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Ratings

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Research Update:

Texas Capital Bancshares Inc. Upgraded To 'BBB-' On Balance Sheet Improvements; Outlook Stable

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Overview

- Texas Capital Bancshares (TCBI) has reduced certain higher risk loan portfolios and significantly boosted many of its capital, funding, and liquidity ratios.
- We also have a positive, though somewhat cautious, view of the new management team's ambitious strategic initiatives to diversify its franchise and meaningfully grow its noninterest revenue over time.
- We have raised the long-term issuer credit ratings on Texas Capital Bancshares Inc. and its subsidiary Texas Capital Bank by one notch each, to 'BBB-' and 'BBB', respectively.
- The stable outlooks reflect our expectation that TCBI will maintain satisfactory funding and liquidity metrics and good asset quality without significantly reducing its capital ratios over the next two years.

Rating Action

On Feb. 25, 2022, S&P Global Ratings raised its issuer credit rating on Texas Capital Bancshares Inc. to 'BBB-' from 'BB+' and its issuer credit rating on Texas Capital Bank to 'BBB' from 'BBB-'. The outlooks on TCBI and Texas Capital Bank are stable.

Rationale

We raised our ratings on TCBI to reflect the improvement in its balance sheet and its efforts to grow its fee income and diversify its franchise. The company has reduced its reliance on higher-risk funding sources, added liquidity, and increased its capital ratios. Its stable funding ratio rose to 115% at Sept. 30, 2021, from 109% at Dec. 31, 2020, by our calculation, roughly in line with the median of rated U.S. banks. Similarly, TCBI's ratio of loans to customer deposits declined to 89% at Sept. 30, 2021, from 133% at year-end 2018, and its core deposits now make up about 80% of its funding base.

These changes, along with TCBI's strategy to reduce higher cost indexed deposits and wholesale funding, and reduce funding risk should benefit TCBI's net interest margin. Because of this, we have revised our assessment of its funding to adequate from moderate. At the same time, we recognize that TCBI still has a meaningful concentration of large depositors and lacks a large retail deposit base.

TCBI's liquidity, which we consider adequate, has also improved significantly. TCBI's cash and securities have risen to roughly 36% of total assets as of Dec. 31, 2021--roughly comparable to the median of rated U.S. banks--from 14% in 2019. The company still has a greater reliance on non-deposit funding than most rated peers, but that dependence has fallen somewhat. TCBI's liquid assets relative to the size of its balance sheet will likely fall, but we expect it to maintain better liquidity than it did prior to the pandemic.

TCBI's capital ratios have risen due to strong earnings retention and a recent reduction in earning assets. The company's common equity tier 1 (CET1) ratio rose to 11.1% as of year-end 2021 from 8.9% at year-end 2019, and its S&P risk-adjusted capital ratio has risen to around 10%. We expect TCBI's capital ratios to ease modestly over time--its target range for the CET1 ratio is 9%-10%--but remain meaningfully higher than they were prior to the pandemic.

The company's focus on existing core markets and growing fee income will likely weigh on earnings in the near term. TCBI aims to strengthen its position in Texas and grow its treasury management, investment banking, and trading businesses. We view these initiatives positively given the company's low proportion of noninterest income. TCBI recently stated its goal to boost noninterest income as a percent of revenue to 15%-20%, from roughly 10% currently, thereby closing the gap relative to most rated bank peers. We expect expense growth to accelerate over the next two years due to increasing headcount but think financial benefits may take longer to accrue.

Outlook: Stable

The stable outlook reflects our expectation that over the next two years, TCBI will maintain good balance sheet metrics as it implements its growth initiatives. We also expect its improved capital, funding, and liquidity ratios may ease somewhat as loan growth rebounds, but we expect them to remain much stronger than they were prior to the pandemic.

Downside scenario

We could lower the rating within the next two years if the company greatly reverses the balance sheet improvements it has shown or its asset quality deteriorates substantially.

Upside scenario

We view another upgrade to the rating as less likely in the next two years, at least until there is greater clarity around the success of the company's strategic efforts. The company's limited fee income, certain loan and deposit concentrations, and peer rating relativities also limit the probability of upgrade in the next two years.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	**BBB/Stable**	**BBB-/Positive**
SACP	bbb	bbb-
Anchor	bbb+	bbb+
Business position	Moderate (-1)	Moderate (-1)
Capital and earnings	Adequate (0)	Adequate (0)
Risk position	Adequate (0)	Adequate (0)
Funding	Adequate (0)	Moderate (-1)
Liquidity	Adequate (0)	Adequate (0)
Comparable ratings analysis	0	0
Support	0	0
ALAC support	0	0
GRE support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

SACP--Stand-alone credit profile.

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Strong Profitability Among U.S. Regional Banks In The Fourth Quarter Likely To Persist, Feb. 16, 2022
- ESG Credit Indicators Report Card: North American Banks, Jan. 19, 2022
- U.S. Bank Outlook 2022: Higher Rates To Provide Boost In Uncertain Times, Jan. 12, 2022
- Rating Component Scores For U.S., Canadian, And Bermudian Banks (December 2021), Dec. 31, 2021
- Comparative Statistics: U.S. Banks (October 2021), Oct. 11, 2021
- How The Economy, Profitability, And Regulations Could Support Certain U.S. Bank Ratings, May 24, 2021
- Various Rating Actions Taken On Regional U.S. Banks Based On Favorable Industry Trends, May 24, 2021

Ratings List

Upgraded

	To	From
Texas Capital Bancshares Inc.		
Subordinated	BB+	BB
Preferred Stock	BB-	B+
Texas Capital Bank		
Subordinated	BBB-	BB+

Upgraded; Outlook Action

	To	From
Texas Capital Bancshares Inc.		
Issuer Credit Rating	BBB-/Stable/--	BB+/Positive/--
Texas Capital Bank		
Issuer Credit Rating	BBB/Stable/--	BBB-/Positive/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.