

Cullen/Frost Bankers (CFR)

\$94.68 (As of 01/15/20)

Price Target (6-12 Months): **\$99.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 09/09/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: C

Momentum: A

Summary

Shares of Cullen/Frost have outperformed the industry, over the past three months. Though earnings estimate have been revised slightly downward ahead of fourth-quarter results, the company displays an impressive earnings surprise history, having surpassed the Zacks Consensus Estimate in three of the trailing four quarters. The rising loan and deposit balances will likely continue to support the company's top-line growth. Steady capital-deployment activities aimed to enhance shareholders' value, seem sustainable. Further, efforts to enhance presence in the lucrative Texas markets through strategic acquisitions seem encouraging. However, the company's significant exposure to real estate in its loan portfolio is a concern. Additionally, rising costs, mainly resulting from expanding franchise, are likely to deter bottom-line growth.

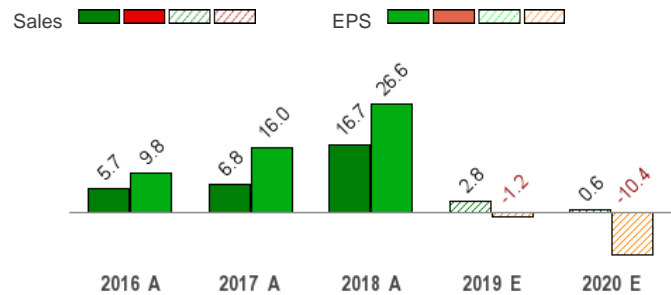
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$106.23 - \$79.86
20 Day Average Volume (sh)	266,061
Market Cap	\$5.9 B
YTD Price Change	-3.2%
Beta	1.39
Dividend / Div Yld	\$2.84 / 3.0%
Industry	Banks - Southwest
Zacks Industry Rank	Top 44% (113 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.4%
Last Sales Surprise	0.4%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	01/30/2020
Earnings ESP	0.1%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	365 E	359 E	368 E	371 E	1,452 E
2019	368 A	360 A	366 A	360 E	1,443 E
2018	321 A	322 A	353 A	361 A	1,404 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.59 E	\$1.51 E	\$1.57 E	\$1.56 E	\$6.11 E
2019	\$1.79 A	\$1.72 A	\$1.73 A	\$1.58 E	\$6.82 E
2018	\$1.61 A	\$1.68 A	\$1.78 A	\$1.82 A	\$6.90 A

*Quarterly figures may not add up to annual.

P/E TTM	13.4
P/E F1	15.5
PEG F1	1.6
P/S TTM	4.0

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/15/2020. The reports text is as of 01/16/2020.

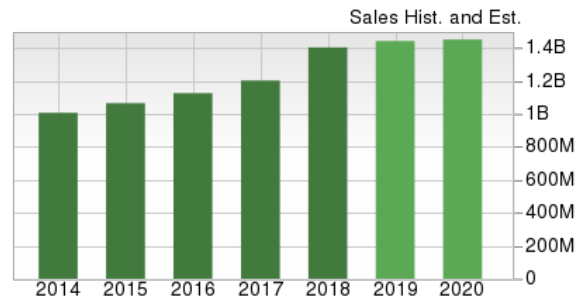
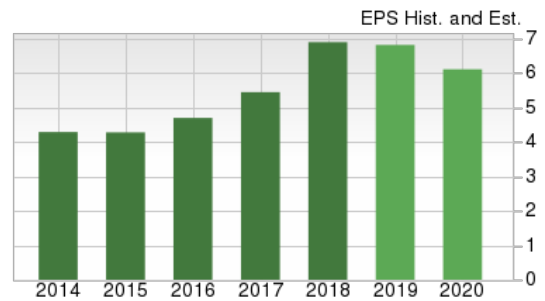
Overview

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 Sep 30, 2019, Cullen/Frost had consolidated total assets of \$33.1 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 Buy:

- ▲ Organic growth remains a key strength at Cullen/Frost, as reflected by its revenue growth story. Revenues witnessed a CAGR of 5.6% over the last five years (2014-2018), with the increasing trend continuing in the first nine months of 2019. 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.
- ▲ 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. Frost opened three branches related to this expansion in early 2019, and further, over the course of 2019 and 2020, expects to open approximately one branch per month. 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 3% (2014-2018), while loans witnessed a CAGR of 6.4% during the same time frame. The increasing trend continued in the first nine months of 2019. 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, this July, 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.
- ▲ s trailing 12-month return on equity (ROE) reflects its superiority in terms of utilizing shareholders' fund. The company's ROE of 13.11% compares favorably with 10.52% for the industry.
- ▲ Cullen/Frost seems undervalued as its current price-to-cash flow (P/CF) and price-to-earnings (P/E) (F1) ratios are below the respective industry averages. Further, it has a Value Score of B.

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 4.4% over the last five years (2014-2018), primarily due to increase in almost all the cost components. The increasing trend continued in the first nine months of 2019. 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. Currently, the company's exposure to these loan portfolios nears about 48% 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 85% 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 0.17% in the third quarter from 0.09% recorded in 2014. Additionally, allowance for losses to year-end loans came in at 0.93% compared with 0.91% in 2014. 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 outperformed the industry in the past three months. Despite this favorable trend, the current-year earnings estimates have been revised slightly downward over the last 30 days. Therefore, given the above concerns and 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.

Last Earnings Report

Cullen/Frost Q3 Earnings Beat, Revenues Up

Cullen/Frost delivered third-quarter 2019 positive earnings surprise of 2.4%. Earnings per share of \$1.73 surpassed the Zacks Consensus Estimate of \$1.69. However, the bottom line compares unfavorably with the prior-year quarter figure of \$1.78 per share.

Top-line strength and higher loan balance were reflected in the quarter. Further, a strong balance-sheet position and expansion of margins were driving factors. However, elevated expenses and provisions were major drags.

The company reported net income available to common shareholders of \$109.8 million compared with \$115.8 million recorded in the prior-year quarter.

Revenues Rise, Expenses Escalate

The company's total revenues were \$365.8 million in the third quarter, up 4.3% from the prior-year quarter. The revenue figure topped the Zacks Consensus Estimate of \$364.6 million.

Net interest income on a taxable-equivalent basis climbed 4.1% year over year to \$276.6 million. Additionally, net interest margin expanded 10 basis points (bps) to 3.76%.

Non-interest income totaled \$89.2 million, up 1.8% from the year-ago quarter. This increase was mainly due to higher trust and investment management, commissions and fees, along with service charge on deposits.

Non-interest expenses of \$208.9 million jumped 7.8% year over year. Increase in almost all the cost components led to elevated expenses in the reported quarter.

Strong Balance Sheet

As of Sep 30, 2019, total loans were \$14.6 billion, up 1.2% sequentially. Total deposits amounted to \$27.1 billion, up 4.2% from the prior quarter.

Credit Quality: A Mixed Bag

As of Sep 30, 2019, provision for loan losses increased significantly on a year-over-year basis to \$8 million. Non-performing assets were \$105 million, up 21.6%.

However, net charge-offs, annualized as a percentage of average loans shrunk 27 bps year over year to 0.17%. Allowance for loan losses, as a percentage of total loans, was 0.93%, down 7 bps.

Steady Profitability and Capital Ratios

As of Sep 30, 2019, Tier 1 risk-based capital ratio was 12.99% compared with 13.24% recorded at the end of the prior-year quarter. Furthermore, total risk-based capital ratio was 14.63%, down from 14.99% as of Sep 30, 2018. Leverage ratio inched up to 9.36% from 9.19% as of Sep 30, 2018.

Return on average assets and return on average common equity were 1.35% and 11.83%, respectively, compared with 1.49% and 14.4% witnessed in the prior-year quarter.

Capital Deployment Update

During the third quarter of 2019, the company repurchased 202,724 shares at a total cost of \$17.2 million.

Outlook

Management estimates full-year 2019 reported earnings of \$6.81.

Quarter Ending **09/2019**

Report Date	Oct 31, 2019
Sales Surprise	0.35%
EPS Surprise	2.37%
Quarterly EPS	1.73
Annual EPS (TTM)	7.06

Recent News

Dividend Update

On Oct 31, Cullen/Frost's board of directors announced a cash dividend of 71 cents. The dividend was paid on Dec 13 to shareholders of record as of Nov 29, 2019.

Valuation

Cullen/Frost's shares are down 3.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 4.9% and 12.7%, respectively, over the past year.

The S&P 500 Index is up 24.5% in the past year.

The stock is currently trading at 15.48X forward 12 months earnings, which compares to 13.93X for the Zacks sub-industry, 14.95X for the Zacks sector and 19X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 19.02X and as low as 9.08X, with a 5-year median of 15.16X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$99 price target reflects 16.25X 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	15.48	13.93	14.95	19
	5-Year High	19.02	17.85	16.21	19.34
	5-Year Low	9.08	10.8	12.01	15.17
	5-Year Median	15.16	14.04	13.98	17.44
P/TB TTM	Current	1.92	2	2.82	4.46
	5-Year High	3.2	2.86	2.89	4.47
	5-Year Low	1.27	1.5	1.83	2.85
	5-Year Median	2.27	2.22	2.5	3.61
P/S F12M	Current	4.07	4	6.53	3.52
	5-Year High	5.35	5.24	6.61	3.52
	5-Year Low	2.06	2.95	5.2	2.54
	5-Year Median	4.1	4.21	6.04	3

As of 01/15/2020

Industry Analysis Zacks Industry Rank: Top 44% (113 out of 254)



Top Peers

BancFirst Corporation (BANF)	Neutral
BOK Financial Corporation (BOKF)	Neutral
Commerce Bancshares, Inc. (CBSH)	Neutral
First Financial Bankshares, Inc. (FFIN)	Neutral
Prosperity Bancshares, Inc. (PB)	Neutral
Southside Bancshares, Inc. (SBSI)	Neutral
Texas Capital Bancshares, Inc. (TCBI)	Neutral
UMB Financial Corporation (UMBF)	Neutral

Industry Comparison Industry: Banks - Southwest				Industry Peers		
	CFR Neutral	X Industry	S&P 500	BOKF Neutral	PB Neutral	TCBI Neutral
VGM Score	B	-	-	F	D	D
Market Cap	5.92 B	287.52 M	24.22 B	6.10 B	4.76 B	2.73 B
# of Analysts	8	2	13	3	7	4
Dividend Yield	3.00%	1.24%	1.75%	2.37%	2.64%	0.00%
Value Score	B	-	-	D	B	C
Cash/Price	0.50	0.44	0.04	0.48	0.09	1.83
EV/EBITDA	5.08	9.21	14.11	12.79	9.06	1.24
PEG Ratio	1.65	1.63	2.06	1.99	1.35	1.20
Price/Book (P/B)	1.59	1.23	3.34	1.26	1.15	1.05
Price/Cash Flow (P/CF)	10.09	13.47	13.57	10.28	13.08	8.19
P/E (F1)	15.70	13.72	18.90	11.93	13.50	9.56
Price/Sales (P/S)	3.97	2.78	2.65	2.80	5.50	1.90
Earnings Yield	6.45%	7.30%	5.29%	8.38%	7.41%	10.45%
Debt/Equity	0.06	0.24	0.72	1.47	0.00	1.11
Cash Flow (\$/share)	9.39	1.61	6.94	8.38	5.32	6.63
Growth Score	C	-	-	F	D	F
Hist. EPS Growth (3-5 yrs)	13.33%	13.33%	10.56%	14.34%	2.15%	21.58%
Proj. EPS Growth (F1/F0)	-10.37%	0.22%	7.59%	-1.21%	7.68%	-10.45%
Curr. Cash Flow Growth	22.71%	30.86%	14.73%	27.64%	12.12%	37.24%
Hist. Cash Flow Growth (3-5 yrs)	13.19%	13.79%	9.00%	4.87%	3.93%	20.22%
Current Ratio	0.62	0.98	1.24	0.86	0.62	1.20
Debt/Capital	5.71%	19.57%	42.99%	59.47%	0.00%	51.22%
Net Margin	30.76%	23.67%	11.14%	22.88%	38.03%	22.29%
Return on Equity	13.11%	10.52%	17.16%	11.20%	8.02%	12.95%
Sales/Assets	0.05	0.05	0.55	0.05	0.04	0.05
Proj. Sales Growth (F1/F0)	0.65%	2.66%	4.23%	1.16%	41.58%	-1.87%
Momentum Score	A	-	-	C	D	A
Daily Price Chg	-0.85%	0.00%	0.27%	-0.06%	-1.32%	-2.69%
1 Week Price Chg	-2.74%	-0.39%	0.39%	-1.58%	-1.82%	1.63%
4 Week Price Chg	-3.49%	-2.14%	2.17%	-1.52%	-3.06%	-9.87%
12 Week Price Chg	0.47%	4.24%	6.65%	9.61%	-5.90%	-3.02%
52 Week Price Chg	-2.65%	6.63%	22.43%	7.73%	-0.40%	-3.75%
20 Day Average Volume	266,061	21,488	1,545,017	121,833	423,861	552,343
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-0.43%	0.00%
(F1) EPS Est 4 week change	0.02%	0.00%	0.00%	0.21%	-0.53%	1.23%
(F1) EPS Est 12 week change	-5.17%	-2.21%	-0.41%	-2.08%	-0.17%	0.02%
(Q1) EPS Est Mthly Chg	-0.63%	0.00%	0.00%	-0.86%	-0.40%	0.00%

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	B
Growth Score	C
Momentum Score	A
VGM Score	B

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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