred and purchasing the Subordinated Debentures, which are its sole assets. The Company owns all of the outstanding common securities, liquidation value $1,000 per share of Texas Capital Statutory Trust II.

On November 19, 2002, Texas Capital Bancshares Statutory Trust I issued $10,310,000 of its Floating Rate Capital Securities Cumulative Trust Preferred Securities (the 2002 Trust Preferred) in a private offering. Proceeds of the 2002 Trust Preferred were invested in the Floating Rate Junior Subordinated Deferrable Interest Securities (the 2002 Subordinated Debentures) of the Company. Interest rate on the 2002 Trust Preferred Subordinated Debentures is three month LIBOR plus 3.35%. After deducting underwriter s compensation and other expenses of the offering, the net proceeds were available to the Company to increase capital and for general corporate purposes, including use in investment and lending activities. Interest payments on the 2002 Subordinated Debentures are deductible for federal income tax purposes.

The 2002 Trust Preferred and the 2002 Subordinated Debentures each mature in November 2032. If certain conditions are met, the maturity dates of the 2002 Trust Preferred and the 2002 Subordinated Debentures may be shortened to a date not earlier than November 19, 2007. The 2002 Trust Preferred and the 2002 Subordinated Debentures also may be redeemed prior to maturity if certain events occur. The 2002 Trust Preferred is subject to mandatory redemption, in whole or in part, upon repayment of the 2002 Subordinated Debentures at maturity or their earlier redemption. The Company also has the right, if certain conditions are met, to defer payment of interest on the 2002 Subordinated Debentures, which would result in a deferral of dividend payments on the 2002 Trust Preferred, at any time or from time to time for a period not to exceed 20 consecutive quarters in a deferral period. The payment by the Company of the principal and interest on the 2002 Subordinated Debentures is subordinated and junior in right of payment to the prior payment in full of all senior indebtedness of the Company, whether outstanding at this time or incurred in the future.

The Company and Texas Capital Bancshares Statutory Trust I believe that, taken together, the obligations of the Company under the Trust Preferred Guarantee Agreement, the Amended and Restated Trust Agreement, the 2002 Subordinated Debentures, the Indenture and the Agreement as to Expenses and Liabilities, entered into in connection with the offering of the 2002 Trust Preferred and the 2002 Subordinated Debentures, in the aggregate constitute a full and unconditional guarantee by the Company of the obligations of Texas Capital Bancshares Statutory Trust I under the 2002 Trust Preferred.

Texas Capital Bancshares Statutory Trust I is a Connecticut business trust created for the purpose of issuing the 2002 Trust Preferred and purchasing the Subordinated Debentures, which are its sole assets. The Company owns all of the outstanding common securities, liquidation value $1,000 per share of Texas Capital Bancshares Statutory Trust I.

In February 2005, the Federal Reserve Board issued a final rule that allows the continued inclusion of trust preferred securities in the Tier I capital of bank holding companies. The Board s final rule limits the aggregate amount of restricted core capital elements (which includes trust preferred securities, among other things) that may be included in the Tier I capital of most bank holding companies to 25% of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. As a result of this final ruling, $81 million of the $113.4 million in trust preferred securities issued by Texas Capital Bancshares Statutory Trusts I, II, III, IV and V is included in Tier I capital at December 31, 2006.

9. Income Taxes

The Company has a gross deferred tax asset of $14.1 million at December 31, 2006, which relates primarily to our allowance for loan losses and our unrealized loss on securities. Although realization is not assured, management believes it is more likely than not that all of the deferred tax assets will be realized. The Company s net deferred tax asset is included in other assets in the consolidated balance sheet.

At December 31, 2005, the Company had a gross deferred tax asset of $13.7 million, which related primarily to our allowance for loan losses.

Income tax expense/(benefit) consists of the following for the years ended:

	Year Ended December 31		
(in thousands)	**2006**	**2005**	**2004**
Current:			
Federal	$ 16,054	$ 14,054	$ 10,086
State	308	247	
Total	$ 16,362	$ 14,301	$ 10,086
Deferred:			
Federal	$ (1,433)	$ (302)	$ (300)
State			
Total	$ (1,433)	$ (302)	$ (300)
Total expense:			
Federal	$ 14,621	$ 13,752	$ 9,786
State	308	247	
Total	$ 14,929	$ 13,999	$ 9,786

The following table shows the breakdown of total income tax expense for continuing operations and discontinued operations for the years ended December 31, 2006, 2005 and 2004:

Total expense:			
From continuing operations	$ 15,064	$ 13,783	$ 10,006
From discontinued operations	(135)	216	(220)
Total	$ 14,929	$ 13,999	$ 9,786

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of deferred tax assets and liabilities are as follows:

	December 31	
(in thousands)	**2006**	**2005**
Deferred tax assets:		
Allowance for loan losses	$ 7,491	$ 6,641
Organizational costs/software	142	289
Loan origination fees	2,155	1,957
Stock compensation	1,183	177
Non-accrual interest	90	151
Unrealized loss on securities	2,816	4,363
Other	260	150
	14,137	13,728
Deferred tax liabilities:		
Loan origination costs	(755)	(677)
FHLB stock dividends	(354)	(250)
Depreciation	(427)	(109)
Other	(23)	
	(1,559)	(1,036)
Net deferred tax asset	$ 12,578	$ 12,692

The reconciliation of income attributable to continuing operations computed at the U.S. federal statutory tax rates to income tax expense (benefit) is as follows:

	Year Ended December 31		
	2006	**2005**	**2004**
Tax at U.S. statutory rate	35%	35%	35%
State taxes	1%	1%	
Non-deductible expenses	1%	1%	1%
Non-taxable income	(2)%	(2)%	(3)%
Other and tax related reserves	(1)%	(1)%	
Total	34%	34%	33%

10. Employee Benefits

The Company has a qualified retirement plan, with a salary deferral feature designed to qualify under Section 401 of the Internal Revenue Code (the 401(k) Plan). The 401(k) Plan permits the employees of the Company to defer a portion of their compensation. Matching contributions may be made in amounts and at times determined by the Company. The Company made no such contributions for the years ended December 31, 2005 and 2004. The Company contributed approximately $340,000 for the year ended December 31, 2006. Employees of the Company are eligible to participate in the 401(k) Plan when they meet certain requirements concerning minimum age and period of credited service. All contributions to the 401(k) Plan are invested in accordance with participant elections among certain investment options.

During 2000, the Company implemented an Employee Stock Purchase Plan (ESPP). Employees are eligible for the plan when they have met certain requirements concerning period of credited service and minimum hours worked. Eligible employees may contribute a minimum of 1% to a maximum of 10% of eligible compensation up to the Section 423 of the Internal Revenue Code limit of $25,000. The Company has allocated 160,000 shares to the plan. As of December 31, 2005 and 2004, 159,478 shares, had been purchased on behalf of the employees. Effective December 30, 2005, the 2000 Employee Stock Purchase Plan was terminated. During January 2006, a new plan (2006 ESPP) was adopted that allocated 400,000 shares to the plan. The 2006 Employee Stock Purchase Plan was approved by stockholders at the 2006 annual meeting. As of December 31, 2006, 12,293 shares had been purchased on behalf of the employees under the 2006 ESPP.

As of December 31, 2006, the Company has two stock option plans, the 1999 Stock Omnibus Plan (1999 Plan) and the 2005 Long-Term Incentive Plan (2005 Plan). The 1999 Plan is no longer available for grants of equity based compensation; however, options to purchase shares previously issued under the plan will remain outstanding and be subject to administration by the Company s board of directors. Under the 2005 Plan, equity-based compensation grants were made by the Board of Directors, or its designated committee. Grants under the 2005 Plan are subject to vesting requirements. Under the 2005 Plan, the Company may grant, among other things, nonqualified stock options, incentive stock options, restricted stock units, stock appreciation rights, or any combination thereof. The 2005 Plan includes grants for employees and directors. Totals shares authorized under the plan for awards is 1,500,000. Total shares which may be issued under the 2005 Plan at December 31, 2006 and 2005 were 695,902 and 1,381,000.

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

The fair value of the options, stock appreciation rights and performance stock appreciation rights were estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2006
Risk-free rate	4.83%
Dividend yield	0.00
Market price volatility factor	.279
Weighted-average expected life of options	5 years

Table of Contents

A summary of the Company s stock option activity and related information for 2006, 2005 and 2004 is as follows:

	December 31, 2006		December 31, 2005		December 31, 2004	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Options outstanding at beginning of year	2,608,006	$ 10.32	2,654,480	$ 9.01	2,686,193	$ 7.85
Options granted			307,250	20.84	309,500	16.38
Options exercised	(259,213)	8.03	(240,814)	7.35	(318,413)	6.52
Options forfeited	(40,690)	13.94	(112,910)	14.62	(22,800)	7.25
Options outstanding at year-end	2,308,103	$ 10.51	2,608,006	$ 10.32	2,654,480	$ 9.01
Options vested and exercisable at year-end	1,526,106	$ 8.82	1,557,207	$ 7.56	1,256,812	$ 7.23
Intrinsic value of options vested and exercisable	$ 16,875,000					
Weighted average remaining contractual life of options vested and exercisable		4.87				
Weighted average fair value of options granted during 2006, 2005 and 2004		$		$ 6.93		$ 5.28
Fair value of shares vested during year	$ 3,618,000		$ 3,163,000		$ 2,442,000	
Intrinsic value of options exercised	$ 3,419,000		$ 3,464,000		$ 3,260,000	
Weighted average remaining contractual life of options currently outstanding in years:		5.63		6.55		7.11

The Company expensed approximately $1,565,000 in 2006 related to stock option awards. Expenses are calculated utilizing the straight-line method. The range of grant prices for all stock options was between $18.62 and $24.05 at December 31, 2005, and $14.45 and $21.84 at December 31, 2004.

In connection with the 2005 Long-term Incentive Plan, stock appreciation rights were issued in 2005 and 2006. These rights are service-based and generally vest over a period of five years. Of the SAR s granted, 300,312 were Performance Stock Appreciation Rights (PSAR s). The PSARs vest as certain price targets are met within a three year period. If the targets are not met with in their stated timeframes, they will be forfeited.

	December 31, 2006		December 31, 2005	
	SARs/	Weighted Average Exercise	SARs/	Weighted Average Exercise

	PSARs		Price	PSARs		Price
SARs outstanding at beginning of year	21,000	$	23.38		$	
SARs granted	1,017,031		21.65	21,000		23.38
SARs exercised						
SARs forfeited	(14,977)		22.65			
SARs outstanding at year-end	1,023,054	$	21.67	21,000	$	23.38
SARs vested at year-end	4,200					
Compensation expense	$ 784,000			$		
Weighted average fair value of SAR s granted during 2006		$	6.81		$	
Weighted average remaining contractual life of SAR s currently outstanding in years			9.50			

Table of Contents

The following table summarizes the status of and changes in the Bank s nonvested restricted stock units:

	Non-Vested Stock Awards Outstanding		
	Number of Shares		Weighted-Average Grant-Date Fair Value
Balance, January 1, 2004	240,750	$	8.53
Granted			
Vested and issued	(105,750)		8.81
Forfeited			
Cancelled			
Balance, December 31, 2004	135,000		8.31
Granted			
Vested and issued	(67,500)		8.31
Forfeited			
Cancelled			
Balance, December 31, 2005	67,500		8.31
Granted	412,383		20.52
Vested and issued	(67,500)		8.31
Forfeited	(815)		22.65
Cancelled			
Balance, December 31, 2006	411,568	$	20.52

The RSU s granted during 2006 generally vest over five years. Compensation cost for restricted stock units was $498,000, $873,000 and $765,000 for years ended December 31, 2006, 2005 and 2004, respectively. The weighted average remaining contractual life of RSU s currently outstanding is 9.81 years.

Total compensation cost for all share-based arrangements, net of taxes, was $1,877,000, for the year ended December 31, 2006.

Unrecognized stock-based compensation expense related to unvested options issued prior to adoption of SFAS 123R is $3.4 million, pre-tax. The weighted average period over which this unrecognized expense is expected to be recognized was 1.9 years. Unrecognized stock-based compensation expense related to SAR grants issued during 2006 is $5.8 million. At December 31, 2006, the weighted average period over which this unrecognized expense is expected to be recognized was 2.6 years. Unrecognized stock-based compensation expense related to RSU grants during 2006 is $8.0 million. At December 31, 2006, the weighted average period over which this unrecognized expense is expected to be recognized was 2.9 years.

Cash flows from financing activities included $4,090,000 in cash inflows from excess tax benefits related to stock compensation. The 2006 tax benefit realized from stock options exercised is $1,431,000.

Upon share option exercise, new shares are issued as opposed to treasury shares.

Table of Contents

The following pro forma information presents net income and earnings per share for 2005 and 2004 as if the fair value method of SFAS 123 had been adopted.

(in thousands except per share data)	Year Ended December 31 2005	2004
Net income from continuing operations	$ 26,776	$ 19,985
Add: Total stock-based employee compensation recorded, net of related tax effects	576	510
Less: Total stock based employee compensation expense determined under fair value based method for all awards, net of related tax effect	(1,526)	(1,274)
Pro forma net income from continuing operations	25,826	19,221
Income from discontinued operations	416	(425)
Pro forma net income from consolidated operations	$ 26,242	$ 18,796
Basic income per share:		
From continuing operations	$ 1.05	$ .79
Pro forma from continuing operations	1.01	.76
As reported	1.06	.77
Pro forma from consolidated operations	1.02	.74
Diluted income per share:		
From continuing operations	$ 1.01	$ .76
Pro forma from continuing operations	.96	.73
As reported	1.02	.75
Pro forma from consolidated operations	.98	.71

The fair value of these options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2005	2004
Risk-free rate	5.26%	3.64%
Dividend yield	0.00	0.00
Market price volatility factor	.390	.288
Weighted-average expected life of options	5 years	5 years

In 1999, the Company entered into a deferred compensation agreement with one of its executive officers. The agreement allows the employee to elect to defer up to 100% of his compensation on an annual basis. All deferred compensation is invested in the Company s common stock held in a rabbi trust. The stock is held in the name of the trustee, and the principal and earnings of the trust are held separate and apart from other funds of the Company, and are used exclusively for the uses and purposes of the deferred compensation agreement. The accounts of the trust have been consolidated with the accounts of the Company.

11. Financial Instruments with Off-Balance Sheet Risk

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

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other

Table of Contents

termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer s credit-worthiness on a case-by-case basis.

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

	December 31	
(in thousands)	**2006**	**2005**
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 1,070,873	$ 851,625
Standby and commercial letters of credit	58,203	52,554

12. Regulatory Restrictions

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2006, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

Financial institutions are categorized as well capitalized or adequately capitalized, based on minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the tables below. As shown below, the Bank s capital ratios exceed the regulatory definition of well capitalized as of December 31, 2006 and 2005. As of March 31, 2006, the most recent notification from the OCC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There have been no conditions or events since the notification that management believes have changed the Bank s category. Based upon the information in its most recently filed call report, the Bank continues to meet the capital ratios necessary to be well capitalized under the regulatory framework for prompt corrective action.

Table of Contents

(in thousands except percentage data)	**Actual** **Amount**	**Ratio**	**For Capital Adequacy Purposes** **Amount**	**Ratio**	**To be Well Capitalized Under Prompt Corrective Action Provisions** **Amount**	**Ratio**
As of December 31, 2006:						
Total capital (to risk-weighted assets):						
Company	$ 375,096	11.16%	$ 268,786	8.00%	N/A	N/A
Bank	339,336	10.10%	268,678	8.00%	$ 335,847	10.00%
Tier 1 capital (to risk-weighted assets):						
Company	$ 325,093	9.68%	$ 134,393	4.00%	N/A	N/A
Bank	318,333	9.48%	134,339	4.00%	$ 201,508	6.00%
Tier 1 capital (to average assets):						
Company	$ 325,093	9.18%	$ 141,595	4.00%	N/A	N/A
Bank	318,333	9.00%	141,541	4.00%	$ 176,926	5.00%
As of December 31, 2005:						
Total capital (to risk-weighted assets):						
Company	$ 275,695	10.83%	$ 203,701	8.00%	N/A	N/A
Bank	258,327	10.15%	203,544	8.00%	$ 254,431	10.00%
Tier 1 capital (to risk-weighted assets):						
Company	$ 256,798	10.09%	$ 101,851	4.00%	N/A	N/A
Bank	239,430	9.41%	101,772	4.00%	$ 152,658	6.00%
Tier 1 capital (to average assets):						
Company	$ 256,798	8.68%	$ 118,296	4.00%	N/A	N/A
Bank	239,430	8.10%	118,220	4.00%	$ 147,775	5.00%

Dividends that may be paid by subsidiary banks are routinely restricted by various regulatory authorities. The amount that can be paid in any calendar year without prior approval of the Bank s regulatory agencies cannot exceed the lesser of net profits (as defined) for that year plus the net profits for the preceding two calendar years, or retained earnings. No dividends were declared or paid during 2006, 2005 or 2004.

The required balance at the Federal Reserve at December 31, 2006 and 2005 was approximately $47,331,000 and $48,210,000, respectively.

13. Earnings Per Share

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

	Year-Ended December 2006	Year-Ended December 2005	Year-Ended December 2004
Numerator:			
Net income from continuing operations	$ 29,184	$ 26,776	$ 19,985
Income (loss) from discontinued operations	(260)	416	(425)
Net income	$ 28,924	$ 27,192	$ 19,560
Denominator:			
Denominator for basic earnings per share-weighted average shares	25,945,065	25,619,594	25,260,526
Effect of employee stock options(1)	523,746	1,025,604	974,111
Denominator for dilutive earnings per share-adjusted weighted average shares and assumed conversions	26,468,811	26,645,198	26,234,637
Basic earning per share from continuing operations	$ 1.12	$ 1.05	$ .79
Basic earning per share	$ 1.11	$ 1.06	$ .77
Diluted earnings per share from continuing operations	$ 1.10	$ 1.00	$ .76
Diluted earnings per share	$ 1.09	$ 1.02	$ .75

(1) Stock options outstanding of 1,032,170 in 2006 and 47,500 in 2005 have not been included in diluted earnings per share because to do so would have been antidilutive for the periods presented. Stock options are antidilutive when the exercise price is higher than the current market price of the Company s common stock.

14. Fair Values of Financial Instruments

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

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

	December 31, 2006		December 31, 2005	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Cash and cash equivalents	$ 93,716	$ 93,716	$ 137,840	$ 137,840
Securities, available-for-sale	532,053	532,053	630,482	630,482
Loans, net	2,916,952	2,908,265	2,168,242	2,163,822
Deposits	3,069,330	3,068,785	2,495,179	2,495,081

Federal funds purchased	165,955	165,955	103,497	103,497
Borrowings	45,604	45,452	162,224	160,544
Long-term debt	113,406	113,213	46,394	46,394

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

Cash and cash equivalents

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

Securities

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

Loans

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

Deposits

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

Federal funds purchased, other borrowings and long-term debt

The carrying value reported in the consolidated balance sheet for federal funds purchased and short-term borrowings approximates their fair value. The fair value of term borrowings and long-term debt is estimated using a discounted cash flow calculation that applies interest rates currently being offered on similar borrowings.

Off-balance sheet instruments

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

15. Commitments and Contingencies

The Company leases various premises under operating leases with various expiration dates. Rent expense incurred under operating leases amounted to approximately $5,354,000, $4,153,000 and $3,068,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

Minimum future lease payments under operating leases are as follows:

Year Ending December 31, *(in thousands)*	*Minimum Payments*
2007	$ 5,747
2008	6,478
2009	7,186
2010	5,638
2011	3,812
2012 and thereafter	35,951
	$ 64,812

16. Parent Company Only

Summarized financial information for Texas Capital Bancshares, Inc. Parent Company Only follows:

Balance Sheets

(in thousands)	**December 31 2006**	**2005**
Assets		
Cash and cash equivalents	$ 30,040	$ 12,655
Investment in subsidiaries	331,162	244,559
Other assets	6,581	5,265
Total assets	$ 367,783	$ 262,479
Liabilities and Stockholders Equity		
Other liabilities	$ 762	$ 513
Long-term debt	113,406	46,394
Total liabilities	114,168	46,907
Common stock	261	258
Additional paid-in capital	182,321	176,131
Retained earnings	76,263	47,288
Accumulated other comprehensive loss	(5,230)	(8,105)
Total stockholders equity	253,615	215,572
Total liabilities and stockholders equity	$ 367,783	$ 262,479

Table of Contents

Statements of Earnings

(in thousands)	Year Ended December 31 2006	2005	2004
Dividend income	$ 160	$ 53	$ 30
Other income	590	565	
Total income	750	618	30
Interest expense	5,439	1,858	1,097
Salaries and employee benefits	441	413	463
Legal and professional	1,174	1,023	883
Other non-interest expense	415	328	375
Total expense	7,469	3,622	2,818
Loss before income taxes and equity in undistributed income of subsidiary	(6,719)	(3,004)	(2,788)
Income tax benefit	(2,284)	(1,016)	(921)
Loss before equity in undistributed income of subsidiary	(4,435)	(1,988)	(1,867)
Equity in undistributed income of subsidiary	33,409	29,230	21,427
Net income	$ 28,974	$ 27,242	$ 19,560

Statements of Cash Flows

(in thousands)	Year Ended December 31 2006	2005	2004
Operating Activities			
Net income	$ 28,974	$ 27,242	$ 19,560
Adjustments to reconcile net income to net cash used in operating activities:			
Equity in undistributed income of subsidiary	(33,409)	(29,230)	(21,427)
(Increase) decrease in other assets	(1,316)	(1,550)	(2,483)
Tax benefit from stock option exercises	1,431	1,424	1,411
Excess tax benefits from stock-based compensation arrangements	(4,090)		
Increase in other liabilities	250	78	51
Net cash used in operating activities	(8,160)	(2,036)	(2,888)
Investing Activities			
Investment in subsidiaries	(47,472)	(40,785)	(7,000)
Net cash used in investing activities	(47,472)	(40,785)	(7,000)
Financing Activities			
Subordinated debentures	67,012	25,774	
Sale of common stock	1,915	2,330	3,223
Excess tax benefits from stock-based compensation arrangements	4,090		
Net cash provided by financing activities	73,017	28,104	3,223
Net increase (decrease) in cash and cash equivalents	17,385	(14,717)	(6,665)
Cash and cash equivalents at beginning of year	12,655	27,372	34,037
Cash and cash equivalents at end of year	$ 30,040	$ 12,655	$ 27,372

Table of Contents

17. Related Party Transactions

Certain members of our board of directors provide legal and consulting services to the Company.

See Notes 3 and 6 for a description of loans and deposits with related parties.

18. Sale of Discontinued Operation Residential Mortgage Lending

On October 16, 2006, the Company completed the sale of its residential mortgage lending division (RML) to Transnational Financial Network, Inc. (TFN). The sale was effective as of September 30, 2006, and is, accordingly, reported as discontinued operations. The terms of the sale agreement stipulated that the Company was to initially receive 1.13 million shares of TFN common stock with an additional 866,355 shares of TFN common stock subject to earn-out provisions. All accounts associated with this transaction have been reflected as discontinued operations. The Company s mortgage warehouse operations were not part of the sale, and are included in the results from continuing operations.

The results of operations of the discontinued component are presented separately in the accompanying consolidated statements of income for 2006, 2005 and 2004, net of tax, following income from continuing operations. Details are presented in the following table:

	Year Ended December 31		
(in thousands)	**2006**	**2005**	**2004**
Revenues	$ 15,812	$ 16,330	$ 6,485
Expenses	16,194	15,698	7,130
Loss on disposal	(13)		
Income (loss) before income taxes	(395)	632	(645)
Income tax expense (benefit)	(135)	216	(220)
Income (loss) from discontinued operations	$ (260)	$ 416	$ (425)

19. New Accounting Standards

Statements of Financial Accounting Standards

SFAS No. 123, Share-Based Payment (Revised 2004). SFAS 123R establishes standards for the accounting for transactions in which an entity (1) exchanges its equity instruments for goods or serves, or (ii) incurs liabilities in exchange for goods or services that are based on the fair value of the entity s equity instruments or that may be settled by the issuance of the equity instruments. SFAS 123R eliminates the ability to account for stock-based compensation using APB 25 and requires that such transactions be recognized as compensation cost in the income statement based on their fair values on the measurement date, which is generally the date of the grant. The Company adopted the provisions of SFAS 123R on January 1, 2006. Details related to the adoption of SFAS 123R and impact to the Company s financial statements are more fully discussed in Note 11 Employee Benefit Plans.

SFAS No. 154, Accounting Changes and Error Corrections, a Replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS 154 establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to a newly adopted accounting principle. Previously, most changes in accounting principle were recognized by including the cumulative effect of changing to the new accounting principle in net income of the period of the change. SFAS 154 carries forward the guidance in APB Opinion 20 Accounting Changes, requiring justification of a change in accounting principle on the basis of preferability. SFAS 154 also carries forward without change the guidance contained in APB Opinion 20, for reporting the correction of an error in previously issued financial statements and for a change in an accounting estimate. The adoption of SFAS 154 on January 1, 2006 did not impact the Company s financial statements.

SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140. SFAS 155 amends SFAS 133, Accounting for Derivative Instruments and Hedging Activities and SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS 155 (i) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (ii) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133, (iii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (iv) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and (v) amends SFAS 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 is effective for the Company on January 1, 2007 and is not expected to have a significant impact on the Company s financial statements.

SFAS No. 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for the Company on January 1, 2008 and is not expected to have a significant impact on the Company s financial statements.

Financial Accounting Standards Board Staff Positions and Interpretations

FASB Staff Position (FSP) No. 115-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. FSP 115-1 provides guidance for determining when an investment is considered impaired, whether impairment is other-than-temporary, and measurement of an impairment loss. An investment is considered impaired if the fair value of the investment is less than its cost. If, after consideration of all available evidence to evaluate the realizable value of its investment, impairment is determined to be other-than-temporary, then an impairment loss should be recognized equal to the difference between the investment s cost and its fair value. FSP 115-1 nullifies certain provisions of Emerging Issues Task Force (EITF) Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, while retaining the disclosure requirements of EITF 03-1 which were adopted in 2003. The adoption of FSP 115-1 on January 1, 2006 did not significantly impact the Company s financial statements.

FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109. Interpretation 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. Interpretation 48 also provides guidance on the accounting for and disclosure of unrecognized tax benefits, interest and penalties. Interpretation 48 is effective for the Company on January 1, 2007 and is not expected to have a significant impact on the Company s financial statements.

SEC Staff Accounting Bulletins

Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of a Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements. SAB 108 addresses how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. The effects of prior year uncorrected errors include the potential accumulation of improper amounts that may result in a material misstatement on the balance sheet or the reversal of prior period errors in the current period that result in a material misstatement of the current period income statement amounts. Adjustments to current or prior period financial statements would be required in the event that after application of various approaches for assessing materiality of a misstatement in current period financial statements and consideration of all relevant quantitative and qualitative factors, a misstatement is determined to be material. SAB 108 is applicable to all financial statements issued by the Company after November 15, 2006. The considerations of SAB 108 did not impact the Company s December 31, 2006 financial statements.

ITEM 9. *CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE*

None.

ITEM 9A. *CONTROLS AND PROCEDURES*

We have established and maintain disclosure controls and other procedures that are designed to ensure that material information relating to us and our subsidiaries required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. For the period covered in this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2006.

The Chief Executive Officer and Chief Financial Officer have also concluded that there were no changes in our internal control over financial reporting identified in connection with the evaluation described in the preceding paragraph that occurred during the fiscal quarter ended December 31, 2006, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management s Report on Internal Control Over Financial Reporting

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed under the supervision of our Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements for external purposes in accordance with generally accepted accounting principles.

As of December 31, 2006, management assessed the effectiveness of the Company s internal control over financial reporting based on the criteria for effective internal control over financial reporting established in Internal Control Integrated Framework, issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on the assessment, management determined that the Company maintained effective internal control over financial reporting as of December 31, 2006, based on those criteria.

Ernst & Young LLP, the independent registered public accounting firm that audited the consolidated financial statements of the Company included in this Annual Report on Form 10-K, has issued an attestation report on management s assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2006. The report, which expresses unqualified opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting as of December 31, 2006, is included in this Item under the heading Report of Independent Registered Public Accounting Firm.

81

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of
Texas Capital Bancshares, Inc.

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting, that Texas Capital Bancshares, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Texas Capital Bancshares, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that Texas Capital Bancshares, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Texas Capital Bancshares, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2006 consolidated financial statements of Texas Capital Bancshares, Inc. and our report dated February 27, 2007 expressed an unqualified opinion thereon.

Dallas, Texas
February 27, 2007

82

ITEM 9B. ***OTHER INFORMATION***

None.

ITEM 10. ***DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT***

Information required by this item is set forth in our definitive proxy materials regarding our annual meeting of stockholders to be held May 15, 2007, which proxy materials will be filed with the SEC no later than April 30, 2007.

ITEM 11. ***EXECUTIVE COMPENSATION***

Information required by this item is set forth in our definitive proxy materials regarding our annual meeting of stockholders to be held May 15, 2007, which proxy materials will be filed with the SEC no later than April 30, 2007.

ITEM 12. ***SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT***

Information required by this item is set forth in our definitive proxy materials regarding our annual meeting of stockholders to be held May 15, 2007, which proxy materials will be filed with the SEC no later than April 30, 2007.

ITEM 13. ***CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS***

Information required by this item is set forth in our definitive proxy materials regarding our annual meeting of stockholders to be held May 15, 2007, which proxy materials will be filed with the SEC no later than April 30, 2007.

ITEM 14. ***PRINCIPAL ACCOUNTANT FEES AND SERVICES***

Information required by this item is set forth in our definitive proxy materials regarding our annual meeting of stockholders to be held May 15, 2007, which proxy materials will be filed with the SEC no later than April 30, 2007.

ITEM 15. ***EXHIBITS***

(a) *Documents filed as part of this report*

(1) All financial statements

Independent Registered Public Accounting Firms Report of Ernst & Young LLP

(2) *All financial statements required by Item 8*

Independent Registered Public Accounting Firms Report of Ernst & Young LLP

(3) *Exhibits*

2.1 Agreement and Plan to Consolidate Texas Capital Bank with and into Resource Bank, National Association and under the Title of Texas Capital Bank, National Association, which is incorporated by reference to Exhibit 2.1 to our registration statement on Form 10 dated August 24, 2001

2.2 Amendment to Agreement and Plan to Consolidate, which is incorporated by reference to Exhibit 2.2 to our registration statement on Form 10 dated August 24, 2001

3.1 Certificate of Incorporation, which is incorporated by reference to Exhibit 3.1 to our registration statement on Form 10 dated August 24, 2001

3.2 Certificate of Amendment of Certificate of Incorporation, which is incorporated by reference to Exhibit 3.2 to our registration statement on Form 10 dated August 24, 2001

3.3	Certificate of Amendment of Certificate of Incorporation, which is incorporated by reference to Exhibit 3.3 to our registration statement on Form 10 dated August 24, 2001
3.4	Certificate of Amendment of Certificate of Incorporation, which is incorporated by reference to Exhibit 3.4 to our registration statement on Form 10 dated August 24, 2001
3.5	Amended and Restated Bylaws of Texas Capital Bancshares, Inc. which is incorporated by reference to Exhibit 3.5 to our registration statement on Form 10 dated August 24, 2001
4.1	Texas Capital Bancshares, Inc. 1999 Omnibus Stock Plan, which is incorporated by reference to Exhibit 4.1 to our registration statement on Form 10 dated August 24, 2001
4.2	Texas Capital Bancshares, Inc. 2006 Employee Stock Purchase Plan, which is incorporated by reference to our registration statement on Form S-8 dated February 3, 2006.
4.3	Texas Capital Bancshares, Inc. 2005 Long-Term Incentive Plan, which is incorporated by reference to our registration statement on Form S-8 dated June 3, 2005.
4.4	Placement Agreement by and among by and among Texas Capital Bancshares Statutory Trust I and SunTrust Capital Markets, Inc., which is incorporated by reference to our Current Report on Form 8-K dated December 4, 2002
4.5	Certificate of Trust of Texas Capital Bancshares Statutory Trust I, dated November 12, 2002 which is incorporated by reference to our Current Report on Form 8-K dated December 4, 2002
4.6	Amended and Restated Declaration of Trust by and among State Street Bank and Trust Company of Connecticut, National Association, Texas Capital Bancshares, Inc. and Joseph M. Grant, Raleigh Hortenstine III and Gregory B. Hultgren, dated November 19, 2002 which is incorporated by reference to our Current Report on Form 8-K dated December 4, 2002
4.7	Indenture dated November 19, 2002 which is incorporated by reference to our Current Report on Form 8-K dated December 4, 2002
4.8	Guarantee Agreement between Texas Capital Bancshares, Inc. and State Street Bank and Trust of Connecticut, National Association dated November 19, 2002, which is incorporated by reference to our Current Report on Form 8-K dated December 4, 2002
4.9	Placement Agreement by and among Texas Capital Bancshares, Inc., Texas Capital Statutory Trust II and Sandler O Neill & Partners, L.P., which is incorporated by reference to our Current Report Form 8-K dated June 11, 2003
4.10	Certificate of Trust of Texas Capital Statutory Trust II, which is incorporated by reference to our Current Report on Form 8-K dated June 11, 2003
4.11	Amended and Restated Declaration of Trust by and among Wilmington Trust Company, Texas Capital Bancshares, Inc., and Joseph M. Grant and Gregory B. Hultgren, dated April 10, 2003, which is incorporated by reference to our Current Report on Form 8-K dated June 11, 2003
4.12	Indenture between Texas Capital Bancshares, Inc. and Wilmington Trust Company, dated April 10, 2003, which is incorporated by reference to our Current Report on Form 8-K dated June 11, 2003
4.13	Guarantee Agreement between Texas Capital Bancshares, Inc. and Wilmington Trust Company, dated April 10, 2003, which is incorporated by reference to our Current Report on Form 8-K dated June 11, 2003
4.14	Amended and Restated Declaration of Trust for Texas Capital Statutory Trust III by and among Wilmington Trust Company, as Institutional Trustee and Delaware Trustee, Texas Capital Bancshares, Inc. as Sponsor, and the Administrators named therein, dated as of October 6, 2005.
4.15	Indenture between Texas Capital Bancshares, Inc., as Issuer, and Wilmington Trust Company, as Trustee, for Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures, dated as of October 6, 2005.
4.16	Guarantee Agreement between Texas Capital Bancshares, Inc. and Wilmington Trust Company, dated as of October 6, 2005.
4.17	Amended and Restated Declaration of Trust for Texas Capital Statutory Trust IV by and among Wilmington Trust Company, as Institutional Trustee and Delaware Trustee, Texas Capital Bancshares, Inc. as Sponsor, and the Administrators named therein, dated as of April 28, 2006

84

4.18	Indenture between Texas Capital Bancshares, Inc., as Issuer, and Wilmington Trust Company, as Trustee, for Floating Rate Junior Subordinated Deferrable Interest Debentures dated as of April 28, 2006
4.19	Guarantee Agreement between Texas Capital Bancshares, Inc. and Wilmington Trust Company, dated as of April 28, 2006
4.20	Amended and Restated Trust Agreement for Texas Capital Statutory Trust V by and among Wilmington Trust Company, as Property Trustee and Delaware Trustee, Texas Capital Bancshares, Inc., as Depositor, and the Administrative Trustees named therein, dated as of September 29, 2006.
4.21	Junior Subordinated Indenture between Texas Capital Bancshares, Inc. and Wilmington Trust Company, as Trustee, for Floating Rate Junior Subordinated Note dated as of September 29, 2006.
4.22	Guarantee Agreement between Texas Capital Bancshares, Inc. and Wilmington Trust Company, dated as of September 29, 2006.
10.1	Deferred Compensation Agreement, which is incorporated by reference to Exhibit 10.2 to our registration statement on Form 10 dated August 24, 2001+
10.2	Amended and Restated Deferred Compensation Agreement Irrevocable Trust+
10.3	Executive Employment Agreement between Joseph M. Grant and Texas Capital Bancshares, Inc. dated October 8, 2002, which is incorporated by reference to Exhibit 10.3 of our Annual Report on Form 10-K dated March 26, 2003+
10.4	Executive Employment Agreement between George F. Jones, Jr. and Texas Capital Bancshares, Inc. dated October 8, 2002, which is incorporated by reference to Exhibit 10.5 of our Annual Report on Form 10-K dated March 26, 2003+
10.5	Executive Employment Agreement between C. Keith Cargill and Texas Capital Bancshares, Inc. dated October 8, 2002, which is incorporated by reference to Exhibit 10.6 of our Annual Report on Form 10-K dated March 26, 2003+
10.6	Executive Employment Agreement between Peter Bartholow and Texas Capital Bancshares, Inc. dated October 6, 2003, which is incorporated by reference to Exhibit 10.7 of our Annual Report on Form 10-K dated March 15, 2004+
10.7	Executive Employment Agreement dated December 20, 2004, by and between Texas Capital Bancshares, Inc. and Joseph M. Grant, which is incorporated by reference to our Current Report on Form 8-K dated December 23, 2004+
10.8	Executive Employment Agreement dated December 20, 2004, by and between Texas Capital Bancshares, Inc. and George F. Jones, Jr., which is incorporated by reference to our Current Report on Form 8-K dated December 23, 2004+
10.9	Executive Employment Agreement dated December 20, 2004, by and between Texas Capital Bancshares, Inc. and C. Keith Cargill, which is incorporated by reference to our Current Report on Form 8-K dated December 23, 2004+
10.10	Executive Employment Agreement dated December 20, 2004, by and between Texas Capital Bancshares, Inc. and Peter B. Bartholow, which is incorporated by reference to our Current Report on Form 8-K dated December 23, 2004+
10.11	Officer Indemnity Agreement dated December 20, 2004, by and between Texas Capital Bancshares, Inc. and Joseph M. Grant, which is incorporated by reference to our Current Report on Form 8-K dated December 23, 2004+
10.12	Officer Indemnity Agreement dated December 20, 2004, by and between Texas Capital Bancshares, Inc. and George F. Jones, Jr., which is incorporated by reference to our Current Report on Form 8-K dated December 23, 2004+
10.13	Officer Indemnity Agreement dated December 20, 2004, by and between Texas Capital Bancshares, Inc. and C. Keith Cargill, which is incorporated by reference to our Current Report on Form 8-K dated December 23, 2004+
10.14	

Officer Indemnity Agreement dated December 20, 2004, by and between Texas Capital Bancshares, Inc. and Peter B. Bartholow, which is incorporated by reference to our Current Report on Form 8-K dated December 23, 2004+

85

10.15	Texas Capital Bancshares, Inc. 1999 Omnibus Stock Plan, which is incorporated by reference to Exhibit 4.1 to our registration statement on Form 10 dated August 24, 2001.
10.16	Texas Capital Bancshares, Inc. 2006 Employee Stock Purchase Plan, which is incorporated by reference to our registration statement on Form S-8 dated February 3, 2006.
10.17	Texas Capital Bancshares, Inc. 2005 Long-Term Incentive Plan, which is incorporated by reference to our registration statement on Form S-8 dated June 3, 2005.
21	Subsidiaries of the Registrant*
23.1	Consent of Ernst & Young LLP*
24.1	Power of Attorney**
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act*
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act*
32.1	Section 1350 Certification of Chief Executive Officer*
32.2	Section 1350 Certification of Chief Financial Officer*

* Filed herewith

\+ Management contract or compensatory plan arrangement

** Included on signature page of this Form 10-K

Table of Contents

SIGNATURES

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

TEXAS CAPITAL BANCSHARES, INC.

By: /s/ JOSEPH M. GRANT

Joseph M. Grant
Chairman of the Board of Directors and
Chief Executive Officer

Date: March 1, 2007

/s/ JOSEPH M. GRANT
Joseph M. Grant
Chairman of the Board of Directors and Chief
Executive Officer (principal executive officer)

Date: March 1, 2007

/s/ PETER BARTHOLOW
Peter Bartholow
Chief Financial Officer and Director
(principal financial officer)

Date: March 1, 2007

/s/ JULIE ANDERSON
Julie Anderson
Controller
(principal accounting officer)

Date: March 1, 2007

/s/ LEO CORRIGAN III
Leo Corrigan III
Director

Date: March 1, 2007

Table of Contents

/s/ FREDERICK B. HEGI, JR.
Frederick B. Hegi, Jr.
Director

Date: March 1, 2007

/s/ LARRY L. HELM
Larry L. Helm
Director

Date: March 1, 2007

/s/ JAMES R. HOLLAND, JR.
James R. Holland, Jr.
Director

Date: March 1, 2007

/s/ GEORGE F. JONES, JR.
George F. Jones, Jr.
Director

Date: March 1, 2007

/s/ WALTER W. MCALLISTER III
Walter W. McAllister III
Director

Date: March 1, 2007

/s/ LEE ROY MITCHELL
Lee Roy Mitchell
Director

Date: March 1, 2007

/s/ STEVE ROSENBERG
Steve Rosenberg
Director

Date: March 1, 2007

/s/ JOHN C. SNYDER
John C. Snyder
Director

Date: March 1, 2007

/s/ ROBERT W. STALLINGS
Robert W. Stallings
Director

Date: March 1, 2007

/s/ IAN J. TURPIN
Ian J. Turpin
Director

Date: March 1, 2007