

Cullen/Frost Bankers (CFR)

\$72.75 (As of 08/06/20)

Price Target (6-12 Months): **\$76.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 05/26/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: C

Growth: F

Momentum: A

Summary

Shares of Cullen/Frost have outperformed the industry over the past six months. The company displays a decent earnings surprise history, having surpassed the Zacks Consensus Estimate in three of the trailing four quarters and missed in one. Second-quarter results reflect lower expenses, partly offset by a fall in revenues. Improving loan and deposit balances along with efforts to enhance presence in the lucrative Texas markets through acquisitions seem encouraging and might aid top-line growth in the quarters ahead. Also, the company is less exposed to credit risk in case of any economic downturn. However, significant exposure to real estate loan portfolios makes us apprehensive. Also, Cullen/Frost has been witnessing a continued rise in operating expenses due to expansion of franchise, which might hamper bottom-line growth in the near term.

Data Overview

52 Week High-Low	\$99.42 - \$47.69
20 Day Average Volume (sh)	429,245
Market Cap	\$4.6 B
YTD Price Change	-25.6%
Beta	1.62
Dividend / Div Yld	\$2.84 / 3.9%
Industry	Banks - Southwest
Zacks Industry Rank	Top 34% (85 out of 252)

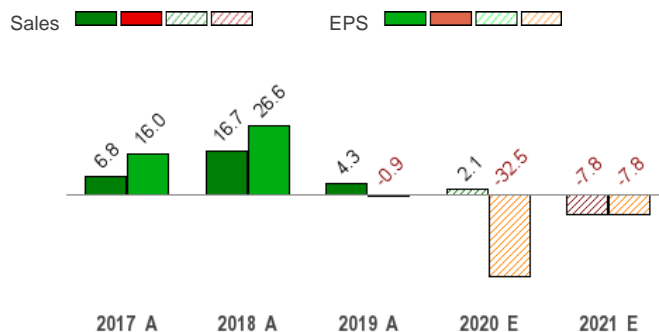
Last EPS Surprise	107.0%
Last Sales Surprise	-2.8%
EPS F1 Est- 4 week change	44.8%
Expected Report Date	10/29/2020
Earnings ESP	0.0%

P/E TTM	13.1
P/E F1	15.8
PEG F1	1.7
P/S TTM	2.9

Price, Consensus & Surprise



Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	339 E	333 E	341 E	345 E	1,378 E
2020	374 A	347 A	346 E	355 E	1,495 E
2019	368 A	360 A	366 A	370 A	1,464 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.86 E	\$0.98 E	\$1.13 E	\$1.19 E	\$4.26 E
2020	-\$0.59 A	\$1.47 A	\$1.22 E	\$1.20 E	\$4.62 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 08/06/2020. The reports text is as of 08/07/2020.

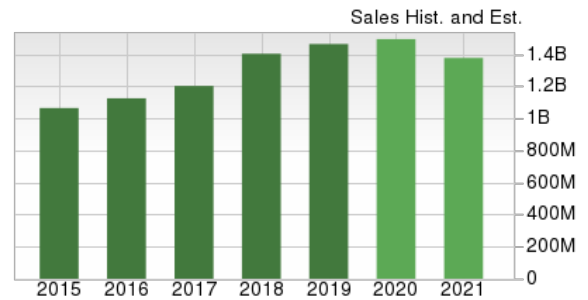
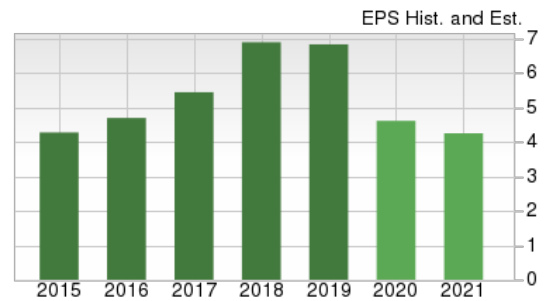
Overview

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 Jun 30, 2020, Cullen/Frost had consolidated total assets of \$39.4 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 Buy:

- ▲ 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 six 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 Jun 30, 2020, the company holds debt worth \$1.82 billion, which has increased in comparison to the past period and its debt-capital ratio, currently 0.05, has remained stable over the same period. Further, the company's time-interest-earned ratio has increased slightly in the past few quarters and is currently at 18.2X. 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 six 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.
- ▲ Shares of Cullen/Frost have outperformed the industry over the past six months. Also, its current-year earnings estimates have been revised 30.3% upward, over the past 30 days. Further, the stock seems undervalued when compared with the broader industry as its current price-to-cash flow and PEG ratios are below respective industry averages. Thus, given the progress on fundamentals and positive estimate revisions, the stock has upside potential.

Cullen/Frost's growth story has been aided by impressive revenue growth, and strong loans and deposit balances. Moreover, strong capital position supports its steady capital deployment measures.

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 the first half of 2020. Therefore, mounting expenses will likely remain a near-term headwind as the company focuses on growing its franchise.
- ▼ Cullen/Frost has significant exposure to real estate loans. As of Jun 30, 2020, the company's exposure to these loan portfolios was about 44% 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 53% 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 two quarters of 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.

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.

Last Earnings Report

Cullen/Frost Q2 Earnings Beat Estimates, Provisions Escalate

Cullen/Frost reported second-quarter 2020 earnings per share of \$1.47, which handily surpassed the Zacks Consensus Estimate of 71 cents. However, it compares unfavorably with the prior-year quarter figure of \$1.72 per share.

Results were supported by a decline in expenses along with improved loan and deposit balance. However, a decline in net interest income and fee income were major drags in the quarter. Also, higher provisions on the coronavirus outbreak were undermining factors.

It reported net income available to common shareholders of \$93.1 million compared with \$109.6 million recorded in the prior-year quarter.

Quarter Ending 06/2020

Report Date	Jul 30, 2020
Sales Surprise	-2.80%
EPS Surprise	107.04%
Quarterly EPS	1.47
Annual EPS (TTM)	4.21

Revenues Decline, Expenses Fall

The company's total revenues were \$347.3 million in the second quarter, down 3.6% from the prior-year quarter. The revenue figure also lagged the Zacks Consensus Estimate of \$357.3 million.

Net interest income on a taxable-equivalent basis slipped 2.9% year over year to \$269.7 million. Additionally, net interest margin contracted 72 basis points (bps) year over year to 3.13%.

Non-interest income declined 6.1% to \$77.6 million on a year-over-year basis. This fall mainly resulted from lower service charges on deposit accounts, interchange and debit card transaction fees along with other charges, commissions and fees.

Non-interest expenses of \$199.7 million fell 1.7% year over year. A decline in almost all the cost components, except for technology, furniture and equipment along with net occupancy resulted in elevated expenses in the reported quarter.

Strong Balance Sheet

As of Jun 30, 2020, total loans were \$18 billion, up 17.2% sequentially. Total deposits amounted to \$32.7 billion, up 16.1% from the prior quarter.

Credit Quality Worsens

Credit metrics deteriorated during the June-end quarter. As of Jun 30, 2020, provision for loan losses more than doubled to \$32 million on a year-over-year basis on the coronavirus crisis. Further, net charge-offs, annualized as a percentage of average loans, expanded 72 bps year over year to 0.94%. Allowance for loan losses, as a percentage of total loans, was 1.39%, up 46 bps from the prior-year quarter.

Non-performing assets were \$85.2 million, up 11.5% from the year-ago quarter.

Steady Profitability and Capital Ratios

As of Jun 30, 2020, Tier 1 risk-based capital ratio was 12.48% compared with 12.94% recorded at the end of the prior-year quarter. Total risk-based capital ratio was 14.43%, down from 14.6% as of Jun 30, 2019. Furthermore, leverage ratio moved down to 8.01% from 9.4% as of Jun 30, 2019. Common Equity Tier 1 Risk-Based Capital Ratio was 12.48% compared with the previous-year quarter's 12.29%.

Return on average assets and return on average common equity were 0.99% and 9.6%, respectively, compared with 1.4% and 12.6% witnessed in the prior-year quarter.

Outlook

Until the pandemic subsides, the company expects continued draws on lines of credit, reduced fee income and low revenues related to investment management, insurance and brokerage operations as well as increased customer and client defaults, including defaults of unsecured loans.

The company expects non-interest expenses in 2020 to grow 6% from that reported in 2019.

Recent News

Dividend Update

On Jul 30, Cullen/Frost's board of directors announced a cash dividend of 71 cents. The dividend will be paid on Sep 15 to shareholders of record as of Aug 31.

Valuation

Cullen/Frost's shares are down 25.6% in the year-to-date period and 17.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 26.2% and 17% respectively in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are down 18% and 8.4%, respectively.

The S&P 500 index is up 3.3% in the year-to-date period and 15.7% in the past year.

The stock is currently trading at 17.25X forward 12 months earnings, which compares to 13.59X for the Zacks sub-industry, 16.5X for the Zacks sector and 22.69X for the S&P 500 index.

Over the past five years, the stock has traded as high as 28.35X and as low as 8.77X, with a 5-year median of 15.18X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$76 price target reflects 18.11X 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	17.25	13.59	16.5	22.69
	5-Year High	28.35	17.87	16.5	22.69
	5-Year Low	8.77	10.53	11.59	15.25
	5-Year Median	15.18	14.09	14.21	17.55
P/TB TTM	Current	1.36	1.52	3.39	15.01
	5-Year High	3.2	2.92	4	15.01
	5-Year Low	1	1.06	2.01	5.96
	5-Year Median	2.21	2.16	3.48	9.55
P/S F12M	Current	3.14	3.34	6.05	3.63
	5-Year High	5.35	5.29	6.66	3.63
	5-Year Low	2.06	2.74	4.97	2.53
	5-Year Median	4.09	4.22	6.06	3.04

As of 08/06/2020

Industry Analysis Zacks Industry Rank: Top 34% (85 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Banc of California, Inc. (BANC)	Neutral	3
BancFirst Corporation (BANF)	Neutral	3
BOK Financial Corporation (BOKF)	Neutral	3
First Financial Bankshares, Inc. (FFIN)	Neutral	3
Prosperity Bancshares, Inc. (PB)	Neutral	3
Peoples United Financial, Inc. (PBCT)	Neutral	4
Texas Capital Bancshares, Inc. (TCBI)	Neutral	3
UMB Financial Corporation (UMBF)	Neutral	3

Industry Comparison Industry: Banks - Southwest				Industry Peers		
	CFR	X Industry	S&P 500	BOKF	PB	TCBI
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	D	-	-	F	C	F
Market Cap	4.56 B	178.71 M	23.20 B	4.02 B	5.22 B	1.68 B
# of Analysts	6	2	14	6	5	7
Dividend Yield	3.90%	1.38%	1.78%	3.57%	3.27%	0.00%
Value Score	C	-	-	D	B	F
Cash/Price	1.47	0.75	0.07	0.79	0.06	5.80
EV/EBITDA	-2.61	4.74	13.21	7.07	10.13	-9.22
PEG Ratio	1.65	6.69	2.94	NA	1.05	18.23
Price/Book (P/B)	1.14	0.84	3.12	0.80	0.88	0.65
Price/Cash Flow (P/CF)	7.44	9.12	12.27	6.88	12.75	4.64
P/E (F1)	15.71	13.24	21.69	11.74	10.46	145.82
Price/Sales (P/S)	2.92	2.00	2.48	1.83	4.47	1.23
Earnings Yield	6.35%	7.55%	4.39%	8.51%	9.55%	0.69%
Debt/Equity	0.06	0.24	0.77	1.15	0.02	1.20
Cash Flow (\$/share)	9.78	1.71	6.94	8.31	4.42	7.18
Growth Score	F	-	-	F	C	F
Hist. EPS Growth (3-5 yrs)	8.31%	12.93%	10.46%	15.63%	5.94%	17.59%
Proj. EPS Growth (F1/F0)	-32.50%	-18.03%	-6.80%	-30.80%	7.25%	-96.33%
Curr. Cash Flow Growth	1.26%	8.59%	5.39%	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	0.71	1.00	1.33	0.78	0.79	1.19
Debt/Capital	5.54%	19.20%	44.50%	53.56%	2.06%	53.10%
Net Margin	23.29%	20.84%	10.13%	17.26%	36.72%	8.10%
Return on Equity	7.27%	7.90%	14.39%	7.72%	8.25%	6.68%
Sales/Assets	0.04	0.05	0.51	0.05	0.04	0.04
Proj. Sales Growth (F1/F0)	2.11%	0.00%	-1.51%	5.53%	38.68%	-4.52%
Momentum Score	A	-	-	C	F	B
Daily Price Chg	-0.34%	-0.10%	-0.04%	0.49%	-1.23%	-1.42%
1 Week Price Chg	-1.29%	-1.65%	0.14%	-1.12%	-1.38%	6.10%
4 Week Price Chg	10.19%	2.23%	7.78%	14.63%	5.29%	27.43%
12 Week Price Chg	15.16%	4.09%	17.48%	36.30%	-0.07%	35.71%
52 Week Price Chg	-17.60%	-29.87%	0.68%	-28.94%	-14.71%	-41.21%
20 Day Average Volume	429,245	16,091	2,057,775	218,214	557,466	497,530
(F1) EPS Est 1 week change	6.85%	0.00%	0.00%	0.00%	-1.03%	0.00%
(F1) EPS Est 4 week change	44.76%	7.65%	1.36%	2.03%	0.30%	23.46%
(F1) EPS Est 12 week change	34.63%	4.18%	1.57%	4.18%	0.63%	1.82%
(Q1) EPS Est Mthly Chg	26.22%	8.41%	0.54%	6.85%	-3.37%	31.92%

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	F
Momentum Score	A
VGM Score	D

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.

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