Texas Capital (TCBI)

$30.04 (As of 06/03/20)

Price Target (6-12 Months): **$26.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 03/30/20) Prior Recommendation: Neutral	**Underperform**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**5-Strong Sell**
	Zacks Style Scores:	VGM:C
	Value: C | Growth: C	Momentum: F

Summary

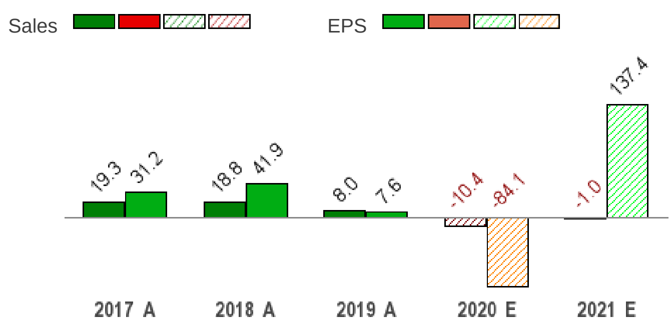
Shares of Texas Capital have underperformed the industry, over the past six months. Also, the company has a dismal earnings surprise history, having beaten the Zacks Consensus Estimate in only one of the trailing four quarters. Texas Capital's persistently rising expenses in order to hire experienced bankers will likely impede bottom-line expansion. Also, high exposure to commercial and real estate loans and debt level are headwinds. Further, the company faces credit risk in case of any economic downturn. However, rising loans and deposits balance suggests a strong capital position, which will help the company undertake expansions. Nevertheless, deterioration in credit quality is a concern. Notably, Texas Capital and Independent Bank Group mutually terminated all-stock merger of equals with due to the impacts of coronavirus pandemic.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$64.88 - $19.10**
20 Day Average Volume (sh)	**979,073**
Market Cap	**$1.5 B**
YTD Price Change	**-47.1%**
Beta	**2.14**
Dividend / Div Yld	**$0.00 / 0.0%**
Industry	**Banks - Southwest**
Zacks Industry Rank	**Bottom 29% (180 out of 253)**
Last EPS Surprise	**-111.7%**
Last Sales Surprise	**-4.0%**
EPS F1 Est- 4 week change	**-8.8%**
Expected Report Date	**07/15/2020**
Earnings ESP	**25.3%**
P/E TTM	**6.6**
P/E F1	**30.3**
PEG F1	**2.9**
P/S TTM	**1.1**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	233 E	241 E	247 E	245 E	951 E
2020	240 A	240 E	243 E	239 E	961 E
2019	266 A	268 A	272 A	266 A	1,072 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$0.46 E	$0.61 E	$0.79 E	$0.80 E	$2.35 E
2020	-$0.11 A	$0.35 E	$0.51 E	$0.53 E	$0.99 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.

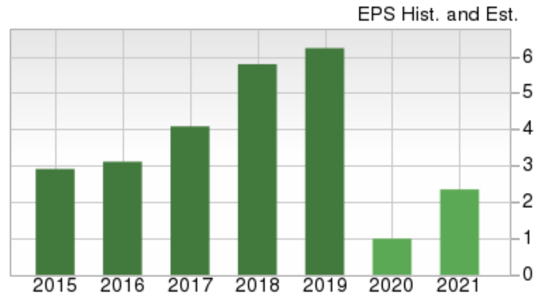
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/03/2020. The reports text is as of 06/04/2020.

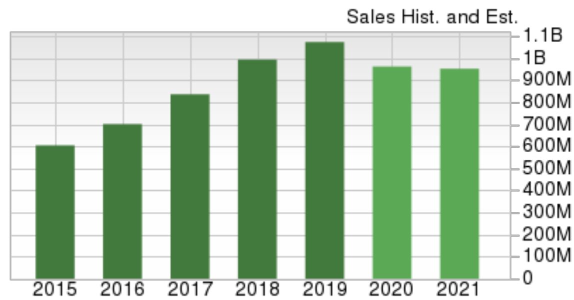
Overview

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 Mar 31, 2020, Texas Capital had total assets of around $35.9 billion, loans of $25.2 billion and deposits of $27.1 billion.

Reasons To Sell:

> 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.

- 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 first-quarter 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.

- Amid the coronavirus crisis and its related impact on economy, the company holds a debt level of $5.6 billion and debt-capital ratio of 65.4 (above the industry's average of 23.22), which has witnessed volatility in the past few quarters and a substantial increase in first-quarter 2020. Therefore, with a declining time-interest-earned ratio of 5 over the past few quarters, which indicates the company's ability to meet its debt obligations based on current income, we believe Texas Capital carries a higher credit risk, and 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 underperformed the industry over the past six months. With this unfavorable trend, the company's current-year earnings estimates have been revised 16.8% downward, over the past 30 days. Also, the stock seems overvalued when compared with the broader industry. Its current price-to-earnings (P/E) (F1) and PEG ratios are above the respective industry averages. Therefore, given the above concerns and lack of positive estimate revisions, we find the stock has limited upside potential.

Risks

- Organic growth is a key strength at Texas Capital, as reflected by its revenue-growth story. Though revenues declined in first-quarter 2020 on low rates and decline in fee 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 first-quarter 2020 witnessed contraction of margin on account of rise in deposit costs and low rates, improvement in economy and 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 first-quarter 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 Mar 31, 2020, the ratio of tangible common equity to total tangible assets was 7.3%. We believe its strong capital position would help it undertake opportunistic expansions in the foreseeable future.

Last Earnings Report

Texas Capital Reports Q1 Loss, Costs Rise

Quarter Ending	03/2020
Report Date	**Apr 22, 2020**
Sales Surprise	**-4.01%**
EPS Surprise	**-111.70%**
Quarterly EPS	**-0.11**
Annual EPS (TTM)	**4.53**

Texas Capital reported adjusted loss per share of 11 cents in first-quarter 2020, against the Zacks Consensus Estimate for earnings of 94 cents. The reported figure excluded certain noteworthy items such as the impacts of the MSR impairment charges and merger-related expenses.

Elevated expenses and pressure on margin were negatives. Further, results reflect a decline in loan balances. Also, a fall in revenues, a substantial rise in provisions and reserve build related to the coronavirus-led crisis were other key headwinds.

After considering one-time items, net loss available to common stockholders was $19.1 million or 38 cents per share against net income of $80.4 million or $1.60 per share recorded in the prior-year quarter.

Revenues Rise, Costs Escalate

Total revenues declined 9.4% year over year to $240.1 million in the first quarter due to lower net interest and non-interest income. Furthermore, revenues lagged the Zacks Consensus Estimate of $244.6 million.

Texas Capital's net interest income was $228.3 million, down 3.1% year over year, mainly stemming from a decline in loan yields, partly muted by a decrease in funding costs. Net interest margin, however, contracted 95 basis points (bps) year over year to 2.78%.

Non-interest income declined 61% year over year to $17.8 million. The downside primarily resulted from lower other non-interest income, partially offset by increases in brokered loan fees, servicing income and swap fees.

Non-interest expenses flared up 17.8% year over year to $165.4 million. The upswing mainly resulted from a rise in almost all components of expenses, partly negated by lower marketing expenses.

As of Mar 31, 2020, total loans declined 7.7% on a sequential basis to $25.2 billion, while deposits rose 2.3% sequentially to $27.1 billion.

Credit Quality Deteriorates

Non-performing assets totaled 0.9% of the loan portfolio plus other real estate-owned assets compared with the prior-year quarter's figure of 0.57%. Total non-performing assets rose 64% to $219.2 million compared with the prior-year quarter.

Provisions for credit losses summed $96 million compared with $20 million in the year-ago quarter. The company's net charge-offs were $57.7 million compared with $4.6 million as of Mar 31, 2019.

Capital Ratios Steady

The company's capital ratios displayed a steady position during the first quarter. Tangible common equity to total tangible assets came in at 7.3% compared with the year-earlier quarter's 8.5%.

Common equity Tier 1 ratio was 9.3%, up from 8.6% in the prior-year quarter. Leverage ratio was 8.5% compared with 10% as of Mar 31, 2019.

Stockholders' equity was up 8.6% year over year to $2.8 billion as of Dec 31, 2019. The uptrend chiefly allied with the retention of net income.

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 47.1% in the year-to-date period and 50.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 22.3% and 17.8%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are down 14.3% and 9.7%, respectively.

The S&P 500 Index is down 3.1% in the year-to-date period but up 11.4% in the past year.

The stock is currently trading at 16.67X forward 12 months earnings, which compares to 16.56X for the Zacks sub-industry, 17.05X for the Zacks sector and 22.56X 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 14.57X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our $26 price target reflects 14.17X 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	16.67	16.56	17.05	22.56
	5-Year High	26.43	17.8	17.05	22.56
	5-Year Low	3.92	10.61	11.57	15.23
	5-Year Median	14.57	14.18	13.96	17.49
P/TB TTM	Current	0.59	1.58	3.36	12.28
	5-Year High	2.58	2.84	4	12.77
	5-Year Low	0.37	1.05	2	5.97
	5-Year Median	1.71	2.19	3.47	9.28
P/S F12M	Current	1.55	3.58	5.8	3.51
	5-Year High	5.71	5.22	6.69	3.51
	5-Year Low	0.98	2.73	4.98	2.53
	5-Year Median	3.52	4.21	6.06	3.02

As of 06/03/2020

Industry Analysis **Zacks Industry Rank:** Bottom 29% (180 out of 253)

Top Peers

Company (Ticker)	Rec	Rank
Associated BancCorp **(ASB)**	Neutral	3
BankUnited, Inc. **(BKU)**	Neutral	3
New York Community Bancorp, Inc. **(NYCB)**	Neutral	3
Bank OZK **(OZK)**	Neutral	3
Prosperity Bancshares, Inc. **(PB)**	Neutral	2
Zions Bancorporation, N.A. **(ZION)**	Neutral	3
BancorpSouth Bank **(BXS)**	Underperform	5
Hancock Whitney Corporation **(HWC)**	Underperform	4

Industry Comparison Industry: Banks - Southwest

Industry Peers

	TCBI	X Industry	S&P 500	HWC	OZK	PB
Zacks Recommendation (Long Term)	Underperform	-	-	Underperform	Neutral	Neutral
Zacks Rank (Short Term)	5	-	-	4	3	2
VGM Score	C	-	-	F	D	B
Market Cap	1.51 B	201.33 M	22.50 B	2.05 B	3.16 B	6.09 B
# of Analysts	5	3	14	9	7	10
Dividend Yield	0.00%	1.12%	1.88%	4.55%	4.42%	2.80%
Value Score	C	-	-	D	B	B
Cash/Price	7.16	0.70	0.06	0.73	0.46	0.06
EV/EBITDA	-5.20	5.87	12.98	2.03	5.17	11.81
PEG Ratio	3.08	2.26	3.05	3.79	NA	1.32
Price/Book (P/B)	0.57	0.93	3.11	0.60	0.77	1.06
Price/Cash Flow (P/CF)	4.18	8.51	12.18	4.74	6.83	14.88
P/E (F1)	31.86	13.21	22.19	30.32	15.79	13.21
Price/Sales (P/S)	1.07	2.10	2.40	1.41	2.52	5.67
Earnings Yield	3.30%	7.26%	4.31%	3.29%	6.35%	7.57%
Debt/Equity	2.00	0.34	0.76	0.11	0.34	0.02
Cash Flow ($/share)	7.18	1.84	7.01	5.01	3.57	4.42
Growth Score	C	-	-	F	F	C
Hist. EPS Growth (3-5 yrs)	21.32%	14.43%	10.87%	20.96%	11.77%	4.67%
Proj. EPS Growth (F1/F0)	-84.04%	-25.73%	-10.74%	-80.49%	-53.16%	-0.84%
Curr. Cash Flow Growth	8.59%	8.85%	5.48%	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	1.29	0.99	1.29	0.82	1.02	0.75
Debt/Capital	65.39%	25.50%	44.75%	9.53%	25.45%	2.10%
Net Margin	15.73%	20.50%	10.59%	9.42%	26.16%	35.42%
Return on Equity	9.11%	9.30%	16.29%	4.71%	8.02%	8.32%
Sales/Assets	0.04	0.05	0.55	0.05	0.05	0.04
Proj. Sales Growth (F1/F0)	-10.32%	0.00%	-2.65%	6.00%	-5.26%	38.69%
Momentum Score	F	-	-	F	D	D
Daily Price Chg	4.74%	2.74%	2.42%	7.18%	5.44%	4.40%
1 Week Price Chg	-6.17%	1.08%	4.60%	12.08%	7.45%	7.87%
4 Week Price Chg	20.16%	9.38%	13.40%	26.44%	19.54%	14.55%
12 Week Price Chg	-6.21%	-6.91%	12.78%	11.26%	16.18%	29.40%
52 Week Price Chg	-50.39%	-26.95%	0.89%	-39.71%	-20.36%	-2.79%
20 Day Average Volume	979,073	22,789	2,528,787	727,583	1,114,909	530,985
(F1) EPS Est 1 week change	-7.07%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-8.85%	-0.55%	-0.14%	-25.03%	-7.36%	0.00%
(F1) EPS Est 12 week change	-74.98%	-26.56%	-16.00%	-80.83%	-46.14%	-8.49%
(Q1) EPS Est Mthly Chg	-16.62%	-1.32%	-0.02%	-5.48%	-10.55%	0.00%

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	C
Growth Score	C
Momentum Score	F
VGM Score	C

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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