Prosperity Bancshares Inc. (PB)

Updated September 2nd, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$65	**5 Year CAGR Estimate:**	9.9%	**Volatility Percentile:**	64.4%
Fair Value Price:	$70	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	31.6%
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.6%	**Growth Percentile:**	55.7%
Dividend Yield:	2.5%	**5 Year Price Target**	$94	**Valuation Percentile:**	66.6%
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Total Return Percentile:**	58.1%

Overview & Current Events

Prosperity Bancshares Inc. was formed in 1983 as a vehicle to acquire the former Allied Bank - chartered in 1949 as the First National Bank of Edna, Texas - which is now known as Prosperity Bank. The bank's main operation is receiving deposits from the general public and using the capital to originate commercial and consumer loans. The bank operates 230 branches in the greater Houston area and some neighboring counties in Texas and 14 more branches in Oklahoma. The company also has the following operations: wealth management, retail brokerage, and mortgage banking investment services. The bank's main lending focus is commercial mortgages, which make up 33% of their loan portfolio, followed by residential mortgages, which make up 24%. The company has a market capitalization of $4.5 billion.

In late July, Prosperity Bancshares reported (7/24/19) financial results for the second quarter of fiscal 2019. The bank continued to benefit from the record-low unemployment rate and strong economic activity in Texas and Oklahoma. However, earnings-per-share grew only 1%, as net interest income decreased 4.3% due to a decrease in loan discount accretion. Due to weaker results than expected in the first half of the year, we have lowered our earnings-per-share forecast for this year by 4%, from $4.97 to $4.75.

On June 17th, Prosperity Bancshares entered into a definitive agreement to acquire LegacyTexas Bank for $6.28 in cash and $35.43 in stock in a deal valued at $2.1 billion. LegacyTexas has 42 branches in Texas and will thus strengthen the position of Prosperity Bancshares in the area. As the deal value of $2.1 billion is almost half of the market cap of Prosperity Bancshares, it is evident that this acquisition is major for the future growth of the latter. The takeover is subject to approval from regulatory authorities and the shareholders of both banks.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.42	$2.73	$3.01	$3.23	$3.65	$4.32	$4.09	$3.94	$3.92	$4.61	***$4.75***	***$6.36***
DPS	$0.57	$0.64	$0.72	$1.00	$0.65	$0.99	$1.12	$1.24	$1.38	$1.49	***$1.64***	***$2.25***
Shares[1]	46.5	46.7	46.9	56.5	66.1	69.8	70.0	69.5	69.5	69.9	***69.7***	***66.0***

Prosperity Bancshares has grown its EPS at a 7.4% average annual rate in the last decade. The bank stalled from 2014 to 2017 but it has reignited growth since last year and is likely to keep growing at a decent pace thanks to its recent major acquisition and the resultant synergies it will enjoy. We expect ~6.0% annual EPS growth over the next five years.

The Bank initiated a quarterly dividend of $0.025 per share in January-1999 and has grown it at a fast clip to $0.41 per quarter this year. In the last five years, the bank has raised its dividend by 10.6% per year on average. Thanks to its low payout ratio (35%) and its promising growth prospects, the company will continue raising its dividend at a healthy pace.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	16.4	14.4	13.4	12.7	17.2	12.9	11.8	18.3	17.7	13.5	***13.7***	***14.8***
Avg. Yld.	1.5%	1.8%	1.8%	2.3%	1.2%	1.7%	2.1%	2.4%	2.1%	2.1%	***2.5%***	***2.4%***

1. In millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Prosperity Bancshares is now trading at a price-to-earnings ratio of 13.7, which is lower than its 10-year average earnings multiple of 14.8. It seems that Prosperity Bancshares is slightly undervalued right now. If the stock reverts to its average valuation level over the next five years, it will enjoy a 1.6% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2024**
Payout	23%	23%	24%	25%	24%	23%	27%	31%	35%	32%	***35%***	***35%***

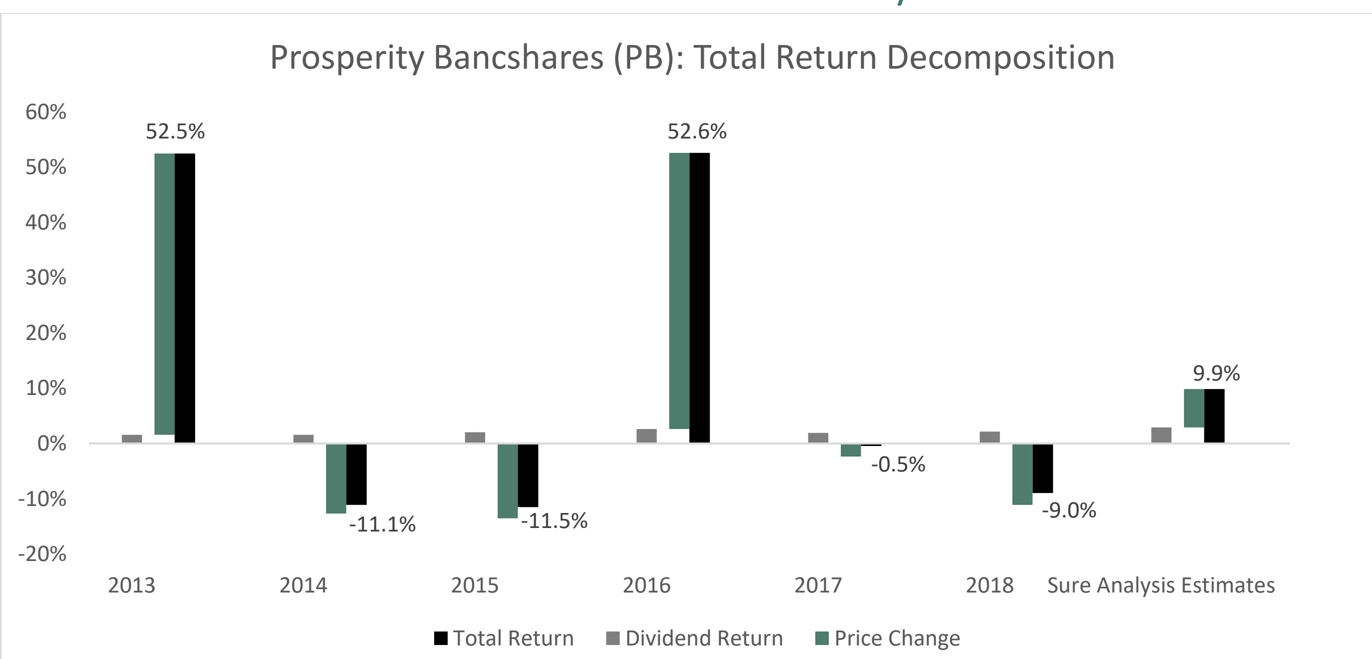
Prosperity Bancshares believes that its competitive advantage is in its presence in market areas with strong economic growth and excellent growth opportunities through acquisitions, new banking center locations and additional business development.

A risk for Prosperity is a downturn in the U.S. economy. The company could experience higher loan and lease charge-offs and higher operating costs in the event of a recession. Other markets also affect the company's operating results. For instance, real estate market conditions directly affect the performance of the company's loans secured by real estate. Although an economic downturn is a risk for Prosperity Bank, the company was able to grow immensely during the last recession. During the Great Recession (2008-2009), its stock price increased 36% throughout the year despite a declining broad market. The company was also able to grow its EPS by an outstanding 29% and its book value per share by nearly 7%. While the bank is likely to outperform its peers during the next recession, investors should not expect similar performance, as the bank was in high-growth mode during the Great Recession.

Final Thoughts & Recommendation

Despite the terrific results of Prosperity Bancshares in 2018 and 2019, the stock is trading at essentially the same level it was trading five years ago, partly due to the indiscriminate lower share prices of all financial stocks, which has resulted from the dovish stance of the Fed this year. As a result, the stock has become somewhat attractive and could now offer a 9.9% average annual return over the next five years. We rate Prosperity Bancshares as a hold at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	367	372	376	447	582	776	736	734	716	728
SG&A Exp.	91	104	112	138	177	236	228	232	227	241
D&A Exp.	18	17	16	16	17	24	22	22	19	18
Net Profit	112	128	142	168	221	297	287	274	272	322
Net Margin	30.5%	34.3%	37.7%	37.6%	38.0%	38.3%	39.0%	37.4%	38.0%	44.2%
Free Cash Flow	39	164	208	197	284	336	301	329	379	305
Income Tax	57	64	72	84	108	148	144	134	134	81

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	8850	9477	9823	14584	18642	21508	22037	22331	22587	22693
Cash & Equivalents	195	159	213	326	381	677	563	436	392	411
Accounts Receivable	31	30	29	42	49	52	52	53	56	57
Goodwill & Int. Ass.	912	953	946	1243	1714	1933	1918	1947	1940	1934
Total Liabilities	7499	8024	8255	12494	15855	18263	18574	18689	18763	18641
Accounts Payable	7	4	3	2	3	3	2	2	3	4
Long-Term Debt	118	467	98	342	135	176	491	991	505	1031
Shareholder's Equity	1351	1452	1567	2089	2787	3245	3463	3642	3824	4053
D/E Ratio	0.09	0.32	0.06	0.16	0.05	0.05	0.14	0.27	0.13	0.25

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	1.2%	1.4%	1.5%	1.4%	1.3%	1.5%	1.3%	1.2%	1.2%	1.4%
Return on Equity	8.6%	9.1%	9.4%	9.2%	9.1%	9.9%	8.5%	7.7%	7.3%	8.2%
ROIC	7.3%	7.5%	7.9%	8.2%	8.3%	9.4%	7.8%	6.4%	6.1%	6.8%
Shares Out.	46.5	46.7	46.9	56.5	66.1	69.8	70.0	69.5	69.5	69.9
Revenue/Share	7.92	7.94	7.99	8.60	9.61	11.26	10.50	10.53	10.31	10.42
FCF/Share	0.83	3.50	4.43	3.80	4.68	4.88	4.30	4.73	5.46	4.37

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.