

## Prosperity Bancshares (PB)

**\$67.86** (As of 01/24/20)

Price Target (6-12 Months): **\$72.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 04/03/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:D

Value: B

Growth: D

Momentum: D

### Summary

Shares of Prosperity Bancshares have underperformed the industry over the past year. Yet, the bank has an impressive earnings surprise history, having surpassed the Zacks Consensus Estimate for earnings in three of the trailing four quarters. The acquisition of LegacyTexas Financial will be accretive to the company's earnings in 2020 and also lead to cost savings. Improving asset quality, and solid loan and deposit balances are likely to support profitability. Moreover, steady capital deployment actions reflect strong balance sheet position. However, weakness in mortgage banking business and pressure on margins (due to low interest rates) are likely to have an adverse impact on revenue growth. Also, mounting costs might hamper bottom-line growth. Further, the earnings estimates have been going down ahead of its fourth quarter 2019 results.

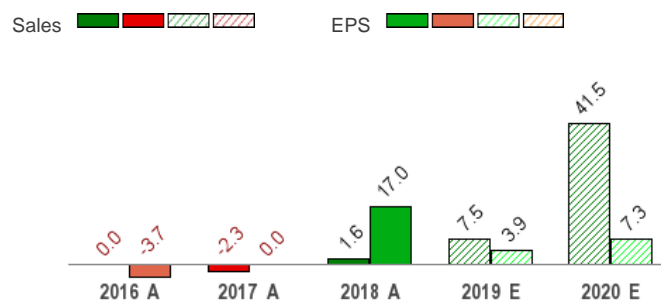
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	<b>\$75.36 - \$61.85</b>
20 Day Average Volume (sh)	<b>408,463</b>
Market Cap	<b>\$4.6 B</b>
YTD Price Change	<b>-5.6%</b>
Beta	<b>1.36</b>
Dividend / Div Yld	<b>\$1.84 / 2.7%</b>
Industry	<b><a href="#">Banks - Southwest</a></b>
Zacks Industry Rank	<b>Bottom 29% (182 out of 255)</b>

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	<b>0.9%</b>
Last Sales Surprise	<b>-0.9%</b>
EPS F1 Est- 4 week change	<b>-0.8%</b>
Expected Report Date	<b>01/29/2020</b>
Earnings ESP	<b>1.4%</b>
P/E TTM	<b>14.3</b>
P/E F1	<b>13.2</b>
PEG F1	<b>1.6</b>
P/S TTM	<b>5.4</b>

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	278 E	282 E	287 E	288 E	1,135 E
2019	183 A	185 A	185 A	249 E	802 E
2018	181 A	190 A	188 A	186 A	746 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.22 E	\$1.27 E	\$1.33 E	\$1.35 E	\$5.14 E
2019	\$1.18 A	\$1.18 A	\$1.19 A	\$1.23 E	\$4.79 E
2018	\$1.07 A	\$1.17 A	\$1.18 A	\$1.19 A	\$4.61 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 01/24/2020. The reports text is as of 01/27/2020.

## 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.

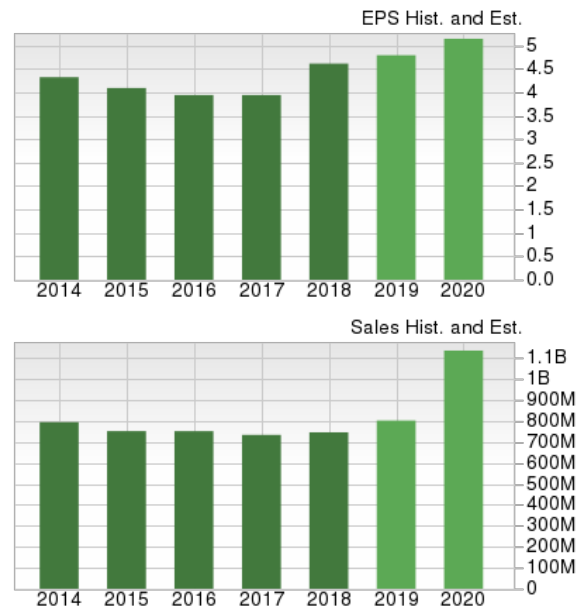
Prosperity Bank provides a wide range of financial products and services — traditional loan and deposit products — to small and medium-sized businesses and consumers. The company provides loans to businesses in the range of \$0.1 million to \$8.0 million. As of Sep 30, 2019, Prosperity Bank operated 243 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 Sep 30, 2019, Prosperity Bancshares had total assets of \$22.1 billion, cash and due from banks of \$420.4 million, total loans of \$10.7 billion, total deposits of \$16.9 billion and shareholders' equity of \$4.1 billion.



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## 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 completed the acquisition of LegacyTexas Financial, which will be accretive to its earnings this year. Given the strong balance sheet position and favorable consolidation backdrop in the banking sector, the company is expected to continue similar expansion strategy.
- ▲ Prosperity Bancshares' growth strategy is driven by organic expansion efforts. Though the company's net revenues declined in the first nine months of 2019, the same witnessed a six-year (2013-2018) CAGR of 4.6%. This upside mainly stemmed from higher loan balances. Further, the company has been able to improve its deposit mix. Non-interest-bearing demand deposits saw a three-year CAGR of 4.5% (ended 2018), with the trend continuing in the first nine months of 2019. Rise in demand for loans and improving economy will likely continue to aid revenues in the upcoming quarters also.
- ▲ Improving credit quality remains a positive for Prosperity Bancshares, with a decrease in net charge-off rates 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 improving economic conditions led to an improvement in 2017 and 2018, with similar trend continuing in first three quarters of 2019. This is expected to continue in the quarters ahead, driven by an improving economy.
- ▲ 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 2018, it had announced a share repurchase program (expiring in January 2020) to buy back up to nearly 3.5 million shares. As of Sep 30, 2019, nearly 2 million shares remained to be repurchased. Given the company's strong balance sheet position and zero debt, enhanced capital deployment activities are projected to remain sustainable.
- ▲ Further, Prosperity Bancshares seems undervalued compared with the broader industry. Its current price/book (P/B) and price/earnings (P/E) (F1) ratios are below the respective industry averages. Also, the stock has a Value Score of B.

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

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## Reasons To Sell:

- ▼ Prosperity Bancshares' net interest margin (NIM) continues to remain under pressure. NIM 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 similar trend continued in the first nine months of 2019 as well. The company's NIM is expected to remain under strain owing to the lower interest rates.
- ▼ Rising non-interest expenses remain a concern for Prosperity Bancshares. Expenses witnessed a four-year CAGR of 1.3% (ended 2018). The increase was mainly due to higher salaries and benefits expenses. While costs declined in the first nine months of 2019, the same is expected to remain elevated in the quarters ahead as the company continues to invest in franchises and grow through acquisitions.
- ▼ Disappointing performance of the mortgage banking business is a big cause of concern for Prosperity Bancshares. Lower origination volumes have led to a fall in mortgage income. Mortgage income declined at a four-year CAGR of 16.3% (ended 2018), with the trend continuing in first three quarters of 2019. 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 8.02% compares unfavorably with ROE of 10.52% for the industry, underlining the fact that it is less efficient in using shareholder funds compared to its peers.
- ▼ Shares of Prosperity Bancshares have underperformed the industry over the past year. Also, the company's 2019 earnings estimates have been revised marginally lower over the past 30 days. Therefore, given the concerns and downward estimate revisions, the stock has limited upside potential.

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

## Last Earnings Report

### Prosperity Bancshares Q3 Earnings & Revenues Beat Estimates

Prosperity Bancshares' third-quarter 2019 earnings of \$1.19 per share surpassed the Zacks Consensus Estimate by a penny. The figure inched up nearly 1% on a year-over-year basis.

Results were primarily driven by lower operating expenses, slight rise in non-interest income and a considerable fall in provisions. Further, loan and deposit growth supported the financials. However, decline in net interest income amid lower interest rates was an undermining factor.

Net income available to common shareholders was \$81.8 million, down nearly 1% from the prior-year quarter.

### Revenues & Expenses Fall

Net revenues were \$184.7 million, down 1.7% from the prior-year quarter. Also, the figure lagged the Zacks Consensus Estimate of \$186.2 million.

Net interest income was \$154 million, declining 2.1% year over year. The decline was mainly due to higher rates on interest-bearing liabilities and fall in investment securities balances. These were partly offset by an increase in loan balances and loan yield.

Net interest margin, on a tax-equivalent basis, inched up 1 basis point to 3.16%.

Non-interest income increased marginally to \$30.7 million. This rise was mainly driven by increase in nonsufficient funds fees.

Non-interest expenses fell 1.3% year over year to \$80.7 million. The decline was largely due to fall in regulatory assessments and FDIC insurance costs, and other noninterest expenses.

As of Sep 30, 2019, total loans were \$10.7 billion, up nearly 1% from the prior-quarter end. Total deposits grew marginally to \$16.9 billion on a sequential basis.

### Credit Quality: Mixed Bag

Provision for credit losses decreased 53.2% to \$0.1 million. Moreover, the ratio of allowance for credit losses to total loans was down 2 basis points year over year to 0.82%.

Also, net charge-offs were \$1 million, down 20.6%. However, as of Sep 30, 2019, total non-performing assets were \$51.2 million, increasing significantly from \$16.8 million in the prior-year quarter.

### Strong Capital & Profitability Ratios

As of Sep 30, 2019, Tier-1 risk-based capital ratio was 16.68%, up from 15.94% as of Sep 30, 2018. Moreover, total risk-based capital ratio was 17.34%, up from 16.60% at the end of the year-ago quarter.

Further, common equity tier 1 capital ratio was 16.68%, up from 15.94% in the prior-year quarter.

The annualized return on average assets was 1.47%, up from 1.46%. Similarly, annualized return on common equity was 7.89% compared with 8.30% in the prior-year quarter.

### Share Repurchase Update

During the second quarter, Prosperity Bancshares repurchased nearly 0.7 million shares at an average price of \$63.59 per share.

Quarter Ending 09/2019

Report Date	Oct 23, 2019
Sales Surprise	-0.85%
EPS Surprise	0.85%
Quarterly EPS	1.19
Annual EPS (TTM)	4.74

## 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.

David Zalman, Senior Chairman and Chief Executive Officer of Prosperity Bancshares, said "This transaction represents a milestone in Prosperity's strategic growth and we welcome the LegacyTexas customers and associates to Prosperity Bank. This merger creates one of the largest Texas-based banks by deposits, and makes Prosperity Bank a dominant player in the vibrant markets of Houston and Dallas/Fort Worth."

### 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 Oct 23, 2019, Prosperity Bancshares announced a cash dividend of 46 cents per share, representing a 12.2% hike from the prior payout. The dividend was paid on Jan 2, 2020 to shareholders on record as of Dec 16.

## Valuation

Prosperity Bancshares' shares are down 4.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 0.1% and 10%, over the past year, respectively.

The S&P 500 index is up 23.8% in the past year.

The stock is currently trading at 13.15X forward 12 months earnings, which compares to 13.51X for the Zacks sub-industry, 14.53X for the Zacks sector and 18.94X 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 Neutral recommendation indicates that the stock will perform in line with the market. Our \$72 price target reflects 13.95X forward earnings.

The table below shows summary valuation data for PB

Valuation Multiples - PB				
	Stock	Sub-Industry	Sector	S&P 500
Current	13.15	13.51	14.53	18.94

P/E F12M	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	14.04	13.98	17.45
P/TBV TTM	Current	2.12	1.94	3.27	12.62
	5-Year High	3.18	2.86	3.98	12.75
	5-Year Low	1.53	1.5	2.44	6.03
	5-Year Median	2.43	2.22	3.46	9.09
P/S F12M	Current	4.08	3.91	6.53	3.52
	5-Year High	7.16	5.24	6.61	3.52
	5-Year Low	3.06	2.95	5.2	2.54
	5-Year Median	5.59	4.19	6.04	3

As of 01/24/2020

## Industry Analysis Zacks Industry Rank: Bottom 29% (182 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 Neutral	X Industry	S&P 500	CBSH Neutral	OZK Neutral	TCBI Neutral
<b>VGM Score</b>	<b>D</b>	-	-	<b>D</b>	<b>D</b>	<b>F</b>
Market Cap	4.64 B	283.95 M	24.13 B	7.67 B	3.56 B	2.67 B
# of Analysts	7	3	13	8	6	8
Dividend Yield	2.71%	1.25%	1.78%	1.53%	3.76%	0.00%
<b>Value Score</b>	<b>B</b>	-	-	<b>C</b>	<b>A</b>	<b>C</b>
Cash/Price	0.09	0.44	0.04	0.23	0.40	1.90
EV/EBITDA	8.81	9.38	14.02	9.65	4.35	1.11
PEG Ratio	1.54	1.61	2.03	6.67	0.78	1.19
Price/Book (P/B)	1.12	1.19	3.30	2.56	0.86	1.03
Price/Cash Flow (P/CF)	12.75	13.17	13.52	15.99	7.49	8.01
P/E (F1)	13.09	13.37	18.92	20.02	9.40	9.55
Price/Sales (P/S)	5.36	2.59	2.65	5.29	2.81	1.83
Earnings Yield	7.57%	7.49%	5.28%	5.00%	10.64%	10.46%
Debt/Equity	0.00	0.24	0.72	0.00	0.17	1.11
Cash Flow (\$/share)	5.32	1.61	6.94	4.26	3.69	6.63
<b>Growth Score</b>	<b>D</b>	-	-	<b>D</b>	<b>F</b>	<b>F</b>
Hist. EPS Growth (3-5 yrs)	2.15%	13.33%	10.60%	15.00%	15.48%	21.58%
Proj. EPS Growth (F1/F0)	7.32%	0.78%	7.59%	-5.06%	-10.91%	-10.69%
Curr. Cash Flow Growth	12.12%	30.86%	13.90%	30.57%	12.43%	37.24%
Hist. Cash Flow Growth (3-5 yrs)	3.93%	13.79%	9.00%	8.38%	37.20%	20.22%
Current Ratio	0.62	0.98	1.22	0.73	1.02	1.20
Debt/Capital	0.00%	19.57%	42.99%	0.08%	14.33%	51.22%
Net Margin	38.03%	23.31%	11.35%	29.06%	33.53%	22.15%
Return on Equity	8.02%	10.52%	17.10%	14.18%	10.57%	12.87%
Sales/Assets	0.04	0.05	0.55	0.06	0.05	0.05
Proj. Sales Growth (F1/F0)	41.58%	3.57%	4.03%	-1.23%	-2.29%	-2.32%
<b>Momentum Score</b>	<b>D</b>	-	-	<b>A</b>	<b>F</b>	<b>D</b>
Daily Price Chg	-1.78%	-0.35%	-1.01%	-0.32%	-1.60%	-1.06%
1 Week Price Chg	0.01%	0.28%	2.29%	0.43%	-3.91%	-3.69%
4 Week Price Chg	-5.47%	-1.42%	1.02%	-0.57%	-11.07%	-7.79%
12 Week Price Chg	-1.68%	2.28%	6.85%	11.00%	-1.53%	-1.68%
52 Week Price Chg	-3.96%	5.76%	20.39%	18.30%	-13.14%	-7.84%
20 Day Average Volume	408,463	10,474	1,536,379	427,623	817,394	588,986
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.02%	-0.73%	-0.46%
(F1) EPS Est 4 week change	-0.79%	0.21%	0.00%	0.60%	-1.01%	0.18%
(F1) EPS Est 12 week change	-1.24%	-1.46%	-0.23%	-0.48%	-4.03%	-0.80%
(Q1) EPS Est Mthly Chg	-0.78%	0.00%	0.00%	-0.94%	-1.11%	2.40%



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## 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.

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### 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>B</b>
Growth Score	<b>D</b>
Momentum Score	<b>D</b>
VGM Score	<b>D</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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