



Cullen/Frost Bankers Inc. (CFR)

Updated January 27th, 2023, by Aristofanis Papadatos

Key Metrics

Current Price:	\$132	5 Year CAGR Estimate:	6.6%	Market Cap:	\$8.5 B
Fair Value Price:	\$154	5 Year Growth Estimate:	1.0%	Ex-Dividend Date:	2/27/23
% Fair Value:	86%	5 Year Valuation Multiple Estimate:	3.1%	Dividend Payment Date:	3/15/23
Dividend Yield:	2.6%	5 Year Price Target	\$162	Years Of Dividend Growth:	29
Dividend Risk Score:	A	Retirement Suitability Score:	A	Rating:	Hold

Overview & Current Events

Cullen/Frost Banker's roots go back to 1868 when Frost Bank was established in San Antonio, Texas, where T.C. Frost provided Texans with the supplies they needed to prosper on the frontier. In 1977, Frost merged with Houston-based Cullen Bankers Inc. to become Cullen/Frost Bankers Inc. Cullen/Frost operates over 130 branches in Texas metropolitan areas, where the community-oriented bank serves individuals and local businesses. The Bank offers consumer and commercial loans, investment management services, mutual funds, insurance, brokerage, and leasing. Other subsidiaries which fall under the \$8.5 billion market cap company include: Frost Insurance Agency, Frost Brokerage Services, Frost Investment Advisors and Frost Securities.

In late January, Cullen/Frost reported (1/26/23) financial results for the fourth quarter of fiscal 2022. Net interest income grew 60.5% over the prior year's quarter thanks to much higher interest rates, which led the net interest margin to jump from 2.3% to 3.3%. Non-interest income dipped -3% but only due to a non-recurring gain in the prior year's quarter. Earnings-per-share nearly doubled, from \$1.54 to \$2.91, and exceeded the analysts' consensus by \$0.13. The bank has exceeded the analysts' estimates for 11 consecutive quarters and is ideally positioned to benefit from rising interest rates. We thus expect record earnings-per-share of about \$11.00 in 2023.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$3.80	\$4.29	\$4.28	\$4.70	\$5.51	\$6.90	\$6.84	\$5.10	\$6.76	\$8.81	\$11.00	\$11.56
DPS	\$1.98	\$2.03	\$2.10	\$2.15	\$2.25	\$2.58	\$2.80	\$2.85	\$2.94	\$3.24	\$3.48	\$4.44
Shares¹	61	63	62	64	64	63	63	63	64	65	65	67

Cullen/Frost had been growing earnings-per-share very consistently over the last decade, with just slight declines in 2013, 2015 and 2019. The company's average growth from 2008 to 2019 was 6.3% per annum, with earnings-per-share nearly doubling. In 2020, earnings decreased -25% due to the pandemic, but they recovered strongly in 2021.

Going forward, Cullen/Frost continues to have growth prospects in its traditional business, but it will also need to continue to expand its fee-based income. Most of the bank's revenue is from net interest income. Low rates have provided a headwind for years but the Fed has been raising them aggressively since last year. We thus expect blowout earnings-per-share this year and 1% average annual growth beyond this year due to a high comparison base.

The dividend is also notable. Cullen/Frost has been consistently raising its dividend for 29 years. This is especially impressive considering that the period includes the last financial crisis, when many banks were forced to significantly reduce their payouts. Moving forward, we anticipate mid-single-digit annual dividend growth.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	17.5	17.8	16.1	13.9	16.9	15.4	13.9	14.7	16.2	15.3	12.0	14.0
Avg. Yld.	3.0%	2.7%	3.1%	3.3%	2.4%	2.4%	3.0%	3.8%	2.7%	2.4%	2.6%	2.7%

¹ In millions.

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Cullen/Frost has traded with an average price-to-earnings ratio of 15.8 over the last decade. However, this was during a time when growth was faster than what we are currently anticipating. We assume a fair price-to-earnings ratio of 14.0 for the stock. The stock is currently trading at a nearly 10-year low forward price-to-earnings ratio of 12.0. If it trades at our assumed fair valuation level in five years, it will enjoy a 3.1% annualized valuation tailwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	52%	47%	49%	46%	41%	37%	41%	56%	43%	37%	32%	38%

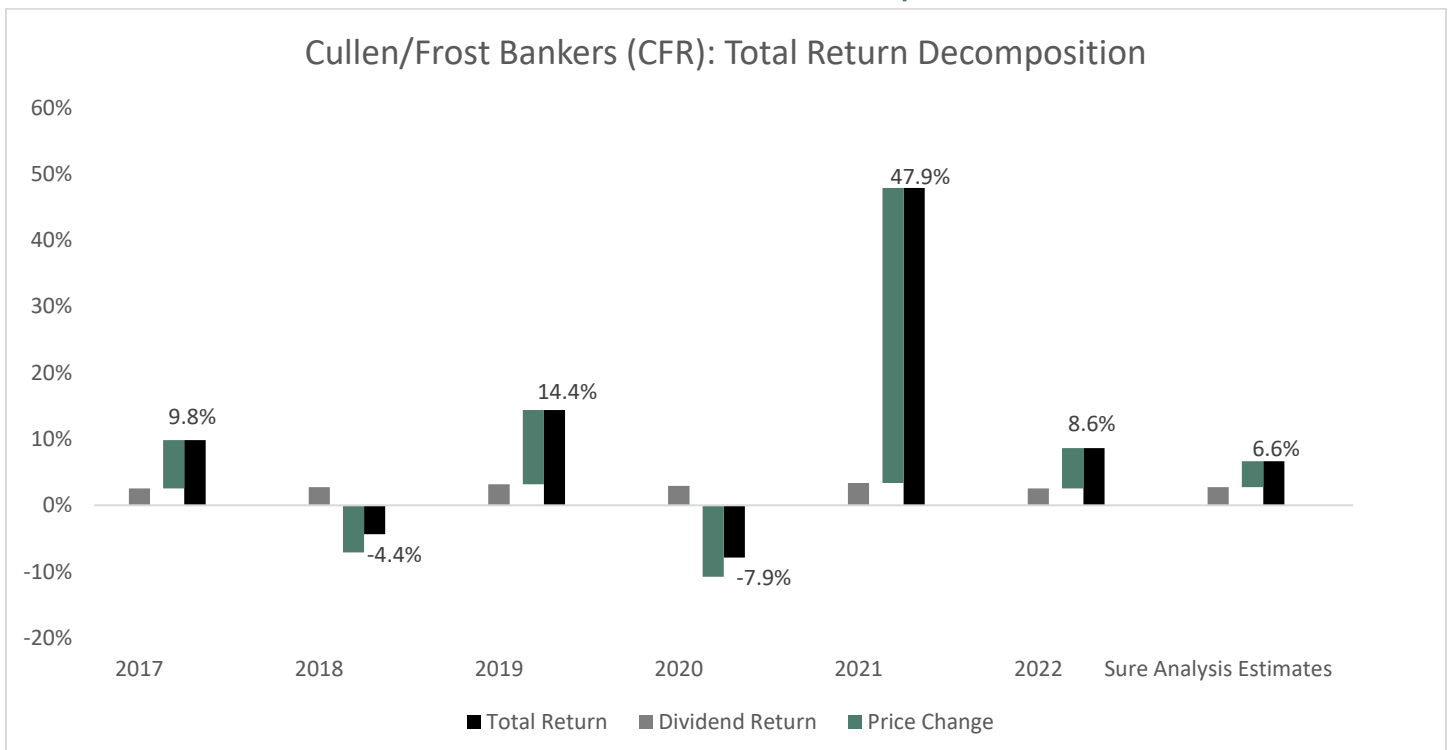
Cullen/Frost has significant competition among commercial banks. The company tries to find a competitive advantage in customer service and responsiveness to customer needs, available loan products, the rates of interest charged on loans, the rates of interest paid for funds, and the availability of trust, brokerage, and insurance services. However, with commoditized products, this is a difficult task for a smaller competitor.

A risk for Cullen/Frost is the specific economic conditions in the state of Texas, and the local markets in which the company operates, especially considering what happened in the energy sector in 2020. During the last recession, Cullen/Frost posted earnings-per-share of \$3.50, \$3.00, and \$3.44 during the 2008 through 2010 stretch, while the dividend kept on rising. This performance is notable, as it indicates that Cullen/Frost may hold up better than a typical financial firm during rough periods. Earnings dipped in 2020 but proved resilient, as an example.

Final Thoughts & Recommendation

Cullen/Frost has proven to be a resilient financial institution and has become reasonably valued thanks to its 17% correction off its all-time high in November. We are forecasting a 6.6% average annual total return potential over the next five years thanks to 1.0% growth, a 2.6% dividend yield and a 3.1% valuation tailwind. The stock receives a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	894	923	1007	1065	1126	1203	1309	1368	1441	1372
SG&A Exp.	368	388	407	439	451	476	492	526	515	529
D&A Exp.	38	38	40	42	48	48	50	54	64	69
Net Profit	238	238	278	279	304	364	455	444	331	443
Net Margin	26.6%	25.8%	27.6%	26.2%	27.0%	30.3%	34.7%	32.4%	23.0%	32.3%
Free Cash Flow	275	134	158	248	384	504	483	427	429	582
Income Tax	71	53	58	40	37	44	54	56	20	46

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	23,124	24,313	28,278	28,566	30,196	31,748	32,293	34,027	42,391	50,878
Cash & Equivalents	3,441	4,532	4,333	3,525	4,123	4,893	3,321	3,432	10,288	16,541
Accounts Receivable	292	285	341	340	397	401	458	441	585	613
Goodwill & Int. Ass.	544	543	667	663	662	660	659	657	657	656
Total Liabilities	20,707	21,799	25,426	25,676	27,194	28,450	28,924	30,116	38,098	46,439
Accounts Payable	424	218	250	203	169	195	172	546	730	754
Long-Term Debt	224	224	237	236	236	235	235	235	235	222
Shareholder's Equity	2,417	2,370	2,707	2,746	2,858	3,153	3,224	3,767	4,148	4,294
LTD/E Ratio	0.09	0.09	0.08	0.08	0.08	0.07	0.07	0.06	0.05	0.05

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	1.1%	1.0%	1.1%	1.0%	1.0%	1.2%	1.4%	1.3%	0.9%	1.0%
Return on Equity	10.1%	9.9%	11.0%	10.2%	10.9%	12.1%	14.3%	12.7%	8.4%	10.5%
ROIC	9.2%	8.8%	9.5%	9.0%	9.6%	10.8%	12.7%	11.4%	7.6%	9.6%
Shares Out.	62	61	63	62	64	64	63	63	63	64
Revenue/Share	14.50	15.11	15.99	16.78	17.88	18.60	20.24	21.56	22.88	21.40
FCF/Share	4.46	2.19	2.51	3.90	6.10	7.79	7.47	6.74	6.81	9.09

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

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