

Cullen/Frost Bankers (CFR)

\$64.98 (As of 05/06/20)

Price Target (6-12 Months): **\$55.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 04/14/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:F

Value: C

Growth: D

Momentum: F

Summary

Shares of Cullen/Frost have underperformed the industry over the past six months. The company displays a decent earnings surprise history, having surpassed the Zacks Consensus Estimate in two of the trailing four quarters. First-quarter results reflect higher expenses and provisions, partially offset by rise in fee income. The company's significant exposure to real estate loan portfolios makes us apprehensive. Also, Cullen/Frost has been witnessing continued rise in operating expenses due to expansion of franchise, which is expected to hamper bottom-line growth in the near term. While improving loan and deposit balances along with efforts to enhance presence in the lucrative Texas markets through strategic acquisitions seem encouraging and will likely support top-line growth in the quarters ahead, deterioration of credit quality concerns.

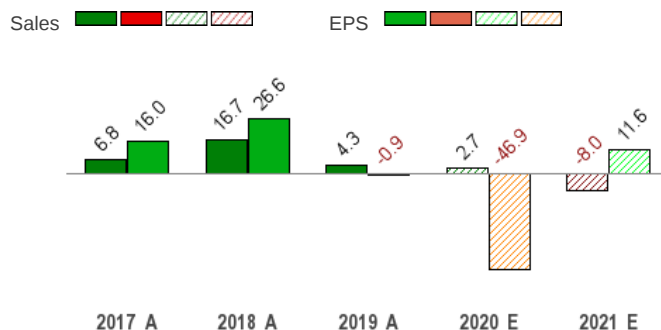
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$101.74 - \$47.69
20 Day Average Volume (sh)	686,585
Market Cap	\$4.1 B
YTD Price Change	-33.6%
Beta	1.64
Dividend / Div Yld	\$2.84 / 4.4%
Industry	Banks - Southwest
Zacks Industry Rank	Bottom 22% (198 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-17.6%
Last Sales Surprise	32.1%
EPS F1 Est- 4 week change	-53.1%
Expected Report Date	07/23/2020
Earnings ESP	7.1%
P/E TTM	11.2
P/E F1	17.9
PEG F1	1.9
P/S TTM	2.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	350 E	349 E	358 E	362 E	1,384 E
2020	481 A	355 E	368 E	347 E	1,504 E
2019	368 A	360 A	366 A	370 A	1,464 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.96 E	\$1.01 E	\$1.16 E	\$1.20 E	\$4.05 E
2020	\$0.75 A	\$0.77 E	\$1.12 E	\$0.78 E	\$3.63 E
2019	\$1.79 A	\$1.72 A	\$1.73 A	\$1.60 A	\$6.84 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/06/2020. The reports text is as of 05/07/2020.

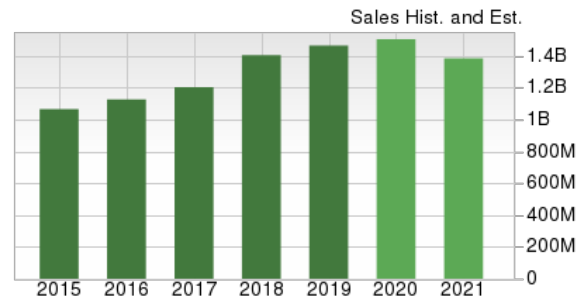
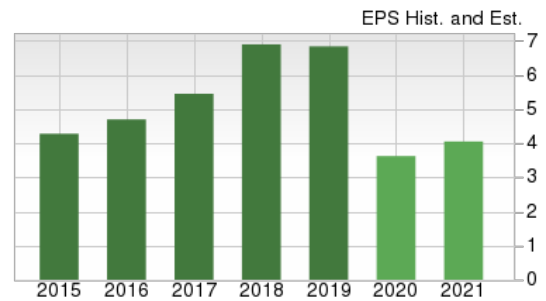
Overview

Headquartered in San Antonio, TX, Cullen/Frost Bankers, Inc. is a financial holding company and a bank holding company, which, through its subsidiaries provide a broad array of products and services throughout numerous Texas markets. In addition to general commercial and consumer banking, other products and services offered include trust and investment management, investment banking, insurance, brokerage, leasing, asset-based lending, treasury management and item processing. As of Mar 31, 2020, Cullen/Frost had consolidated total assets of \$34.1 billion.

The corporation is managed under a matrix organizational structure with two primary operating segments:

- **Banking:** This operating segment includes commercial and consumer banking services and Frost Insurance Agency. Commercial banking 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. Frost Insurance Agency provides insurance brokerage services to individuals and businesses covering corporate and personal property and casualty products, as well as group health and life insurance products and human resources consulting services.
- **Frost Wealth Advisors:** This operating segment includes fee-based services within private trust, retirement services and financial management services, including personal wealth management and brokerage services.

The third operating segment, *Non-Banks*, is for the most part, the parent holding company, while certain other insignificant non-bank subsidiaries of the parent, for the most part, have little or no activity. The parent company's principal activities include direct and indirect ownership of the corporation's banking and non-banking subsidiaries, and issuance of debt and equity. Its principal source of revenue is dividends from its subsidiaries.



Reasons To Sell:

- ▼ Cullen/Frost's expanding cost base exposes the company to operational risks. Notably, non-interest expenses recorded a CAGR of 3.3% over the last five years (2015-2019), primarily due to increase in almost all the cost components. Costs continued to rise in first-quarter 2020. Therefore, mounting expenses will likely remain a near-time headwind as the company focuses on growing its franchise.
- ▼ Cullen/Frost has significant exposure to real estate loans. As of Mar 31, 2020, the company's exposure to these loan portfolios was about 50% of the total loans. Though the housing sector has been showing signs of improvement, any further deterioration in real estate prices will act as a significant headwind. Additionally, almost 89% of the company's loan portfolio consists of commercial and industrial loans, commercial real estate mortgage loans and energy loans, which are relatively larger in volume and more exposed to default risk than residential real estate loans.
- ▼ Cullen/Frost's credit quality seems to have worsened over the years. The ratio of net charge-offs to total average loans increased to 0.23% in 2019 from 0.14% recorded in 2015. Additionally, allowance for losses to year-end loans came in at 0.9% compared with 0.18% in 2015. Notably, credit quality deteriorated in first-quarter 2020 on the adoption of CECL and the coronavirus outbreak. Continued deterioration in credit quality is likely to escalate borrowing costs for the company, in turn, impacting its bottom line.
- ▼ Shares of Cullen/Frost have underperformed the industry over the past six months. Moreover, its current-year earnings estimates have declined 16.6% over the past 30 days. Also, the stock seems overvalued as its current price-to-book (P/B) and price-to-earnings (P/E) ratios are above the respective industry averages. Therefore, given the above concerns and the lack of positive estimates revision, the stock has limited upside potential.

Escalating expenses on account of the company's efforts to growing its franchise remains a key concern. Also, exposure to risky loan portfolio and deterioration in credit quality are headwinds.

Risks

- Organic growth remains a key strength at Cullen/Frost, as reflected by its revenue growth story. Revenues witnessed a CAGR of 6.4% over the last five years (2015-2019), with the trend continuing in the first three months of 2020. Moreover, the low-cost funding source — non-interest bearing deposits — representing more than 40% of total deposits, are expected to boost the net interest income and margin. Hence, we believe the company is well positioned to maintain its increasing revenue trend, going forward.
 - As of Mar 31, 2020, the company held debt worth \$1.4 billion which has witnessed a fall over the past period and while its debt-capital ratio, currently 0.06, has remained almost stable. Further, as of same date, the company display strong cash and cash equivalents of \$4.2 billion,. Thus, we believe Cullen/Frost carries low credit risk and lesser likelihood of default of interest and debt repayments if the economic situation worsens.
 - Cullen/Frost continues to enhance its presence in the lucrative Texas markets. Texas has transformed over the years from a rich oil-producing state into a well-diversified economy. Also, the company believes the economy's low-cost structure and developed infrastructure positions it well to sustain volatility in commodity prices. Notably, the company is also expanding its presence in the Houston region. We believe the company is well poised to further capitalize on its growth momentum in diverse markets.
 - Cullen/Frost exhibits a strong liquidity position. Notably, the company's deposit base recorded a five-year CAGR of 2.8% (2015-2019), while loans witnessed a CAGR of 6.4% during the same time frame. Both metrics continued to increase in the first three months of 2020. Therefore, strong deposit balances will help the company generate higher loans and meet other general business purposes in the quarters ahead.
 - We remain encouraged by Cullen/Frost's steady capital deployment activities. In April 2019, the company hiked its quarterly stock dividend by 6%. Notably, it has increased dividends annually for 26 consecutive years. Also, in July 2019, its board of directors approved a \$100-million common stock-repurchase program. This reflects the company's commitment to return value to its shareholders, backed by a strong capital position. Moreover, the company's debt/equity ratio compares favorably with that of the broader industry which along with improving earnings reflects the fact that such activities are sustainable in the future. Notably, it temporarily suspended the share buyback program, following the coronavirus-related slowdown.
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Last Earnings Report

Cullen/Frost Q1 Earnings Disappoint, Provisions Escalate

Cullen/Frost delivered first-quarter 2020 earnings per share of 75 cents, missing the Zacks Consensus Estimate of 91 cents. Results also compare unfavorably with the prior-year quarter figure of \$1.79 per share.

Escalating expenses and a decline in net interest income were major drags in the quarter. Also, higher provisions on adoption of CECL and the coronavirus outbreak were undermining factors. However, higher fee income, along with rise in loans and deposit balances, were the positives.

The company reported net income available to common shareholders of \$47.2 million compared with the \$114.5 million recorded in the prior-year quarter.

Revenue Growth Offsets Escalating Expenses

The company's total revenues were \$481.5 million in the first quarter, up 30.8% from the prior-year quarter. The revenue figure also surpassed the Zacks Consensus Estimate of \$365 million.

Net interest income on a taxable-equivalent basis slipped 1% year over year to \$268.5 million. Additionally, net interest margin contracted 23 basis points (bps) year over year to 3.56%.

Non-interest income more than doubled to \$213 million on a year-over-year basis. This increase mainly resulted from net gains on securities transactions.

Non-interest expenses of \$224.2 million flared up 11.1% year over year. Rise in almost all the cost components resulted in elevated expenses in the reported quarter.

Strong Balance Sheet

As of Mar 31, 2020, total loans were \$15.3 billion, up 3.4% sequentially. Total deposits amounted to \$28.1 billion, up 1.8% from the prior quarter.

Credit Quality: A Mixed Bag

As of Mar 31, 2020, provision for loan losses more than doubled to \$175.2 million on a year-over-year basis on the coronavirus crisis. Further, net charge-offs, annualized as a percentage of average loans, expanded 85 bps year over year to 1.04%. Allowance for loan losses, as a percentage of total loans, was 1.72%, up 77 bps from the prior-year quarter.

Non-performing assets were \$67.5 million, down 30.7% from the year-ago quarter.

Steady Profitability and Capital Ratios

As of Mar 31, 2020, Tier 1 risk-based capital ratio was 12.02% compared with the 13% recorded at the end of the prior-year quarter. Total risk-based capital ratio was 13.97%, down from 14.68% as of Mar 31, 2019. Furthermore, leverage ratio edged down to 8.84% from 9.35% as of Mar 31, 2019. Common Equity Tier 1 Risk-Based Capital Ratio was 12.02% compared with the previous-year quarter's 12.34%.

Return on average assets and return on average common equity were 0.57% and 4.88%, respectively, compared with the 1.48% and 14.08% witnessed in the prior-year quarter.

Outlook

Management expects net interest income and net interest margin to decline sequentially in second-quarter 2020, given the Fed's rate cuts in March and a continuing decline in LIBOR rates.

The company expects non-interest expenses in 2020 to grow 8.5% from that reported in 2019.

Quarter Ending 03/2020

Report Date	Apr 30, 2020
Sales Surprise	32.05%
EPS Surprise	-17.58%
Quarterly EPS	0.75
Annual EPS (TTM)	5.80

Recent News

Dividend Update

On Apr 30, Cullen/Frost's board of directors announced a cash dividend of 71 cents. The dividend will be paid on Jun 15 to shareholders of record as of May 29.

Valuation

Cullen/Frost's shares are down 33.6% in the year-to-date period and 35.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 34.6% and 28.1%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are down 32.1% and 22.4%, respectively.

The S&P 500 Index is down 11.5% in the year-to-date period and 1.3% in the past year.

The stock is currently trading at 16.02X forward 12 months earnings, which compares to 13.84X for the Zacks sub-industry, 14.69X for the Zacks sector and 20.52X for the S&P 500 Index.

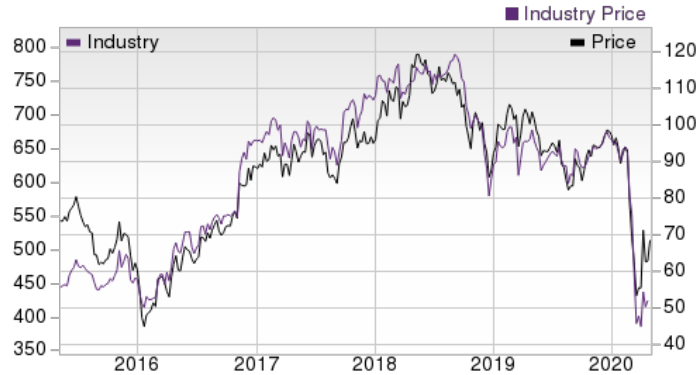
Over the past five years, the stock has traded as high as 19.02X and as low as 8.77X, with a 5-year median of 15.16X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$55 price target reflects 13.62X forward earnings.

The table below shows summary valuation data for CFR

Valuation Multiples - CFR					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	16.02	13.84	14.69	20.52
	5-Year High	19.02	17.8	16.18	20.52
	5-Year Low	8.77	9.78	11.24	15.19
	5-Year Median	15.16	14.06	13.94	17.44
P/TB TTM	Current	1.29	1.42	2.38	10.76
	5-Year High	3.2	2.84	4	12.78
	5-Year Low	1	1.05	1.99	6.02
	5-Year Median	2.27	2.2	3.47	9.2
P/S F12M	Current	2.82	3.03	4.98	3.21
	5-Year High	5.25	5.22	6.7	3.44
	5-Year Low	2.06	2.73	4.98	2.54
	5-Year Median	4.1	4.21	6.06	3.01

As of 05/05/2020

Industry Analysis Zacks Industry Rank: Bottom 22% (198 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Banc of California Inc (BANC)	Neutral	3
BancFirst Corporation (BANF)	Neutral	4
BOK Financial Corporation (BOKF)	Neutral	5
First Financial Bankshares Inc (FFIN)	Neutral	3
Opus Bank (OPB)	Neutral	3
Prosperity Bancshares Inc (PB)	Neutral	3
Texas Capital Bancshares Inc (TCBI)	Underperform	5
UMB Financial Corporation (UMBF)	Underperform	5

Industry Comparison Industry: Banks - Southwest				Industry Peers		
	CFR	X Industry	S&P 500	BOKF	PB	TCBI
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Underperform
Zacks Rank (Short Term)	5	-	-	5	3	5
VGM Score	F	-	-	D	F	C
Market Cap	4.06 B	200.11 M	19.11 B	3.26 B	5.44 B	1.26 B
# of Analysts	6	3	14	7	10	4
Dividend Yield	4.37%	1.60%	2.2%	4.39%	3.21%	0.00%
Value Score	C	-	-	B	D	C
Cash/Price	0.99	0.82	0.06	0.83	0.07	6.93
EV/EBITDA	0.11	5.04	11.69	6.49	10.48	-5.68
PEG Ratio	1.98	1.89	2.48	1.77	1.15	3.22
Price/Book (P/B)	1.06	0.84	2.58	0.65	0.93	0.48
Price/Cash Flow (P/CF)	6.64	7.57	10.40	5.59	12.99	3.48
P/E (F1)	18.81	11.87	18.81	10.64	11.53	25.77
Price/Sales (P/S)	2.54	1.88	1.97	1.47	5.07	0.89
Earnings Yield	5.59%	8.43%	4.99%	9.39%	8.68%	3.88%
Debt/Equity	0.06	0.30	0.75	1.15	0.02	2.00
Cash Flow (\$/share)	9.78	1.99	7.01	8.31	4.42	7.18
Growth Score	D	-	-	F	D	C
Hist. EPS Growth (3-5 yrs)	12.72%	12.72%	10.87%	16.47%	4.67%	21.32%
Proj. EPS Growth (F1/F0)	-47.00%	-25.67%	-9.86%	-37.96%	-0.84%	-84.43%
Curr. Cash Flow Growth	1.26%	12.62%	5.88%	7.34%	12.62%	8.59%
Hist. Cash Flow Growth (3-5 yrs)	10.10%	14.05%	8.55%	8.19%	2.48%	19.05%
Current Ratio	0.66	0.99	1.25	0.78	0.75	1.29
Debt/Capital	5.79%	22.84%	44.23%	53.56%	2.10%	65.39%
Net Margin	23.89%	20.47%	10.87%	20.35%	35.42%	15.73%
Return on Equity	10.23%	9.53%	16.36%	9.30%	8.32%	9.11%
Sales/Assets	0.05	0.05	0.55	0.05	0.04	0.04
Proj. Sales Growth (F1/F0)	2.72%	0.00%	-2.18%	-1.75%	38.69%	-8.71%
Momentum Score	F	-	-	D	C	F
Daily Price Chg	-2.20%	-1.32%	-1.27%	-4.25%	-1.32%	-5.59%
1 Week Price Chg	9.13%	6.72%	0.53%	7.20%	14.65%	6.10%
4 Week Price Chg	-1.66%	1.53%	0.68%	-6.88%	11.00%	-3.47%
12 Week Price Chg	-30.41%	-31.15%	-22.30%	-41.79%	-21.72%	-55.73%
52 Week Price Chg	-35.36%	-31.31%	-11.55%	-45.77%	-20.39%	-61.17%
20 Day Average Volume	686,585	22,065	2,470,143	316,328	781,540	939,298
(F1) EPS Est 1 week change	-50.65%	0.00%	0.00%	-4.38%	3.86%	-2.85%
(F1) EPS Est 4 week change	-53.09%	-3.33%	-6.52%	-18.63%	5.11%	-47.71%
(F1) EPS Est 12 week change	-63.11%	-24.06%	-14.84%	-38.35%	-8.81%	-72.62%
(Q1) EPS Est Mthly Chg	-30.23%	0.00%	-12.48%	-19.69%	-0.83%	-43.96%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	D
Momentum Score	F
VGM Score	F

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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