



Cullen/Frost Bankers, Inc.

A Texas Financial Services Family



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**Cullen/Frost Bankers, Inc.** is a financial holding company, headquartered in San Antonio, Texas, with assets of \$9.6 billion at December 31, 2002. Frost National Bank operates 78 financial centers across Texas in Austin, Boerne, Corpus Christi, Dallas, Fort Worth, Galveston, Harlingen, Houston, McAllen, New Braunfels, San Antonio and San Marcos. The corporation provides a full range of commercial and consumer banking products, investment, trust and brokerage services, insurance products and investment banking services.



**The annual meeting of shareholders** is scheduled for May 21, 2003, at 10 a.m. in the Commanders Room of Frost National Bank, 100 West Houston Street, San Antonio, Texas.

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**Financial Highlights**

(In thousands, except per share amounts)

<b>For The Year</b>	<b>2002</b>	<b>2001</b>
<b>Income from Continuing Operations</b> .....	<b>\$ 122,233</b>	<b>\$ 80,106</b>
Earnings Per Diluted Common Share .....	<b>2.33</b>	<b>1.50</b>
Return on Average Assets .....	<b>1.46%</b>	<b>1.02%</b>
Return on Average Equity .....	<b>18.77</b>	<b>13.05</b>
<b>Net Income</b> .....	<b>\$ 116,986</b>	<b>\$ 80,916</b>
Earnings Per Diluted Common Share .....	<b>2.23</b>	<b>1.52</b>
Return on Average Assets .....	<b>1.40%</b>	<b>1.03%</b>
Return on Average Equity .....	<b>17.96</b>	<b>13.18</b>
Shareholders' Equity Per share (at year end) .....	<b>\$ 13.72</b>	<b>\$ 11.58</b>
Cash Dividends Per Share .....	<b>.875</b>	<b>.84</b>
<b>At Year End</b>		
Loans .....	<b>\$4,518,913</b>	<b>\$4,518,608</b>
Securities .....	<b>2,458,256</b>	<b>2,156,596</b>
Deposits .....	<b>7,628,143</b>	<b>7,098,007</b>
Shareholders' Equity .....	<b>703,790</b>	<b>594,919</b>
Total Assets .....	<b>9,552,318</b>	<b>8,369,584</b>

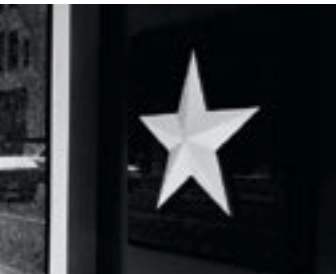
## To Our Shareholders

As we have every year since this company was founded 135 years ago, during 2002 we challenged ourselves to reflect on and refine our corporate culture. Last year, as the national conscience fixated on lapses in business ethics and corporate governance, the merits of our old-fashioned way of doing business were brought to the forefront. At a time when other companies are focusing on values and ethics and mission statements in their annual reports, we made a conscious decision to back away from that approach. There's no need for us to highlight our values. After all, we've been living them for 135 years.

So fundamental are these values to our company that we have decided to deliver our annual report to shareholders this year in a simple and straightforward way, solely through my letter. This annual report is dedicated to all the people in this company who bring these values and the Frost Philosophy to life every day and sustain the legacy of our founder.

The year 2002 was our best year ever, with record annual earnings of \$117 million, or \$2.23 per diluted common share. To some extent, our success during this difficult economic environment and a time of historically low interest rates was the result of strategic actions taken at the end of 2001 to align our expense base with revenue streams. But that success was also due to a diligent effort on the part of our employees to build business and reduce expenses throughout 2002. In late 2001, amid an uncertain economy, we made some tough decisions. We implemented a staff reduction of 2 percent, eliminating 73 jobs. We enacted an across-the-board salary freeze, which lasted for most of the year. When we offered an early retirement program in late 2001, 131 employees opted to accept, and these individuals were not replaced. Although this was not initially done as a cost-saving measure, the impact on 2002 earnings was \$6.6 million. And we reduced future pension plan volatility by freezing our defined benefit plan and adding a deferred profit sharing plan.

At the same time, as a result of uncertainty in the economy, we built our loan loss reserve to 1.83 percent, up from 1.61 percent a year earlier. During a year when the Federal Reserve cut interest rates to the lowest level in more than four decades,





I consider it an accomplishment that our net interest income for the year was basically flat, down just \$2.1 million from the previous year.

Margins were squeezed throughout the year due to our asset-sensitive balance sheet, and loans were essentially flat. However, when adjusted for the run-off of indirect lending, which we no longer offer, and mortgages, which are now provided through a co-branding arrangement with GMAC Mortgage, our average loan growth was 2.8 percent. Strong deposit growth of 5.2 percent produced higher earning assets, which helped mitigate the margin squeeze. Non-interest income rose 9.4 percent in 2002, led by increases in commercial service charges and insurance commissions.

Throughout the year, we made a conscious effort to manage and control expenses company-wide, which resulted in an 8.1 percent decrease in non-interest expense. To help put this into perspective, the 2001 expense base included a restructuring charge and goodwill amortization. New accounting rules no longer require the amortization of goodwill, and we did not take a restructuring charge in 2002. Excluding these two items from last year's expenses, non-interest expense would have been flat, a validation of our efforts to control expenses and the result of the tough decisions we made at the end of the previous year.

Our Frost Insurance Agency subsidiary doubled insurance referral income over the previous year, fueling insurance revenue growth of 39 percent over 2001. Frost Insurance Agency is now one of the 15 largest bank-owned insurance agencies in the country.

We take pride in all of our subsidiaries' contributions to the bottom line. But we never lose sight of the fact that our success is also due to strong execution in basic banking services, including loans, deposits and related banking products. In fact,





58 percent of our non-interest income comes from core banking activities. One example is our Frost ATM & Checkcard, which brought in revenues of \$5.8 million. We understand the importance of offering new products to raise the level of cross-selling, while driving home our core banking business. We have \$7.6 billion in deposits on our balance sheet, more than 40 percent of which is in demand deposits. This, in turn, reduces our cost of funds to extremely low levels and gives us a better net interest margin than most banks. We expect the margin squeeze to improve when interest rates eventually increase.

For more than a century, we have provided basic check clearing, payment processing and related services to other banks. Correspondent Banking continues to be a strong segment of our business, most of it coming from relationships we've built over the years.

Our consumer banking business continues to grow with the addition of two locations in 2002, one in Harlingen in the fast-growing Rio Grande Valley market and the other in Northwest San Antonio. Our newest San Antonio location incorporates an inviting customer-friendly approach and is the prototype for new financial centers. In 2003, we plan to open three new locations, one in North Austin and two in San Antonio in the Medical Center and the Southwest area of the city. We continue to explore better ways to serve our core customer base through a variety of products and delivery channels. In the process of staying in regular contact with our customers, we have developed a strategic program that enables us to anticipate and respond to their financial needs.

The Internet continues to be an important delivery channel for us. More than 50,000 customers had registered for our Internet Banking service, *My Frost*, by year-end, and we now average one million logins each quarter. We increased the functionality and created greater efficiencies by moving our Bill Pay service from an external vendor to one that is

managed in-house. Early in 2003, we redesigned our home page to enhance the customer experience. Building on our ability to allow customers to view their statements online, we will soon be offering them an online statement delivery notification and the option of stopping mailed statements altogether.

During 2002, we also worked to improve how we serve our business customers. Paralleling a similar effort the previous year with our consumer accounts, we realigned our business account products, simplifying the account offerings. Business customers can now access accounts online through *My Frost for Business*, which offers broad Internet functionality. Early in 2003, we expanded online services to include Safekeeping and began offering Lockbox Imaging for Treasury Management customers.

Fees from Trust, Brokerage and Financial Management Services accounted for \$59.2 million in revenues during 2002. In fact, our Brokerage and Financial Management Services areas have increased fee income 17.6 percent over a two-year period, an outstanding feat in a tough market and challenging economy.

Portfolio performance was at the forefront this year, as the performance presentation for our entire managed asset portfolios was examined over a five-year period and verified by a third-party consultant as being compliant with the Global Investment Performance Standards (GIPS®) developed by the Association of Investment Management & Research (AIMR®). This marks an important milestone in our company's efforts to expand our institutional, managed, fixed-income and equity business. Based on three-year returns, the performance of our two fixed-income Commingled Funds made the Effron-PSN "Top Gun" two-star list. Effron-PSN is one of the most comprehensive investment manager evaluation databases, and this ranking will help us document our legitimacy to clients and prospects.

As you know, last year we discontinued operations of the equity capital markets segment of our investment banking firm, Frost Securities. We continue to operate the corporate finance and strategic advisory segments of the investment banking business to assist our middle market commercial customers.





Early in 2003, we were pleased to learn that Standard and Poor's had upgraded its rating on Cullen/Frost in all categories. This vote of confidence by a widely recognized and respected service, at a time when most rating changes are downgrades, recognizes our company's stability and strength and reinforces our business strategy.

In the midst of continued economic uncertainty, we feel more certain than ever about the fundamentals of this company. Today, in our 135th year, we have an outstanding staff, a more finely tuned sales culture, more efficient processes and disciplines throughout the company and better knowledge about our customers. Combined, these factors will help us meet the competition head-on, win new business and continue to expand in the great Texas markets we serve.

Whatever the future may hold, the rock-solid values instituted by our founder, nurtured by company leaders throughout our history and reinforced by our people every single day will help us achieve our goals and face the challenges ahead.

As always, I am deeply grateful for your steadfast support and for the confidence you have entrusted in our company.

Sincerely,

A handwritten signature in blue ink that reads "Dick Evans". The signature is fluid and cursive.

**Dick Evans**

Chairman and Chief Executive Officer





## Banking Locations

San Antonio 210.220.4011	Galveston 409.763.1151
Austin 512.473.4343	Harlingen 956.430.6595
Boerne 830.249.2551	Houston 713.388.7600
Corpus Christi 361.844.1010	McAllen 956.682.1241
Dallas 214.515.4900	New Braunfels 830.643.3500
Fort Worth 817.420.5200	San Marcos 512.393.5600



## Cullen/Frost Bankers, Inc. Corporate Headquarters

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## Form 10-K and Investor Inquiries

Analysts, investors and others desiring additional financial data about Cullen/Frost Bankers, Inc. may contact Greg Parker, Senior Vice President, Director of Investor Relations, at 210.220.5632.

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