

Prosperity Bancshares (PB)

\$66.79 (As of 03/03/20)

Price Target (6-12 Months): **\$78.00**

Long Term: 6-12 Months

Zacks Recommendation:

Outperform

(Since: 02/03/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

1-Strong Buy

Zacks Style Scores:

VGM:D

Value: C

Growth: F

Momentum: B

Summary

Shares of Prosperity Bancshares have outperformed the industry over the past year. Moreover, the bank has an impressive earnings surprise history. Its earnings have surpassed the Zacks Consensus Estimate in three of the trailing four quarters. Notably, the LegacyTexas Financial buyout is expected to be accretive to the company's 2020 earnings and will also result in substantial cost savings. Although weakness in mortgage business, pressure on net interest margin (NIM) and mounting operating expenses remain major near-term concerns, impressive credit quality and strong domestic economy are likely to continue supporting the company's profitability. Moreover, the company's top line is expected to benefit from continued growth in loan balances. Additionally, enhanced capital deployment actions reflect strong balance sheet position.

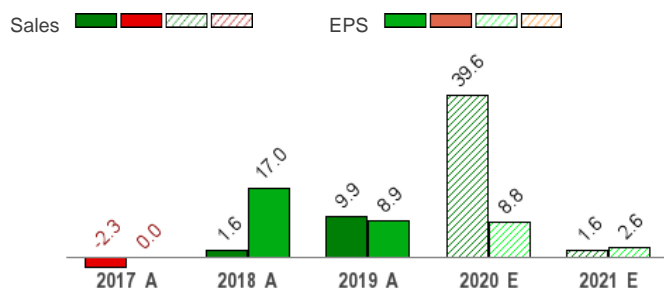
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$75.25 - \$61.85
20 Day Average Volume (sh)	567,066
Market Cap	\$4.6 B
YTD Price Change	-7.1%
Beta	1.22
Dividend / Div Yld	\$1.84 / 2.8%
Industry	Banks - Southwest
Zacks Industry Rank	Top 10% (25 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	17.1%
Last Sales Surprise	7.6%
EPS F1 Est- 4 week change	1.0%
Expected Report Date	04/22/2020
Earnings ESP	2.4%
P/E TTM	13.4
P/E F1	12.2
PEG F1	1.4
P/S TTM	4.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	281 E	287 E	293 E	294 E	1,163 E
2020	284 E	286 E	289 E	288 E	1,145 E
2019	183 A	185 A	185 A	268 A	820 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.38 E	\$1.42 E	\$1.45 E	\$1.45 E	\$5.60 E
2020	\$1.30 E	\$1.32 E	\$1.41 E	\$1.42 E	\$5.46 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 03/03/2020. The reports text is as of 03/04/2020.

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.

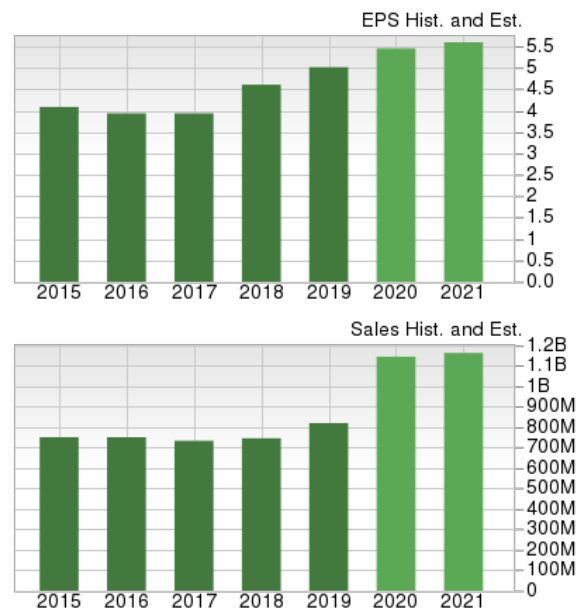
Prosperity Bank provides a wide range of financial products and services — traditional loan and deposit products — to small and medium-sized businesses and consumers. The company provides loans to businesses in the range of \$0.1 million to \$8.0 million. As of Dec 31, 2019, Prosperity Bancshares operated 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. The company has completed more than 40 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, the bank acquired LegacyTexas Financial Group, Inc.

As of Dec 31, 2019, Prosperity Bancshares had total assets of \$32.2 billion, cash and due from banks of \$573.6 million, total loans of \$18.8 billion, total deposits of \$24.2 billion and shareholders' equity of \$6 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. Notably, it has successfully completed more than 40 deals, with the last one closed in November 2019, when it acquired LegacyTexas Financial. The transaction will be accretive to the company's earnings this year. Given the strong balance sheet position, the company is expected to continue a similar 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%. This upside mainly stemmed from higher loan balances. Further, the company has been able to improve its deposit mix. Non-interest-bearing deposits saw a three-year CAGR of 17.5% (ended 2019). Rise in demand for loans and improving economy is likely to continue aiding revenues in the upcoming quarters also.
- ▲ Improving credit quality remains a positive for Prosperity Bancshares, with a decrease in net charge-off rates, provisions for credit losses and allowance for credit losses to total loans ratio over the last few years. Though the asset quality deteriorated in 2016 due to a stressed energy portfolio, a rebound in oil prices and strong economy have led to an improvement since then. This is expected to continue in the quarters ahead, driven by an improving economy.
- ▲ We remain encouraged by Prosperity Bancshares' steady capital deployment activities. In January 2020, the company announced a share repurchase program (expiring in January 2021) to buy back up to nearly 4.7 million shares. Also, the company has been consistently increasing its dividend annually since 1999, with the last hike of 12.2% announced in October 2019. Given the company's strong balance sheet position and negligible debt levels, enhanced capital deployment activities are projected to remain sustainable.
- ▲ Shares of Prosperity Bancshares have outperformed the industry over the past six months. Also, the company's 2020 earnings estimates have been revised 5.4% upward over the past 60 days. Further, the stock seems undervalued compared with the broader industry. Its current price/book (P/B) and price/cash flow (P/CF) ratios are below the respective industry averages. Therefore, given the strong fundamentals and positive estimate revisions, the stock has upside potential.

Inorganic expansion efforts, higher loan balance and improving asset quality will aid Prosperity Bancshares' profitability. Further, the bank's capital deployment actions are impressive.

Risks

- Prosperity Bancshares' NIM continues to remain under pressure. Though NIM increased in 2019, the same 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 strain owing to the lower interest rates.
 - Rising non-interest expenses pose a concern for Prosperity Bancshares. Expenses witnessed a five-year CAGR of 6% (ended 2019). The increase was mainly due to higher salaries and benefits costs, and inorganic growth strategy. Expenses are expected to remain elevated as the company continues to invest in franchises and grow through acquisitions.
 - Disappointing performance of the mortgage banking business is a cause of concern for Prosperity Bancshares. Though mortgage income grew in 2019 on the back of lower mortgage rates, the same declined at a four-year CAGR of 10.9% (2016-2019). Lower origination volumes were the primary reason for this dismal performance. This downward trend 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) undercuts its growth potential. The company's ROE of 8.04% compares unfavorably with ROE of 10.42% for the industry, underlining the fact that it is less efficient in using shareholder funds compared to its peers.
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Last Earnings Report

Prosperity Bancshares Q4 Earnings Beat on LegacyTexas Deal

Prosperity Bancshares' fourth-quarter 2019 adjusted earnings of \$1.44 per share surpassed the Zacks Consensus Estimate of \$1.23. Results were primarily driven by the closure of merger with LegacyTexas Financial Group, Inc. on Nov 1, 2019. The deal supported the company's top-line growth and also resulted in rise in loan and deposit balances. However, increase in operating expenses and a rise in provisions acted as headwinds.

Results in the reported quarter excluded LegacyTexas Financial merger-related charges. Including this, net income available to common shareholders was \$86.1 million or \$1.01 per share compared with \$83.3 million or \$1.19 per share in the prior-year quarter.

Adjusted earnings of \$5.02 per share in 2019 outpaced the consensus estimate of \$4.79. Including merger-related charges, net income available to common shareholders was \$332.6 million or \$4.52 per share compared with \$321.8 million or \$4.61 per share in 2018.

Revenues & Expenses Rise

Net revenues in the quarter were \$267.5 million, up 43.6% from the prior-year quarter. Also, the figure beat the Zacks Consensus Estimate of \$248.7 million.

In 2019, net revenues grew almost 10% to \$820.1 million. Further, it surpassed the Zacks Consensus Estimate of \$801.7 million.

Net interest income was \$232 million, surging 47.6% year over year. The rise was mainly due to merger and higher loan discount accretion. Net interest margin, on a tax-equivalent basis, jumped 50 basis points (bps) to 3.66%.

Non-interest income increased 22.1% to \$35.5 million.

Non-interest expenses jumped 93.6% year over year to \$156.5 million. The increase was largely due to the merger-related expenses, additional expenses related to two months of operations pertaining to the LegacyTexas and lending function.

As of Dec 31, 2019, total loans were \$18.8 billion, up 76.6% from the prior-quarter end. Total deposits grew 42.9% to \$24.2 billion on a sequential basis.

Credit Quality Worsens

Provision for credit losses increased 54.5% to \$1.7 million. Also, net charge-offs were \$1.2 million, rising substantially year over year. As of Dec 31, 2019, total non-performing assets were \$62.9 million, increasing significantly from \$19 million.

However, the ratio of allowance for credit losses to total loans was down 36 bps year over year to 0.46%.

Strong Capital & Profitability Ratios

As of Dec 31, 2019, Tier-1 risk-based capital ratio was 12.30%, compared with 16.32% as of Dec 31, 2018. Moreover, total risk-based capital ratio was 12.70% compared with 16.99% at the end of the year-ago quarter.

Further, common equity tier 1 capital ratio was 12.30%, up from 16.32% in the prior-year quarter.

The annualized return on average assets was 1.19%, down from 1.47%. Annualized return on common equity was 6.33% compared with 8.25% in the prior-year quarter.

Share Repurchase Update

Concurrent with the earnings release, Prosperity Bancshares announced share repurchase authorization of 4.7 million shares. The buyback plan will expire on Jan 28, 2021.

Outlook

The company expects pre-tax loan discount accretion to be \$13-\$14 million in the first quarter of 2020. Additionally, NIM on GAAP basis is expected to be the 3.45-3.55% range and core NIM to be mid-3.30% over the next few quarters.

Loan growth is projected to be 2.5% in 2020.

Management believes that till the system integration and conversion related to LegacyTexas Financial deal are completed, non-interest expenses will be in the range of \$120-\$125 million per quarter. Also, the company expects to realize part of targeted 25% cost savings related to the deal beginning third-quarter 2020.

The company anticipates the CECL reserve to be between \$340 million and \$360 million. This includes the LegacyTexas Financial deal.

Quarter Ending **12/2019**

Report Date	Jan 29, 2020
Sales Surprise	7.58%
EPS Surprise	17.07%
Quarterly EPS	1.44
Annual EPS (TTM)	4.99

Recent News

Prosperity Bancshares Closes Buyout of LegacyTexas Financial – Nov 1, 2019

Prosperity Bancshares has closed the acquisition of LegacyTexas Financial Group, Inc. for \$2.1 billion. The stock and cash transaction, announced in June, has further expanded the company's presence in Texas.

Also, LegacyTexas Bank was merged into Prosperity Bank. LegacyTexas' operations will continue as "Prosperity Bank dba LegacyTexas Bank" till the systems conversion is completed by early June 2020. Following the conversion, the combined entity will operate as Prosperity Bank.

Deal Details

At the time of announcement, shareholders of LegacyTexas were to receive \$6.28 cash and 0.5280 shares of Prosperity Bancshares for each LegacyTexas share. Prosperity Bancshares' footprint significantly expanded in and around the Dallas-Fort Worth area as LegacyTexas has 42 branches in 19 cities there. Also, the combined company has \$32 billion of assets, \$24 billion of deposits and a diversified loan portfolio worth \$20 billion.

LegacyTexas President and CEO, Kevin Hanigan, became the President and Chief Operating Officer of Prosperity Bancshares. LegacyTexas EVP and Chief Financial Officer, Mays Davenport will be named as EVP and Director of Corporate Strategy of Prosperity Bancshares.

Further, Prosperity Bancshares increased the size of the company board to 14 and added three LegacyTexas representatives – Kevin Hanigan, Bruce Hunt and George Fisk – to it.

Financial Benefits

At the time of deal announcement, it was noted that it will be accretive to Prosperity Bancshares' earnings by approximately 10.3% in 2020. Also, it will lead to expense savings of 25% of LegacyTexas' non-interest expense base (with 50% phase-in in 2020 and 100% thereafter). Further, the acquisition is expected enhance Prosperity Bancshares' loan-to-deposit ratio to 71% from 61%. Also, the deal will result in one-time pre-tax charge of \$60 million.

Dividend Update

On Jan 30, Prosperity Bancshares announced a cash dividend of 46 cents per share. The dividend will be paid out on Apr 1 to shareholders on record as of Mar 16.

Valuation

Prosperity Bancshares' shares are down 10.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 13.1% and 0.3% over the past year, respectively.

The S&P 500 index is up 9.6% in the past year.

The stock is currently trading at 12.18X forward 12 months earnings, which compares to 12.24X for the Zacks sub-industry, 13.68X for the Zacks sector and 17.66X for the S&P 500 index.

Over the past five years, the stock has traded as high as 18.76X and as low as 8.30X, with a 5-year median of 13.94X. Our Outperform recommendation indicates that the stock will perform better than the market. Our \$78 price target reflects 14.23X 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	12.18	12.24	13.68	17.66
	5-Year High	18.76	17.85	16.21	19.34
	5-Year Low	8.3	10.8	12.01	15.18
	5-Year Median	13.94	14.14	13.97	17.46
P/TB TTM	Current	2.15	1.83	2.9	11.8
	5-Year High	3.18	2.86	3.98	12.94
	5-Year Low	1.53	1.5	2.44	6.03
	5-Year Median	2.41	2.22	3.46	9.13
P/S F12M	Current	3.97	3.62	6.55	3.26
	5-Year High	7.16	5.24	6.65	3.43
	5-Year Low	3.06	2.95	5.39	2.54
	5-Year Median	5.59	4.19	6.04	3.01

As of 03/03/2020

Industry Analysis Zacks Industry Rank: Top 10% (25 out of 255)



Top Peers

Commerce Bancshares, Inc. (CBSH)	Neutral
Cullen/Frost Bankers, Inc. (CFR)	Neutral
F.N.B. Corporation (FNB)	Neutral
Bank OZK (OZK)	Neutral
Signature Bank (SBNY)	Neutral
Texas Capital Bancshares, Inc. (TCBI)	Neutral
Umpqua Holdings Corporation (UMPQ)	Neutral
Washington Federal, Inc. (WAFD)	Neutral

Industry Comparison Industry: Banks - Southwest				Industry Peers		
	PB Outperform	X Industry	S&P 500	CBSH Neutral	OZK Neutral	TCBI Neutral
VGM Score	D	-	-	D	D	B
Market Cap	4.57 B	263.94 M	21.37 B	6.92 B	3.27 B	2.35 B
# of Analysts	9	2.5	13	8	6	8
Dividend Yield	2.75%	1.35%	2.04%	1.68%	4.10%	0.00%
Value Score	C	-	-	D	A	A
Cash/Price	0.13	0.55	0.05	0.26	0.46	1.87
EV/EBITDA	8.60	8.63	12.65	8.40	3.90	1.68
PEG Ratio	1.44	1.35	1.87	5.99	0.73	1.05
Price/Book (P/B)	0.77	1.06	2.96	2.32	0.79	0.88
Price/Cash Flow (P/CF)	10.91	10.64	11.68	14.20	7.10	6.49
P/E (F1)	12.23	12.06	16.98	17.98	8.73	8.40
Price/Sales (P/S)	4.77	2.52	2.44	4.78	2.58	1.61
Earnings Yield	8.17%	8.30%	5.87%	5.55%	11.46%	11.90%
Debt/Equity	0.02	0.31	0.70	0.00	0.17	1.04
Cash Flow (\$/share)	6.12	1.70	7.01	4.35	3.57	7.18
Growth Score	F	-	-	C	F	F
Hist. EPS Growth (3-5 yrs)	3.30%	13.60%	10.85%	15.65%	15.48%	22.72%
Proj. EPS Growth (F1/F0)	8.74%	1.31%	6.36%	-4.05%	-11.87%	-10.85%
Curr. Cash Flow Growth	12.62%	18.74%	6.07%	-1.69%	-2.88%	8.59%
Hist. Cash Flow Growth (3-5 yrs)	1.02%	12.35%	8.52%	8.41%	37.20%	19.05%
Current Ratio	0.75	0.97	1.23	0.73	1.02	1.21
Debt/Capital	2.06%	23.27%	42.57%	0.08%	14.33%	49.67%
Net Margin	34.66%	22.55%	11.57%	29.06%	33.53%	22.15%
Return on Equity	8.04%	10.42%	16.66%	14.18%	10.57%	12.66%
Sales/Assets	0.04	0.05	0.54	0.06	0.05	0.05
Proj. Sales Growth (F1/F0)	39.57%	0.00%	4.01%	-1.04%	-2.29%	-2.41%
Momentum Score	B	-	-	B	F	B
Daily Price Chg	-1.81%	-2.04%	-2.60%	-2.65%	-3.90%	-4.31%
1 Week Price Chg	-13.09%	-8.47%	-12.06%	-11.57%	-8.90%	-16.30%
4 Week Price Chg	-7.83%	-8.11%	-10.01%	-11.76%	-6.83%	-15.95%
12 Week Price Chg	-5.07%	-7.71%	-7.46%	-5.25%	-16.62%	-24.59%
52 Week Price Chg	-10.67%	-7.74%	2.54%	3.39%	-22.14%	-24.42%
20 Day Average Volume	567,066	19,511	2,406,738	482,620	731,682	353,354
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-0.18%
(F1) EPS Est 4 week change	1.03%	0.00%	-0.06%	0.55%	-1.08%	-0.18%
(F1) EPS Est 12 week change	5.27%	-0.33%	-0.39%	1.67%	-2.08%	-0.90%
(Q1) EPS Est Mthly Chg	0.39%	0.00%	-0.45%	0.00%	0.00%	0.00%

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	B
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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