

Cullen/Frost Bankers (CFR)

\$60.40 (As of 04/15/20)

Price Target (6-12 Months): **\$50.00**

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: F

Growth: F

Momentum: D

Summary

Shares of Cullen/Frost have underperformed the industry over the past year. The company displays an impressive earnings surprise history, having surpassed the Zacks Consensus Estimate in three of the trailing four quarters. The company's significant exposure to real estate loan portfolios makes us apprehensive. Also, Cullen/Frost has been witnessing continued rise in operating expenses, mainly resulting from expanding franchise. While improving loan and deposit balances, its steady capital-deployment activities 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, persistent rise in expenses are expected to hamper bottom-line growth in the near term. A stretched valuation limits the stock's upside potential.

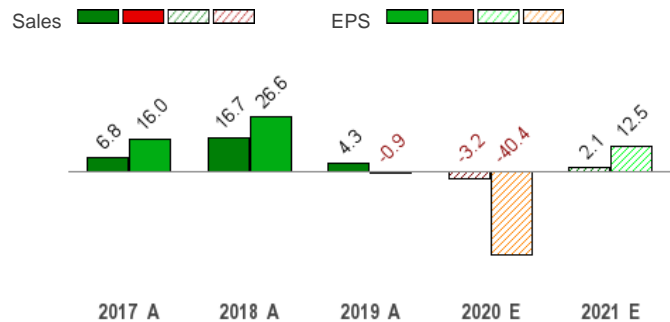
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$104.53 - \$47.69
20 Day Average Volume (sh)	694,748
Market Cap	\$3.8 B
YTD Price Change	-38.2%
Beta	1.53
Dividend / Div Yld	\$2.84 / 4.7%
Industry	Banks - Southwest
Zacks Industry Rank	Bottom 17% (211 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.3%
Last Sales Surprise	1.6%
EPS F1 Est- 4 week change	-29.3%
Expected Report Date	04/23/2020
Earnings ESP	0.0%
P/E TTM	8.8
P/E F1	14.8
PEG F1	1.6
P/S TTM	2.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	363 E	358 E	369 E	373 E	1,447 E
2020	365 E	346 E	350 E	353 E	1,417 E
2019	368 A	360 A	366 A	370 A	1,464 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.13 E	\$1.11 E	\$1.20 E	\$1.19 E	\$4.59 E
2020	\$0.93 E	\$0.93 E	\$1.04 E	\$1.20 E	\$4.08 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 04/15/2020. The reports text is as of 04/16/2020.

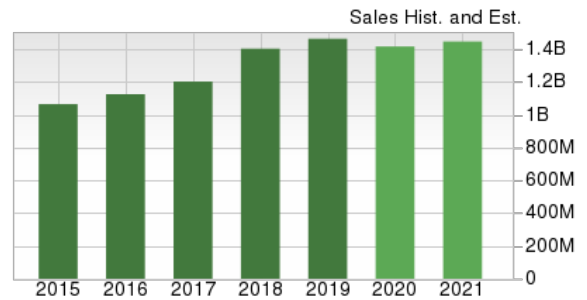
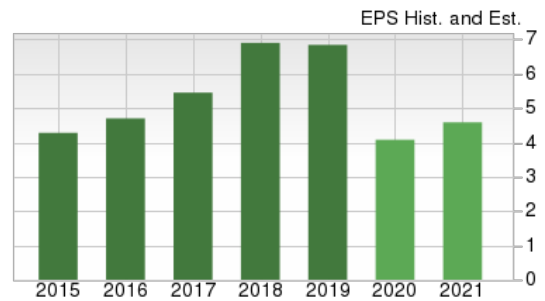
Overview

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 Dec 31, 2019, Cullen/Frost had consolidated total assets of \$34 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. 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. 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 0.23% 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. 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 in the past year. Moreover, its current-year earnings estimates have been revised 15.9% downward over the past seven 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 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). 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 2.8% (2015-2019), while loans witnessed a CAGR of 6.4% during the same time frame. 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.
 - The company's trailing 12-month return on equity (ROE) reflects its superiority in terms of utilizing shareholders' fund. The company's ROE of 12.19% compares favorably with 10.46% for the industry.
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Last Earnings Report

Cullen/Frost Q4 Earnings Beat Estimates, Revenues Rise

Cullen/Frost delivered fourth-quarter 2019 positive earnings surprise of 1.3%. Earnings per share of \$1.60 surpassed the Zacks Consensus Estimate of \$1.58. However, the bottom line compared unfavorably with the prior-year quarter figure of \$1.82 per share.

Results reflected top-line strength aided by higher loan and deposit balances. However, elevated expenses and provisions, along with contracting margins, were major drags.

The company reported net income available to common shareholders of \$101.7 million, down 13.3% from the prior-year quarter.

In 2019, earnings of \$6.84 per share were down nearly 1% from the prior year's figure, but outpaced the consensus estimate by 2 cents. Net income declined 2.5% to \$435.5 million.

Revenues Rise, Expenses Escalate

The company's total revenues were \$370.3 million in the fourth quarter, up 2.6% from the prior-year quarter. The revenue figure topped the Zacks Consensus Estimate of \$364.6 million.

In 2019, total revenues were \$1.5 billion, up 4.3%. Also, the top line matched the consensus estimate.

Net interest income on a taxable-equivalent basis moved marginally upward year over year to \$275 million. Additionally, net interest margin contracted 10 basis points (bps) to 3.62%.

Non-interest income totaled \$95.3 million, up 9.3% from the year-ago quarter. This increase was due to rise in all the components except interchange and debit card transaction fees, and other charges, commissions and fees.

Non-interest expenses of \$220.8 million jumped 10.6% year over year. Increase in almost all the cost components led to elevated expenses in the reported quarter.

Strong Balance Sheet

As of Dec 31, 2019, total loans were \$14.8 billion, marginally up from the prior quarter. Total deposits amounted to \$27.6 billion, up 2.1% sequentially.

Credit Quality: A Mixed Bag

As of Dec 31, 2019, provision for loan losses increased significantly on a year-over-year basis to \$8.4 million. Non-performing assets were \$109.5 million, up 46.2%. Also, net charge-offs, annualized as a percentage of average loans, expanded 8 bps year over year to 0.34%. However, allowance for loan losses, as a percentage of total loans, was 0.90%, down 4 bps.

Profitability and Capital Ratios

As of Dec 31, 2019, Tier 1 risk-based capital ratio was 12.99% compared with 12.94% recorded at the end of the prior-year quarter. Furthermore, total risk-based capital ratio was 14.57%, down from 14.64% as of Dec 31, 2018. Leverage ratio moved up to 9.28% from 9.06% as of Dec 31, 2018.

Return on average assets and return on average common equity were 1.21% and 10.74%, respectively, compared with 1.48% and 14.85% in the prior-year quarter.

Outlook

Management expects full-year 2020 earnings of \$6.13.

Quarter Ending **12/2019**

Report Date	Jan 30, 2020
Sales Surprise	1.57%
EPS Surprise	1.27%
Quarterly EPS	1.60
Annual EPS (TTM)	6.84

Recent News

Dividend Update

On Jan 30, Cullen/Frost's board of directors announced a cash dividend of 71 cents. The dividend was paid on Mar 13 to shareholders on record as of Feb 28.

Valuation

Cullen/Frost's shares are down 38.3% in the year-to-date period and 42% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 36.2% and 24.6%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are down 33.8% and 19.1%, respectively.

The S&P 500 Index is down 11.8% in the year-to-date period and 2.4% in the past year.

The stock is currently trading at 10.13X forward 12 months earnings, which compares to 11.01X for the Zacks sub-industry, 13.70X for the Zacks sector and 18.98X for the S&P 500 Index.

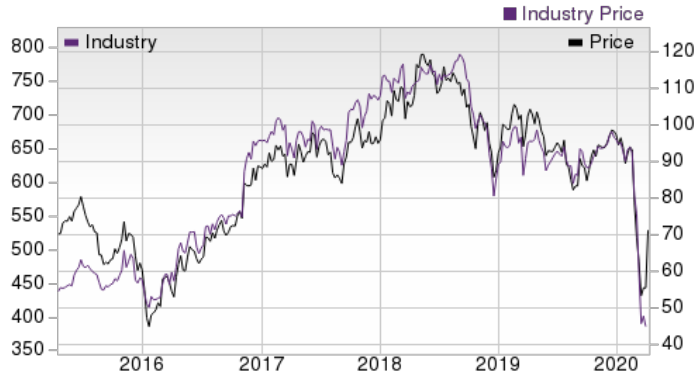
Over the past five years, the stock has traded as high as 19.02X and as low as 8.77X, with a 5-year median of 15.21X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$50 price target reflects 8.39X forward earnings.

The table below shows summary valuation data for CFR

Valuation Multiples - CFR					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	10.13	11.01	13.7	18.98
	5-Year High	19.02	17.8	16.19	19.34
	5-Year Low	8.77	9.78	11.23	15.19
	5-Year Median	15.21	14	13.95	17.45
P/TB TTM	Current	1.23	1.27	2.46	10.73
	5-Year High	3.2	2.84	3.97	12.78
	5-Year Low	1	1.04	1.97	6.02
	5-Year Median	2.27	2.21	3.45	9.15
P/S F12M	Current	2.55	2.9	4.93	3.16
	5-Year High	5.35	5.22	6.65	3.44
	5-Year Low	2.06	2.74	4.93	2.54
	5-Year Median	4.12	4.2	6.03	3.01

As of 04/15/2020

Industry Analysis Zacks Industry Rank: Bottom 17% (211 out of 253)



Top Peers

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

Industry Comparison Industry: Banks - Southwest				Industry Peers		
	CFR Underperform	X Industry	S&P 500	BOKF Underperform	PB Neutral	TCBI Underperform
VGM Score	F	-	-	C	D	F
Market Cap	3.79 B	175.29 M	19.18 B	3.24 B	4.37 B	1.22 B
# of Analysts	8	2	14	6	9	7
Dividend Yield	4.70%	1.51%	2.24%	4.44%	3.99%	0.00%
Value Score	F	-	-	A	C	C
Cash/Price	0.86	0.67	0.06	0.76	0.11	3.00
EV/EBITDA	0.50	5.41	11.46	5.41	7.94	-0.51
PEG Ratio	1.48	1.33	2.08	1.33	0.94	0.89
Price/Book (P/B)	1.00	0.77	2.58	0.67	0.73	0.45
Price/Cash Flow (P/CF)	6.17	6.92	10.15	5.54	10.45	3.36
P/E (F1)	14.09	9.46	17.24	7.99	9.42	7.10
Price/Sales (P/S)	2.53	1.79	1.99	1.45	4.57	0.83
Earnings Yield	6.75%	10.57%	5.64%	12.53%	10.61%	14.08%
Debt/Equity	0.06	0.31	0.70	0.99	0.02	1.04
Cash Flow (\$/share)	9.78	1.99	7.01	8.31	4.42	7.18
Growth Score	F	-	-	F	D	F
Hist. EPS Growth (3-5 yrs)	13.60%	13.60%	10.92%	15.98%	3.30%	22.72%
Proj. EPS Growth (F1/F0)	-40.37%	-11.61%	-2.92%	-18.11%	-2.39%	-45.40%
Curr. Cash Flow Growth	1.26%	12.62%	5.93%	7.34%	12.62%	8.59%
Hist. Cash Flow Growth (3-5 yrs)	10.10%	12.62%	8.55%	8.19%	2.48%	19.05%
Current Ratio	0.63	0.97	1.24	0.80	0.75	1.21
Debt/Capital	5.67%	23.22%	42.36%	49.69%	2.06%	49.67%
Net Margin	29.62%	22.60%	11.64%	22.49%	34.66%	22.15%
Return on Equity	12.19%	10.46%	16.74%	10.77%	8.04%	12.66%
Sales/Assets	0.05	0.05	0.54	0.05	0.04	0.05
Proj. Sales Growth (F1/F0)	-3.24%	0.00%	0.00%	-2.08%	34.71%	-8.59%
Momentum Score	D	-	-	D	A	C
Daily Price Chg	-5.88%	-4.88%	-3.26%	-5.02%	-8.79%	-6.43%
1 Week Price Chg	28.52%	8.99%	16.01%	28.24%	20.46%	31.67%
4 Week Price Chg	6.60%	3.05%	16.73%	7.93%	-11.60%	8.01%
12 Week Price Chg	-36.42%	-33.58%	-22.44%	-44.56%	-33.19%	-54.76%
52 Week Price Chg	-42.00%	-35.02%	-14.41%	-47.16%	-36.01%	-58.71%
20 Day Average Volume	694,748	30,471	3,301,889	437,264	971,205	865,197
(F1) EPS Est 1 week change	-15.86%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-29.27%	-9.64%	-6.78%	-13.06%	-8.14%	-34.26%
(F1) EPS Est 12 week change	-33.27%	-12.97%	-9.07%	-20.29%	-4.65%	-39.78%
(Q1) EPS Est Mthly Chg	-31.33%	-9.74%	-11.31%	-8.77%	-3.69%	-30.48%

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	F
Growth Score	F
Momentum Score	D
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.

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