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CULLEN FROST BANKERS INC
Form 10-Q
July 25, 2001

Securities and Exchange Commission
Washington, D.C. 20549

Form 10-Q

Quarterly Report Under Section 13 or 15(d)
of the Securities Exchange Act of 1934

For Quarter Ended June 30, 2001

Commission file number 0-7275

Cullen/Frost Bankers, Inc.
(Exact name of registrant as specified in its charter)

Texas
(State or other jurisdiction of
incorporation or organization)

74-1751768
(I.R.S. Employer
Identification No.)

100 W. Houston Street, San Antonio, Texas
(Address of principal executive offices)

78205
(Zip code)

(210) 220-4011
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last
report)

Indicate by check mark whether the registrant (1) has filed all reports
required to be filed by Section 13 or 15(d) of the 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 X. No .

Indicate the number of shares outstanding of each of the issuer's classes of
common stock, as of the latest practicable date: At July 20, 2001, there were
51,580,959 shares of Common Stock, \$.01 par value, outstanding.

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Part I. Financial Information

Item 1. Financial Statements (Unaudited)

Consolidated Statements of Income
 Cullen/Frost Bankers, Inc. and Subsidiaries
 (dollars in thousands, except per share amounts)

	Three Months Ended June 30		Six Months Ended June 30	
	2001	2000	2001	2000
INTEREST INCOME				
Loans, including fees	\$ 90,033	\$ 97,254	\$188,636	\$188,522
Securities:				
Taxable	22,137	26,290	46,460	51,103
Tax-exempt	1,869	1,847	3,759	3,652
Total Securities	24,006	28,137	50,219	54,755
Time deposits	99	125	215	270
Federal funds sold and securities purchased under resale agreements	3,520	1,372	5,764	2,100
Total Interest Income	117,658	126,888	244,834	245,647
INTEREST EXPENSE				
Deposits	32,422	38,260	71,962	73,317
Federal funds purchased and securities sold under repurchase agreements	3,417	4,376	7,779	7,914
Guaranteed preferred beneficial interests in the Corporation's junior subordinated deferrable interest debentures	2,119	2,119	4,238	4,238
Long-term notes payable and other borrowings	502	2,151	1,038	2,644
Total Interest Expense	38,460	46,906	85,017	88,113
Net Interest Income	79,198	79,982	159,817	157,534
Provision for possible loan losses	1,000	2,867	16,031	5,549
Net Interest Income After Provision For Possible Loan Losses	78,198	77,115	143,786	151,985
NON-INTEREST INCOME				
Trust fees	12,837	12,446	24,843	24,132
Service charges on deposit accounts	18,051	14,765	34,551	29,164
Insurance commissions	3,598	1,586	7,493	3,106
Other service charges, collection and exchange charges, commissions and fees	6,665	5,009	12,599	9,545
Net loss on securities transactions	(12)		(2)	(8)
Other	7,334	9,068	15,747	16,552
Total Non-Interest Income	48,473	42,874	95,231	82,491
NON-INTEREST EXPENSE				
Salaries and wages	36,711	34,439	72,321	67,668
Pension and other employee benefits	8,339	7,171	17,250	15,221
Net occupancy of banking premises	7,343	6,850	14,546	13,616
Furniture and equipment	6,240	5,219	12,252	10,285
Intangible amortization	3,752	3,818	7,632	7,774
Other	21,382	20,259	42,367	39,265
Total Non-Interest Expense	83,767	77,756	166,368	153,829

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Income Before Income Taxes and Cumulative Effect of Accounting Change	42,904	42,233	72,649	80,647
Income Taxes	14,243	14,603	24,458	27,861
Income Before Cumulative Effect of Accounting Change	28,661	27,630	48,191	52,786
Cumulative effect of change in accounting for derivatives, net of tax			3,010	
Net Income	\$ 28,661	\$ 27,630	\$ 51,201	\$ 52,786
Basic per share:				
Income before cumulative effect of accounting change	\$.56	\$.53	\$.93	\$ 1.01
Cumulative effect of change in accounting, net of taxes			.06	
Net Income	\$.56	\$.53	\$.99	\$ 1.01
Diluted per share:				
Income before cumulative effect of accounting change	\$.54	\$.52	\$.90	\$.98
Cumulative effect of change in accounting, net of taxes			.06	
Net Income	\$.54	\$.52	\$.96	\$.98
Dividends per common share	\$.215	\$.195	\$.410	\$.370

See notes to consolidated financial statements.

Consolidated Balance Sheets
Cullen/Frost Bankers, Inc. and Subsidiaries
(dollars in thousands, except per share amounts)

	June 30 2001	December 31 2000	June 30 2000
Assets			
Cash and due from banks	\$ 975,169	\$ 820,459	\$ 660,068
Time deposits	4,379	3,574	6,709
Securities held to maturity	61,534	71,153	78,337
Securities available for sale	1,651,385	1,594,860	1,614,106
Trading account securities	1,665	2,471	
Federal funds sold and securities purchased under resale agreements	141,650	215,050	135,275
Loans, net of unearned discount of \$6,762 at June 30, 2001; \$7,349 at December 31, 2000 and \$6,713 at June 30, 2000	4,545,914	4,534,645	4,425,799
Less: Allowance for possible loan losses	(65,254)	(63,265)	(58,965)
Net loans	4,480,660	4,471,380	4,366,834
Banking premises and equipment	149,853	149,893	146,591
Accrued interest and other assets	398,191	331,532	320,010

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Total Assets	\$7,864,486	\$7,660,372	\$7,327,930
	=====	=====	=====
Liabilities			
Demand Deposits:			
Commercial and individual	\$2,029,368	\$1,817,761	\$1,781,292
Correspondent banks	250,451	245,734	201,493
Public funds	40,077	55,129	52,265
	-----	-----	-----
Total demand deposits	2,319,896	2,118,624	2,035,050
Time Deposits:			
Savings and Interest-on-Checking	951,151	1,012,790	946,060
Money market deposit accounts	1,820,766	1,774,656	1,665,102
Time accounts	1,271,100	1,275,289	1,237,584
Public funds	324,177	318,331	243,774
	-----	-----	-----
Total time deposits	4,367,194	4,381,066	4,092,520
	-----	-----	-----
Total deposits	6,687,090	6,499,690	6,127,570
Federal funds purchased and securities sold under repurchase agreements	342,896	363,111	273,218
Accrued interest and other liabilities	123,468	125,977	304,031
Guaranteed preferred beneficial interest in the Corporation's junior subordinated deferrable interest debentures, net	98,595	98,568	98,541
	-----	-----	-----
Total Liabilities	7,252,049	7,087,346	6,803,360
Shareholders' Equity			
Common stock, par value \$.01 per share	536	536	536
Shares authorized:90,000,000			
Shares issued: 53,561,616			
Surplus	190,240	187,673	186,176
Retained earnings	473,932	448,006	414,305
Accumulated other comprehensive gain (loss), net of tax	3,605	(4,023)	(37,901)
Treasury stock(1,980,490; 2,131,534; 1,531,024 shares)	(55,876)	(59,166)	(38,546)
	-----	-----	-----
Total Shareholders' Equity	612,437	573,026	524,570
	-----	-----	-----
Total Liabilities and Shareholders' Equity	\$7,864,486	\$7,660,372	\$7,327,930
	=====	=====	=====

See notes to consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity
Cullen/Frost Bankers, Inc. and Subsidiaries
(dollars in thousands)

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income/(Loss) net of tax	Treasury Stock	Tota
	-----	-----	-----	-----	-----	-----
Balance at January 1, 2000	\$536	\$185,437	\$382,168	\$ (39,110)	\$ (19,720)	\$509,

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Net income for the twelve months ended December 31, 2000			108,817			108,
Unrealized gain on securities available for sale of \$36,826, net of tax and reclassification adjustment for after-tax losses included in net income of \$3				36,829		36,
Additional minimum pension Liability, net of tax				(1,742)		(1,

Total comprehensive income						143,

Proceeds from employee stock purchase plan and options	28		(3,532)		6,208	2,
Tax benefit related to exercise of stock options		1,926				1,
Purchase of treasury stock					(44,985)	(44,
Treasury stock obtained on the exercise of stock options					(2,177)	(2,
Issuance of restricted stock	282		(5)		1,508	1,
Restricted stock plan deferred compensation, net			112			
Cash dividend			(39,554)			(39,

Balance at December 31, 2000	536	187,673	448,006	(4,023)	(59,166)	573,
Net income for the six months ended June 30, 2001			51,201			51,
Unrealized gain on securities available for sale of \$7,627, net of tax and reclassification adjustment for after-tax losses included in net income of \$1				7,628		7,

Total comprehensive income						58,

Proceeds from employee stock purchase plan and options			(4,662)		7,155	2,
Tax benefit related to exercise of stock options		2,497				2,
Treasury stock obtained on the exercise of stock options					(4,145)	(4,
Issuance of restricted stock		70			280	
Restricted stock plan deferred compensation, net			524			
Cash dividend			(21,137)			(21,

Balance at June 30, 2001	\$536	\$190,240	\$473,932	\$ 3,605	\$(55,876)	\$612,
	=====	=====	=====	=====	=====	=====

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows
Cullen/Frost Bankers, Inc. and Subsidiaries
(dollars in thousands)

Six Months Ended
June 30

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	2001	2000
Operating Activities		
Net income	\$ 51,201	\$ 52,786
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for possible loan losses	16,031	5,549
Credit for deferred taxes	(965)	(2,688)
Accretion of discounts on loans	(594)	(566)
Accretion of securities' discounts	(2,767)	(1,338)
Amortization of securities' premiums	1,073	885
Net decrease in trading securities	806	1
Net loss on securities transactions	2	8
Net gain on sale of assets	(1,397)	(2,113)
Depreciation and amortization	17,891	16,764
Increase in interest receivable	(4,792)	(5,419)
(Decrease) increase in interest payable	(2,446)	2,637
Originations of loans held-for-sale	(6,510)	(52,313)
Proceeds from sales of loans held-for-sale	14,408	53,042
Tax benefit from exercise of employee stock options	2,497	707
Net change in other assets and liabilities	22,832	18,476
Net cash provided by operating activities	107,270	86,418
Investing Activities		
Proceeds from maturities of securities held to maturity	9,562	6,819
Purchases of investment securities		(100)
Proceeds from sales of securities available for sale	181,295	95,784
Proceeds from maturities of securities available for sale	362,815	131,805
Purchases of securities available for sale	(587,152)	(294,538)
Purchase of bank-owned life insurance	(100,000)	
Net increase in loans	(31,916)	(264,206)
Net increase in bank premises and equipment	(9,007)	(10,541)
Proceeds from sales of repossessed properties	707	732
Net cash and cash equivalents paid for acquisitions		(859)
Net cash used by investing activities	(173,696)	(335,104)
Financing Activities		
Net increase in demand deposits, IOC accounts, and savings accounts	191,589	171,048
Net (decrease) increase in certificates of deposits	(4,189)	2,690
Net (decrease) increase in short-term borrowings	(20,215)	114,759
Proceeds from employee stock purchase plan and options	2,493	1,340
Purchase of treasury stock		(21,805)
Dividends paid	(21,137)	(19,402)
Net cash provided by financing activities	148,541	248,630
Increase (decrease) in cash and cash equivalents	82,115	(56)
Cash and cash equivalents at beginning of year	1,039,083	802,108
Cash and cash equivalents at the end of the period	\$1,121,198	\$802,052
Supplemental information:		
Interest paid	\$ 79,684	\$ 85,476

See notes to consolidated financial statements.

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Notes to Consolidated Financial Statements
Cullen/Frost Bankers, Inc. and Subsidiaries
(tables in thousands)

Note A - Basis of Presentation

The consolidated financial statements include the accounts of Cullen/Frost Bankers, Inc. ("Cullen/Frost" or the "Corporation") and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The consolidated financial statements have not been audited by independent accountants, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the financial position and results of operations. All such adjustments were of a normal and recurring nature. For further information, refer to the consolidated financial statements and footnotes thereto included in Cullen/Frost's Annual Report on Form 10-K for the year ended December 31, 2000. The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Certain reclassifications have been made to make prior periods comparable.

Note B - Allowance for Possible Loan Losses

An analysis of the transactions in the allowance for possible loan losses is presented below. The amount charged to operating expense is based on management's assessment of the adequacy of the allowance based on estimated probable losses in the loan portfolio.

	Six Months Ended June 30	
(in thousands)	2001	2000
Balance at beginning of the period	\$63,265	\$58,345
Provision for possible loan losses	16,031	5,549
Net charge-offs:		
Losses charged to the allowance	(18,444)	(6,680)
Recoveries	4,402	1,751
Net charge-offs	(14,042)	(4,929)
Balance at the end of period	\$65,254	\$58,965

Note C - Impaired Loans

A loan within the scope of SFAS No. 114 is considered impaired when, based on current information and events, it is probable the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement, including scheduled principal and interest payments. All impaired loans are included in non-performing assets. At June 30, 2001, the majority of the impaired loans were commercial loans and collectibility was measured based on the fair value of the collateral. Interest payments on impaired loans are typically applied to principal unless collectibility of the principal amount is fully assured, in which case interest is recognized on the cash basis. Interest revenue recognized on impaired loans for the six months ended June 30, 2001 was \$627 thousand compared to none for the first six months of 2000. The total allowance for possible loan losses includes activity related to allowances calculated in accordance with SFAS No. 114 and activity related to other loan loss allowances determined in accordance with SFAS No. 5.

The following is a summary of loans considered to be impaired:

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(in thousands)	June 30	
	2001	2000
Impaired loans with no valuation reserve	\$ 1,621	\$1,473
Impaired loans with a valuation reserve	16,997	6,343
Total recorded investment in impaired loans	\$18,618	\$7,816
Average recorded investment in impaired loans	\$15,492	\$8,637
Valuation reserve	7,318	2,632

Note D - Common Stock and Earnings Per Common Share

A reconciliation of earnings per share follows:

(in thousands, except per share amounts)	Six Months Ended June 30		Three Months Ended June 30	
	2001	2000	2001	2000
Numerators for both basic and diluted earnings per share, net income	\$51,201	\$52,786	\$28,661	\$27,630
Denominators:				
Denominators for basic earnings per share, average outstanding common shares	51,540	52,458	51,562	52,235
Dilutive effect of stock options	2,008	1,139	1,685	1,283
Denominator for diluted earnings per share	53,548	53,597	53,247	53,518
Basic per share:				
Income before cumulative effect of accounting change	\$.93	\$ 1.01	\$.56	\$.53
Cumulative effect of change in accounting, net of taxes	.06			
Net Income	\$.99	\$ 1.01	\$.56	\$.53
Diluted per share:				
Income before cumulative effect accounting change	\$.90	\$.98	\$.54	\$.52
Cumulative effect of change in accounting, net of taxes	.06			
Net Income	\$.96	\$.98	\$.54	\$.52

Note E - Capital

The table below reflects various measures of regulatory capital at June 30, 2001 and 2000 for Cullen/Frost.

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Capital	June 30, 2001		June 30, 2000	
	Amount	Ratio	Amount	Ratio

Risk-Based				
Tier 1 Capital	\$ 587,793	10.70%	\$ 539,611	10.62%
Tier 1 Capital minimum requirement	219,691	4.00	203,255	4.00
Total Capital	\$ 653,047	11.89%	\$ 598,576	11.78%
Total Capital minimum requirement	439,382	8.00	406,509	8.00
Risk-adjusted assets, net of goodwill	\$5,492,274		\$5,081,363	
Leverage ratio		7.78%		7.68%
Average equity as a percentage of average assets		7.84		7.33

At June 30, 2001 and 2000, Cullen/Frost's subsidiary bank was considered "well capitalized" as defined by the FDIC Improvement Act of 1991, the highest rating, and Cullen/Frost's capital ratios were in excess of "well capitalized" levels. A financial institution is deemed to be well capitalized if the institution has a total risk-based capital ratio of 10.0 percent or greater, a Tier 1 risk-based capital ratio of 6.0 percent or greater, and a Tier 1 leverage ratio of 5.0 percent or greater, and the institution is not subject to an order, written agreement, capital directive or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. Cullen/Frost and its subsidiary bank currently exceed all minimum capital requirements. Management is not aware of any conditions or events that would have changed the Corporation's capital rating since June 30, 2001.

Cullen/Frost is subject to the regulatory capital requirements administered by the Federal Reserve Bank. Regulators can initiate certain mandatory actions, if the Corporation fails to meet the minimum requirements, that could have a direct material effect on the Corporation's financial statements.

Note F - Income Taxes

The following is an analysis of Cullen/Frost's income taxes included in the consolidated statements of operations for the six-month periods and quarters ended June 30, 2001 and 2000:

(in thousands)	Six Months Ended June 30		Three Months Ended June 30	
	2001	2000	2001	2000
Current income tax expense	\$25,423	\$30,549	\$14,546	\$15,998
Deferred income tax benefit	(965)	(2,688)	(303)	(1,395)
Income taxes	\$24,458	\$27,861	\$14,243	\$14,603
Current income tax expense related to the cumulative effect of change in accounting for derivatives		1,620		

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Income tax payments	\$18,925	\$25,276	\$18,925	\$25,276
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Net deferred tax assets at June 30, 2001, were \$17.7 million with no valuation allowance. The deferred tax assets were supported by taxes paid in prior years.

Note G - Merger and Acquisitions

Cullen/Frost regularly evaluates acquisition opportunities and conducts due diligence activities in connection with possible acquisitions. As a result, acquisition discussions and, in some cases, negotiations may take place and future acquisitions involving cash, debt or equity securities may occur. Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of the Corporation's book value and net income per common share may occur in connection with any future transactions.

On June 14, 2001, Frost Insurance Agency ("FIA"), a subsidiary of The Frost National Bank, announced the acquisition of AIS Insurance & Risk Management, an independent insurance agency in Fort Worth. AIS offers a broad range of commercial insurance for small to mid-size businesses, including property and casualty, employee benefits (health, life and retirement plans), business succession planning and risk management services. The transaction is subject to regulatory approval and is expected to close on August 1, 2001.

On July 1, 2000, FIA acquired Nieman Hanks Puryear Partners and Nieman Hanks Puryear Benefits ("Nieman Hanks"), an Austin-based independent insurance agency. Nieman Hanks offers property and casualty insurance, professional and umbrella liability, homeowners and auto insurance, group health, life and disability policies and 401(k) retirement plans and executive planning. Results of operations have been included from the date of acquisition. The Nieman Hanks acquisition did not have a material impact on Cullen/Frost's results of operations for the quarter or year-to-date ended June 30, 2001 and 2000.

On April 1, 2000, FIA acquired Wayland Hancock, a Houston-based independent insurance agency. Wayland Hancock offers a full range of life and health insurance, as well as retirement and financial planning, to individuals and businesses. Results of operations have been included from the date of acquisition. This acquisition did not have a material impact on Cullen/Frost's results of operations for the quarter or year-to-date ended June 30, 2001 and 2000.

Note H - Accounting for SFAS No. 133

On January 1, 2001 Cullen/Frost adopted SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133). SFAS No. 133 requires the recognition of all derivatives on the balance sheet at fair value. Derivatives that do not meet the specified "hedge" criterion of SFAS No. 133 hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings.

Cullen/Frost uses derivative instruments to protect against the risk of interest rate movements on the value of certain assets or on future cash flows. The Company generally uses interest rate swaps to hedge fair values on certain fixed rate loans. Prior to the adoption of SFAS No. 133, the fair value of derivative instruments held by Cullen/Frost were not recorded on the balance sheet. On January 1, 2001, Cullen/Frost adopted SFAS No. 133, and at that time, designated anew certain derivative instruments used for risk management into hedging relationships in accordance with the requirements of SFAS No. 133. Derivative instruments, particularly interest rate swaps, used to hedge changes in the fair value of certain fixed rate loans due to changes in interest rates

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were formally designated as fair value hedges. As of January 1, 2001, Cullen/Frost also held an interest rate floor with a notional amount of \$1 billion. Prior to the adoption of SFAS No. 133, this interest rate floor contract was considered a hedge of interest rate exposure associated with commercial loan accounts in an environment of falling interest rates. This interest rate floor did not meet the criteria for hedge accounting under SFAS No. 133; and therefore, Cullen/Frost accounted for this floor as trading upon adoption of SFAS No. 133. Additionally, one interest rate swap contract historically characterized as a cash-flow type hedge of a pool of commercial floating rate loans also did not meet the criteria for hedge accounting upon adoption of SFAS No. 133. This interest rate swap contract was recorded at fair-value at January 1, 2001 as a trading derivative with an offsetting amount recorded as other comprehensive loss. On March 30, 2001, this interest rate contract matured and the fair value recorded at January 1, 2001 was reversed.

The adoption of SFAS No. 133 on January 1, 2001 resulted in the after-tax cumulative effect of accounting change of approximately \$3 million being recognized as income in the statement of income and the after-tax cumulative effect of accounting change of approximately \$185 thousand recorded to other comprehensive income. The cumulative effect adjustments were determined based on the interpretive guidance issued by the Financial Accounting Standards Board to date. The after-tax cumulative effect of accounting change of approximately \$3 million (net of taxes of \$1.6 million) to the statement of income was primarily due to the recording of the fair value of the interest rate floor as there was no intrinsic value to this interest rate floor. Subsequent to the adoption of SFAS No. 133, the interest rate floor was sold with an additional pre-tax gain of approximately \$1.1 million recorded in other income above the amount reported in the cumulative effect amount.

Cullen/Frost had 33 interest rate swaps with a notional amount of \$95.7 million at June 30, 2001 used to hedge changes in the fair value of certain fixed rate loans due to changes in interest rates. These interest rate swaps were formally designated as fair value hedges. Each swap is expected to be highly effective as a fair value hedge for a specific fixed rate commercial loan or lease. As of June 30, 2001, the Corporation recognized an immaterial net pre-tax loss in other non-interest expense which represents the period change in the ineffective portion of all the fair-value hedges.

All interest rate contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. Each counterparty to a swap transaction has a credit rating that is investment grade. The net amount payable or receivable under interest rate swaps/floor is accrued as an adjustment to interest income and these amounts have not been material in 2001 or 2000.

SFAS No. 133, as applied to Cullen/Frost's risk management strategies, may increase or decrease reported net income and stockholders' equity prospectively, depending on future levels of interest rates and other variables affecting the fair values of derivative instruments and hedged items, but will have no effect on cash flows or economic risk.

Note I - Accounting Changes

In September 2000, the FASB issued SFAS No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (SFAS No. 140). SFAS No. 140 replaces SFAS No. 125. The guidance in SFAS No. 140, while not changing most of the guidance originally issued in SFAS No. 125, revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain additional disclosures related to transferred assets. Certain provisions of the statement related to the recognition, reclassification and disclosure of collateral, as well as the disclosure of securitization transactions, became effective for Cullen/Frost for 2000 year-end reporting. Other provisions related to the transfer and servicing of financial assets and extinguishments of liabilities are effective for transactions occurring after March 31, 2001. Based on current circumstances, the application of the new rules did not have a material impact on the Corporation's results of operations, financial position or liquidity.

On July 20, 2001, the FASB issued SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets." These Statements make significant changes to the accounting for business combinations, goodwill,

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and intangible assets. SFAS No. 141 eliminates the pooling-of-interests method of accounting for business combinations with limited exceptions for combinations initiated prior to July 1, 2001. In addition, it further clarifies the criteria for recognition of intangible assets separately from goodwill. This statement is effective for business combinations completed after June 30, 2001.

SFAS No. 142 discontinues the practice of amortizing goodwill and indefinite lived intangible assets and initiates an annual review for impairment. Impairment would be examined more frequently if certain indicators are encountered. Intangible assets with a determinable useful life will continue to be amortized over that period. The amortization provisions apply to goodwill and intangible assets acquired after June 30, 2001. Goodwill and intangible assets on the books at June 30, 2001 will be affected when the Corporation adopts the Statement.

Cullen/Frost will adopt this statement on January 1, 2002. Application of the non-amortization provisions of the Statement is expected to result in additional net income of approximately \$7 million per year or \$.13 per diluted common share. During 2002, the Corporation will perform the first of the required impairment tests of goodwill as of January 1, 2002 and has not yet determined what the effect of these tests will be on the earnings and financial position of the Corporation.

Note J - Operating Segments

Cullen/Frost has three reportable operating segments: Banking, the Financial Management Group and Frost Securities Inc. Banking includes both commercial and consumer banking services. Commercial services are provided to corporations and other business clients and include a wide array of lending and cash management products. Consumer banking services include direct lending and depository services. The Financial Management Group includes fee based services within private trust, retirement services, and financial management services including personal wealth management, insurance, and brokerage services. Frost Securities Inc., an investment banking subsidiary, began operations in August of 1999. These business units were identified through the products and services that are offered within each unit. Prior period amounts have been reclassified to conform to the current year's presentation.

The accounting policies of each reportable segment are the same as those of the Corporation except for the following items, which impact the Banking and Financial Management Group segments. The Corporation uses a match-funded transfer pricing process to assess operating segment performance. Expenses for consolidated back-office operations are allocated to operating segments based on estimated uses of those services. General overhead type expenses such as executive administration, accounting, internal audit, and personnel are allocated based on the direct expense level of the operating segment. Income tax expense for the individual segments is calculated basically at the statutory rate. Parent Company records the tax expense or benefit necessary to reconcile to the consolidated total.

Six Months Ended:

(in thousands)	Banking	Financial Management Group	Frost Securities	Non-Ban
June 30, 2001				
Revenues from (expenses to) external customers	\$220,288	\$33,702	\$ 5,329	\$ (4,27
Net income (loss)	\$ 50,988	\$ 5,669	\$ (2,013)	\$ (3,44

June 30, 2000

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Revenues from (expenses to) external customers	\$207,745	\$33,408	\$ 3,112	\$ (4,24
Net income (loss)	\$ 51,023	\$ 8,074	\$ (1,140)	\$ (5,17

Three Months Ended:	Banking	Financial Management Group	Frost Securities	Non-Ba
(in thousands)				
June 30, 2001				
Revenues from (expenses to) external customers	\$109,610	\$17,242	\$ 2,926	\$ (2,10
Net income (loss)	\$ 28,114	\$ 3,235	\$ (958)	\$ (1,73

March 31, 2001				
Revenues from (expenses to) external customers	\$110,677	\$16,460	\$ 2,403	\$ (2,16
Net income (loss)	\$ 22,874	\$ 2,434	\$ (1,055)	\$ (1,71

June 30, 2000				
Revenues from (expenses to) external customers	\$106,243	\$17,069	\$ 1,676	\$ (2,13
Net income (loss)	\$ 26,694	\$ 4,142	\$ (682)	\$ (2,52

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Financial Review
Cullen/Frost Bankers, Inc. and Subsidiaries
(taxable-equivalent basis - tables in thousands)

Forward-Looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"), not withstanding that they are not specifically identified as such. In addition, certain statements in future filings by Cullen/Frost with the Securities and Exchange Commission, in press releases, and in oral and written statements made by or with the approval of the Corporation which are not statements of historical fact also constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans and objectives of Cullen/Frost or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes", "anticipates", "expects", "intends", "targeted" and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors

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that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to: (i) local, regional and international economic conditions and the impact they may have on Cullen/Frost and its customers; (ii) the effects of and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve Board; (iii) inflation, interest rate, market and monetary fluctuations; (iv) the timely development and acceptance of new products and services and the perceived overall value of these products and services by users; (v) changes in consumer spending, borrowings and savings habits; (vi) technological changes; (vii) acquisitions and integration of acquired businesses; (viii) the ability to increase market share and control expenses; (ix) changes in the competitive environment among financial institutions; (x) the effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which Cullen/Frost and its subsidiaries must comply; (xi) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies as well as the Financial Accounting Standards Board; (xii) changes in the Corporation's organization, compensation and benefit plans; (xiii) the costs and effects of litigation and of unexpected or adverse outcomes in such litigation; (xiv) costs or difficulties related to the integration of the businesses of Cullen/Frost being greater than expected; and (xv) the Corporation's success at managing the risks involved in the foregoing.

Such forward-looking statements speak only as of the date on which such statements are made. Cullen/Frost undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

Results of Operations

The results of operations are included in the material that follows. All balance sheet amounts are presented in averages unless otherwise indicated. Certain reclassifications have been made to make prior periods comparable. Taxable-equivalent adjustments assume a 35 percent federal income tax rate. Dollar amounts in tables are stated in thousands, except for per share amounts.

Cullen/Frost reported net income of \$28.7 million or \$.54 per diluted common share for the quarter ended June 30, 2001 compared to \$22.5 million or \$.42 per diluted common share for the first quarter of 2001 and net income of \$27.6 million or \$.52 per diluted common share for the second quarter of 2000. First quarter 2001 results were impacted by an additional provision for possible loan losses of \$13.0 million related to a single shared national credit. Partially offsetting this impact on the first quarter's results was a pre-tax gain of \$5.7 million related to the sale of interest rate floors which had been purchased to hedge interest rate exposure in an environment of falling interest rates. Of the gain, \$1.1 million was included in other non-interest income, with the remainder included, net of tax, as the cumulative effect of adopting SFAS No. 133, which went into effect January 1, 2001. Excluding the after-tax net impact of the additional provision and the gain on the sale of the interest rate floors, earnings per diluted common share for the first quarter of 2001 would have been \$.51. Second quarter 2000 results were impacted by a \$2 million gain from the sale of mortgage servicing rights to GMAC Mortgage Corporation. Excluding the after-tax net impact from the sale of mortgage servicing rights, earnings per diluted common share for the second quarter of 2000 would have been \$.50. Net income for the six months ended June 30, 2001 was \$51.2 million or \$.96 per diluted common share compared to \$52.8 million or \$.98 per diluted common share for the same period of 2000.

Return on average equity and average assets were 19.09 percent and 1.50 percent, respectively for the second quarter of 2001. This compares to 21.31 percent and 1.56 percent for the second quarter of 2000 or 20.58 percent and 1.51 percent excluding the gain from the mortgage servicing sale. Return on average equity and average assets for the six months ended June 30, 2001 decreased to 17.31 percent and 1.36 percent compared to 20.54 percent and 1.52 percent for 2000.

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	Summary of Operations				
	Six Months Ended June 30		Three Months Ended		
			2001		2000
	2001	2000	June 30	March 31	June 30
Taxable-equivalent net interest income	\$162,176	\$159,807	\$80,367	\$81,809	\$81,095
Taxable-equivalent adjustment	2,359	2,273	1,169	1,190	1,113
Net interest income	159,817	157,534	79,198	80,619	79,982
Provision for possible loan losses	16,031	5,549	1,000	15,031	2,867
Non-Interest income:					
Net (loss) gain on securities transactions	(2)	(8)	(12)	10	
Other	95,233	82,499	48,485	46,748	42,874
Total non-interest income	95,231	82,491	48,473	46,758	42,874
Non-Interest expense:					
Goodwill amortization	4,032	3,850	2,012	2,020	1,924
Other intangible amortization	3,600	3,924	1,740	1,860	1,894
Other	158,736	146,055	80,015	78,721	73,938
Total non-interest expense	166,368	153,829	83,767	82,601	77,756
Income before income taxes and cumulative effect of accounting change	72,649	80,647	42,904	29,745	42,233
Income taxes	24,458	27,861	14,243	10,215	14,603
Income before cumulative effect of accounting change	48,191	52,786	28,661	19,530	27,630
Cumulative effect of change in accounting for derivatives, net of tax	3,010			3,010	
Net income	\$ 51,201	\$ 52,786	\$28,661	\$22,540	\$27,630
Net income per diluted common share:	\$.96	\$.98	\$.54	\$.42	\$.52
Return on Average Assets	1.36%	1.52%	1.50%	1.23%	1.56%
Return on Average Equity	17.31	20.54	19.09	15.48	21.31

Results of Segment Operations

Cullen/Frost's operations are managed along three major Operating Segments: Banking, the Financial Management Group and Frost Securities Inc. ("FSI"), the investment banking subsidiary started in August of 1999. A description of each business and the methodologies used to measure financial performance are described in Note J to the Consolidated Financial Statements on page 11. The following table summarizes net income by Operating Segment for the six months and three months ended June 30, 2001 and 2000.

Three Months Ended

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(in thousands)	Six Months Ended June 30		2001		2000
	2001	2000	June 30	March 31	June 30
Banking	\$50,988	\$51,023	\$28,114	\$22,874	\$26,694
Financial Management Group	5,669	8,074	3,235	2,434	4,142
Frost Securities Inc.	(2,013)	(1,140)	(958)	(1,055)	(682)
Non-Banks	(3,443)	(5,171)	(1,730)	(1,713)	(2,524)
Consolidated net income	\$51,201	\$52,786	\$28,661	\$22,540	\$27,630

Banking net income was \$28.1 million for the second quarter of 2001 up \$5.2 million, or 22.9%, over the first quarter of 2001, and \$1.4 million over the second quarter of 2000. First quarter results for the Banking segment were negatively impacted by the additional provision for possible loan losses of \$13.0 million and the offsetting gain on sale of interest rate floors previously discussed in the Results of Operations section on page 13. The increase over the same quarter last year represents higher fee income from insurance commissions, up \$2.0 million, and other service charges, up \$1.3 million, offset partially by the \$2 million gain from the sale of mortgage servicing rights included in the second quarter of 2000. Also offsetting this increase was higher non-interest expense, up 4.9 percent, due to increased salaries and benefits impacted by the insurance acquisitions and normal merit and market increases. For the six months ended June 30, 2001 Banking net income was \$51.0 million, which is essentially flat with the same period of 2000. Higher insurance commissions, positively impacted by the combined success of two insurance acquisitions made in the second and third quarters of 2000 and the existing Frost Insurance Agency, were offset by lower net interest margins, resulting from the steep decline in rates over the first half of this year, and higher non-interest expenses, up 5.5 percent, related to the same factors as in the quarter comparison.

The Financial Management Group ("FMG") net income for the current quarter was \$3.2 million, up \$801 thousand over the previous quarter and down \$907 thousand from the same quarter of 2000. Most of the increase from the first quarter of 2001 is due to an increase in oil and gas fees and tax fees. The decrease from the second quarter last year was due to higher expenses, including overhead allocations and higher salaries and benefits, and lower net interest margin due to lower funds transfer pricing. Net income for the first half of 2001 for FMG was \$5.7 million, down \$2.4 million from the first six months of 2000, due to the same factors.

Frost Securities recorded a net loss of \$958 thousand for the current quarter, an improvement over last quarter and up \$276 thousand from the second quarter of 2000. The comparable loss for the six months ended June 30, 2001 was \$2.0 million up \$873 thousand from the first six months of 2000. The loss in the current year was impacted by less than favorable market conditions. Revenues were up \$1.3 million or 74.6 percent for the second quarter of 2001 compared to the same quarter of 2000, and \$2.2 million or 71.2 percent for the six month periods, driven primarily by equities sales. Non-interest expenses were up 60.8 percent to \$4.4 million for the current quarter over the same quarter last year, and 72.5 percent to \$8.4 million for the six-month periods. These increases were due to increased staffing, expenses related to business development and increased outside professional services. Staffing at June 30, 2001 included 47 employees compared to 34 at June 30, 2000.

Most of the reduction in the operating loss for non-banks in the first half of 2001 was due to a decrease in expenses relating to incentive based compensation.

Net Interest Income

Net interest margin was 5.00 percent for the second quarter of 2001

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compared to 5.18 percent and 5.33 percent for the first quarter of 2001 and second quarter of 2000, respectively. The net interest spread of 4.23 percent was flat with the first quarter of 2001 and decreased 11 basis points from the second quarter of 2000. The decreases in net interest margin and spread were primarily the result of a lag affect in deposit pricing compared to the immediate repricing of earning assets in an environment of rapidly declining market rates. Interest rates have decreased 125 basis points in the second quarter of 2001 for a total of 275 basis points since the beginning of the year. Also as rates fall, deposit mixes have shifted toward higher rate products negatively impacting the net interest margin.

Change in Net Interest Income (Taxable-Equivalent)			
Second Quarter 2001	Second Quarter 2001	First Six Months 2001	
vs. Second Quarter 2000	vs. First Quarter 2001	vs. First Six Months 2000	
Amount	Amount	Amount	
Due to volume	\$3,629	\$ 396	\$8,764
Due to interest rate spread	(4,357)	(1,838)	(6,395)
	\$ (728)	\$ (1,442)	\$2,369

Non-Interest Income

Growth in non-interest income continues to come from banking business growth, and was favorably impacted by the acquisitions of Nieman Hanks and Wayland Hancock by FIA in the third and second quarters of 2000 and operations related to Frost Securities.

	Six Months Ended June 30		Three Months Ended		
	2001	2000	2001 June 30	2001 March 31	2000 June 30
Non-Interest Income					
Trust fees	\$24,843	\$24,132	\$12,837	\$12,006	\$12,446
Service charges on deposit accounts	34,551	29,164	18,051	16,500	14,765
Insurance commissions	7,493	3,106	3,598	3,895	1,586
Other service charges, collection and exchange charges, commissions and fees	12,599	9,545	6,665	5,934	5,009
Net (loss) gain on securities transactions	(2)	(8)	(12)	10	
Other	15,747	16,552	7,334	8,413	9,068
Total	\$95,231	\$82,491	\$48,473	\$46,758	\$42,874

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For the second quarter 2001...

Total non-interest income was up \$1.7 million or 3.7 percent compared to the first quarter of 2001 and (excluding the \$2 million gain recognized from the sale of the mortgage servicing rights) up \$7.6 million, or 18.6 percent compared to the second quarter of 2000. These increases from comparable quarters resulted from banking business growth, the favorable impact of the acquisitions of Nieman Hanks and Wayland Hancock by FIA in the third and second quarters of 2000 and operations related to Frost Securities.

Trust fees were up \$831 thousand or 6.9 percent compared to the first quarter of 2001 and up \$391 thousand or 3.1 percent compared to the second quarter of 2000. Trust income was up from the first quarter 2001 and second quarter 2000 due to an increase in oil and gas fees, which remains a positive for the Corporation and the state of Texas. The increase from the previous quarter was also impacted by higher tax fees. The market value of trust assets at the end of the second quarter of 2001 was \$13.1 billion, up \$251 million and \$48 million from the first quarter of 2001 and second quarter of 2000, respectively. Trust assets were comprised of discretionary assets of \$5.8 billion and non-discretionary assets of \$7.3 billion compared to \$5.5 billion and \$7.6 billion, respectively, a year ago.

Service charges on deposit accounts for the second quarter of 2001 increased \$1.6 million or 9.4 percent from the first quarter of this year. This increase was mainly due to higher revenues associated with commercial accounts and a modest increase in overdraft charges and NSF income. When compared to the second quarter of 2000 service charges increased by \$3.3 million or 22.3 percent. The increase from the second quarter of last year is primarily attributable to higher revenues associated with commercial accounts as well as an increase in individual account fees and higher overdraft fees offset by lower NSF charges. The increase in commercial service charges is primarily the result of a lower earnings credit rate, which results in more payment for services through the payment of fees rather than through balances. The increase in individual accounts resulted from the simplification of deposit account offerings while providing Cullen/Frost customers with better value.

Insurance commissions were down \$297 thousand or 7.6 percent compared to the first quarter of 2001 and up \$2 million, or 127 percent compared to the second quarter of 2000. The decrease from the first quarter 2001 is related to the normal business cycle due to policy effective dates. The increases from the second quarter a year ago was the result of the combined success of the insurance acquisitions made in the third and second quarters of 2000 and the continued selling efforts of Frost Insurance Agency.

Other service charges were up \$731 thousand or 12.3 percent compared to the previous quarter and up \$1.7 million or 33.1 percent from the same quarter a year ago. The primary contributor to this growth was revenue from Frost Securities.

Other non-interest income decreased \$1.1 million or 12.8 percent when compared to the previous quarter this year and \$1.7 million or 19.1 percent when compared to the second quarter a year ago. The decrease from the first quarter of 2001 is mainly due to the \$1.1 million gain recognized on the sale of a LIBOR interest rate floor contract (see page nine) and rebate income recognized in the first quarter of 2000 related to the favorable performance of insurance policies written. The decrease from the second quarter 2000 is related to the \$2 million gain recognized from the sale of the mortgage servicing rights and higher gains recognized on the sale of student loans during the second quarter of 2000. During the second quarter of 2001, Cullen/Frost purchased bank owned life insurance on certain of its employees and is the beneficiary on these policies. The increase in cash surrender value during the quarter was \$764 thousand and was recorded in other non-interest income offsetting some of the decrease from the previous periods. Also offsetting the decrease from the second quarter 2000 was higher revenues received on larger balances held by the provider of the Corporation's official checks program.

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For the six months ended June 30, 2001...

Non-interest income was up \$12.7 million or 15.4 percent compared to the same period last year. Trust income increased \$711 thousand or 2.9 percent from the same period a year ago, primarily in oil and gas and investment fees. Service charges on deposits increased \$5.4 million or 18.5 percent compared to the same period one year ago. This increase can be attributed to higher revenues associated with both commercial and individual accounts and higher overdraft fees offset by lower NSF charges. The increase in commercial service charges is primarily the result of a lower earnings credit rate, which results in more payment for services through the payment of fees rather than through balances. The increase in individual accounts resulted from the simplification of deposit account offerings while providing Cullen/Frost customers with better value. Insurance commissions increased \$4.4 million or 141.2 percent compared to the same period ago. The increases from a year ago was the result of the combined success of the insurance acquisitions made in the third and second quarters of 2000 and the existing Frost Insurance Agency. Other service charge income increased \$3.1 million or 32.0 percent from the same period last year. The primary contributor to this growth was the equities sales revenue from Frost Securities. Other income was down \$805 thousand or 4.9 percent compared to the same period last year. This resulted primarily from the \$2 million non-recurring pre-tax gain from the sale of the mortgage servicing rights in the second quarter of 2000 and lower gains on the sale of student loans offset by income related to the bank owned life insurance program initiated in the second quarter of 2001. Also offsetting the decrease from a year ago was higher revenues received on larger balances held by the provider of the Corporation's official checks program.

Non-Interest Expense

Growth in non-interest expense can be attributed to higher personnel and operating expenses connected with fee business expansion, as well as increases in salaries and wages.

	Six Months Ended		Three Months Ended		
	June 30		2001		2000
Non-Interest Expense	2001	2000	June 30	March 31	June 30
Salaries and wages	\$ 72,321	\$ 67,668	\$36,711	\$35,610	\$34,439
Pension and other employee benefits	17,250	15,221	8,339	8,911	7,171
Net occupancy of banking premises	14,546	13,616	7,343	7,203	6,850
Furniture and equipment	12,252	10,285	6,240	6,012	5,219
Intangible amortization	7,632	7,774	3,752	3,880	3,818
Other	42,367	39,265	21,382	20,985	20,259
Total	\$166,368	\$153,829	\$83,767	\$82,601	\$77,756
	=====	=====	=====	=====	=====

For the second quarter 2001...

Non-interest expense was up \$1.2 million or 1.4 percent compared to last quarter and increased \$6.0 million or 7.7 percent compared to the second quarter of 2000. Excluding expenses related to insurance and investment

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banking non-interest expense would have been up 2.4 percent from the second quarter last year.

Salaries and wages increased \$1.1 million or 3.1 percent compared with the first quarter of 2001 and were up \$2.3 million or 6.6 percent from the second quarter of 2000. The increase from the first quarter of 2001 was primarily related to higher incentive compensation. The increase of 6.6 percent from the second quarter last year is primarily related to increases at Frost Insurance Agency and Frost Securities (acquisition related for insurance and new hires for investment banking). Excluding those businesses, salaries were up 1.0 percent, or 2.7 percent excluding \$600 thousand of severance costs recorded in the second quarter last year related to the sale of the mortgage servicing rights and the initiation of the co-branding mortgage origination program with GMAC Mortgage Corporation. Pension and employee benefits were down \$572 thousand or 6.4 percent compared to last quarter and up \$1.2 million or 16.3 percent compared to the second quarter of 2000. The decrease from the previous quarter was a result of lower payroll taxes. The increase from a year ago is due primarily from higher payroll taxes related to the acquisitions and higher retirement plan expense.

Net occupancy of banking premises expenses remained flat from the first quarter of 2001 and up \$493 thousand or 7.2 percent from the second quarter of 2000. The increase from the second quarter a year ago was related to new locations, general building maintenance and utility expenses. Furniture and equipment expense was up \$228 thousand or 3.8 percent from the first quarter of 2001 and increased by \$1.0 million or 19.6 percent from the second quarter of 2000. The increase from the previous quarter is due to higher service contracts, while the increase from the second quarter a year ago is due to higher software maintenance and amortization partially related to the Corporation's enhanced web site introduced in November of 2000.

Other non-interest expenses remained flat from the first quarter of 2001 and up \$1.1 million or 5.5 percent from the second quarter of 2000. The increase from the second quarter a year ago is related to higher professional, advertising, and travel expenses primarily related to our fee business expansion efforts, partially offset by good expense control in our core banking business.

For the six months ended June 30, 2001...

Total non-interest expense was up \$12.5 million or 8.2 percent compared to the same period one year ago. Salaries and wages were up \$4.7 million or 6.9 percent compared to the same period a year ago primarily related to Frost Securities and acquisitions made by Frost Insurance Agency. Severance costs of almost \$600 thousand impacted the first half of 2000 as a result of the sale of the mortgage servicing rights and the initiation of the co-branding mortgage origination program. Pension and other benefits increased \$2.0 million or 13.3 percent from the same period last year due primarily from higher retirement plan expense and higher payroll taxes partially offset by lower medical insurance costs. Net occupancy of banking premises was up \$930 thousand or 6.8 percent compared to a year ago. The increase from a year ago was related to new locations, general building maintenance and utility expenses. Furniture and equipment expense increased \$2.0 million or 19.1 percent due to higher software maintenance and amortization partially related to the Corporation's enhanced web site introduced in November of 2000. Other non-interest expenses increased \$3.1 million or 7.9 percent primarily due to higher professional, advertising, and travel expenses primarily related to our fee business expansion efforts, partially offset by good expense control in our core banking business.

Income Taxes

Cullen/Frost's effective tax rate for the first and second quarters of 2001 approximated 34 and 33 percent, respectively. The effective tax rate for the second quarter of 2000 approximated 35 percent. The decrease in the effective tax rate in the second quarter of 2001 is due to an increase in tax-exempt income resulting from the purchase of bank owned life insurance.

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Cash Earnings

The Corporation has historically paid cash and used the purchase method of accounting for the majority of its acquisitions, which has resulted in the creation of intangible assets. These intangible assets are deducted from capital in the determination of regulatory capital. Thus, "cash" or "tangible" earnings represents regulatory capital generated during the year and can be viewed as net income excluding intangible amortization, net of tax. While the definition of "cash" or "tangible" earnings may vary by company, we believe this definition is appropriate as it measures the per share growth of regulatory capital, which impacts the amount available for dividends and acquisitions.

The following table reconciles reported earnings to net income excluding intangible amortization ("cash" earnings):

	Six Months Ended					
	June 2001			June 2000		
	Reported Earnings	Intangible Amortization	"Cash" Earnings	Reported Earnings	Intangible Amortization	"Cash" Earnings
Income before income taxes and cumulative effect of accounting change	\$72,649	\$7,632	\$80,281	\$80,647	\$7,774	\$88,421
Income taxes	24,458	1,662	26,120	27,861	1,701	29,562
Income before cumulative effect of accounting change	48,191	5,970	54,161	52,786	6,073	58,859
Cumulative effect of accounting change, net of tax	3,010		3,010			
Net income	\$51,201	\$5,970	\$57,171	\$52,786	\$6,073	\$58,859
Net income per diluted common share	\$.96	\$.11	\$ 1.07	\$.98	\$.12	\$ 1.10
Return on assets	1.36%		1.52%*	1.52%		1.69%*
Return on equity	17.31		19.33**	20.54		22.90**
* Calculated as A/B						
** Calculated as A/C				June 2001	June 2000	
(A) Net income before intangible amortization (including goodwill and core deposit intangibles, net of tax)				\$ 57,171	\$ 58,859	
(B) Total average assets				7,566,596	7,004,765	
(C) Average shareholders' equity				596,360	516,829	

Three Months Ended

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	June 2001			March 2001		
	Reported Earnings	Intangible Amortization	"Cash" Earnings	Reported Earnings	Intangible Amortization	"Cash" Earnings
Income before income taxes	\$42,904	\$3,752	\$46,656	\$29,745	\$3,880	\$33,625
Income taxes	14,243	809	15,052	10,215	853	11,068
Income before cumulative effect of accounting change	28,661	2,943	31,604	19,530	3,027	22,557
Cumulative effect of accounting change, net of tax				3,010		3,010
Net income	\$28,661	\$2,943	\$31,604	\$22,540	\$3,027	\$25,567
Net income per common share	\$.54	\$.05	\$.59	\$.42	\$.06	\$.48
Return on assets	1.50%		1.65%*	1.23%		1.39%*
Return on equity	19.09		21.05**	15.48		17.56**

* Calculated as A/B

** Calculated as A/C

	June 2001	March 2001
(A) Net income before intangible amortization (including goodwill and core deposit intangibles, net of tax)	\$ 31,604	\$ 25,567
(B) Total average assets	7,680,715	7,451,495
(C) Average shareholders' equity	602,201	590,454

	Three Months Ended		
	June 2000		
	Reported Earnings	Intangible Amortization	"Cash" Earnings
Income before income taxes	\$42,233	\$3,818	\$46,051
Income taxes	14,603	827	15,430
Income before cumulative effect of accounting change	27,630	2,991	30,621
Cumulative effect of Accounting change, Net of tax			
Net income	\$27,630	\$2,991	\$30,621
Net income per common share	\$.52	\$.05	\$.57
Return on assets	1.56%		1.73%*
Return on equity	21.31		23.61 **

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* Calculated as A/B
 ** Calculated as A/C

	June 2000

(A) Net income before intangible amortization (including goodwill and core deposit intangibles, net of tax)	\$ 30,621
(B) Total average assets	7,111,133
(C) Average shareholders' equity	521,594

Cullen/Frost's cash earnings for the six months and second quarter ending June 30, 2001 were \$57.2 million or \$1.07 per diluted common share and \$31.6 million or \$.59 per diluted common share, respectively. Cash earnings return on assets and return on equity for the second quarter of 2001 were 1.65 percent and 21.05 percent, respectively.

Balance Sheet

Average assets for the second quarter were \$7.7 billion up \$570 million or 8.0 percent from the second quarter of 2000. Total deposits averaged \$6.5 billion for the current quarter, up \$508 million or 8.5 percent when compared to the second quarter of 2000. This growth was influenced by one major customer of the bank where deposits increased related to the clearing of payments for mortgage refinances. Excluding the impact of this customer the growth from the second quarter of 2000 would have been 5.9 percent. Average loans for the second quarter of 2001 were \$4.6 billion. This is flat with the first quarter of 2001 and up 5.2 percent from the second quarter of last year or 9 percent excluding the combined impact of mortgage lending (mortgage products are now offered through a co-branding relationship with GMAC Mortgage) and indirect loans which have been de-emphasized.

Loans

Loan Portfolio	2001		2000	
	June 30	Percentage of Total	December 31	June 30
Period-End Balances	-----		-----	
Commercial and industrial:				
Energy	\$ 108,409	2.4%	\$ 141,682	\$ 129,947
Other	1,793,030	39.4	1,678,537	1,596,477
Consumer:				
Indirect	98,210	2.2	136,914	176,709
Other	330,365	7.3	308,726	308,423
Real estate	2,151,071	47.3	2,191,732	2,121,647
Other	71,591	1.6	84,403	99,309
Unearned discount	(6,762)	(.2)	(7,349)	(6,713)
	-----	-----	-----	-----
Total Loans	\$4,545,914	100.0%	\$4,534,645	\$4,425,799
	=====	=====	=====	=====

At June 30, 2001 period-end loans totaled \$4.5 billion flat from the previous quarter and up 2.7 percent from the same period last year. Period-end loans would have been flat and up 6.2 percent, respectively, from the first quarter of 2001 and second quarter of 2000 excluding the combined impact of mortgage lending and indirect loans. As indicated below, purchased shared national credits outstanding have decreased during 2001 affecting loan volumes. These loans decreased \$45 million since March 31, 2001. Declines in energy (primarily shared national credits) and other residential loans offset the

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increases in direct consumer loans and other commercial and industrial loans when compared to the first quarter of 2001. Most of the increase from a year ago is attributable to commercial and industrial loans, excluding energy, up \$197 million or 12.3 percent.

At June 30, 2001, Cullen/Frost had approximately \$258 million of purchased shared national credits outstanding down from \$303 million at March 31, 2001 and \$316 million at year-end 2000. These participations are done in the normal course of business to meet the needs of the Corporation's customers. General corporate policy towards participations is to lend to companies either headquartered in or having significant operations within our markets. In addition, Cullen/Frost must have an existing banking relationship or the expectation of broadening the relationship with other bank products. Approximately 28 percent of the outstanding balance of shared national credits are energy related with the remainder diversified throughout various industries.

Real Estate Loans

Real estate loans at June 30, 2001, were \$2.2 billion or 47.3 percent of period-end loans compared to 47.9 percent a year ago. Amortizing permanent mortgages represented 54.4 percent of the total real estate loan portfolio at quarter end. Other real estate loans increased \$59 million and was offset by \$37 million in permanent mortgages including 1-4 family residential mortgages which were impacted as Cullen/Frost withdrew from mortgage origination. Mortgage loans are now offered through Cullen/Frost's co-branding arrangement with GMAC Mortgage. This arrangement will broaden the mortgage products that can be offered to the Corporation's customer base, as well as leverage GMAC's commitment to web-based mortgage products. Real estate loans categorized as "other" are primarily amortizing commercial and industrial loans with maturities of less than five years secured by real property. Approximately 42 percent of all commercial real estate loans are owner occupied or have a major tenant (National or Regional company) which historically has resulted in lower risk, provides financial stability and is less susceptible to economic swings.

At June 30, 2001, real estate loans 90 days past due (excluding non-accrual loans) were \$9.4 million, compared with \$4.6 million at March 31, 2001, and \$2.4 million at June 30, 2000. The increase from the prior quarter is related to a \$7.5 million commercial real estate loan that is well secured and in the process of collection.

	2001		2000
Real Estate Loans Period-End Balances	June 30	Percentage of Total	June 30
Construction	\$ 411,379	19.1%	\$ 403,747
Land	145,864	6.8	145,861
Permanent mortgages:			
Commercial	485,699	22.6	481,517
1-4 Family residential	282,798	13.2	328,396
Other residential	392,270	18.2	388,314
Other	433,061	20.1	373,812
	\$2,151,071	100.0%	\$2,121,647
	=====	=====	=====
Non-accrual	\$ 1,716	.1%	\$ 4,175

Mexico

Cullen/Frost's cross border outstandings to Mexico, excluding \$14.7 million in loans secured by assets held in the United States, totaled \$74 thousand at June 30, 2001 compared to \$32 thousand at March 31, 2001 and down from \$8.8 million last year. The variance from the second quarter last year represents normal fluctuations in lines of credit used by Mexican banks to finance trade. At June 30, 2001, there were no Mexican-related loans on non-

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performing status compared to \$285 thousand a year ago.

Non-Performing Assets

June 30, 2001	NON-PERFORMING ASSETS		
	Real Estate	Other	Total
Non-accrual	\$1,716	\$21,198	\$22,914
Foreclosed assets	2,418	384	2,802
Total	\$4,134	\$21,582	\$25,716
	=====	=====	=====
As a percentage of total non-performing assets	16.1%	83.9%	100.0%

Non-performing assets totaled \$25.7 million at June 30, 2001 up 61.1 percent from \$16.0 million at June 30, 2000 and up 11.7 percent from \$23.0 million at March 31, 2001. Included in non-performing loans is a shared national credit currently recorded at \$6.6 million. Non-performing assets as a percentage of total loans and foreclosed assets increased to .57 percent at June 30, 2001 from .36 percent one year ago. Non-performing assets as a percentage of total assets was .33 percent for the second quarter 2001 compared to .22 percent for the second quarter 2000. The Company expects non-performing assets will continue to increase through the remainder of 2001.

Foreclosed assets consist of property which has been formally repossessed. Foreclosed assets are valued at the lower of the loan balance or estimated fair value, less estimated selling costs, at the time of foreclosure. Write-downs occurring at foreclosure are charged against the allowance for possible loan losses. On an ongoing basis, properties are appraised as required by market indications and applicable regulations. Write-downs are provided for subsequent declines in value. Expenses related to maintaining foreclosed properties are included in other non-interest expense.

The after-tax impact (assuming a 35 percent marginal tax rate) of lost interest from non-performing assets was approximately \$473 thousand for the second quarter of 2001, compared to approximately \$649 thousand for the first quarter of 2001 and approximately \$325 thousand for the second quarter of 2000. Accruing loans past due are summarized below:

	ACCRUING LOANS PAST DUE		
	June 30 2001	December 31 2000	June 30 2000
30 to 89 days	\$31,656	\$43,671	\$24,106
90 days or more	13,369	7,972	5,810
Total	\$45,025	\$51,643	\$29,916
	=====	=====	=====

Allowance for Possible Loan Losses

The allowance for possible loan losses was \$65.3 million or 1.44 percent of period-end loans at June 30, 2001, compared to \$59.0 million or 1.33 percent at June 30, 2000 and \$64.1 million or 1.40 percent at March 31, 2001. The allowance for possible loan losses as a percentage of non-accrual loans was 285 percent at June 30, 2001, compared to 453 percent at June 30, 2000 and 310 percent at the end of the first quarter of 2001.

Cullen/Frost recorded a \$1.0 million provision for possible loan losses

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during the second quarter of 2001. This compares to \$2.9 million provision for possible loan losses during the second quarter of 2000 and \$15.0 million for the first quarter of 2001. Net recoveries in the second quarter of 2001 totaled \$189 thousand, compared to net charge-offs of \$2.4 million and \$14.2 million for the second quarter of 2000 and for the first quarter of 2001, respectively. The higher provision and charge-offs in the first quarter of 2001 resulted from a write down to discounted collateral value of \$6.9 million of the \$20 million previously mentioned shared national credit.

	NET CHARGE-OFFS (RECOVERIES)		
	2001		2000
	Second Quarter	First Quarter	Second Quarter
Real estate	\$ (688)	\$ 77	\$ (7)
Commercial and industrial	84	13,563	1,689
Consumer	387	594	688
Other, including foreign	28	(3)	(3)
	\$ (189)	\$14,231	\$ 2,367
Provision for possible loan losses	\$ 1,000	\$15,031	\$ 2,867
Allowance for possible loan losses	65,254	64,065	58,965

Capital and Liquidity

At June 30, 2001, shareholders' equity was \$612.4 million compared to \$524.6 million at June 30, 2000 and \$592.5 million at March 31, 2001. Activity in the shareholders equity account during 2001 includes \$21.1 million of dividends paid offset by earnings of \$51.2 million. In addition, Cullen/Frost had an unrealized gain on securities available for sale, net of deferred taxes, of \$3.6 million as of June 30, 2001 compared to an unrealized loss of \$4.0 million as of December 31, 2000 which had the effect of increasing capital by \$7.6 million. Currently, under regulatory requirements, the unrealized gain or loss on securities available for sale is not included in the calculation of risk-based capital and leverage ratios. See page seven for a discussion of the Corporation's regulatory capital ratios.

The Cullen/Frost board of directors raised the cash dividend 10.3 percent in the second quarter of 2001 to \$.215 per common share compared to \$.195 per common share paid since the second quarter of 2000. This equates to a dividend payout ratio of 38.7 percent and 44.6 percent for the second and first quarters of 2001, respectively. The dividend payout ratio for the second quarter of 2000 was 36.8 percent.

Funding sources available at the holding company level include a \$7.5 million short-term line of credit. There were no borrowings outstanding from this source at June 30, 2001 or 2000.

Asset liquidity is provided by cash and assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash, short-term time deposits in banks, securities available for sale, maturities and cash flow from securities held to maturity, and Federal funds sold and securities purchased under resale agreements.

Liability liquidity is provided by access to funding sources which include core depositors and correspondent banks in Cullen/Frost's natural trade area which maintain accounts with and sell Federal funds to The Frost National Bank, as well as Federal funds purchased and securities sold under repurchase agreements from upstream banks. The liquidity position of Cullen/Frost is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate.

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Consolidated Average Balance Sheets and Interest Income Analysis-Year-to-Date
Cullen/Frost Bankers, Inc. and Subsidiaries
(dollars in thousands - taxable-equivalent basis)

	June 30, 2001			June 30, 2000		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
ASSETS						
Time deposits	\$ 7,071	\$ 215	5.24%	\$ 6,952	\$ 270	5.72%
Securities:						
U.S. Treasury	59,556	1,784	6.04	127,765	3,701	5.83
U.S. Government agencies and corporations	1,339,492	43,525	6.50	1,344,320	45,883	6.83
States and political subdivisions						
Tax-exempt	163,199	5,851	7.17	148,448	5,603	7.55
Taxable	3,378	109	6.48	3,463	115	6.67
Other	34,793	1,050	6.04	34,707	1,458	8.40
Total securities	1,600,418	52,319	6.54	1,658,703	56,760	6.85
Federal funds sold and securities purchased under resale agreements	238,654	5,764	4.80	68,417	2,100	6.07
Loans, net of unearned discount	4,561,781	188,895	8.35	4,272,968	188,790	8.89
Total Earning Assets and Average Rate Earned						
	6,407,924	247,193	7.76	6,007,040	247,920	8.29
Cash and due from banks	741,280			604,410		
Allowance for possible loan losses	(64,529)			(58,773)		
Banking premises and equipment	150,477			145,062		
Accrued interest and other assets	331,444			307,026		
Total Assets	\$7,566,596			\$7,004,765		
LIABILITIES						
Demand deposits:						
Commercial and individual	\$1,744,306			\$1,601,978		
Correspondent banks	242,229			220,686		
Public funds	37,486			30,520		
Total demand deposits	2,024,021			1,853,184		
Time deposits:						
Savings and Interest-on-Checking	960,548	2,542	.53	976,027	3,237	.67
Money market deposit accounts	1,802,539	30,022	3.36	1,638,872	35,157	4.31
Time accounts	1,279,978	33,333	5.25	1,229,774	29,792	4.87
Public funds	301,746	6,065	4.05	232,334	5,131	4.44
Total time deposits	4,344,811	71,962	3.34	4,077,007	73,317	3.62
Total deposits	6,368,832			5,930,191		
Federal funds purchased and securities sold under repurchase agreements	361,322	7,779	4.28	302,376	7,914	5.18
Guaranteed preferred beneficial interests in the Corporation's junior subordinated deferrable interest debentures, net	98,582	4,238	8.60	98,529	4,238	8.60
Long-term notes payable	3,347	109	6.57	2,548	70	5.53
Other borrowings	31,623	929	5.93	69,832	2,574	7.41
Total Interest-Bearing Funds and Average Rate Paid	4,839,685	85,017	3.53	4,550,292	88,113	3.89
Accrued interest and other liabilities	106,530			84,460		

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Total Liabilities	6,970,236	6,487,936
SHAREHOLDERS' EQUITY	596,360	516,829
	-----	-----
Total Liabilities and Shareholders' Equity	\$7,566,596	\$7,004,765
	=====	=====
Net interest income	\$162,176	\$159,807
	=====	=====
Net interest spread		4.23%
		====
Net interest income to total average earning assets		5.09%
		====
		5.34%
		====

The above information is shown on a taxable-equivalent basis assuming a 35% tax rate. Non-accrual loans are included in the average loan amounts outstanding for these computations.

Consolidated Average Balance Sheets and Interest Income Analysis-By Quarter
Cullen/Frost Bankers, Inc. and Subsidiaries
(dollars in thousands - taxable-equivalent basis)

	June 30, 2001			March 31, 2001		
	Average Balance	Interest Income/Expense	Yield/Cost	Average Balance	Interest Income/Expense	Yield/Cost
	-----	-----	-----	-----	-----	-----
ASSETS						
Time deposits	\$ 7,751	\$ 99	5.11%	\$ 6,383	\$ 116	5.37%
Securities:						
U.S. Treasury	17,028	192	4.52	102,556	1,592	6.29
U.S. Government agencies and corporations	1,337,607	21,427	6.41	1,341,398	22,098	6.59
States and political subdivisions						
Tax-exempt	163,453	2,908	7.12	162,943	2,943	7.22
Taxable	3,388	55	6.46	3,368	55	6.50
Other	32,751	469	5.73	36,858	580	6.30
	-----	-----	-----	-----	-----	-----
Total securities	1,554,227	25,051	6.45	1,647,123	27,268	6.63
Federal funds sold and securities purchased under resale agreements	315,871	3,520	4.41	160,578	2,244	5.59
Loans, net of unearned discount	4,559,623	90,157	7.93	4,563,963	98,738	8.77
	-----	-----	-----	-----	-----	-----
Total Earning Assets and Average Rate Earned	6,437,472	118,827	7.40	6,378,047	128,366	8.14
Cash and due from banks	806,665			675,168		
Allowance for possible loan losses	(65,728)			(63,316)		
Banking premises and equipment	150,376			150,581		
Accrued interest and other assets	351,930			311,015		
	-----			-----		
Total Assets	\$7,680,715			\$7,451,495		
	=====			=====		
LIABILITIES						
Demand deposits:						
Commercial and individual	\$1,828,870			\$1,658,802		
Correspondent banks	248,370			236,020		
Public funds	35,709			39,282		
	-----			-----		
Total demand deposits	2,112,949			1,934,104		
Time deposits:						

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Savings and Interest-on-Checking	970,673	1,115	.46	950,311	1,427	.61
Money market deposit accounts	1,824,869	12,857	2.83	1,780,012	17,166	3.91
Time accounts	1,276,765	15,741	4.95	1,283,226	17,592	5.56
Public funds	293,816	2,709	3.70	309,713	3,355	4.39
	-----	-----		-----	-----	
Total time deposits	4,366,123	32,422	2.98	4,323,262	39,540	3.71
	-----	-----		-----	-----	
Total deposits	6,479,072			6,257,366		
Federal funds purchased and securities sold under repurchase agreements	360,786	3,417	3.75	361,864	4,362	4.82
Guaranteed preferred beneficial interests in the Corporation's junior subordinated deferrable interest debentures, net	98,589	2,119	8.60	98,575	2,119	8.60
Long-term notes payable	3,060	47	6.17	3,637	62	6.92
Other borrowings	31,405	455	5.81	31,843	474	6.04
	-----	-----		-----	-----	
Total Interest-Bearing Funds and Average Rate Paid	4,859,963	38,460	3.17	4,819,181	46,557	3.91
	-----	-----		-----	-----	
Accrued interest and other liabilities	105,602			107,756		
	-----			-----		
Total Liabilities	7,078,514			6,861,041		
SHAREHOLDERS' EQUITY	602,201			590,454		
	-----			-----		
Total Liabilities and Shareholders' Equity	\$7,680,715			\$7,451,495		
	=====			=====		
Net interest income		\$ 80,367			\$ 81,809	
		=====			=====	
Net interest spread			4.23%			4.23%
			====			====
Net interest income to total average earning assets			5.00%			5.18%
			====			====

The above information is shown on a taxable-equivalent basis assuming a 35% tax rate. Non-accrual loans are included in the average loan amounts outstanding for these computations.

Consolidated Average Balance Sheets and Interest Income Analysis-By Quarter
Cullen/Frost Bankers, Inc. and Subsidiaries
(dollars in thousands - taxable-equivalent basis)

	December 31, 2000			September 30, 2000		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
	-----	-----	-----	-----	-----	-----
ASSETS						
Time deposits	\$ 8,092	\$ 121	5.96%	\$ 6,903	\$ 114	6.60%
Securities:						
U.S. Treasury	131,205	2,107	6.39	133,932	2,108	6.26
U.S. Government agencies and corporations	1,369,655	23,281	6.80	1,287,967	22,080	6.86
States and political subdivisions						
Tax-exempt	155,761	2,835	7.28	154,421	2,847	7.38
Taxable	3,319	55	6.59	3,354	56	6.65
Other	36,443	590	6.42	35,608	569	6.39
	-----	-----		-----	-----	

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Total securities	1,696,383	28,868	6.80	1,615,282	27,660	6.85
Federal funds sold and securities purchased under resale agreements	202,699	3,354	6.47	182,310	3,052	6.55
Loans, net of unearned discount	4,458,675	103,971	9.28	4,405,125	101,765	9.19
<hr/>						
Total Earning Assets and Average Rate Earned	6,365,849	136,314	8.52	6,209,620	132,591	8.50
Cash and due from banks	646,062			632,534		
Allowance for possible loan losses	(60,396)			(59,170)		
Banking premises and equipment	147,372			147,221		
Accrued interest and other assets	304,500			308,265		
<hr/>						
Total Assets	\$7,403,387			\$7,238,470		
<hr/>						
LIABILITIES						
Demand deposits:						
Commercial and individual	\$1,678,877			\$1,662,944		
Correspondent banks	226,760			242,942		
Public funds	35,241			34,598		
<hr/>						
Total demand deposits	1,940,878			1,940,484		
Time deposits:						
Savings and Interest-on-Checking	948,065	1,548	.65	945,462	1,559	.66
Money market deposit accounts	1,795,348	21,125	4.68	1,739,909	20,255	4.63
Time accounts	1,257,464	17,797	5.63	1,238,874	16,909	5.43
Public funds	302,853	3,542	4.65	234,320	2,806	4.76
<hr/>						
Total time deposits	4,303,730	44,012	4.07	4,158,565	41,529	3.97
<hr/>						
Total deposits	6,244,608			6,099,049		
Federal funds purchased and securities sold under repurchase agreements	368,071	5,205	5.53	332,446	4,770	5.61
Guaranteed preferred beneficial interests in the Corporation's junior subordinated deferrable interest debentures, net	98,561	2,119	8.60	98,547	2,118	8.60
Long-term notes payable	3,683	61	6.63	6,270	73	4.67
Other borrowings	34,750	530	6.07	78,701	1,038	5.25
<hr/>						
Total Interest-Bearing Funds and Average Rate Paid	4,808,795	51,927	4.29	4,674,529	49,528	4.21
<hr/>						
Accrued interest and other liabilities	93,988			84,695		
<hr/>						
Total Liabilities	6,843,661			6,699,708		
SHAREHOLDERS' EQUITY	559,726			538,762		
<hr/>						
Total Liabilities and Shareholders' Equity	\$7,403,387			\$7,238,470		
<hr/>						
Net interest income		\$ 84,387			\$ 83,063	
<hr/>						
Net interest spread			4.23%			4.29%
<hr/>						
Net interest income to total average earning assets			5.28%			5.33%
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The above information is shown on a taxable-equivalent basis assuming a 35% tax rate. Non-accrual loans are included in the average loan amounts outstanding for these computations.

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Consolidated Average Balance Sheets and Interest Income Analysis-By Quarter
Cullen/Frost Bankers, Inc. and Subsidiaries
(dollars in thousands - taxable-equivalent basis)

	June 30, 2000		
	Average Balance	Interest Income/ Expense	Yield/ Cost
ASSETS			
Time deposits	\$ 7,022	\$ 125	6.04%
Securities:			
U.S. Treasury	123,932	1,837	5.96
U.S. Government agencies and corporations	1,372,244	23,515	6.85
States and political subdivisions			
Tax-exempt	148,872	2,794	7.51
Taxable	3,460	58	6.67
Other	35,067	934	10.66
Total securities	1,683,575	29,138	6.93
Federal funds sold and securities purchased under resale agreement	86,578	1,372	6.27
Loans, net of unearned discount	4,334,450	97,366	9.04
Total Earning Assets and Average Rate Earned	6,111,625	128,001	8.41
Cash and due from banks	607,792		
Allowance for possible loan losses	(58,951)		
Banking premises and equipment	146,498		
Accrued interest and other assets	304,169		
Total Assets	\$7,111,133		
LIABILITIES			
Demand deposits:			
Commercial and individual	\$1,636,719		
Correspondent banks	217,843		
Public funds	29,157		
Total demand deposits	1,883,719		
Time deposits:			
Savings and Interest-on-Checking	974,995	1,621	.67
Money market deposit accounts	1,645,561	18,343	4.48
Time accounts	1,235,310	15,593	5.08
Public funds	231,319	2,703	4.70
Total time deposits	4,087,185	38,260	3.76
Total deposits	5,970,904		
Federal funds purchased and securities sold under repurchase agreements	318,303	4,376	5.44
Guaranteed preferred beneficial interests in the Corporation's junior subordinated deferrable interest debentures, net	98,534	2,119	8.60
Long-term notes payable	2,460	31	5.04
Other borrowings	113,074	2,120	7.54
Total Interest-Bearing Funds and Average Rate Paid	4,619,556	46,906	4.07
Accrued interest and other liabilities	86,264		

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Total Liabilities	6,589,539	
SHAREHOLDERS' EQUITY	521,594	

Total Liabilities and Shareholders' Equity	\$7,111,133	
	=====	
Net interest income	\$ 81,095	
	=====	
Net interest spread		4.34%
		=====
Net interest income to total average earning assets		5.33%
		=====

The above information is shown on a taxable-equivalent basis assuming a 35% tax rate. Non-accrual loans are included in the average loan amounts outstanding for these computations.

Item 3.

Quantitative and Qualitative Disclosures About Market Risks

Market risk is the potential loss arising from adverse changes in the fair value of a financial instrument due to the changes in market rates and prices. In the ordinary course of business, Cullen/Frost's market risk is primarily interest rate risk. The Corporation's interest rate sensitivity and liquidity are monitored by its Asset/Liability Management Committee on an ongoing basis. The Committee seeks to avoid fluctuating net interest margins and to maintain consistent growth of net interest income through periods of changing interest rates. A variety of measures are used to provide for a comprehensive view of the magnitude of interest rate risk, the distribution of risk, level of risk over time and exposure to changes in certain interest rate relationships.

Cullen/Frost utilizes an earnings simulation model as the primary quantitative tool in measuring the amount of interest rate risk associated with changing market rates. The model quantifies the effects of various interest rate scenarios on the projected net interest income and net income over the ensuing 12 month period. The model was used to measure the impact on net interest income relative to a base case scenario, of rates increasing or decreasing ratably 200 basis points over the next 12 months. These simulations incorporate assumptions regarding balance sheet growth and mix, pricing and the repricing and maturity characteristics of the existing and projected balance sheet. All off-balance sheet financial instruments such as derivatives are included in the model. Other interest rate-related risks such as prepayment, basis and option risk are also considered. The resulting model simulations show that a 200 basis point increase in rates will result in a positive variance in net interest income of 1.9 percent relative to the base case over the next 12 months; while a decrease of 200 basis points will result in a negative variance in net interest income of 3.6 percent. This compares to the year-end 2000 estimate when a 200 basis points increase in rates resulted in a positive variance in net interest income of 0.9 percent relative to the base case over the next 12 months; while a decrease of 200 basis points resulted in a negative variance in net interest income of 1.8 percent. The Corporation's trading portfolio is immaterial and as such separate quantitative disclosure is not presented.

Cullen/Frost continuously monitors and manages the balance between interest rate-sensitive assets and liabilities. The Corporation's objective is to manage the impact of fluctuating market rates on net interest income within acceptable levels. In order to meet this objective, the Corporation may lengthen or shorten the duration of assets or liabilities or enter into derivative contracts to mitigate potential market risk.

Part II: Other Information

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Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of Shareholders of the Corporation was held on May 30, 2001. The following matters were submitted to a vote of the Corporation's shareholders.

1. Election of Directors:

Election of one director nominee into Class I, with a term expiring in 2003, and seven director nominees into Class II, with terms expiring in 2004, was approved with no nominee receiving less than 41.1 million votes.

Nominee -----	Total Votes For -----	Total Votes Withheld -----
Class I:		
Carlos Alvarez	46,146,369	189,903
Class II:		
Royce S. Caldwell	46,171,885	164,387
Richard W. Evans, Jr.	41,195,676	5,140,596
T. C. Frost	41,201,630	5,134,642
Preston M. Geren III	46,172,151	164,121
Karen E. Jennings	46,161,921	174,351
Richard M. Kleberg, III	46,172,551	163,721
Horace Wilkins, Jr.	46,172,551	163,721

2. Approval of the Cullen/Frost Bankers, Inc. 2001 Stock Plan

Total Votes For	31,697,738
Total Votes Against	9,405,281
Total Abstentions	148,894

3. Amend the Cullen/Frost Bankers, Inc. 1997 Director Stock Plan

Total Votes For	32,460,926
Total Votes Against	8,601,201
Total Abstentions	189,788

4. Selection of Independent Auditors

Total Votes For	46,081,065
Total Votes Against	198,472
Total Abstentions	56,735

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None

(b) Reports on Form 8-K

During the quarter ended June 30, 2001, a Current Report on Form 8-K, dated April 18, 2001, was filed with the Commission by Cullen/Frost.

Signatures

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

Cullen/Frost Bankers, Inc.
(Registrant)

Date: July 25, 2001

By: /S/Phillip D. Green

Phillip D. Green
Group Executive Vice President
and Chief Financial Officer
(Duly Authorized Officer and
Principal Accounting Officer)

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