Prosperity Bancshares Inc. (PB)

Updated April 30th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$61	**5 Year CAGR Estimate:**	12.4%	**Market Cap:**	$5.1 B
Fair Value Price:	$74	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	6/12/2020
% Fair Value:	83%	**5 Year Valuation Multiple Estimate:**	3.8%	**Dividend Payment Date:**	7/1/2020
Dividend Yield:	3.0%	**5 Year Price Target**	$98	**Years Of Dividend Growth:**	16
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	12.2%

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 271 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 $5.1 billion.

On November 1st, Prosperity Bancshares completed the acquisition of LegacyTexas Bank in a deal valued at $2.1 billion. LegacyTexas has 42 branches in Texas and thus it has strengthened the position of Prosperity Bancshares in the area. As the deal value of $2.1 billion was almost half of the market cap of Prosperity Bancshares before the deal, it is evident that this acquisition is major for the future growth of Prosperity.

In late April, Prosperity Bancshares reported (4/29/20) financial results for the first quarter of fiscal 2020. Earnings-per-share grew 18% over last year's quarter, from $1.18 to $1.39, primarily thanks to the aforementioned acquisition. Loans grew 1.5% during the quarter while non-performing loans remained low, at 0.25% of interest-earning assets. Due to the severe recession caused by the coronavirus, the bank increased its provisions for losses from $87.5 million to $327.2 million. It is worth noting that the bank has some exposure to the energy sector, which has been severely hit by the collapse of the oil price to 20-year lows. On the other hand, this bank has a reputation for its disciplined management and hence we expect it to endure the ongoing recession without any problem.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.73	$3.01	$3.23	$3.65	$4.32	$4.09	$3.94	$3.92	$4.61	$4.52	***$5.00***	***$6.69***
DPS	$0.64	$0.72	$1.00	$0.65	$0.99	$1.12	$1.24	$1.38	$1.49	$1.64	***$1.84***	***$2.50***
Shares[1]	46.7	46.9	56.5	66.1	69.8	70.0	69.5	69.5	69.9	94.7	***92.5***	***90.0***

Prosperity Bancshares has grown its earnings-per-share at a 5.8% average annual rate in the last decade, primarily thanks to strong economic activity in Texas and Oklahoma. The bank stalled from 2014 to 2017 but it has reignited growth in the last two years. It is now facing the strong headwind from the pandemic but we expect the economy to begin to recover from next year. We expect the bank to grow its EPS by 6.0% per year on average over the next five years thanks to its recent major acquisition and the resultant synergies it will enjoy.

The Bank initiated a quarterly dividend of $0.025 per share in January-1999 and has grown it at a fast clip to $0.46 per quarter this year. In the last five years, the bank has raised its dividend by 13.2% per year on average. Thanks to its low payout ratio (37%) and its promising growth prospects, the company can continue raising its dividend at a healthy pace.

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[1] In millions.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.4	13.4	12.7	17.2	12.9	11.8	18.3	17.7	13.5	15.4	***12.2***	***14.7***
Avg. Yld.	1.8%	1.8%	2.3%	1.2%	1.7%	2.1%	2.4%	2.1%	2.1%	2.4%	***3.0%***	***2.5%***

Prosperity Bancshares is now trading at a price-to-earnings ratio of 12.2, which is lower than its 10-year average earnings multiple of 14.7. If the stock reverts to its average valuation level over the next five years, it will enjoy a 3.8% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	23%	24%	25%	24%	23%	27%	31%	35%	32%	36%	***37%***	***37%***

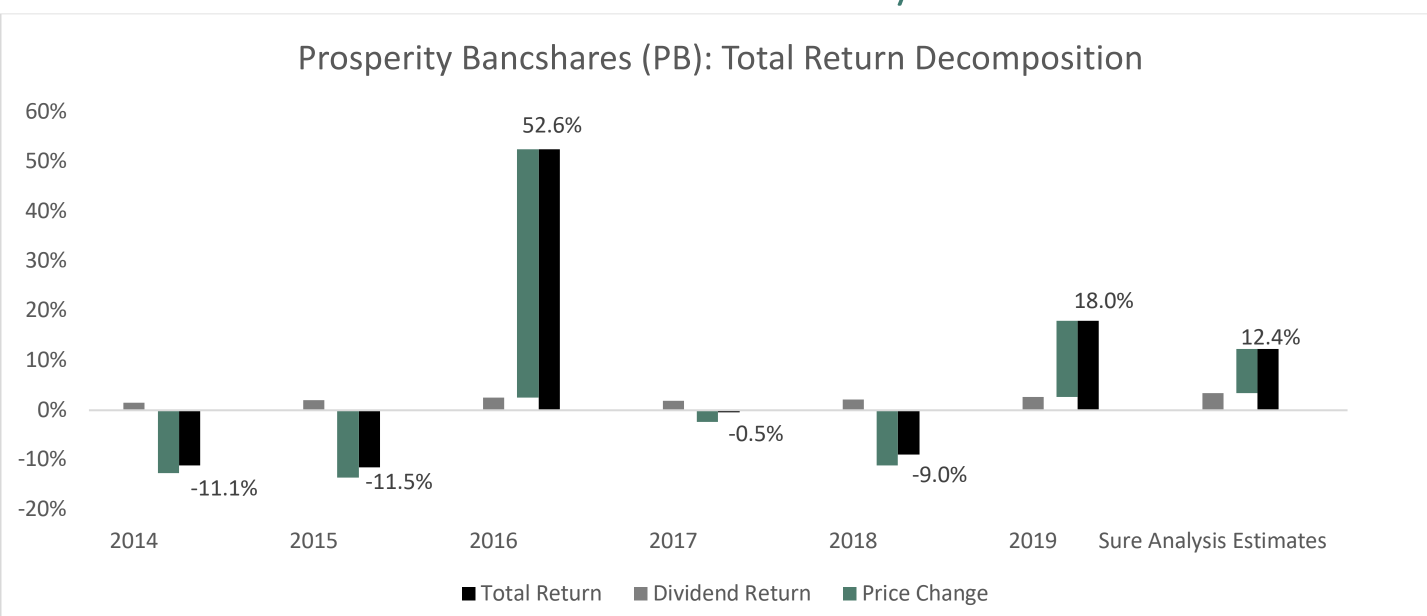
Prosperity Bancshares believes that its competitive advantage is in its presence in areas with strong economic growth and excellent growth opportunities through acquisitions, new banking center locations and business development.

A risk for Prosperity is the current recession in the U.S. economy, which has been caused by the pandemic. The company could experience increased loan and lease charge-offs. Although this economic downturn is a risk for Prosperity Bank, the bank was able to grow immensely in the last recession. During the Great Recession (2008-2009), its stock rallied 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 could outperform its peers during the ongoing recession, investors should not expect similar performance, as the bank was in high-growth mode back then.

Final Thoughts & Recommendation

Prosperity Bancshares is facing a headwind from the recession caused by the coronavirus, but the bank is conservatively managed and hence we expect it to outperform its peers, just like it did in the Great Recession. Thanks to its recent -19% correction, the stock has become attractive and could now offer a 12.4% average annual return over the next five years. We rate Prosperity Bancshares as a buy.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	372	376	447	582	776	736	734	716	728	796
SG&A Exp.	104	112	138	177	236	228	232	227	241	256
D&A Exp.	17	16	16	17	24	22	22	19	18	20
Net Profit	128	142	168	221	297	287	274	272	322	333
Net Margin	34.3%	37.7%	37.6%	38.0%	38.3%	39.0%	37.4%	38.0%	44.2%	41.8%
Free Cash Flow	164	208	197	284	336	301	329	379	305	384
Income Tax	64	72	84	108	148	144	134	134	81	87

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	9477	9823	14584	18642	21508	22037	22331	22587	22693	32186
Cash & Equivalents	159	213	326	381	677	563	436	392	411	574
Accounts Receivable	30	29	42	49	52	52	53	56	57	81
Goodwill & Int. Ass.	953	946	1243	1714	1933	1918	1947	1940	1934	3310
Total Liabilities	8024	8255	12494	15855	18263	18574	18689	18763	18641	26215
Accounts Payable	4	3	2	3	3	2	2	3	4	9
Long-Term Debt	467	98	342	135	176	491	991	505	1031	1430
Shareholder's Equity	1452	1567	2089	2787	3245	3463	3642	3824	4053	5971
D/E Ratio	0.32	0.06	0.16	0.05	0.05	0.14	0.27	0.13	0.25	0.24

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	1.4%	1.5%	1.4%	1.3%	1.5%	1.3%	1.2%	1.2%	1.4%	1.2%
Return on Equity	9.1%	9.4%	9.2%	9.1%	9.9%	8.5%	7.7%	7.3%	8.2%	6.6%
ROIC	7.5%	7.9%	8.2%	8.3%	9.4%	7.8%	6.4%	6.1%	6.8%	5.3%
Shares Out.	46.7	46.9	56.5	66.1	69.8	70.0	69.5	69.5	69.9	94.7
Revenue/Share	7.94	7.99	8.60	9.61	11.26	10.50	10.53	10.31	10.42	10.83
FCF/Share	3.50	4.43	3.80	4.68	4.88	4.30	4.73	5.46	4.37	5.23

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