Prosperity Bancshares Inc. (PB)

Updated August 16th, 2023 by Aristofanis Papadatos

Key Metrics

Current Price:	$57	**5 Year CAGR Estimate:**	11.8%	**Market Cap:**	$5.5 B
Fair Value Price:	$65	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	9/14/2023
% Fair Value:	88%	**5 Year Valuation Multiple Estimate:**	2.5%	**Dividend Payment Date:**	10/2/2023
Dividend Yield:	3.9%	**5 Year Price Target**	$86	**Years Of Dividend Growth:**	19
Dividend Risk Score:	B	**Retirement Suitability Score:**	A	**Rating:**	Buy

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 261 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, followed by residential mortgages. The company has a market capitalization of $5.5 billion.

On October 11th 2022, Prosperity Bancshares agreed to acquire First Bancshares and Lone Star State Bancshares. The two banks are headquartered in Texas and have 21 bank offices in total. After the completion of the two acquisitions, Prosperity Bancshares will have more than $6 billion of assets in West Texas and will be the largest bank in Midland and Odessa markets. The first acquisition has been completed while the second one is expected to close in the third quarter.

In late July, Prosperity Bancshares reported (7/26/23) financial results for the second quarter of fiscal 2023. Non-performing loans remained low, at 0.18% of interest-earning assets, and loans grew 10.6%. However, net interest margin slipped from 2.97% in last year's quarter to 2.73% due to an increased cost of deposits while the bank incurred material costs for the aforementioned acquisitions. As a result, earnings-per-share fell -33%. Prosperity Bancshares has a reputation for its disciplined management and thus it has easily endured the pandemic and low interest rates in recent years. Its record earnings in 2020-2021 and its dividend hikes in 2020-2021 are testaments to its resilience to downturns. On the other hand, the stock has shed -21% this year due to the collapse of Silicon Valley Bank, Credit Suisse and First Republic. We expect the bank to endure this crisis and we note that its deposits grew 1.4% sequentially. Due to high merger-related costs, we have lowered our forecast for annual earnings-per-share from $5.75 to $5.00.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$3.65	$4.32	$4.09	$3.94	$3.92	$4.61	$4.52	$5.68	$5.60	$5.73	***$5.00***	***$6.69***
DPS	$0.65	$0.99	$1.12	$1.24	$1.38	$1.49	$1.64	$1.87	$1.99	$2.11	***$2.20***	***$2.96***
Shares[1]	66.1	69.8	70.0	69.5	69.5	69.9	94.7	92.6	92.2	91.3	***92.0***	***85.0***

Prosperity Bancshares has grown its earnings-per-share at a 5.1% average annual rate in the last decade, primarily thanks to strong economic activity in Texas and Oklahoma. Texas has the fastest-growing population and one of the highest economic growth rates in the nation. It is also expected to outperform most other states in economic growth in the upcoming years. Prosperity Bancshares stalled from 2014 to 2017 but it has reignited growth in the last five years. In addition, the pandemic did not disrupt the growth trajectory of the bank. Moreover, the Fed has been raising interest rates aggressively since last year and thus it will provide a tailwind to the entire financial sector. Due to the somewhat low earnings this year, we expect the bank to grow its earnings-per-share by 6.0% per year on average 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 $0.55

[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.

per quarter. In the last five years, the bank has raised its dividend by 8% per year on average. Thanks to its low payout ratio (44%) and its promising growth prospects, it should be able to continue raising its dividend at a healthy pace.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	17.2	12.9	11.8	18.3	17.7	13.5	15.4	10.5	13.0	12.5	***11.4***	***12.9***
Avg. Yld.	1.2%	1.7%	2.1%	2.4%	2.1%	2.1%	2.4%	3.1%	2.7%	3.0%	***3.9%***	***3.4%***

Due to the ongoing financial turmoil, Prosperity Bancshares is trading at a price-to-earnings ratio of 11.4, which is lower than its 10-year average earnings multiple of 14.3. We assume a fair earnings multiple of 12.9, which is the equal to the 4-year average. If the stock trades at its fair valuation level in five years, it will enjoy a 2.5% annualized valuation gain.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	24%	23%	27%	31%	35%	32%	36%	33%	36%	37%	***44%***	***44%***

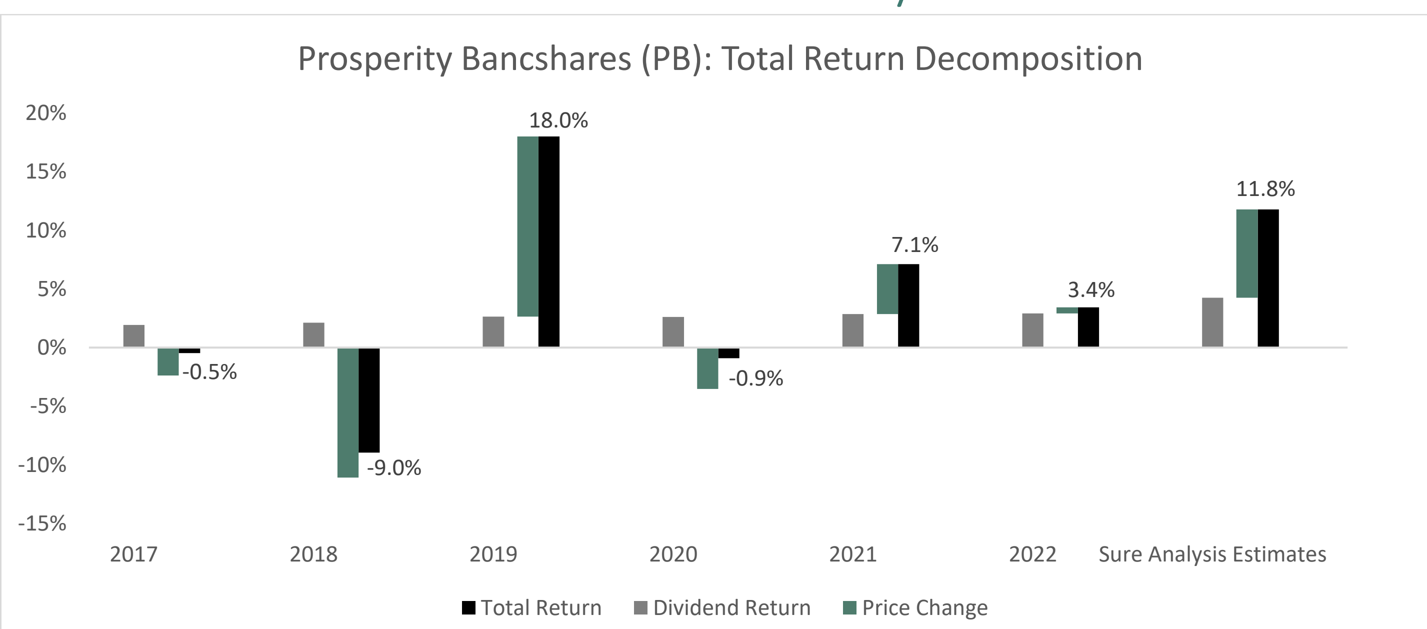
Prosperity Bancshares believes that its competitive advantage is in its presence in areas with strong economic growth and excellent growth opportunities through acquisitions, new banking center locations and business development.

Moreover, Prosperity Bancshares has proved resilient to recessions. In the coronavirus crisis, the bank managed to post record earnings-per-share. In addition, the bank was able to grow immensely in the previous 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 earnings-per-share by an outstanding 29% and its book value per share by nearly 7%.

Final Thoughts & Recommendation

Prosperity Bancshares is conservatively managed and endured the pandemic without any problem. The stock has shed -21% this year due to the broad sell-off of regional banks but we expect this high-quality bank to endure the turmoil. We expect the stock to offer an 11.8% average annual return over the next five years thanks to 6.0% earnings growth, its 3.9% dividend and a 2.5% potential valuation tailwind. The stock earns a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	582	776	736	734	716	728	796	1,122	1,098	1,114
SG&A Exp.	177	236	228	232	227	241	256	343	344	339
D&A Exp.	17	24	22	22	19	18	20	31	30	29
Net Profit	221	297	287	274	272	322	333	529	519	525
Net Margin	38.0%	38.3%	39.0%	37.4%	38.0%	44.2%	41.8%	47.1%	47.3%	47.1%
Free Cash Flow	284	336	301	329	379	305	384	560	676	464
Income Tax	108	148	144	134	134	81	87	116	140	142

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	18,642	21,508	22,037	22,331	22,587	22,693	32,186	34,059	37,834	37,690
Cash & Equivalents	381	677	563	436	392	411	574	1,343	2,548	424
Accounts Receivable	49	52	52	53	56	57	81	82	66	88
Goodwill & Int. Ass.	1,714	1,933	1,918	1,947	1,940	1,934	3,310	3,305	3,293	3,283
Total Liabilities	15,855	18,263	18,574	18,689	18,763	18,641	26,215	27,929	31,407	30,990
Accounts Payable	3	3	2	2	3	4	9	3	1	4
Long-Term Debt	135	176	491	991	505	1,031	1,430	---	---	1,850
Shareholder's Equity	2,787	3,245	3,463	3,642	3,824	4,053	5,971	6,131	6,427	6,699
LTD/E Ratio	0.05	0.05	0.14	0.27	0.13	0.25	0.24	---	---	0.28

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	1.3%	1.5%	1.3%	1.2%	1.2%	1.4%	1.2%	1.6%	1.4%	1.4%
Return on Equity	9.1%	9.9%	8.5%	7.7%	7.3%	8.2%	6.6%	8.7%	8.3%	8.0%
ROIC	8.3%	9.4%	7.8%	6.4%	6.1%	6.8%	5.3%	7.8%	8.3%	7.0%
Shares Out.	66.1	69.8	70.0	69.5	69.5	69.9	94.7	92.6	92.2	91.6
Revenue/Share	9.61	11.26	10.50	10.53	10.31	10.42	10.83	12.06	11.85	12.2
FCF/Share	4.68	4.88	4.30	4.73	5.46	4.37	5.23	6.02	7.29	5.07

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