

Texas Capital (TCBI)

\$44.47 (As of 03/05/20)

Price Target (6-12 Months): **\$47.00**

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:B

Value: A

Growth: F

Momentum: C

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 two of the trailing four quarters. Texas Capital's persistently rising costs is likely to impede its bottom-line growth. Also, significant exposure to commercial and real estate loans is a headwind. Moreover, deterioration in credit quality remain a headwind for Texas Capital. Nonetheless, growth in revenues due to increasing NII acts as a tailwind. Also, rising loans and deposits balance suggests a strong capital position, which would help the company undertake opportunistic expansions. Texas Capital's recent all-stock merger of equals with Independent Bank Group reflects the companies' efforts for business expansion and expects cost synergies.

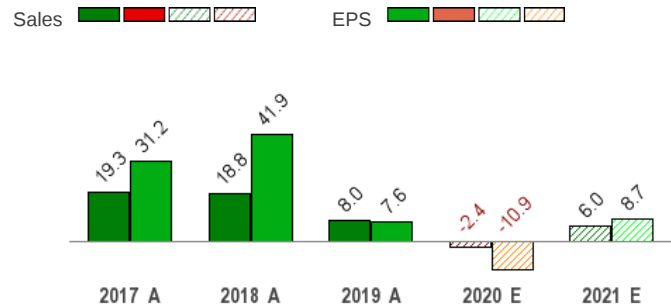
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$66.61 - \$41.85
20 Day Average Volume (sh)	372,789
Market Cap	\$2.2 B
YTD Price Change	-21.7%
Beta	1.74
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Banks - Southwest
Zacks Industry Rank	Top 7% (19 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-7.1%
Last Sales Surprise	2.5%
EPS F1 Est- 4 week change	-0.2%
Expected Report Date	04/15/2020
Earnings ESP	-4.1%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	263 E	277 E	286 E	287 E	1,109 E
2020	252 E	259 E	268 E	266 E	1,046 E
2019	266 A	268 A	272 A	266 A	1,072 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.29 E	\$1.46 E	\$1.53 E	\$1.44 E	\$6.03 E
2020	\$1.28 E	\$1.33 E	\$1.51 E	\$1.43 E	\$5.55 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.

P/E TTM	7.1
P/E F1	8.0
PEG F1	0.8
P/S TTM	1.5

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/05/2020. The reports text is as of 03/06/2020.

Overview

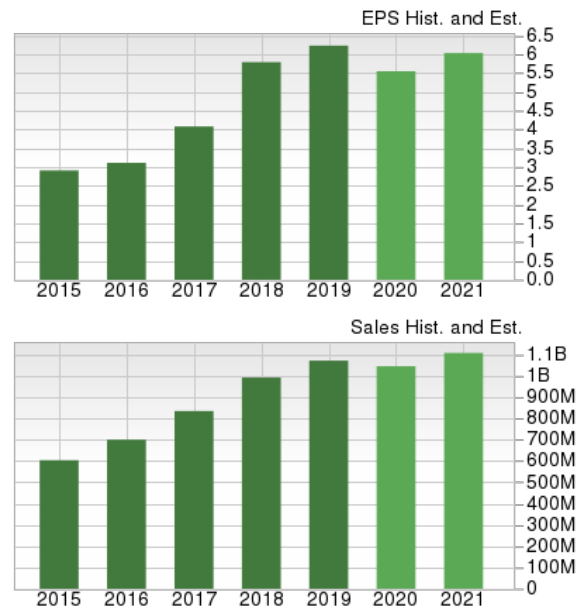
Texas Capital Bancshares Inc., a financial holding company, is the parent company of Texas Capital Bank, a Texas-based bank headquartered in Dallas. The company focuses on leveraging local business and community ties to the five major metropolitan areas of Texas — Dallas, Houston, Fort Worth, Austin 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 Dec 31, 2019, Texas Capital had total assets of around \$32.5 billion, loans of \$27.2 billion and deposits of \$26.5 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 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 interest income 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 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 10.2%) and deposits (CAGR of 15.1%) over the last five years (2015-2019). 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 Dec 31, 2019, the ratio of tangible common equity to total tangible assets was 8.2%. 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 12.66% compares favorably with 10.42% for the industry.
- ▲ 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.

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 a rise in expenses, which witnessed a CAGR of 15.9% over the last five years (2015-2019). 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 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.
- ▼ 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 slightly downward, over the past 30 days. Therefore, given the above concerns and lack of positive estimate revisions, we find 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 Q4 Earnings Miss Estimates on Higher Costs

Texas Capital reported adjusted earnings per share of \$1.44 in fourth-quarter 2019, lagging the Zacks Consensus Estimate of \$1.55. However, results compare favorably with the prior-year quarter's \$1.38.

Elevated expenses and pressure on margin were negatives. Further, results reflect decline in both loans and deposit balances. Yet, rise in revenues and lower provisions were driving factors.

Including merger-related expenses of \$1.3 million, or 2 cents per share, net income available to common stockholders came in at \$71.5 million or \$1.42 per share compared with the \$69.5 million or \$1.38 per share recorded in the prior-year quarter.

For full-year 2019, earnings per share reached \$6.21 per share comparing favorably with the year-ago earnings of \$5.79 per share. Net income available to common shareholders was \$313.1 million, up 7.6% year over year.

Revenues Rise, Loans & Deposits Down, Costs Escalate

For full-year 2019, the company reported revenues of \$1.07 billion, up 7.8% year over year. Moreover, the figure beat the Zacks Consensus Estimate of \$1.06 billion.

Total revenues (net of interest expense) jumped 4% year over year to \$266.2 million in the fourth quarter, driven by higher net interest and non-interest income. Furthermore, revenues surpassed the Zacks Consensus Estimate of \$259.7 million.

Texas Capital's net interest income was \$248.4 million, up 3.2% year over year, mainly stemming from rise in total loans, partly muted by decreased loan yields. Net interest margin, however, contracted 83 basis points (bps) year over year to 2.95%.

Non-interest income escalated 16% year over year to \$17.8 million. This upside primarily resulted from increased brokered loan fees and servicing income, partly offset by decreased other non-interest income.

Non-interest expenses flared up 22% year over year to \$158.7 million. This upswing mainly resulted from rise in almost all components of expenses, partly negated by lower other expenses.

As of Dec 31, 2019, total loans declined slightly on a sequential basis to \$27.3 billion, while deposits slumped 3.3% sequentially to \$26.5 billion.

Credit Quality: A Mixed Bag

Non-performing assets totaled 0.91% of the loan portfolio, plus other real estate-owned assets, compared with the prior-year quarter's figure of 0.36%. Total non-performing assets more than doubled to \$225.4 million compared with the prior-year quarter.

Provisions for credit losses summed \$17 million, down 51.4% year on year. The company's net charge-offs plummeted 60.7% on a year-over-year basis to \$12.8 million.

Steady Capital and Profitability Ratios

The company's capital ratios displayed a steady position during the October-December quarter. As of Dec 31, 2019, return on average equity was 10.68%, and return on average assets was 0.85% compared with the 11.82% and 1.09%, respectively, recorded in the year-ago quarter. Tangible common equity to total tangible assets came in at 8.2% compared with the year-earlier quarter's 8.3%.

Common equity Tier 1 ratio was 8.9%, up from 8.6% in the prior-year quarter. Leverage ratio was 8.4% compared with 9.9% as of Dec 31, 2018.

Stockholders' equity was up 13% year over year to \$2.8 billion as of Dec 31, 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 \$3 billion for 2020.

Decline in average balances for total mortgage finance loans is likely to be in high teens for 2020. Also, average LHI is expected to grow in mid-single digits, reflecting continued reduction in energy and leveraged, but includes growth in core C&I, including new verticals as well as growth from adding some one-to-four family loans to the LHI portfolio

Average deposits are expected to remain flat Our outlook for average total deposits is flat as the company focus on repositioning the funding mix, including approximately \$1 billion in deposits from Bask expected by year-end 2020.

Management expects net revenues to decline by low single-digit percent. This reflects full year of lower rates from the 3 rate cuts along with continued slower growth in core LHI and an overall lower level of mortgage finance.

Net interest margin (NIM) is projected at 3.05-3.15% for 2020, due to lower rate environment.

Provision expenses are projected to be around low to high \$60 million for 2020, with continued resolution of existing problem loans, primarily in leveraged and energy.

Rise in non-interest expenses are expected in mid single-digit in 2020, which reflects the investment in Bask Bank, which is approximately \$44

Quarter Ending **12/2019**

Report Date	Jan 22, 2020
Sales Surprise	2.48%
EPS Surprise	-7.10%
Quarterly EPS	1.44
Annual EPS (TTM)	6.24

million for the year, with over 50% of those costs being variable. Efficiency ratio is projected in the high 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%.

Valuation

Texas Capital's shares are down 21.7% in the year-to-date period and 24.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 18.2% and 7.7%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry is down 15.1% while the sector is up 1.7%.

The S&P 500 Index is down 3% in the year-to-date period while up 12.5% in the past year.

The stock is currently trading at 7.87X forward 12 months earnings, which compares to 11.52X for the Zacks sub-industry, 13.74X for the Zacks sector and 17.88X 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 15.01X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$47 price target reflects 8.32X 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	7.87	11.52	13.74	17.88
	5-Year High	26.43	17.85	16.21	19.34
	5-Year Low	7.31	10.8	12.01	15.18
	5-Year Median	15.01	14.14	13.97	17.46
P/TB TTM	Current	0.86	1.71	2.91	11.93
	5-Year High	2.58	2.86	3.98	12.94
	5-Year Low	0.86	1.5	2.44	6.03
	5-Year Median	1.76	2.22	3.46	9.13
P/S F12M	Current	2.12	3.52	6.55	3.3
	5-Year High	5.71	5.24	6.65	3.43
	5-Year Low	2.03	2.95	5.39	2.54
	5-Year Median	3.71	4.19	6.04	3.01

As of 03/05/2020

Industry Analysis Zacks Industry Rank: Top 7% (19 out of 255)



Top Peers

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

Industry Comparison Industry: Banks - Southwest				Industry Peers		
	TCBI Neutral	X Industry	S&P 500	HWC Neutral	OZK Neutral	PB Outperform
VGM Score	B	-	-	C	D	D
Market Cap	2.24 B	263.00 M	21.47 B	2.87 B	3.18 B	6.23 B
# of Analysts	8	2.5	13	8	6	9
Dividend Yield	0.00%	1.49%	2.04%	3.28%	4.22%	2.80%
Value Score	A	-	-	A	A	C
Cash/Price	1.87	0.55	0.05	0.19	0.46	0.13
EV/EBITDA	1.46	9.50	12.81	5.19	3.75	12.07
PEG Ratio	0.76	1.29	1.88	1.01	0.72	1.21
Price/Book (P/B)	0.83	1.04	2.95	0.83	0.77	1.04
Price/Cash Flow (P/CF)	6.19	10.30	11.75	6.58	6.90	14.89
P/E (F1)	7.88	11.96	17.19	8.07	8.59	12.05
Price/Sales (P/S)	1.54	2.44	2.32	1.99	2.50	6.51
Earnings Yield	12.48%	8.37%	5.81%	12.38%	11.64%	8.30%
Debt/Equity	1.04	0.31	0.70	0.10	0.17	0.02
Cash Flow (\$/share)	7.18	1.70	7.01	5.01	3.57	4.42
Growth Score	F	-	-	F	F	D
Hist. EPS Growth (3-5 yrs)	22.72%	13.60%	10.85%	24.55%	15.48%	3.30%
Proj. EPS Growth (F1/F0)	-10.91%	1.31%	6.27%	1.78%	-13.03%	8.68%
Curr. Cash Flow Growth	8.59%	18.74%	6.07%	1.88%	-2.88%	12.62%
Hist. Cash Flow Growth (3-5 yrs)	19.05%	12.35%	8.52%	9.27%	37.20%	1.02%
Current Ratio	1.21	0.97	1.23	0.82	1.02	0.75
Debt/Capital	49.67%	23.27%	42.57%	9.43%	14.33%	2.06%
Net Margin	22.15%	22.55%	11.69%	22.71%	33.53%	34.66%
Return on Equity	12.66%	10.42%	16.66%	10.64%	10.57%	8.04%
Sales/Assets	0.05	0.05	0.54	0.05	0.05	0.04
Proj. Sales Growth (F1/F0)	-2.44%	0.00%	3.90%	5.20%	-2.29%	39.58%
Momentum Score	C	-	-	C	F	C
Daily Price Chg	-6.79%	-2.25%	-3.79%	-3.46%	-4.27%	-3.46%
1 Week Price Chg	-16.30%	-8.47%	-12.06%	-15.79%	-8.90%	-13.09%
4 Week Price Chg	-22.43%	-9.82%	-10.92%	-19.69%	-11.90%	-9.76%
12 Week Price Chg	-28.45%	-10.52%	-8.10%	-22.67%	-21.67%	-8.49%
52 Week Price Chg	-24.63%	-7.85%	4.09%	-20.96%	-20.19%	-9.12%
20 Day Average Volume	372,789	19,757	2,483,920	529,581	722,262	583,418
(F1) EPS Est 1 week change	-0.25%	0.00%	0.00%	-0.35%	-1.32%	-0.06%
(F1) EPS Est 4 week change	-0.25%	0.00%	-0.06%	-0.35%	-1.32%	-0.06%
(F1) EPS Est 12 week change	-0.96%	-0.47%	-0.42%	-1.59%	-3.37%	5.21%
(Q1) EPS Est Mthly Chg	0.20%	0.00%	-0.29%	0.34%	-0.56%	0.29%

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	A
Growth Score	F
Momentum Score	C
VGM Score	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.

Disclosures

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