

Texas Capital (TCBI)

\$55.66 (As of 01/03/20)

Price Target (6-12 Months): **\$58.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 09/17/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: C

Growth: F

Momentum: A

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 costs, due to hiring of experienced bankers, is likely to impede its bottom-line growth to some extent. Also, significant exposure to commercial and real estate loans remain a headwind. Nonetheless, growth in revenues due to increasing net interest income acts as a tailwind. Also, rising loans and deposits balance suggests a strong capital position which would help the company undertake opportunistic expansions over the long haul. Texas Capital's recent all-stock merger of equals with Independent Bank Group reflects the companies' strategic efforts for business expansion.

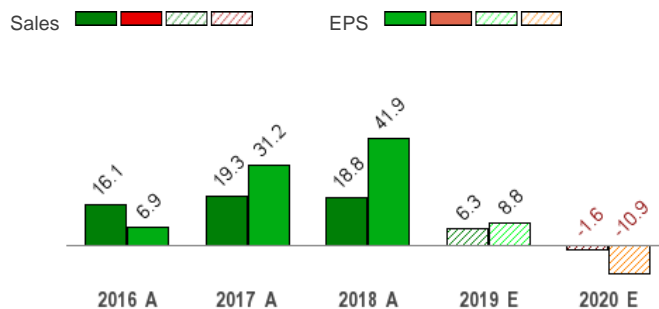
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$66.61 - \$50.77
20 Day Average Volume (sh)	637,913
Market Cap	\$2.8 B
YTD Price Change	-2.0%
Beta	1.88
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Banks - Southwest
Zacks Industry Rank	Bottom 21% (198 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	14.1%
Last Sales Surprise	4.0%
EPS F1 Est- 4 week change	0.2%
Expected Report Date	01/22/2020
Earnings ESP	-3.3%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	249 E	257 E	268 E	265 E	1,039 E
2019	266 A	268 A	272 A	260 E	1,056 E
2018	230 A	249 A	258 A	256 A	993 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.27 E	\$1.37 E	\$1.54 E	\$1.48 E	\$5.61 E
2019	\$1.60 A	\$1.50 A	\$1.70 A	\$1.55 E	\$6.30 E
2018	\$1.38 A	\$1.38 A	\$1.65 A	\$1.38 A	\$5.79 A

*Quarterly figures may not add up to annual.

P/E TTM	9.0
P/E F1	9.9
PEG F1	1.0
P/S TTM	2.0

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/03/2020. The reports text is as of 01/06/2020.

Overview

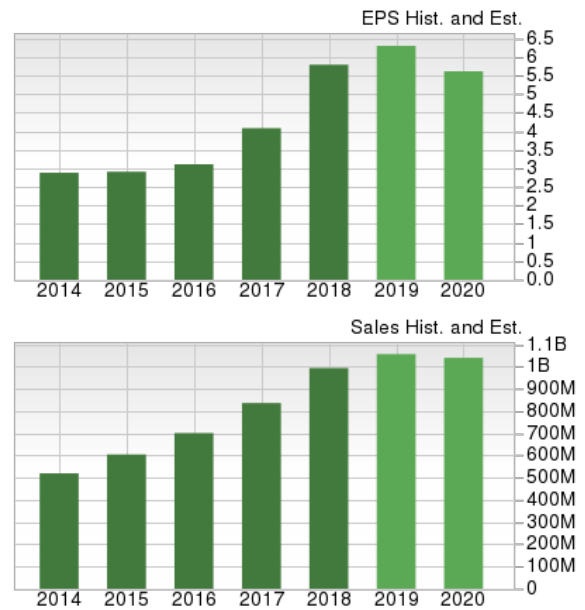
Texas Capital Bancshares Inc., a financial holding company, is the parent company of Texas Capital Bank, a Texas-based bank headquartered in Dallas. The company focuses on leveraging local business and community ties to the five major metropolitan areas of Texas — Dallas, Houston, Fort Worth, Austin 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 Sep 30, 2019, Texas Capital had total assets of around \$33.5 billion, loans of \$27.4 billion and deposits of \$27.4 billion.



Reasons To Buy:

- ▲ Organic growth remained a key strength at Texas Capital, as reflected by its revenue growth story with a compounded annual growth rate (CAGR) of 17.6% over the last five years (2014-2018), primarily due to elevated net interest income, driven by rise in average earning assets as well as rise in non-interest income. The increasing trend continued in the first nine months of 2019 as well. Further, diversified fee income base and rising interest income will continue to support 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 the first nine months of 2019 witnessed contraction of margin on account of rise in deposit costs, 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 12.4%) and deposits (CAGR of 12.9%) over the last five years (2014-2018), with the rising trend continuing in the first nine months of 2019 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 Sep 30, 2019, the ratio of tangible common equity to total tangible assets was 7.7%. We believe its strong capital position would help it undertake opportunistic expansions in the foreseeable future.
- ▲ Texas Capital's trailing 12-month return on equity (ROE) reflects its superiority in terms of utilizing shareholders' fund. The company's ROE of 12.95% compares favorably with 10.52% for the industry.
- ▲ Shares of Texas Capital have underperformed the industry over the past six months. Despite this unfavorable trend, the company's current-year earnings estimates have been revised marginally upward, over the past 30 days. Also, the stock seems undervalued when compared with the broader industry. Its current price-to-earnings (P/E) (F1) and price-to-book (P/B) ratios are below the respective industry averages. Therefore, given the strong fundamentals and positive estimate revisions, we find the stock has upside potential.

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

Reasons To Sell:

- ▼ The company continues to witness an increase in expenses, which rose at a CAGR of around 16.5% over the last five years (2014-2018), with the rising trend continuing in the first nine months of 2019. 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 the first nine months of 2019 with some quarterly volatility. Therefore, continuation of such trend can be risky for the company amid challenging global economy and competitive markets.
- ▼ 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.

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 Q3 Earnings Top Estimates on Higher Revenues

Texas Capital reported earnings per share of \$1.70 in third-quarter 2019, outpacing the Zacks Consensus Estimate of \$1.49. Results compare favorably with the prior-year quarter's \$1.65 as well.

Rise in revenues was a positive factor. Further, results reflect organic growth, with significant rise in loans and deposit balances. However, elevated expenses were on the downside.

Net income available to common stockholders came in at \$85.7 million compared with the \$83.1 million recorded in the prior-year quarter.

Quarter Ending **09/2019**

Report Date	Oct 16, 2019
Sales Surprise	3.95%
EPS Surprise	14.09%
Quarterly EPS	1.70
Annual EPS (TTM)	6.18

Revenues Rise, Loans & Deposits Go Up, Costs Escalate

Total revenues (net of interest expense) jumped 5.7% year over year to \$272.5 million in the quarter, driven by higher net interest income, partly offset by lower non-interest income. Furthermore, revenues surpassed the Zacks Consensus Estimate of \$262.1 million.

Texas Capital's net interest income was \$252.2 million, up 8.6% year over year, mainly stemming from rise in average total loans and liquidity assets, partly muted by rise in average interest-bearing liabilities and deposit costs. Net interest margin, however, contracted 54 basis points (bps) year over year to 3.16%.

Non-interest income declined 20.4% year over year to \$20.3 million. This downside primarily resulted from decreased servicing income due to fall in mortgage servicing rights associated with the company's MCA program and net gain/(loss) on sale of LHS, partially offset by higher brokered loan fees.

Non-interest expenses flared up 9.8% year over year to \$149.4 million. This upswing mainly resulted from rise in almost all components of expenses, partly muted by lower FDIC insurance assessment and other expenses.

As of Sep 30, 2019, total loans rose 8.3% on a sequential basis to \$27.5 billion, while deposits climbed 19.1% sequentially to \$27.4 billion.

Credit Quality: A Mixed Bag

Non-performing assets totaled 0.49% of the loan portfolio, plus other real estate-owned assets, in line with the prior year. Total non-performing assets came in at \$120.7 million, up 12.2% year over year.

Provisions for credit losses summed \$11 million, down 15.4% year on year. The company's net charge-offs increased significantly on a year-over-year basis to \$36.9 million.

Steady Capital and Profitability Ratios

The company's capital ratios displayed a steady position during the July-September quarter. As of Sep 30, 2019, return on average equity was 13.22%, and return on average assets was 1.06% compared with 14.68% and 1.31%, respectively, recorded in the year-ago quarter. Tangible common equity to total tangible assets came in at 7.7% compared with 8.3% reported in the year-earlier quarter.

Common equity Tier 1 ratio was 8.6%, in line with the prior-year quarter. Leverage ratio was 8.6% compared with 9.7% as of Sep 30, 2018.

Stockholders' equity was up 16.7% year over year to \$2.8 billion as of Sep 30, 2019. The uptrend chiefly allied with the retention of net income.

Outlook

Management estimates the contribution of MCA business to total mortgage loans to be around \$2.5 billion for 2019.

Management expects C&I leveraged loans to decline further in 2019.

Growth in average balances for total mortgage finance loans is likely to be in mid-to-high thirties for 2019. Also, average LHI is expected to grow in mid-single digits.

Average deposits are expected to record high teens percent growth for 2019.

Management expects net revenues in high single-digit percent growth.

Net interest margin (NIM) is projected at 3.20-3.30% for 2019, down from the previous estimate of 3.35-3.35%. The downside primarily resulted from the earning assets shift witnessed.

The net interest income decline is likely to be 6% to 9% over the next 12 months, assuming 75 basis points of additional rate cut.

Provision expenses are projected to be around high \$60 million to high \$70 million level for 2019.

Rise in non-interest expenses are expected in mid to high single-digit in 2019. Efficiency ratio is projected in the low 50s.

Long-term Targets

Return on assets (ROE) and return on capital employed (ROCE) to be above 1.3% and 15%, respectively. Efficiency ratio is projected to be

below 50s.

Recent News

Texas Capital's Ratings Affirmed, Outlook Lowered by Moody's - Dec 9, 2019

Ratings of Texas Capital and its banking subsidiary, Texas Capital Bank, National Association have been affirmed by Moody's Investors Service, the rating division of Moody's Corporation. However, the ratings outlook moved down to negative from stable.

Notably, the bank's standalone baseline credit assessment (BCA) was baa2 and its long-term issuer rating was Baa3. Further, the subsidiary's long- and short-term deposits were rated A3 and Prime-2, respectively.

Reasons for Affirmation

The ratings affirmation follows the announcement of an all-stock 'merger of equals' deal between Texas Capital and Independent Bank Group, Inc. The unchanged ratings reflect that the credit profile of the merged entity will be on par with that of Texas Capital.

Following the merger, the loan portfolio and deposit franchise will be more diversified, reducing the bank's mortgage warehouse exposure, and will also provide opportunity to cut costs. However, the deal will increase its commercial real estate's loan exposure. Further, there will be a significant integration risk, which was the key reason behind the outlook change.

Historically good financial performance and operating efficiency along with strong asset quality during the 2007-09 recession and 2015-17 energy downturn is incorporated in Texas Capital's BCA. Lack of diversification of deposits and the fact that the bank has been rated lowest among the U.S. banks with respect to its capitalization have been taken into consideration while affirming the ratings. Further, Texas Capital expects the common equity Tier 1 ratio of the combined entity to be 8.6%, which is similar to the bank's ratio before merger, and lower than that of Independent Bank.

Further, per Moody's, Texas Capital's higher loan losses in 2018 and 2019 due to soft credit environment are indicative of rapid loan growth and leveraged lending risks. Moreover, the bank is reducing its exposure in the leveraged loan portfolio in 2019, which will benefit its asset risk.

The bank's funding profile benefits from less dependence on confidence-sensitive market funding due to its sizeable deposit base. Yet, Texas Capital's focus on commercial banking and its limited number of branches lead to "less balanced franchise" and decreased granular deposit book value than its peers. Thus, the bank's deposits cannot completely fund its loans and it has large deposits concentrations. Moody's expects these problems to ease with the bank's more granular deposit base being sourced from increased branch network.

Texas Capital & Independent Bank to Merge in Deal Worth \$5.5 Billion - Dec 9, 2019

Texas Capital entered into a stock-cash acquisition deal with Independent Bank Group, Inc, per which the former will merge with the latter in an all-stock merger of equals. The combined holding entity will operate under the name of Independent Bank Group, headquartered at McKinney, TX, while the name of the combined bank will be Texas Capital.

Additionally, retaining the Independent Financial branding, operations in retail locations in Colorado will continue. The combined company, for a total market value of \$5.5 billion, will trade under the symbol "IBTX" on the Nasdaq Stock Market.

The deal, approved by the boards of both banks, on completion will be listed as a premier Texas-based super regional bank.

The combined entity is aimed at capturing market opportunities and boosting client base. Moreover, the companies' expanded scale, technological advancement and increased product offerings will help capitalize its market share.

However, the deal awaits certain customary approvals by shareholders of both companies and other closing conditions. The transaction is anticipated to close in mid-2020.

Terms of the Deal

Per the terms of the deal, each common shareholder of Texas Capital will get stock equivalent to 1.0311 of Independent Bank Group shares for every Texas Capital share held. Specifically, Texas Capital shareholders in total will own about 55% of the combined entity, while shareholders of Independent Bank Group will own the remaining.

Further, shareholders of the combined entity will be entitled to an annualized dividend on common stock of \$1.00 per share after the deal's closure, subject to board of directors' approval.

Texas Capital and Independent Bank Group will create the combined entity, with \$48 billion in assets. Strategically, the combined entity will enhance through advanced technologies, innovative products and core deposit business, creating a competitive edge in Texas.

Also, the combination will cater various needs of businesses, professionals and individuals with diversified products. On completion, Texas Capital and Independent Bank Group, maintaining the strong working cultures, aim to offer superior client services.

Members from both Texas Capital and Independent Bank Group will lead the combined entity. The organization's board of directors will include seven directors from Texas Capital and six from Independent Bank Group. Independent Bank Group chairman and CEO David R. Brooks will lead as chairman, president and CEO of the combined entity, while Texas Capital president and CEO C. Keith Cargill will act as a special advisor to the CEO assisting in retaining clients and serve as advisor on key strategic initiatives.

Financial Benefits

Cost synergies are anticipated to approximate around \$170 million on annual run-rate cost savings, boosting profitability and supporting sustained growth.

Per Texas Capital's expectations, the deal is likely to be 14% accretive to earnings by the first full year post closure, while around 27% TBVPS accretion and 26% EPS accretion is expected for Independent Bank Group. Such expectations assume 75% phase-in of cost savings.

The combined entity is likely to record operating and return metrics with cost savings on 75% phased-in basis, on a pro forma basis. Notably, return on tangible common equity is likely to approximate 15%, while return on average assets is projected at 1.3%.

Goldman Sachs & Co. LLC, a unit of Goldman Sachs, acted as financial advisor for Texas Capital, while Keefe, Bruyette & Woods, acted as financial advisor for Independent Bank Group.

Valuation

Texas Capital's shares are up 4.8% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 11.4% and 16.6%, over the past year, respectively.

The S&P 500 index is up 25.7% in the past year.

The stock is currently trading at 9.90X forward 12 months earnings, which compares to 14.11X for the Zacks sub-industry, 14.79X for the Zacks sector and 18.71X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.43X and as low as 7.31X, with a 5-year median of 15.11X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$58 price target reflects 10.32X 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	9.9	14.11	14.79	18.71
	5-Year High	26.43	17.85	16.21	19.34
	5-Year Low	7.31	10.8	12.01	15.17
	5-Year Median	15.11	14.11	13.98	17.44
P/TBV TTM	Current	1.11	2.02	3.29	12.36
	5-Year High	2.58	2.86	3.98	12.45
	5-Year Low	0.99	1.5	2.44	6.03
	5-Year Median	1.76	2.22	3.46	9.06
P/S F12M	Current	2.69	4	6.53	3.47
	5-Year High	5.71	5.24	6.61	3.47
	5-Year Low	2.03	2.95	5.2	2.54
	5-Year Median	3.73	4.21	6.04	3

As of 01/03/2020

Industry Analysis Zacks Industry Rank: Bottom 21% (198 out of 252)



Top Peers

BankUnited, Inc. (BKU)	Neutral
BancorpSouth Bank (BXS)	Neutral
Hancock Whitney Corporation (HWC)	Neutral
New York Community Bancorp, Inc. (NYCB)	Neutral
Bank OZK (OZK)	Neutral
Prosperity Bancshares, Inc. (PB)	Neutral
Zions Bancorporation, N.A. (ZION)	Neutral
Associated Banc-Corp (ASB)	Underperform

Industry Comparison Industry: Banks - Southwest				Industry Peers		
	TCBI Neutral	X Industry	S&P 500	HWC Neutral	OZK Neutral	PB Neutral
VGM Score	D	-	-	D	C	D
Market Cap	2.80 B	289.00 M	23.66 B	3.79 B	3.95 B	4.92 B
# of Analysts	6	3	13	3	5	6
Dividend Yield	0.00%	1.24%	1.79%	2.48%	3.27%	2.56%
Value Score	C	-	-	B	B	C
Cash/Price	1.82	0.45	0.04	0.14	0.26	0.09
EV/EBITDA	1.38	9.39	13.88	7.13	5.62	9.39
PEG Ratio	0.95	1.68	1.99	1.32	0.86	1.39
Price/Book (P/B)	1.07	1.25	3.36	1.04	0.97	1.19
Price/Cash Flow (P/CF)	8.39	13.65	13.62	8.64	8.30	13.52
P/E (F1)	9.81	13.97	18.74	10.54	10.31	13.90
Price/Sales (P/S)	1.95	2.82	2.67	2.67	3.09	5.69
Earnings Yield	10.08%	7.16%	5.32%	9.50%	9.70%	7.20%
Debt/Equity	1.11	0.24	0.72	0.11	0.16	0.00
Cash Flow (\$/share)	6.63	1.61	6.94	5.03	3.69	5.32
Growth Score	F	-	-	F	D	D
Hist. EPS Growth (3-5 yrs)	21.58%	13.33%	10.56%	21.92%	17.58%	2.15%
Proj. EPS Growth (F1/F0)	-10.87%	0.53%	7.41%	1.56%	-9.73%	7.71%
Curr. Cash Flow Growth	37.24%	30.86%	14.83%	26.05%	12.43%	12.12%
Hist. Cash Flow Growth (3-5 yrs)	20.22%	13.79%	9.00%	8.63%	37.20%	3.93%
Current Ratio	1.20	0.98	1.23	0.82	1.00	0.62
Debt/Capital	51.22%	19.57%	42.92%	9.53%	13.64%	0.00%
Net Margin	22.29%	23.67%	11.08%	23.37%	34.43%	38.03%
Return on Equity	12.95%	10.52%	17.10%	11.03%	11.19%	8.02%
Sales/Assets	0.05	0.05	0.55	0.05	0.06	0.04
Proj. Sales Growth (F1/F0)	-1.60%	2.66%	4.20%	5.93%	-1.37%	41.55%
Momentum Score	A	-	-	F	D	F
Daily Price Chg	-0.96%	-0.51%	-0.61%	-0.87%	-0.58%	-0.66%
1 Week Price Chg	-3.78%	-0.66%	0.13%	-0.41%	-0.45%	-0.84%
4 Week Price Chg	-2.57%	2.07%	2.60%	6.28%	0.92%	3.39%
12 Week Price Chg	6.47%	7.14%	8.87%	18.44%	16.83%	4.79%
52 Week Price Chg	7.37%	15.14%	29.34%	21.34%	29.47%	13.36%
20 Day Average Volume	637,913	19,947	1,603,615	548,269	560,224	428,696
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-0.05%
(F1) EPS Est 4 week change	0.15%	0.00%	0.00%	0.11%	0.00%	-0.16%
(F1) EPS Est 12 week change	-3.47%	-3.09%	-0.57%	-2.15%	-5.91%	0.02%
(Q1) EPS Est Mthly Chg	0.16%	0.00%	0.00%	0.25%	-0.35%	-0.12%

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	F
Momentum Score	A
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.

Disclosures

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