

2001 ANNUAL REPORT

Mapping a Path to the Future



Cullen/Frost Bankers, Inc.

A Texas Financial Services Family



In November of 1863, less than five years before our company was founded, Abraham Lincoln delivered a speech at Gettysburg, Pennsylvania following a terrible battle of the Civil War. As we look for appropriate ways to respond to the tragic losses of September 11th and to channel our grief into resolve, Lincoln's words resonate across the centuries, still relevant and meaningful to us today.



"It is rather for us to be here dedicated to the great task remaining before us – that from these honored dead we take increased devotion to that cause for which they gave the last full measure of devotion – that we here highly resolve that these dead shall not have died in vain – that this nation, under God, shall have a new birth of freedom – and that government of the people, by the people, for the people, shall not perish from the earth."

– Abraham Lincoln

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FINANCIAL HIGHLIGHTS

(In thousands, except per share amounts)

For The Year	2001	2000
Net Income	\$ 80,916	\$ 108,817
Earnings Per Diluted Common Share	1.52	2.03
Return on Average Assets	1.03 %	1.52 %
Return on Average Equity	13.18	20.41
Shareholders' Equity (at year end)	\$ 11.58	\$ 11.14
Dividends84	.76
Operating Earnings*	\$ 93,828	\$ 108,817
Operating Earnings Per Diluted Common Share	1.76	2.03
Operating Return on Average Assets	1.20 %	1.52 %
Operating Return on Average Equity	15.28	20.41
* Operating Earnings exclude the after-tax impact of \$12.9 million associated with the restructuring charges recorded in the fourth quarter 2001.		
Cash Operating Earnings**	\$ 105,678	\$ 121,005
Operating Earnings Per Diluted Common Share	1.98	2.26
Return on Average Assets	1.35 %	1.69 %
Return on Average Equity	17.21	22.70
** Net income before intangible amortization (including goodwill and core deposit intangibles, net of tax)		
At Year End		
Loans	\$ 4,518,608	\$ 4,534,645
Securities	2,156,596	1,668,484
Deposits	7,098,007	6,499,690
Shareholders' Equity	594,919	573,026
Total Assets	8,369,584	7,660,372

Cullen/Frost Bankers, Inc. is a financial holding company, headquartered in San Antonio, with assets of \$8.4 billion at December 31, 2001. Frost National Bank operates 80 financial centers across Texas in Austin, Boerne, Corpus Christi, Dallas, Fort Worth, Galveston, Houston, McAllen, New Braunfels, San Antonio and San Marcos. The corporation provides a full range of commercial and consumer banking products, investment and brokerage services, insurance products and investment banking services.

The annual meeting of shareholders is scheduled for May 22, 2002, at 10 a.m. in the Commanders Room of Frost National Bank, 100 West Houston Street, San Antonio, Texas.

TO OUR SHAREHOLDERS

Looking back on the challenges we faced in 2001, we reflect on a year that was filled with economic uncertainty and disappointments, as the tragic events of September 11th cast a shadow over our nation. Speaking not only for this organization, but for all of America as well, I was relieved to see the year 2001 come to an end. At the same time, I am proud of the conservative and aggressive approach we took in responding to these difficult times. We tackled problems head-on in a manner that was consistent with this company's 134-year heritage and took aggressive actions to better prepare our company for the future. In spite of a disappointing operating performance, Cullen/Frost Bankers, Inc. still had its third most profitable year ever.

Several economic factors impacted our earnings in 2001, perhaps none more significant than a drop in the Fed Funds rate from 6.50 percent at the beginning of the year to 1.75 percent by year-end. As the Federal Reserve attempted to revive an already lagging economy – made even worse after September 11th – interest rates fell 475 basis points during the year, resulting in a reduction of our net interest income. Because we are funded primarily with core deposits, especially demand deposits, we feel the impact of these rate cuts more acutely than many other banks. This low-cost deposit base is one of our company's fundamental competitive advantages. However, in times of unusually sharp rate declines, such as 2001, we can't cut rates proportionately, which squeezes margins. We believe we are near the bottom of the interest rate cycle, and as rates head back up, we anticipate our asset-sensitive balance sheet will once again be beneficial to earnings.

Net interest income was also impacted by slower loan growth year-over-year, which was fueled by several factors, including a slowing economy. Our decision to discontinue making mortgage and indirect auto loans was another driver in this reduced loan growth. We also adjusted our exposure to shared national credits, as we made fewer of these loans and as many existing customers paid down their balances. Because of the reductions in these port-

folios, our year-end loans were flat compared to the previous year, although loans still grew at a 5 percent core rate without these factors.

Our credit quality sustained two company-specific hits, producing an area of disappointment in 2001. These two large charge-offs accounted for a higher provision for loan losses than in prior years. Without these two credits, the charge-offs were .19 percent of loans, a number comparable to our previous history, indicating there is no wholesale deterioration in the portfolio. We are firm believers in learning from our mistakes, and we have examined the characteristics of these two problem loans. While the credits are in unrelated industries, both were highly leveraged and were expanding through acquisitions. Consistent with our 134-year history of managing credit risk, we have instituted additional controls to our credit procedures to help protect Frost against these and other credit risks.

Despite these challenges, we did make progress on a number of fronts in 2001, including demand deposit growth of 15.3 percent. We have a long-standing goal of expanding our fee income sources, as these sources are less subject to interest rate fluctuation and variables in net interest margin. With this objective in mind, we were pleased to have a 9.5 percent increase in non-interest income as a percentage of revenue this year. Trust income, always a solid non-interest income performer for Cullen/Frost, dropped 1 percent this year. Given the overall market volatility, we feel good about our relative performance for the year, as our money managers beat most market indices during what can only be described as a difficult year.

Helping to offset this, Frost Insurance Agency showed continued growth, as we added an important North Texas presence to our insurance family with the acquisition of AIS Insurance and Risk Management. Frost Securities, our investment banking division, grew revenue by 63.9 percent year-over-year, showing progress during the fourth quarter in spite of the challenging environment in which it operates.

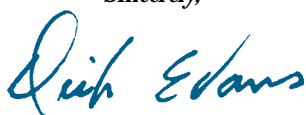
After a major revamping of our website, we saw a 135 percent growth in the number of people using the Internet for banking transactions. Driven by our commitment to make the Internet experience a positive one for our customers, our site offers outstanding functionality as well as consistent and timely customer service response. Our Internet banking product, *My Frost*, gives customers a wide range of state-of-the-art banking, investment and treasury management options.

We reported operating earnings for 2001 of \$93.8 million, or \$1.76 per diluted common share for the fourth quarter of 2001, excluding the after-tax impact of a fourth quarter \$19.9 million restructuring charge. Included in this restructuring charge were: the freezing of the corporation's defined benefit pension plan that was replaced by a deferred profit sharing plan; a 2 percent reduction in workforce; and a voluntary early retirement program developed in early March of 2001 and accepted by 4 percent of the staff. Except for the staff reduction, these steps were taken for reasons other than cost containment, although that will ultimately be a result. It's important to understand that these actions realign our expense base with revenue streams, reduce the volatility of benefit expense and put our company in a strong position to take advantage of growth opportunities going forward. These steps are consistent with our conservative mindset and historical perspective and will ultimately strengthen the company.

Throughout the economic uncertainty of this trying year, we continued to draw upon our collective experience in getting through tough times. Now, as always, our outstanding staff continues to bring the Frost philosophy to life every day.

We operate in strong, diversified and resilient markets in a great state, which has outperformed the U.S. economy in virtually every category. As always, we are grateful for your support and for the trust you have placed in our organization. We look optimistically to the future, well prepared to prosper in the stronger economic times ahead.

Sincerely,



Dick Evans

Chairman and Chief Executive Officer

PRESERVING THE PAST FOR THE NEXT GENERATION



Last year, Frost Bank began a year-long project in partnership with the Texas General Land Office. The bank spearheaded a major initiative, along with the Texas Society of Professional Surveyors, to help restore hundreds of old Texas maps that have fallen into disrepair over the years. In addition to sponsoring 20 county maps, mostly in the communities where Frost Bank has operations, the bank partnered with *Texas Monthly* in a marketing campaign to encourage others to "adopt" maps to finance the costly process of restoration. By preserving these important pieces of Texas history, Frost Bank hopes to strengthen this state's unique heritage for future generations.



Mapping a Path to the Future

Using surveyor's tools, parchment paper, a fine ink pen and a steady hand, early Texas mapmakers created maps that identified cities, rivers and streets, along with significant land grants.

These old Texas maps reinforce the state's proud history. After all, the best maps not only show you where you're going. They also show you where you've been.

"Two things form the basis of our company's success – our dedicated people and the legacy handed down through the years of fiscal and personal integrity. Thanks to the talents and expertise of more than 3,000 employees all over the state, in every line of business, we are building the history of Cullen/Frost Bankers for tomorrow. Our staff performs well not only in good years, but also in difficult times, facing issues head-on in all environments, always exceeding expectations. I'm proud to work with every one of them."



Dick Evans
Chairman and CEO

Pioneers and pathfinders – charting a course

As an early Texas banking pioneer, Frost has a proud heritage and roots that go almost as deep as the state itself. Today, Cullen/Frost Bankers, Inc. is building on the strength of its corporate history and longevity to chart its future as a full-service financial company for tomorrow.

The tools needed for the next part of the journey are considerably more sophisticated than those used in the bank's early years. Armed with technical resources, such as state-of-the-art systems and the Internet, the company is well-equipped to navigate through the years ahead.

More fundamental to the company's success than any software package or network, however, are old-fashioned values and integrity – qualities that go back 134 years – and the people who embody these values. At Frost, advancement doesn't mean computers and technology replacing the personal touch. It means using technology to enhance and strengthen the company's core values and providing employees with the tools, resources and environment to perform efficiently and succeed.

After all, it is outstanding individuals who brought Frost to this point, and other exceptional people who will continue that tradition. At every step in the company's history, there have been pathfinders and pioneers whose energy and vision strengthen the company. That is as true today as it was a century ago. Building on the company's heritage, they will be at the forefront of implementing the strategies for the future.

2001–Meeting the challenges

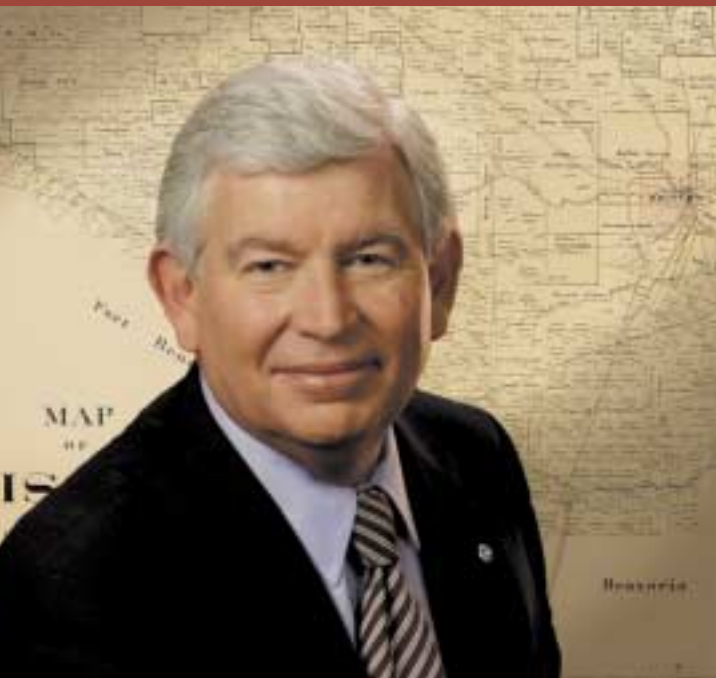
The year 2001 was a difficult one, presenting a unique set of emotional and economic challenges to all Americans. These challenges, however, are very different from the ones related to the economic crisis Texas went through two decades ago. The state's economy is much stronger and more diversified than it was in the 1980s. And so is Cullen/Frost.

When a company endures a crisis such as the one that occurred in Texas in the 80s, it develops a strength of survivorship that enables that organization to adapt quickly to change, take whatever actions are needed and move forward. This unique institutional experience has given Frost the perspective and tenacity to deal with the current challenges, navigate through difficult and uncertain times and emerge stronger than before.

A framework for the future

It's been a year of strengthening the company's core businesses and expanding its newer ones, a year of changing with the times and embracing new technology, a year of building new locations and reinforcing old-fashioned values. During a decade of acquisition and expansion, Cullen/Frost has built a strong framework for its growing financial services business and established a solid presence in major Texas markets. Starting with the foundations of banking and trust, expanding the financial management and investment areas, then adding investment banking and insurance, Frost has built a full-service Texas financial services firm to help Texans with all their financial needs.

Chip Allen
Commercial Banking, Houston



"The Texas business owner has always been at the heart of our company. With new technology and effective treasury management services, we can provide those businesses with the tools they need to manage cash flow and help their business succeed. Today, we're also serving as trusted financial advisors to our business customers, using our expertise and industry knowledge to help them make smart business decisions. With the continued emphasis on credit quality, knowing our customers well is helping us to make smart credit decisions."

"Our website has undergone a huge transformation the last few years. This technology gives customers yet another channel to do business with us as we have expanded the types of transactions people can conduct on their Frost accounts through the Internet. We've also focused on improving the customer experience online, from better functionality and cleaner graphics to faster transactions. While we continue to offer our customers a wide range of options, we never lose sight of the importance of the personal touch in all customer relationships, including the one with those who choose to do business with us through the Internet."



Brenda Gonzales
E-Commerce, San Antonio

Increasing efficiency in core banking business

Continuing a process that began in 2000, Frost Bank worked to explore and implement new ways of staying in touch with its best and most profitable customers. This involves refining the personal banking platform and using improved technology to reinforce and reward customer loyalty.

With the introduction in 2000 of a completely new line of consumer deposit products, the bank streamlined both account offerings and the selling process. Increasing customer retention was a significant focus during the year. To achieve this goal, the company put programs in place within targeted customer groups, resulting in dramatically improved retention rates. These programs enable the officers to anticipate and meet customer needs through the use of technology, giving them the tools to build on strong personal relationships and recommend products and services appropriate for each customer. This provides better value for the customer while cultivating greater profitability and preserving existing relationships.

Building on the successful changes in consumer deposit products, the bank is in the process of implementing a similar approach to business accounts. Throughout Frost's history, the entrepreneur has been the backbone of the company's customer base. The process of refining the business deposit products not only offers the opportunity to simplify accounts; it also provides incentives for business customers to maintain larger balances, which increases account profitability. The new business products will reward customers committed to a full banking relationship with Frost Bank.

With new locations in Austin, Dallas, Houston and Fort Worth, Frost has been expanding its offices to take care of a broad range of customers' financial needs. And the locations themselves make that process easier and more inviting. Borrowing ideas from successful retailers, the new financial centers feature an open layout with greeter stations and Internet Banking areas where customers can learn how to electronically access their account information.



Jeanne Glorioso
Frost Investment Services, Austin

“Our goal in the Frost Financial Management Group is to help successful people make smart decisions. That’s more than just a slogan with us. It’s a commitment to offering our customers a broad range of services – from investment services, financial planning and retirement services to estate planning and trusts – all designed to help people manage their money better. We work hard to provide customers with outstanding professional service, convenience and flexibility.”

Financial management strengthens trust, investment, retirement options

Fee income has always represented a significant part of the company's revenue, and this year, approximately one-third of the bank's fee income came from trust and financial management services, well above peer banks. Fee income growth helps to insulate Frost from the impact of a declining interest rate environment.

The need for good estate planning has become even more crucial following complex reforms in the tax code. More than ever, individuals need the advice of investment and estate planning professionals to help them determine the best course of action. In the retirement services area, a new affiliation with Invesco provides enhanced client reporting and more complete education and administration through the Internet.

There has been a renewed focus this year on leveraging the bank's existing customer base and formalizing the process of referrals among private banking, private client services/wealth management and commercial banking. This synergy has the potential to strengthen customer relationships and cultivate the customer loyalty Frost values so much.

In spite of an industry trend to limit access to investment professionals based on the size of an investor's portfolio, Frost Brokerage continues to focus on personal interaction and financial planning, while making technology available for routine transactions. This area continues to grow, as more customers are seeking advice about their investments, while handling trades on the Internet through the bank's website.

With more than \$13 billion in trust assets – nearly \$6 billion under management and \$7.3 billion in custody assets – Frost is recognized as a significant provider of sophisticated trust, financial management and custodial services. Frost has been successful in building a profitable service model that provides leading-edge investment technology and products, delivered with Frost's expertise and commitment to personalized client service.

During 2001, Frost also established a Securities Lending unit, which affords institutional investors the opportunity to add incremental returns on their investment and pension portfolios, with minimal risk and exposure. Securities Lending is a sophisticated financial service that provides liquidity in financial markets, with institutional investors lending custodial-held securities to a broker or dealer. Based in Dallas, Frost Securities Lending works with both lenders and borrowers in this process.

New business initiatives continue to grow

This was also a year of growth for the company's new business initiatives. Frost Insurance Agency acquired a highly regarded Fort Worth agency, AIS Insurance and Risk Management, adding an important presence in the North Texas market. The focus this year has been on increasing the breadth of insurance services available to customers, with an emphasis on the commercial sector.

Agency acquisitions over the past few years have not only broadened Frost Insurance Agency's geographical footprint. They have also extended the range and depth of services the agency offers. Building on existing expertise in employee benefits, the integration of the Austin agencies acquired in 2000 spurred a dramatic expansion in employee benefits services. As a result, Frost Insurance Agency now has a large professional staff offering special expertise to companies needing assistance in the development and financial management of benefits plans for employees. Frost Insurance Agency is now a full-service multiple lines insurance company, ranking in the top 20 percent of all independent agencies nationwide in revenues.

Frost Securities, the company's investment banking subsidiary, grew revenues by 64 percent year-over-year, continuing to build a presence, even in a difficult equity environment. There is a growing interest in using the services of a Texas-based investment banking firm that focuses on the industries and companies of the Southwest.

Cody Acree
Frost Securities, Dallas

"Texas businesses have been very responsive to a Texas-based investment banking firm, and that's what Frost Securities offers. The firm's two main areas of focus are technology and energy, which are two huge industries for Texas. Our investment banking professionals help companies with mergers and acquisitions, public offerings, leveraged buy outs and other areas of financial advisory, while our research, sales and trading departments provide investment advice and support to institutional clients across the country."



E-Commerce growing in importance

2001 marked the first full year of operations for *frostbank.com*, the company's revamped website. With the introduction of *My Frost* and the improvement of other online services, the Internet has become fully integrated as a delivery channel for bank services.

Throughout the year, Frost has added functionality and improved the usability of the website. Customers can check account balances, transfer funds, see copies of checks or deposits and perform other transactions at any time of the day or night. They can access their Frost investment or retirement accounts, make transactions and trade stocks through Frost Brokerage. And commercial customers can handle a wide array of treasury management services online. The goal continues to be for Frost customers to have a "high tech, high touch" experience when they log on to the site. Frost Internet Banking specialists are available extended hours to assist customers. And their quick response time ranks significantly above industry averages.

Consumer customers can log in to *My Frost* instantaneously, using their Frost checkcard. This immediate access feature sets Frost apart from many competitors and makes Internet banking access simple and easy. Since the introduction of *My Frost*, customer log-ins have tripled.

During 2002, Frost will implement *My Frost* for the business customer. Doing so will increase the functionality of the business side of the website and allow business customers to access valuable account and product details, as they explore the benefits of Frost's commercial banking, treasury management and insurance products. With these expanded online offerings, Frost bankers will be able to increase retention and use the Internet as a sales platform, opening the way to introduce other business products and services.

Mike Delabano
Frost Insurance Agency, Fort Worth



"Frost Insurance Agency offers the benefits of an independent agency that helps individuals and businesses manage risk with cost-effective solutions. Once financial services modernization legislation made it possible for banks to own insurance agencies, this opened up great opportunities within the industry for Frost to expand customer relationships. As the president of a company Frost acquired last year, I've been pleased to be able to offer my customers the services of a bank that's been a part of Texas for over 130 years."

"Consumer bankers focus on retaining our customers and expanding the relationships we have with them. Recently, we revamped our product line to support this goal, reducing and streamlining the number of products we offer and adding new products and packages that encourage customers to take advantage of multiple accounts and services. In addition, our bankers are committed to a discipline of outreach that keeps us in constant contact with our customers, ready to respond to needs and suggest solutions."



Raquel Cardenas
Consumer Sales Administration, San Antonio

What has changed...what hasn't

Over the past few years, in light of financial services modernization laws that have transformed this industry, change has become a way of life in the Cullen/Frost organization. This is reflected in new lines of business, expanded opportunities to strengthen customer relationships and new ways of delivering products and services to customers.

What has not changed – and will not change – is Cullen/Frost's commitment to the values and philosophy that have helped this organization survive and thrive for 134 years.

Cullen/Frost Bankers, Inc.

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Owner,
R. Denny Alexander & Company

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The Gambrinus Company

Isaac Arnold, Jr.
Oil, Real Estate, Investments

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SBC Communications, Inc.

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Retired,
Texace Corporation

Harry H. Cullen
Oil, Real Estate, Investments

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Ruben M. Escobedo, C.P.A.

Dick Evans
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Tom Frost
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Attorney and Businessman;
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Group Executive Vice President

Bill Perotti
Group Executive Vice President
and Chief Credit Officer

Jerry Salinas
Senior Executive Vice President
and Treasurer

Bill Sirakos
Senior Executive Vice President

Larry Sprouse
Senior Executive Vice President

Pam Thomas
Executive Vice President

Vernon D. Torgeson
Senior Executive Vice President

Frost Bank

Directors

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Owner,
R. Denny Alexander
& Company

Carlos Alvarez
Chairman, President & CEO,
The Gambrinus Company

Isaac Arnold, Jr.
Oil, Real Estate, Investments

Royce S. Caldwell
Retired,
SBC Communications, Inc.

Bob W. Coleman
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Pape-Dawson Consulting Engineers

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Mary Beth Williamson
Education (Consultant)

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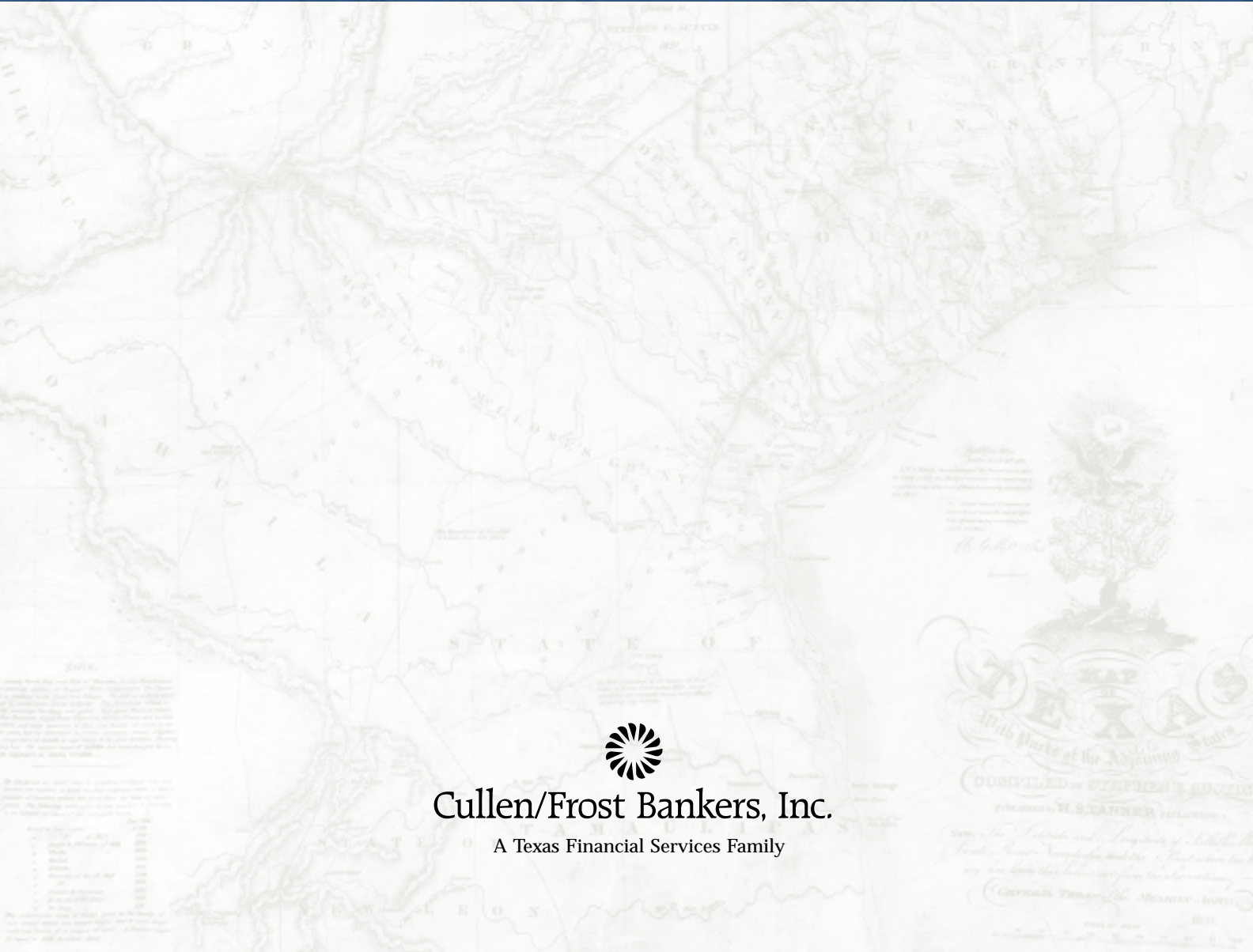
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