

Texas Capital (TCBI)

\$33.22 (As of 07/31/20)

Price Target (6-12 Months): **\$35.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 07/01/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:F

Value: F

Growth: F

Momentum: C

Summary

Shares of Texas Capital have outperformed the industry over the past three months. Also, the company has a decent earnings surprise history, having beaten the Zacks Consensus Estimate in two of the trailing four quarters for as many misses. The second-quarter 2020 results reflected revenue growth, escalating expenses and a substantial rise in provisions and reserve build amid the coronavirus crisis. Rising loans and deposits balance suggest a strong capital position. Diversified fee income base and rising average earning assets support top-line growth. However, rising expenses will likely impede bottom-line expansion. Also, high exposure to commercial and real estate loans and debt level are headwinds. Notably, Texas Capital and Independent Bank Group mutually terminated all-stock merger of equals due to the impact of the coronavirus crisis.

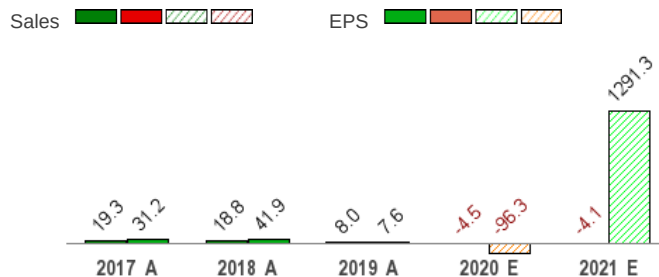
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$64.88 - \$19.10
20 Day Average Volume (sh)	524,772
Market Cap	\$1.7 B
YTD Price Change	-41.5%
Beta	2.20
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Banks - Southwest
Zacks Industry Rank	Top 23% (58 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	62.5%
Last Sales Surprise	19.3%
EPS F1 Est- 4 week change	22.7%
Expected Report Date	NA
Earnings ESP	0.0%
P/E TTM	10.1
P/E F1	144.4
PEG F1	14.0
P/S TTM	1.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	240 E	249 E	255 E	253 E	982 E
2020	240 A	280 A	252 E	251 E	1,024 E
2019	266 A	268 A	272 A	266 A	1,072 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.62 E	\$0.85 E	\$1.00 E	\$1.02 E	\$3.20 E
2020	-\$0.11 A	\$0.26 A	\$0.62 E	\$0.76 E	\$0.23 E
2019	\$1.60 A	\$1.50 A	\$1.70 A	\$1.44 A	\$6.23 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 07/31/2020. The reports text is as of 08/03/2020.

Overview

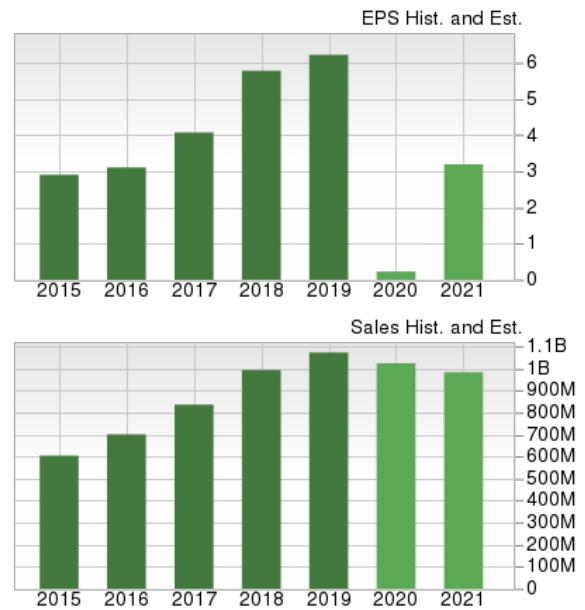
Texas Capital Bancshares Inc., a financial holding company, is the parent company of Texas Capital Bank, a Texas-based bank headquartered in Dallas. The company focuses on leveraging local business and community ties to the five major metropolitan areas of Texas — Dallas, Houston, Fort Worth, Austin and San Antonio. All of its business activities are conducted through its bank subsidiary. The company was founded in November 1996, and commenced operations in December 1998.

While the Texas market continues to be central to the company's growth and success, it has developed several lines of business, including mortgage finance, mortgage correspondent aggregation ("MCA"), homebuilder finance, insurance premium finance, lender finance and asset-based lending, that offer specialized loan and deposit products to businesses regionally and across the nation.

Texas Capital focuses primarily on middle-market business customers and high-net-worth individuals in each of the five major metropolitan markets of Texas. For its business customers, the company offers commercial loans for general corporate purposes including financing for working capital, internal growth, acquisitions and financing for business insurance premiums. Additionally, the company provides real estate term and construction loans, equipment leasing, cash management services, trust and escrow services and letters of credit.

The company also provides complete banking services for its individual customers, including personal trust and wealth management services, certificates of deposit, interest bearing and non-interest bearing checking accounts with optional features such as Visa debit/ATM cards and overdraft protection, traditional money market and savings accounts, consumer loans (both secured and unsecured), branded Visa credit card accounts including gold-status accounts and internet banking.

As of Jun 30, 2020, Texas Capital had total assets of \$36.6 billion, loans of \$26 billion and deposits of \$30.2 billion.



Reasons To Buy:

- ▲ Organic growth is a key strength at Texas Capital, as reflected by its revenue-growth story. Though revenues declined in the first six months of 2020 on low rates and decline in net interest income, the figure witnessed a compounded annual growth rate (CAGR) of 15.4% over the last five years (2015-2019), primarily due to elevated net interest income, driven by rise in average earning assets, as well as rise in non-interest income. Further, a diversified fee income base and rising average earning assets will keep supporting revenue growth in the near term.
- ▲ With the gradual change in the rate environment, margin pressure for Texas Capital eased. After facing a declining trend for years, the company reported a stabilized net interest margin (NIM) in 2016 and improvement in 2017 and 2018, as a result of rate hikes since December 2016. Also, the company has been benefiting from better fee pricing and improved loan yields. Amid the Fed's accommodative monetary-policy stance, though 2019 and the first six months of 2020 witnessed contraction of margin on account of rise in deposit costs and low rates, decent loan growth might support margins.
- ▲ Growth remains the key story at Texas Capital, and it continues to perform well on a variety of metrics. The company continued to experience growth in total loans held for investment (CAGR of around 10.2%) and deposits (CAGR of 15.1%) over the last five years (2015-2019). The increasing trend continued in the first six months of 2020 as well. We believe this growth has stemmed from a gain in market share from the company's economizing competitors which struggled against Texas Capital's relationship-based model.
- ▲ The company's capital ratios remain above the levels required to be considered well capitalized and have been enhanced with the additional capital raised since 2008. As of Jun 30, 2020, the ratio of tangible common equity to total tangible assets was 7%. We believe its strong capital position would help it undertake opportunistic expansions in the foreseeable future.
- ▲ Further, Texas Capital seems undervalued when compared with the broader industry. Its current price-to-book and price-to-cash flow ratios are below the respective industry averages.

Texas Capital is poised for top-line growth with support from diversified fee income base and rise in average earnings assets. Also, the company continues to benefit from rising loans and deposits.

Reasons To Sell:

- ▼ The company continues to see a rise in expenses, witnessing a CAGR of 15.9% over the last five years (2015-2019), with the increasing trend continuing in the first six months of 2020. Though the company's efforts to hire experienced bankers and expand its presence are encouraging, the resultant expenses, which continue to rise at the rate higher than the revenues, negate the incremental effects of business expansion.
- ▼ Deterioration in credit quality metrics remain a headwind for Texas Capital. The company witnessed an increase in non-performing assets and higher charge-offs primarily related to energy loans during 2016, and while those levels have moderated in 2017 and 2018, they still remain elevated compared to the overall loan portfolio. Furthermore, the metrics have increased in 2019 with some quarterly volatility. Therefore, continuation of such trend can be risky for the company amid challenging global economy and competitive markets.
- ▼ As of Jun 30, 2020, the company held a debt level of \$3.3 billion, which has witnessed volatility in the past few quarters. Therefore, with a declining time-interest-earned ratio of 3.9X over the past few quarters, which indicates the company's ability to meet its debt obligations based on current income, we believe Texas Capital has an enhanced likelihood of default of interest and debt repayments if the economic situation worsens.
- ▼ Texas Capital's business is concentrated geographically in Texas, with management's focus being limited on diversification as compared to some of its peers. We anticipate that lack of diversifying efforts will potentially hamper its top- and bottom-line growth in the future.
- ▼ Shares of Texas Capital have outperformed the industry over the past three months. However, the company's current-year earnings estimates have been revised 71.3% downward over the past 30 days. Therefore, given the above-mentioned concerns and lack of positive estimate revisions, the stock has limited upside potential.

Deterioration in credit quality and lack of geographical diversification remain concerns for Texas Capital. Additionally, escalating expenses on hiring of experienced bankers is a near term headwind.

Last Earnings Report

Texas Capital Q2 Earnings Beat Estimates, Revenues Up

Texas Capital reported adjusted earnings per share of 26 cents in second-quarter 2020, beating the Zacks Consensus Estimate for earnings of 16 cents. The reported figure excluded certain noteworthy items, such as the impacts of the MSR impairment charges, severance accruals, non-recurring software and merger-related expenses.

The results reflect stellar revenue growth on higher non-interest income. Higher deposits and loan balances also acted as tailwinds. However, escalating expenses, lower net interest income and a substantial rise in provisions and reserve build due to the coronavirus crisis remain major concerns.

After considering one-time items, net loss available to common stockholders was \$36.8 million or 73 cents per share as against the net income of \$75.4 million or \$1.50 per share recorded in the prior-year quarter.

Revenues Rise, Costs Escalate

Total revenues increased 4.7% year over year to \$280.4 million in the second quarter on higher non-interest income. Furthermore, revenue surpassed the Zacks Consensus Estimate of \$235.2 million.

Texas Capital's net interest income was \$209.9 million, down 13.8% year over year, mainly stemming from a decline in loan yields, partly muted by a decrease in funding costs. Net interest margin, moreover, contracted 111 basis points (bps) year over year to 2.30%.

Non-interest income increased significantly year over year to \$70.5 million. This upside primarily resulted from higher gains from sale of loans held for investment, brokered loan fees and servicing income, partially offset by lower other non-interest income.

Non-interest expenses flared up 57% year over year to \$222.4 million. The upswing mainly resulted from a rise in almost all components of expenses.

As of Jun 30, 2020, total loans were up 3% on a sequential basis to \$26 billion, while deposits rose 11.3% sequentially to \$30.2 billion.

Credit Quality Deteriorates

Non-performing assets totaled 0.68% of the loan portfolio plus other real estate-owned assets compared with the prior-year quarter's figure of 0.47%. Total non-performing assets rose 52.5% to \$174 million compared with the year-ago quarter.

Provisions for credit losses came in at \$100 million compared with the year-ago quarter's \$27 million. The company's net charge-offs were \$74.1 million compared with \$20 million as of Jun 30, 2019.

Capital Ratios Steady

The company's capital ratios displayed a steady position during the second quarter. Tangible common equity to total tangible assets came in at 7% compared with the year-earlier quarter's 8.3%.

Common equity Tier 1 ratio was 8.9%, up from the prior-year quarter's 8.7%. Leverage ratio was 7.5% compared with 9.2% as of Jun 30, 2019.

Stockholders' equity was up 3% year over year to \$2.7 billion as of Jun 30, 2020. The uptrend chiefly allied with the retention of net income.

Outlook

Management plans to achieve an earnings level in the next six to 18 months, which can provide the company the strategic options while managing strong liquidity and capital levels. It plans a significant cut to run rate expense base, which will pay off beginning the second quarter. These plans also include managing the asset side of the balance sheet to get more yields from the excess liquidity, a back-to-basic strategy in middle market to capture new clients and to increase share of wallet, and a lower provision expense as the large exposures within the energy and leveraged loan portfolio already dealt with.

Notably, management is reducing annualized non-interest expense run rate by about \$30 million focused on salaries and amortization of capitalized software. It also targets some additional G&A expense saves for the second half of 2020 and 2021 that are not included in that \$30 million. Other expenses are estimated at \$10 million in annual run rate.

Based on the current environment, management expects positive trend in gain on sale to continue for the next several quarters, but at lower levels than Q2. Since, Q2 was the peak, management expects the third- and fourth-quarter gain numbers to be more modest, around \$10-\$12 million per quarter.

Mortgage finance yields are expected to be flat to down a little bit. Volumes in MCA are not expected to start to diminish much through the third quarter and seasonality is expected in the fourth.

Quarter Ending 06/2020

Report Date	Jul 22, 2020
Sales Surprise	19.26%
EPS Surprise	62.50%
Quarterly EPS	0.26
Annual EPS (TTM)	3.29

Recent News

Texas Capital's Outlook Unchanged Despite Merger Termination - May 27, 2020

Mutual termination of Texas Capital and Independent Bank Group merger agreement announced in December 2019 is seen to be a credit positive by Moody's Investors Service — the rating services arm of Moody's Corporation. However, the deal cancellation failed to encourage Moody's to upgrade ratings.

The banks announced the decision earlier this week due to the impacts of coronavirus pandemic.

Per the ratings agency, the merger could have resulted in "material integration risks", having considered the size of both companies. At the time of the announcement, Moody's had thus downgraded the rating outlook to negative.

The outlook remained negative due to Moody's assessment of Texas Capital's asset risk, especially exposure to commercial real estate, including construction and development lending, energy sector and mortgage warehouse lending.

The coronavirus outbreak had significant impacts on the global economic outlook as it resulted in a decline in oil prices, and lower asset price, leading to a severe and extensive credit shock across many sectors, regions and markets. Moody's expects Texas Capital's energy portfolio to be stressed under the current low oil prices.

Further, Texas Capital has a weak capital position in comparison with other US banks. The company's common equity Tier 1 ratio was 9.3% as of Mar 31, 2020, up 8.9% from the previous quarter end. However, Texas Capital's decision to not pay common dividends is seen as a tailwind by Moody's as it provides the management greater flexibility in managing capital position in the current uncertain operating environment.

Also, the bank's conservative underwriting standards and effective risk management are expected to help in countering the exposure to risky loan portfolios. Moreover, funding profile benefits from a low reliance on confidence-sensitive market funding, owing to its sizeable deposit base.

What Could Trigger Change in Ratings?

Per Moody's, Texas Capital's outlook is less likely to be upgraded in the coming 12-18 months. However, the outlook can return to stable, if the company is able to sustain its current capitalization over the outlook period despite expected pressures on profitability and credit costs due to the pandemic.

However, Texas Capital's ratings could be downgraded if Moody's feels weakening in internal controls or underwriting in the loan portfolio or if there is a material decline in capitalization. Also, indications of an increase in risk appetite could lead to a rating downgrade.

Texas Capital & Independent Bank Terminate Proposed Merger - May 26, 2020

Texas Capital and Independent Bank Group mutually terminated the merger agreement announced in December 2019. Per the agreement, Texas Capital was supposed to merge with Independent Bank Group in an all-stock merger of equals.

Given the significant impact of the coronavirus pandemic globally and considering the companies' capability to fully realize the synergies expected to achieve post-merger, both companies' boards of directors agreed for the termination. Though Texas lagged behind other states in applying quarantine measures, it still recorded an upsurge in unemployment. Moreover, the energy sector has been hit hard by the sharp decline in oil prices. Notably, Texas Capital is highly concentrated to oil and gas loans in its portfolio.

Additionally, volatile markets have hurt the companies' ability to work and their stock prices have been impacted as well significantly, as corporate-bond markets recorded price disparities. Therefore, banking stocks have been under pressure as investors' concerns rose on the coronavirus-related mayhem.

"Due to the unprecedented impact of the COVID-19 pandemic, both companies' boards of directors believe it is in the best interests of our employees, clients and all of our shareholders to focus on managing our business during this time," said Larry Helm, chairman, Texas Capital Bancshares.

Helm continued, "As a result of our significant multi-year investments, healthy balance sheet, ability to recruit and foster the best talent and history of driving strong results, Texas Capital Bank is well positioned to continue to execute against a standalone strategy. Our team and resources will be focused on leveraging our innovative and differentiated capabilities to continue providing a premier client experience and deliver elevated returns. Further, we maintain the scalability and commitment to operational excellence that will enable us to drive increased efficiencies and profitability and support sustainable, long-term value creation. Our dedicated team, whose tireless efforts to enhance our clients' experience and the communities where we operate, will continue to guide Texas Capital Bank's purpose and success."

Neither of the company will be paying any termination fee, as the decision to terminate the merger agreement is mutual.

Following the merger termination, C. Keith Cargill, president and CEO, and a member of the board of directors of Texas Capital has stepped down, effective immediately. However, Cargill, appointed as CEO in 2014, will continue to serve as the vice chairman until the end of this year.

Valuation

Texas Capital's shares are down 41.5% in the year-to-date period and 40.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 27.5% and 18.4% in the year-to-date period. Over the past year, the Zacks sub-industry and sector are down 17.4% and 9.1%, respectively.

The S&P 500 Index is up 1.7% in the year-to-date period and 15.4% in the past year.

The stock is currently trading at 16.79X forward 12 months earnings, which compares to 13.39X for the Zacks sub-industry, 16.27X for the Zacks sector and 22.64X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 26.43X and as low as 3.92X, with a 5-year median of 14.54X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$35 price target reflects 17.69X forward earnings.

The table below shows summary valuation data for TCBI

Valuation Multiples - TCBI					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	16.79	13.39	16.27	22.64
	5-Year High	26.43	17.87	16.27	22.64
	5-Year Low	3.92	10.53	11.59	15.25
	5-Year Median	14.54	14.09	14.21	17.55
P/TB TTM	Current	0.67	1.49	3.33	12.9
	5-Year High	2.58	2.92	4	12.94
	5-Year Low	0.37	1.06	2.01	5.96
	5-Year Median	1.62	2.17	3.48	9.54
P/S F12M	Current	1.68	3.25	6.04	3.59
	5-Year High	5.71	5.29	6.66	3.59
	5-Year Low	0.98	2.74	4.96	2.53
	5-Year Median	3.3	4.22	6.06	3.04

As of 07/31/2020

Industry Analysis Zacks Industry Rank: Top 23% (58 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Associated BancCorp (ASB)	Neutral	4
BankUnited, Inc. (BKU)	Neutral	3
BancorpSouth Bank (BXS)	Neutral	3
Hancock Whitney Corporation (HWC)	Neutral	4
New York Community Bancorp, Inc. (NYCB)	Neutral	3
Bank OZK (OZK)	Neutral	3
Prosperity Bancshares, Inc. (PB)	Neutral	3
Zions Bancorporation, N.A. (ZION)	Neutral	3

Industry Comparison Industry: Banks - Southwest				Industry Peers		
	TCBI	X Industry	S&P 500	HWC	OZK	PB
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	4	3	3
VGM Score	F	-	-	F	C	B
Market Cap	1.68 B	177.52 M	22.59 B	1.64 B	3.11 B	5.15 B
# of Analysts	7	2	14	4	6	8
Dividend Yield	0.00%	1.37%	1.83%	5.67%	4.53%	3.31%
Value Score	F	-	-	D	B	B
Cash/Price	6.15	0.76	0.07	0.46	0.52	0.07
EV/EBITDA	-9.23	4.69	12.94	2.45	4.38	9.90
PEG Ratio	14.24	6.58	3.04	NA	NA	1.05
Price/Book (P/B)	0.65	0.84	3.17	0.50	0.76	0.87
Price/Cash Flow (P/CF)	4.63	9.16	12.51	3.81	6.73	12.58
P/E (F1)	147.09	13.68	21.87	NA	14.89	10.47
Price/Sales (P/S)	1.22	1.94	2.44	1.14	2.56	4.41
Earnings Yield	0.69%	7.28%	4.31%	-5.25%	6.74%	9.56%
Debt/Equity	1.20	0.25	0.75	0.12	0.30	0.02
Cash Flow (\$/share)	7.18	1.71	6.94	5.01	3.57	4.42
Growth Score	F	-	-	F	F	C
Hist. EPS Growth (3-5 yrs)	17.59%	15.63%	10.85%	23.48%	7.35%	4.67%
Proj. EPS Growth (F1/F0)	-96.33%	-21.11%	-7.75%	-124.88%	-51.06%	5.75%
Curr. Cash Flow Growth	8.59%	8.59%	5.39%	1.88%	7.01%	12.62%
Hist. Cash Flow Growth (3-5 yrs)	19.05%	14.05%	8.55%	9.27%	28.37%	2.48%
Current Ratio	1.19	1.00	1.31	0.80	0.99	0.79
Debt/Capital	53.10%	19.78%	44.32%	10.43%	23.27%	2.06%
Net Margin	8.10%	20.84%	10.44%	-4.74%	21.95%	36.72%
Return on Equity	6.68%	7.90%	14.73%	-1.24%	6.49%	8.25%
Sales/Assets	0.04	0.05	0.52	0.05	0.05	0.04
Proj. Sales Growth (F1/F0)	-4.52%	0.00%	-1.95%	7.31%	-2.23%	39.54%
Momentum Score	C	-	-	D	A	B
Daily Price Chg	0.74%	-0.69%	-0.92%	-2.03%	-3.68%	-3.68%
1 Week Price Chg	15.28%	2.17%	0.37%	2.72%	3.89%	2.31%
4 Week Price Chg	15.83%	-0.55%	3.81%	-2.06%	4.57%	-3.12%
12 Week Price Chg	29.46%	1.43%	11.93%	1.55%	17.26%	-2.54%
52 Week Price Chg	-43.71%	-30.40%	-1.92%	-51.46%	-16.35%	-17.26%
20 Day Average Volume	524,772	17,396	1,887,986	530,414	938,264	528,735
(F1) EPS Est 1 week change	-1.86%	0.00%	0.00%	0.00%	7.67%	0.79%
(F1) EPS Est 4 week change	22.71%	4.76%	0.38%	-515.40%	2.77%	1.94%
(F1) EPS Est 12 week change	-0.12%	3.04%	-0.07%	-184.18%	-3.21%	1.78%
(Q1) EPS Est Mthly Chg	32.86%	4.68%	0.16%	17.99%	4.42%	0.37%

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	F
Growth Score	F
Momentum Score	C
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.

Disclosures

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