

Prosperity Bancshares (PB)

\$57.80 (As of 07/01/20)

Price Target (6-12 Months): **\$61.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/17/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:B

Value: B

Growth: C

Momentum: C

Summary

Shares of Prosperity Bancshares have outperformed the industry over the past year. The bank's earnings outpaced the Zacks Consensus Estimate on three occasions and reported in line in one of the trailing four quarters. Its first-quarter 2020 results reflect benefits from the LegacyTexas Financial deal amid lower rates and coronavirus-induced slowdown. Solid loan and deposit balances, strategic acquisitions, and a strong balance sheet position are likely to support profitability. Its steady capital deployment actions seem sustainable and will enhance shareholder value. However, near-zero interest rates and the Federal Reserve's accommodative monetary policy are expected to put pressure on margins. This apart, weakness in the mortgage banking business will likely hurt top-line growth. Further, mounting expenses are a matter of concern.

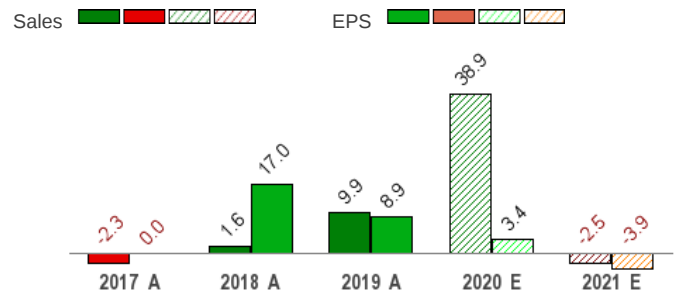
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$75.22 - \$42.02
20 Day Average Volume (sh)	610,755
Market Cap	\$5.4 B
YTD Price Change	-19.6%
Beta	1.47
Dividend / Div Yld	\$1.84 / 3.2%
Industry	Banks - Southwest
Zacks Industry Rank	Bottom 28% (182 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	15.8%
Last Sales Surprise	3.2%
EPS F1 Est- 4 week change	0.4%
Expected Report Date	07/22/2020
Earnings ESP	2.7%
P/E TTM	11.1
P/E F1	11.1
PEG F1	1.3
P/S TTM	5.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	275 E	280 E	285 E	287 E	1,110 E
2020	290 A	278 E	283 E	283 E	1,139 E
2019	183 A	185 A	185 A	268 A	820 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.25 E	\$1.30 E	\$1.34 E	\$1.36 E	\$4.99 E
2020	\$1.39 A	\$1.16 E	\$1.34 E	\$1.35 E	\$5.19 E
2019	\$1.18 A	\$1.18 A	\$1.19 A	\$1.44 A	\$5.02 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 07/01/2020. The reports text is as of 07/02/2020.

Overview

Houston, TX-based Prosperity Bancshares, Inc. was formed in 1983 as a vehicle to acquire the former Allied Bank in Edna, TX, which was chartered in 1949 as The First National Bank of Edna and is presently known as Prosperity Bank. The financial holding company, pursuant to the Gramm-Leach-Bliley Act, derives substantially all of its revenues and income from its bank subsidiary — Prosperity Bank.

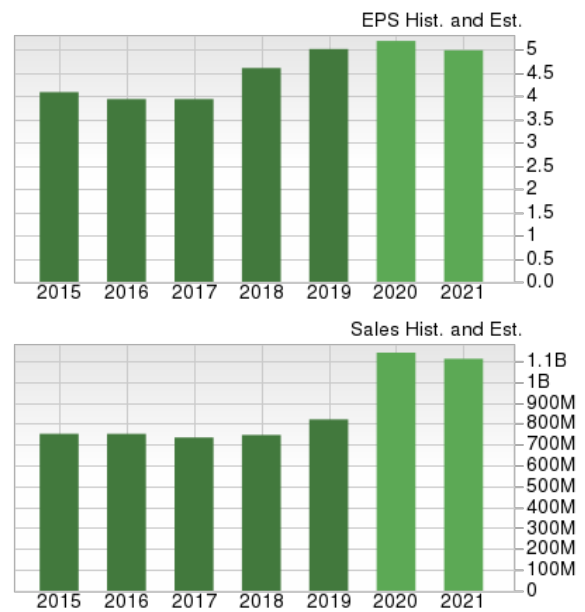
Prosperity Bank provides a wide range of financial products and services — traditional loan and deposit products — to small and medium-sized businesses and consumers. The company provides loans to businesses in the range of \$0.1 million to \$8.0 million. As of Mar 31, 2020, Prosperity Bank operated 285 full-service banking centers.

Since its inception, Prosperity Bancshares has been growing considerably through the acquisition of community banks and branches of other banks. Moreover, since 1998, the company has completed more than 30 deals.

The major buyouts include Commercial Bancshares, Inc. in 2001, First Capital Bankers, Inc. in 2005, Texas United Bancshares, Inc. in 2007, Franklin Bank in 2008 and First Bank in 2010. Further, in 2012, Prosperity Bancshares acquired Texas Bankers, Inc., The Bank Arlington, American State Financial Corporation and Bellaire-based Community National Bank.

In 2013, Prosperity Bancshares completed the buyouts of East Texas Financial Services Inc., Coppermark Bancshares, Inc. and FVNB Corp. In 2014, the company acquired F&M Bancorporation Inc., while in 2016 it completed the merger of Tradition Bancshares, Inc. In 2019, it completed the acquisition of LegacyTexas Financial Group, Inc.

As of Mar 31, 2020, Prosperity Bancshares had total assets of \$31.7 billion, cash and due from banks of \$381.5 million, total loans of \$19.1 billion, total deposits of \$23.8 billion, as well as shareholders' equity of \$5.9 billion.



Reasons To Buy:

- ▲ Acquisitions remain one of the major contributors to Prosperity Bancshares' growth. Over the years, the company has significantly expanded its operations through the buyout of community banks and branches of other banks. Since 1998, it has completed more than 30 deals. In November 2019, the bank acquired LegacyTexas Financial, which will be accretive to earnings in the upcoming quarters. Given a strong balance sheet position, the company is likely to continue with the expansion strategy.
- ▲ Prosperity Bancshares' growth strategy is driven by organic expansion efforts. The company's net revenues witnessed a five-year (2015-2019) CAGR of 2.2%, with the trend continuing in first-quarter 2020. This upside mainly stemmed from higher loan balances and acquisitions. Further, it has been able to improve the deposit mix. A rise in demand for loans will likely continue to aid revenues in the upcoming quarters.
- ▲ As of Mar 31, 2020, Prosperity Bancshares had total debt of \$1.8 billion, and cash and cash equivalents worth \$381.5 million. Nonetheless, its times interest earned — which has been improving in the last few quarters — of 20.3X at the end of first-quarter 2020 compared favorably with the industry average of 6.9X. This implies that the company's earnings are likely to be sufficient to meet interest and/or debt obligations if the economic situation worsens.
- ▲ We remain encouraged by Prosperity Bancshares' steady capital deployment activities. The company has been consistently increasing its dividend annually since 1999, with the last hike announced in October 2019. Further, in January, it had announced a share repurchase program (expiring in January 2021) to buy back up to nearly 4.7 million shares. Given the company's strong balance sheet position and solid earnings strength, capital deployment activities are projected to remain sustainable.
- ▲ Shares of Prosperity Bancshares have outperformed the industry over the past year. Moreover, the company's 2020 earnings estimates have been revised marginally upward over the past seven days. Further, the stock seems undervalued than the broader industry. Its current price/earnings (F1) and PEG ratios are below the respective industry averages. It has a Value Score of B. Therefore, given the strong fundamentals and positive estimate revisions, the stock has decent upside potential.

Inorganic expansion efforts, higher loan balance and a solid balance sheet position will aid Prosperity Bancshares' profits. Further, the bank's capital deployment actions are impressive.

Reasons To Sell:

- ▼ Prosperity Bancshares' net interest margin (NIM) continues to remain under pressure. Though NIM increased to 3.32% in 2019, it has been persistently declining over the past several years — 3.18% in 2018, 3.19% in 2017, 3.35% in 2016, 3.38% in 2015 and 3.80% in 2014. The company's NIM is expected to remain under pressure owing to near-zero interest rates.
- ▼ Rising non-interest expenses remain a concern for Prosperity Bancshares. Expenses witnessed a four-year CAGR of 6% (ended 2019). The uptrend persisted in the first three months of 2020. The increase was mainly due to higher salaries and benefits expenses. The same trend expected to continue in the quarters ahead as the company continues to invest in franchises and grow through acquisitions.
- ▼ Weak performance of the mortgage banking business is a big cause of concern for Prosperity Bancshares. Though mortgage income grew in 2019, the majority of it came in the last quarter owing to lower rates and improving consumer sentiments. In the first quarter of 2020, it declined on a sequential basis. Dismal mortgage performance is likely to continue in the near term, as the operating backdrop is not expected to change much.
- ▼ Prosperity Bancshares' trailing 12-month return on equity (ROE) is indicative of growth potential. The company's ROE of 8.32% compares unfavorably with 9.30% for the industry, underlining the fact that it is less efficient in using shareholder funds than peers.

Pressure on margins amid lower interest rates is a major concern for Prosperity Bancshares. Further, mounting operating expenses and weakness in the mortgage business are expected to hurt profitability.

Last Earnings Report

Prosperity Bancshares Q1 Earnings Beat, Revenues Up Y/Y

Prosperity Bancshares' first-quarter 2020 earnings per share of \$1.39 surpassed the Zacks Consensus Estimate of \$1.20. Also, the bottom line increased 17.8% year over year.

Results were primarily driven by an increase in revenues. Moreover, the balance sheet position remained strong during the quarter. Also, the company did not record any provision for credit losses in the quarter. However, higher expenses were an undermining factor.

Net income available to common shareholders was \$130.8 million compared with \$82.4 million recorded in the prior-year quarter.

Revenues Improve, Expenses Rise

Net revenues were \$290.4 million, up 58.7% from the prior-year quarter. Also, the figure beat the Zacks Consensus Estimate of \$281.4 million.

Net interest income was \$256 million, surging 65.3% year over year. The increase was primarily driven by the LegacyTexas merger and a rise in loan discount accretion. Net interest margin, on a tax-equivalent basis, jumped 61 basis points (bps) year over year to 3.81%.

Non-interest income increased 22.2% year over year to \$34.4 million. Almost all fee income components, except for brokerage income, witnessed a rise.

Non-interest expenses jumped 58.8% year over year to \$124.7 million. The increase was largely due to the merger-related expenses that the company incurred during the quarter in connection with LegacyTexas.

As of Mar 31, 2020, total loans were \$19.1 billion, up 1.5% from the prior quarter end. Total deposits declined 1.5% sequentially to \$23.8 billion.

Credit Quality: A Mixed Bag

The company did not record any provision for credit losses in the first quarter against provisions of \$0.7 million recorded in the prior-year quarter. Net charge-offs were \$0.8 million, down 23.6% year over year.

As of Mar 31, 2020, total non-performing assets were \$67.2 million, increasing 64.3% year over year. The ratio of allowance for credit losses to total loans was 1.71%, up from 0.83% recorded in the prior-year quarter.

Capital Ratios Worsen, Profitability Ratios Improve

As of Mar 31, 2020, Tier-1 risk-based capital ratio was 12.27%, down from 16.76% as of Mar 31, 2019. Moreover, total risk-based capital ratio was 12.81% compared with 17.42% at the end of the year-ago quarter. Further, common equity tier 1 capital ratio was 12.27%, down from 16.76% in the prior-year quarter.

The annualized return on average assets was 1.67%, up from 1.46% at the end of the prior-year quarter. Annualized return on common equity was 8.86% compared with 8.05% in the prior-year quarter.

Share Repurchase Update

During the quarter, the company repurchased 2.092 million shares for \$52.59 per share.

Outlook

The company expects NIM to be from 3.45-3.55% going forward, while low to mid 3.30s without accretion.

Normalized non-interest expenses are anticipated to range around \$120-\$125 million. Additionally, one-time merger expenses related to LegacyTexas Financial's systems conversion are likely to be \$3-\$5 million. Further, the company expects to incur expenses related to SBA paycheck protection program in the second quarter, which are not included in the normalized non-interest expense guidance.

The company expects additional cost savings of nearly \$8-\$9 million per quarter from LegacyTexas Financial acquisition, after having already realized \$2-\$3 million cost savings in the first quarter 2020.

Quarter Ending 03/2020

Report Date	Apr 29, 2020
Sales Surprise	3.21%
EPS Surprise	15.83%
Quarterly EPS	1.39
Annual EPS (TTM)	5.20

Recent News

Dividend Update

On Apr 29, Prosperity Bancshares announced a cash dividend of 46 cents per share. The dividend was paid on Jul 1 to shareholders of record as of Jun 15.

Valuation

Prosperity Bancshares' shares are down 19.6% in the year-to-date period and 14.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 26.2% and 21.3% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 19.1% and 17%, respectively.

The S&P 500 index is down 3.8% in the year-to-date period and up 4.1% in the past year.

The stock is currently trading at 11.42X forward 12 months earnings, which compares to 15.34X for the Zacks sub-industry, 16.06X for the Zacks sector and 22.19X for the S&P 500 index.

Over the past five years, the stock has traded as high as 18.76X and as low as 8.19X, with a 5-year median of 13.93X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$61 price target reflects 12.05X forward earnings.

The table below shows summary valuation data for PB

Valuation Multiples - PB					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	11.42	15.34	16.06	22.19
	5-Year High	18.76	17.87	16.18	22.19
	5-Year Low	8.19	10.53	11.57	15.25
	5-Year Median	13.93	14.16	14.06	17.52
P/TB TTM	Current	2.14	1.52	3.22	12.21
	5-Year High	3.18	2.92	4	12.78
	5-Year Low	1.39	1.06	2	5.96
	5-Year Median	2.38	2.19	3.48	9.42
P/S F12M	Current	4.76	3.4	6	3.47
	5-Year High	8.55	5.29	6.66	3.47
	5-Year Low	3.06	2.74	4.96	2.53
	5-Year Median	5.77	4.22	6.06	3.02

As of 07/01/2020

Industry Analysis Zacks Industry Rank: Bottom 28% (182 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Commerce Bancshares, Inc. (CBSH)	Neutral	3
CullenFrost Bankers, Inc. (CFR)	Neutral	3
F.N.B. Corporation (FNB)	Neutral	3
Bank OZK (OZK)	Neutral	3
Signature Bank (SBNY)	Neutral	3
Umpqua Holdings Corporation (UMPQ)	Neutral	3
Washington Federal, Inc. (WAFD)	Neutral	4
Texas Capital Bancshares, Inc. (TCBI)	Underperform	3

Industry Comparison Industry: Banks - Southwest				Industry Peers		
	PB	X Industry	S&P 500	CBSH	OZK	TCBI
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Underperform
Zacks Rank (Short Term)	2	-	-	3	3	3
VGM Score	B	-	-	D	C	C
Market Cap	5.36 B	193.86 M	21.87 B	6.46 B	2.92 B	1.49 B
# of Analysts	9	2.5	14	9	7	6
Dividend Yield	3.18%	1.30%	1.94%	1.87%	4.79%	0.00%
Value Score	B	-	-	D	B	B
Cash/Price	0.07	0.75	0.07	0.27	0.47	6.70
EV/EBITDA	10.32	5.19	12.69	8.89	4.79	-5.24
PEG Ratio	1.31	1.99	2.86	NA	NA	4.10
Price/Book (P/B)	0.94	0.90	2.98	2.09	0.71	0.56
Price/Cash Flow (P/CF)	13.09	8.00	11.63	13.31	6.31	4.12
P/E (F1)	11.14	13.51	21.27	24.81	14.48	32.78
Price/Sales (P/S)	4.99	2.19	2.27	4.47	2.33	1.05
Earnings Yield	8.98%	7.39%	4.48%	4.02%	6.91%	3.04%
Debt/Equity	0.02	0.29	0.76	0.24	0.34	2.00
Cash Flow (\$/share)	4.42	1.84	6.94	4.35	3.57	7.18
Growth Score	C	-	-	F	F	C
Hist. EPS Growth (3-5 yrs)	4.67%	14.43%	10.93%	15.11%	11.77%	21.32%
Proj. EPS Growth (F1/F0)	3.45%	-25.73%	-9.61%	-34.82%	-52.77%	-85.53%
Curr. Cash Flow Growth	12.62%	8.85%	5.51%	-1.69%	7.01%	8.59%
Hist. Cash Flow Growth (3-5 yrs)	2.48%	14.05%	8.62%	8.41%	28.37%	19.05%
Current Ratio	0.75	1.01	1.30	0.75	1.02	1.29
Debt/Capital	2.10%	22.50%	44.46%	18.87%	25.45%	65.39%
Net Margin	35.42%	20.50%	10.62%	26.01%	26.16%	15.73%
Return on Equity	8.32%	9.30%	15.75%	12.44%	8.02%	9.11%
Sales/Assets	0.04	0.05	0.55	0.06	0.05	0.04
Proj. Sales Growth (F1/F0)	38.95%	0.00%	-2.57%	-2.15%	-5.04%	-10.99%
Momentum Score	C	-	-	B	A	D
Daily Price Chg	-2.66%	-0.87%	-0.32%	-2.66%	-3.83%	-4.24%
1 Week Price Chg	-9.61%	-3.17%	-3.90%	-7.46%	-10.39%	-16.12%
4 Week Price Chg	-12.09%	-1.95%	-4.56%	-11.35%	-7.54%	-1.60%
12 Week Price Chg	11.78%	8.73%	9.62%	3.89%	23.81%	14.13%
52 Week Price Chg	-14.69%	-27.65%	-7.80%	1.63%	-22.89%	-51.14%
20 Day Average Volume	610,755	33,508	2,688,665	527,282	1,269,670	1,172,453
(F1) EPS Est 1 week change	0.91%	0.00%	0.00%	-1.13%	-0.18%	-3.04%
(F1) EPS Est 4 week change	0.39%	0.00%	0.00%	0.29%	0.83%	-7.99%
(F1) EPS Est 12 week change	9.54%	-9.82%	-9.63%	-20.18%	-35.25%	-69.45%
(Q1) EPS Est Mthly Chg	-2.55%	0.00%	0.00%	-3.27%	2.73%	-11.32%

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	C
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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