

(713) 693-9300

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer (Do not check if a smaller reporting company) Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 4, 2016, there were 69,483,828 outstanding shares of the registrant's Common Stock, par value \$1.00 per share.

PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PROSPERITY BANCSHARES, INC.[®] AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	September 30, 2016	December 31, 2015
	(Dollars in thousands, except par value)	
ASSETS		
Cash and due from banks	\$ 341,483	\$ 562,544
Federal funds sold	630	1,418
Total cash and cash equivalents	342,113	563,962
Available for sale securities, at fair value	129,677	103,064
Held to maturity securities, at cost (fair value of \$9,020,897 and \$9,393,175, respectively)	8,858,344	9,399,363
Total securities	8,988,021	9,502,427
Loans held for sale	29,457	23,933
Loans held for investment	9,518,857	9,414,656
Total loans	9,548,314	9,438,589
Less: allowance for credit losses	(85,585)	(81,384)
Loans, net	9,462,729	9,357,205
Accrued interest receivable	48,469	51,924
Goodwill	1,900,349	1,868,827
Core deposit intangibles, net	48,010	49,417
Bank premises and equipment, net	270,386	267,996
Other real estate owned	16,280	2,963
Bank owned life insurance (BOLI)	248,149	235,429
Federal Home Loan Bank of Dallas stock	35,449	68,413
Other assets	44,089	68,653
TOTAL ASSETS	\$ 21,404,044	\$ 22,037,216
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$ 5,159,333	\$ 5,136,579
Interest-bearing	11,762,076	12,544,540
Total deposits	16,921,409	17,681,119
Other borrowings	425,916	491,399
Securities sold under repurchase agreements	318,449	315,253
Accrued interest payable	3,496	1,896
Other liabilities	139,962	84,639
Total liabilities	17,809,232	18,574,306
COMMITMENTS AND CONTINGENCIES	—	—
SHAREHOLDERS' EQUITY:		

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Preferred stock, \$1 par value; 20,000,000 shares authorized; none issued or outstanding	—	—
Common stock, \$1 par value; 200,000,000 shares authorized; 69,477,578 shares issued and outstanding at September 30, 2016; 70,058,761 shares issued and 70,021,673 shares outstanding at December 31, 2015	69,477	70,059
Capital surplus	2,025,722	2,036,378
Retained earnings	1,498,111	1,355,040
Accumulated other comprehensive income—net unrealized gain on available for sale securities, net of tax of \$808 and \$1,098, respectively	1,502	2,040
Less: treasury stock, at cost, 37,088 shares	—	(607)
Total shareholders' equity	3,594,812	3,462,910
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$21,404,044	\$ 22,037,216

See notes to consolidated financial statements.

PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
(Dollars in thousands, except per share data)				
INTEREST INCOME:				
Loans, including fees	\$ 116,247	\$ 116,911	\$ 359,066	\$ 361,193
Securities	48,132	48,610	151,802	145,702
Federal funds sold	81	22	242	234
Total interest income	164,460	165,543	511,110	507,129
INTEREST EXPENSE:				
Deposits	9,396	8,753	29,647	27,499
Other borrowings	752	473	1,944	967
Securities sold under repurchase agreements	248	209	694	620
Junior subordinated debentures	—	—	37	791
Total interest expense	10,396	9,435	32,322	29,877
NET INTEREST INCOME	154,064	156,108	478,788	477,252
PROVISION FOR CREDIT LOSSES	2,000	5,310	22,000	7,060
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	152,064	150,798	456,788	470,192
NONINTEREST INCOME:				
Nonsufficient funds (NSF) fees	8,764	9,082	24,984	25,310
Credit card, debit card and ATM card income	5,903	5,955	17,659	17,596
Service charges on deposit accounts	4,698	4,438	13,898	12,806
Trust income	1,851	1,986	5,640	6,042
Mortgage income	2,143	1,770	5,386	4,431
Brokerage income	1,213	1,596	3,789	4,546
Net gain on sale of assets	37	173	1,389	1,822
Other	5,075	6,780	16,205	17,945
Total noninterest income	29,684	31,780	88,950	90,498
NONINTEREST EXPENSE:				
Salaries and employee benefits	48,328	46,587	146,666	144,372
Net occupancy and equipment	5,997	6,088	17,362	17,864
Credit and debit card, data processing and software amortization	4,207	3,924	12,801	11,786
Regulatory assessments and FDIC insurance	3,434	3,366	10,311	11,973
Core deposit intangibles amortization	2,418	2,356	6,974	7,235
Depreciation	3,289	3,313	9,924	9,649
Communications	2,870	2,663	8,790	8,307
Other real estate expense	44	123	136	384
Other	8,889	8,010	26,275	24,057
Total noninterest expense	79,476	76,430	239,239	235,627
INCOME BEFORE INCOME TAXES	102,272	106,148	306,499	325,063

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PROVISION FOR INCOME TAXES	33,621	35,550	100,826	108,892
NET INCOME	\$68,651	\$70,598	\$205,673	\$216,171
EARNINGS PER SHARE:				
Basic	\$0.99	\$1.01	\$2.95	\$3.09
Diluted	\$0.99	\$1.01	\$2.95	\$3.09

See notes to consolidated financial statements.

PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(Dollars in thousands)			
Net income	\$68,651	\$70,598	\$205,673	\$216,171
Other comprehensive loss, before tax:				
Securities available for sale:				
Change in unrealized gain during period	(186)	(867)	(828)	(1,949)
Total other comprehensive loss	(186)	(867)	(828)	(1,949)
Deferred taxes related to other comprehensive loss	65	303	290	682
Other comprehensive loss, net of tax	(121)	(564)	(538)	(1,267)
Comprehensive income	\$68,530	\$70,034	\$205,135	\$214,904

See notes to consolidated financial statements.

PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(UNAUDITED)

	Common Stock Shares	Common Stock Amount	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Shareholders' Equity
(In thousands, except share and per share data)							
BALANCE AT							
DECEMBER 31, 2014	69,816,653	\$69,817	\$2,025,235	\$1,146,652	\$ 3,729	\$ (607)	\$3,244,826
Net income				216,171			216,171
Other comprehensive loss					(1,267)		(1,267)
Common stock issued in connection with the exercise of stock options and restricted stock awards	260,925	261	(38)				223
Stock based compensation expense			8,540				8,540
Cash dividends declared, \$0.8175 per share				(57,254)			(57,254)
BALANCE AT							
SEPTEMBER 30, 2015	70,077,578	\$70,078	\$2,033,737	\$1,305,569	\$ 2,462	\$ (607)	\$3,411,239
BALANCE AT							
DECEMBER 31, 2015	70,058,761	\$70,059	\$2,036,378	\$1,355,040	\$ 2,040	\$ (607)	\$3,462,910
Net income				205,673			205,673
Other comprehensive loss					(538)		(538)
Common stock issued in connection with the exercise of stock options and restricted stock awards	21,267	21	646				667
Common stock issued in connection with the acquisition of Tradition Bancshares, Inc.	679,528	679	31,843				32,522
Treasury stock cancellation	(37,088)	(37)	(570)			607	—
Common stock repurchase	(1,244,890)	(1,245)	(49,812)				(51,057)
Stock based compensation expense			7,237				7,237
Cash dividends declared, \$0.9000 per share				(62,602)			(62,602)
BALANCE AT							
SEPTEMBER 30, 2016	69,477,578	\$69,477	\$2,025,722	\$1,498,111	\$ 1,502	\$ —	\$3,594,812

See notes to consolidated financial statements.

PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Nine Months Ended September 30,	
	2016	2015
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$205,673	\$216,171
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and core deposit intangibles amortization	16,898	16,884
Provision for credit losses	22,000	7,060
Net amortization of premium on investments	31,972	44,456
Loss (gain) on sale of other real estate	330	(86)
Gain on sale of assets	(1,389)	(1,822)
Net accretion of discount on loans	(31,418)	(44,283)
Net accretion of discount on deposits	(935)	(860)
Gain on sale of loans	(4,910)	(4,267)
Proceeds from sale of loans held for sale	205,137	185,319
Originations of loans held for sale	(208,095)	(185,014)
Stock based compensation expense	7,237	8,540
Decrease (increase) in accrued interest receivable and other assets	63,096	(1,388)
Increase in accrued interest payable and other liabilities	46,744	38,413
Net cash provided by operating activities	352,340	279,123
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal paydowns of held to maturity securities	1,410,155	1,261,788
Purchase of held to maturity securities	(655,865)	(1,825,802)
Proceeds from maturities and principal paydowns of available for sale securities	8,123,458	4,642,623
Purchase of available for sale securities	(8,151,073)	(4,609,999)
Net decrease in loans held for investment	135,818	78,211
Purchase of bank premises and equipment	(3,933)	(7,959)
Proceeds from sale of bank premises, equipment and other real estate	7,206	9,948
Net cash used in the purchase of Tradition Bancshares, Inc.	(8,963)	—
Net cash provided by (used in) investing activities	856,803	(451,190)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in noninterest-bearing deposits	(287,225)	156,755
Net decrease in interest-bearing deposits	(961,271)	(909,116)
Net (repayments) proceeds from other short-term borrowings	(65,000)	780,000
Repayments of other long-term borrowings	(483)	(2,153)
Net increase (decrease) in securities sold under repurchase agreements	3,196	(5,485)
Redemption of junior subordinated debentures	(7,217)	(167,531)
Proceeds from stock option exercises	667	223
Repurchase of common stock	(51,057)	—
Payments of cash dividends	(62,602)	(57,254)

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Net cash used in financing activities	(1,430,992)	(204,561)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(221,849)	(376,628)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	563,962	677,854
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$342,113	\$301,226
NONCASH ACTIVITIES:		
Stock issued in connection with the Tradition Bancshares, Inc. acquisition	\$32,522	\$—
Acquisition of real estate through foreclosure of collateral	14,583	2,079
SUPPLEMENTAL INFORMATION:		
Income taxes paid	\$83,275	\$73,274
Interest paid	30,722	35,069

See notes to consolidated financial statements.

PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2016

(UNAUDITED)

1. BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Prosperity Bancshares, Inc.® (“Bancshares”) and its wholly-owned subsidiary, Prosperity Bank® (the “Bank,” collectively referred to as the “Company”). All intercompany transactions and balances have been eliminated.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for financial information and with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the statements reflect all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows of the Company on a consolidated basis, and all such adjustments are of a normal recurring nature. These financial statements and the notes thereto should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2015. Operating results for the nine-month period ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016 or any other period.

2. INCOME PER COMMON SHARE

Outstanding stock options issued by the Company represent the only dilutive effect reflected in diluted weighted average shares. The following table illustrates the computation of basic and diluted earnings per share:

	Three Months Ended September 30,		Nine Months Ended September 30,					
	2016	2015	2016	2015	2016	2015	2016	2015
	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
Net income	\$68,651		\$70,598		\$205,673		\$216,171	
Basic:								
Weighted average shares outstanding	69,478	\$ 0.99	70,041	\$ 1.01	69,738	\$ 2.95	70,037	\$ 3.09
Diluted:								
Add incremental shares for:	6		12		7		17	

Effect of dilutive securities -
options

Total	69,484	\$ 0.99	70,053	\$ 1.01	69,745	\$ 2.95	70,054	\$ 3.09
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There were no stock options exercisable during the three and nine months ended September 30, 2016 or 2015 that would have had an anti-dilutive effect on the above computation.

3. NEW ACCOUNTING STANDARDS

Accounting Standards Updates (“ASU”)

ASU 2016-15, “Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments.” ASU 2016-15 addresses certain cash receipts and cash payments with the objective of reducing the existing diversity in practice. ASU 2016-15 will be effective for the Company on January 1, 2018 and is not expected to have a significant impact on the Company's financial statements.

ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326)—Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances. Additionally, available for sale debt securities may realize value either through collection of contractual cash flows or through sale of the security at fair value. Therefore, the amendments limit the amount of the allowance for credit losses to the difference between amortized cost and fair value. ASU 2016-13 will be effective for the Company as of January 1, 2020. The Company is currently evaluating the potential impact of ASU 2016-13 on the Company's financial statements.

PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2016

(UNAUDITED)

ASU 2016-12, “Revenue from Contracts with Customers (Topic 606)—Narrow-Scope Improvements and Practical Expedients.” ASU 2016-12 addresses narrow-scope improvements to the guidance on collectability, noncash consideration and completed contracts at transition. Additionally, the amendments in this update provide a practical expedient for contract modifications at transition and an accounting policy election related to the presentation of sales taxes and other similar taxes collected from customers. The amendments in this update affect the guidance in ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” which is effective January 1, 2018. The Company is in the process of evaluating the impact of this guidance and does not currently anticipate a significant impact on the Company’s financial statements.

ASU 2016-10, “Revenue from Contracts with Customers (Topic 606)—Identifying Performance Obligations and Licensing.” ASU 2016-10 clarifies two aspects of “Revenue from Contracts with Customers (Topic 606)” (i) identifying performance obligations and (ii) the licensing implementation guidance. This ASU adds guidance on how to identify the promised goods or services in the contract and how to evaluate whether promised goods and services are distinct. Additionally, this update includes guidance on determining whether an entity’s promise to grant a license provides a customer with either a right to use the entity’s intellectual property (which is satisfied at a point in time) or a right to access the entity’s intellectual property (which is satisfied over time) and when to recognize revenue for a sales-based or use-based royalty promised in exchange for a license of intellectual property. The amendments in this update affect the guidance in ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” which is effective January 1, 2018. The Company is in the process of evaluating the impact of this guidance and does not currently anticipate a significant impact on the Company’s financial statements.

ASU 2016-09, “Compensation - Stock Compensation (Topic 718) — Improvements to Employee Share-Based Payment Accounting.” ASU 2016-09 was issued as part of the FASB’s simplification initiative and affects all entities that issue share-based payment awards to their employees. This ASU covers accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 will be effective for the Company as of January 1, 2017. The Company is currently evaluating the potential impact of ASU 2016-09 on the Company’s financial statements.

ASU 2016-08, “Revenue from Contracts with Customers (Topic 606)—Principal versus Agent Considerations (Reporting Revenue Gross versus Net).” ASU 2016-08 states that when another party is involved in providing goods or services to a customer, an entity is required to determine whether the nature of its promise is to provide the specified good or service itself (that is, the entity is a principal) or to arrange for that good or service to be provided by the other party (that is, the entity is an agent). Additionally, when an principal entity satisfies a performance obligation, the entity recognizes revenue in the gross amount of consideration to which it expects to be entitled in exchange for the specified good or service transferred to the customer, but when an agent entity satisfies a performance obligation, the entity recognizes revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified good or service to be provided by the other party. The amendments in this update affect the guidance in ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” which is effective January 1, 2018. The Company is in the process of evaluating the impact of this guidance and does not currently anticipate a significant impact on the Company’s financial statements.

ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 requires that lessees and lessors recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. ASU 2016-02 is effective for public companies for annual periods beginning January 1, 2019, including interim periods within those fiscal years. The Company is currently evaluating the potential impact of ASU 2016-02 on the Company's financial statements.

ASU 2016-01, "Financial Instruments—Overall (Subtopic 825-10) — Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 (i) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (iv) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (v) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (vi) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (vii) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet

PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2016

(UNAUDITED)

or the accompanying notes to the financial statements; and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The amendments in this update affect all entities that hold financial assets or owe financial liabilities. ASU 2016-01 is effective for the Company beginning January 1, 2018, and is not expected to have a significant impact on the Company's financial statements.

ASU 2015-16, "Business Combinations (Topic 805) — Simplifying the Accounting for Measurement-Period Adjustments." ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The acquirer must record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Additionally, the entity is required to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. ASU 2015-16 became effective for the Company on January 1, 2016 and did not have a significant impact on the Company's financial statements.

ASU 2015-01, "Income Statement - Extraordinary and Unusual Items (Subtopic 225-20) — Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items." ASU 2015-01 eliminates from U.S. GAAP the concept of extraordinary items, which, among other things, required an entity to segregate extraordinary items considered to be unusual and infrequent from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. ASU 2015-01 became effective for the Company on January 1, 2016 and did not have a significant impact on the Company's financial statements.

ASU 2014-12, "Compensation - Stock Compensation (Topic 718) — Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. ASU 2014-12 became effective for the Company on January 1, 2016 and did not have a significant impact on the Company's financial statements.

ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 supersedes the revenue recognition requirements in Revenue Recognition (Topic 605), and most industry-specific guidance throughout the

Industry Topics of the Codification. Additionally, ASU 2014-09 supersedes some cost guidance included in Revenue Recognition—Construction-Type and Production-Type Contracts (Subtopic 605-35). In addition, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer are amended to be consistent with the guidance on recognition and measurement. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2015-14, “Revenue from Contracts with Customers (Topic 606)—Deferral of the Effective Date” deferred the effective date for ASU 2014-09 by one year to January 1, 2018, with retrospective application to each prior reporting period presented. The Company is currently evaluating the requirements of ASU 2014-09, but it is not expected to have a significant impact on the Company’s financial statements.

PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2016

(UNAUDITED)

4. SECURITIES

The amortized cost and fair value of investment securities were as follows:

	September 30, 2016			
	Amortized	Gross	Gross	Fair Value
	Cost	Unrealized	Unrealized	
	(Dollars in thousands)			
Available for Sale				
States and political subdivisions	\$2,574	\$ 6	\$ —	\$2,580
Collateralized mortgage obligations	21,427	13	(307)	21,133
Mortgage-backed securities	90,777	2,566	(174)	93,169
Other securities	12,588	253	(46)	12,795
Total	\$127,366	\$ 2,838	\$ (527)	\$129,677
Held to Maturity				
U.S. Treasury securities and obligations of U.S. Government agencies	\$33,479	\$ 1,028	\$ —	\$34,507
States and political subdivisions	389,555	8,801	(45)	398,311
Collateralized mortgage obligations	903	17	(4)	916
Mortgage-backed securities	8,434,307	154,373	(1,617)	8,587,063
Other securities	100	—	—	100
Total	\$8,858,344	\$ 164,219	\$ (1,666)	\$9,020,897

	December 31, 2015			
	Amortized	Gross	Gross	Fair Value
	Cost	Unrealized	Unrealized	
	(Dollars in thousands)			
Available for Sale				
States and political subdivisions	\$5,463	\$ 22	\$ —	\$5,485
Collateralized mortgage obligations	25,991	25	(100)	25,916
Mortgage-backed securities	55,884	3,098	(11)	58,971
Other securities	12,588	150	(46)	12,692
Total	\$99,926	\$ 3,295	\$ (157)	\$103,064

Held to Maturity

U.S. Treasury securities and obligations of U.S. Government agencies	\$47,598	\$ 798	\$ —	\$48,396
States and political subdivisions	363,505	7,080	(542)	370,043
Collateralized mortgage obligations	2,107	17	(2)	2,122
Mortgage-backed securities	8,986,153	68,868	(82,407)	8,972,614
Other securities	—	—	—	—
Total	\$9,399,363	\$ 76,763	\$ (82,951)	\$9,393,175

Management evaluates securities for other-than-temporary impairment (“OTTI”) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI analysis. Investment securities classified as available for sale or held to maturity are evaluated for OTTI under Financial Accounting Standards Board (“FASB”): Accounting Standards Codification (“ASC”) Topic 320, “Investments-Debt and Equity Securities.”

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In determining OTTI, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI will be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI will be separated into the amount representing the credit-related portion of the impairment loss ("credit loss") and the noncredit portion of the impairment loss ("noncredit portion"). The amount of the total OTTI related to the credit loss is determined based on the difference between the present value of cash flows expected to be collected and the amortized cost basis and such difference is recognized in earnings. The amount of the total OTTI related to the noncredit portion is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings will become the new amortized cost basis of the investment.

As of September 30, 2016, management does not have the intent to sell any of its investment securities and believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of cost. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2016, management believes any impairment in the Company's securities is temporary, and therefore no impairment loss has been realized in the Company's consolidated statement of income.

Securities with unrealized losses, segregated by length of time, that have been in a continuous loss position were as follows:

September 30, 2016		
Less than 12 Months	More than 12 Months	Total
Estimated Unrealized Fair Value Losses	Estimated Unrealized Fair Value Losses	Estimated Unrealized Fair Value Losses
(Dollars in thousands)		

Available for Sale

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Collateralized mortgage obligations	\$18,791	\$ (307)	\$25	\$ —	\$18,816	\$ (307)
Mortgage-backed securities	48,836	(166)	2,231	(8)	51,067	(174)
Other securities	—	—	1,691	(46)	1,691	(46)
Total	\$67,627	\$ (473)	\$3,947	\$ (54)	\$71,574	\$ (527)

Held to Maturity

States and political subdivisions	\$3,567	\$ (8)	\$4,636	\$ (37)	\$8,203	\$ (45)
Collateralized mortgage obligations	131	(4)	52	—	183	(4)
Mortgage-backed securities	877,968	(1,067)	97,324	(550)	975,292	(1,617)
Total	\$881,666	\$ (1,079)	\$102,012	\$ (587)	\$983,678	\$ (1,666)

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	December 31, 2015					
	Less than 12 Months Estimated Fair Value	Unrealized Losses	More than 12 Months Estimated Fair Value	Unrealized Losses	Total Estimated Fair Value	Unrealized Losses
(Dollars in thousands)						
Available for Sale						
Collateralized mortgage obligations	\$14,331	\$(100)	\$1	\$—	\$14,332	\$(100)
Mortgage-backed securities	793	(1)	2,465	(10)	3,258	(11)
Other securities	—	—	1,691	(46)	1,691	(46)
Total	\$15,124	\$(101)	\$4,157	\$(56)	\$19,281	\$(157)
Held to Maturity						
States and political subdivisions	\$15,700	\$(82)	\$45,952	\$(460)	\$61,652	\$(542)
Collateralized mortgage obligations	156	—	94	(2)	250	(2)
Mortgage-backed securities	3,233,601	(36,016)	1,662,482	(46,391)	4,896,083	(82,407)
Total	\$3,249,457	\$(36,098)	\$1,708,528	\$(46,853)	\$4,957,985	\$(82,951)

At September 30, 2016 and December 31, 2015, there were 411 securities and 474 securities, respectively, in an unrealized loss position for more than 12 months.

The amortized cost and fair value of investment securities at September 30, 2016, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations at any time with or without call or prepayment penalties.

	Held to Maturity		Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(Dollars in thousands)				
Due in one year or less	\$33,476	\$33,633	\$12,688	\$12,895
Due after one year through five years	189,175	192,485	2,474	2,480
Due after five years through ten years	172,389	177,838	—	—
Due after ten years	28,094	28,962	—	—
Subtotal	423,134	432,918	15,162	15,375
Mortgage-backed securities and collateralized mortgage obligations	8,435,210	8,587,979	112,204	114,302
Total	\$8,858,344	\$9,020,897	\$127,366	\$129,677

The Company recorded no gain or loss on sale of securities for the three and nine months ended September 30, 2016 and 2015. As of September 30, 2016, the Company did not own any non-agency collateralized mortgage obligations.

At September 30, 2016 and December 31, 2015, the Company did not own securities of any one issuer (other than the U.S. government and its agencies) for which aggregate adjusted cost exceeded 10% of the consolidated shareholders' equity at such respective dates.

Securities with an amortized cost of \$5.17 billion and \$5.81 billion and a fair value of \$5.25 billion and \$5.79 billion at September 30, 2016 and December 31, 2015, respectively, were pledged to collateralize public deposits and for other purposes required or permitted by law.

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5. LOANS AND ALLOWANCE FOR CREDIT LOSSES

The loan portfolio consists of various types of loans and is categorized by major type as follows:

	September 30, 2016	December 31, 2015
	(Dollars in thousands)	
Residential mortgage loans held for sale	\$29,457	\$ 23,933
Commercial and industrial	1,542,059	1,692,246
Real estate:		
Construction, land development and other land loans	1,205,820	1,073,198
1-4 family residential (includes home equity)	2,677,995	2,616,732
Commercial real estate (includes multi-family residential)	3,158,569	3,131,083
Farmland	473,957	434,349
Agriculture	190,123	214,469
Consumer and other	270,334	252,579
Total loans held for investment	9,518,857	9,414,656
Total	\$9,548,314	\$ 9,438,589

Concentrations of Credit. Most of the Company's lending activity occurs within the states of Texas and Oklahoma. The majority of the Company's loan portfolio consists of commercial real estate, 1-4 family residential loans and commercial and industrial loans. As of September 30, 2016 and December 31, 2015, there were no concentrations of loans related to any single industry in excess of 10% of total loans.

Foreign Loans. The Company has U.S. dollar-denominated loans and commitments to borrowers in Mexico. The outstanding balance of these loans and the unfunded amounts available under these commitments were not significant at September 30, 2016 or December 31, 2015.

Related Party Loans. As of September 30, 2016 and December 31, 2015, loans outstanding to directors, officers and their affiliates totaled \$4.1 million. All transactions entered into between the Company and such related parties are done in the ordinary course of business and made on the same terms and conditions as similar transactions with unaffiliated persons.

An analysis of activity with respect to these related party loans is as follows:

	September 30, 2016	December 31, 2015
	(Dollars in thousands)	
Beginning balance on January 1	\$4,063	\$ 4,940
New loans	199	428
Repayments and reclassified related loans	(184)	(1,305)
Ending balance	\$4,078	\$ 4,063

Nonperforming Assets and Nonaccrual and Past Due Loans. The Company has several procedures in place to assist it in maintaining the overall quality of its loan portfolio. The Company has established underwriting guidelines to be followed by its officers, including requiring appraisals on loans collateralized by real estate. The Company also monitors its delinquency levels for any negative or adverse trends. Nevertheless, the Company's loan portfolio could become subject to increasing pressures from deteriorating borrower credit due to general economic conditions.

The Company generally places a loan on nonaccrual status and ceases accruing interest when the payment of principal or interest is delinquent for 90 days, or earlier in some cases, unless the loan is in the process of collection and the underlying collateral fully supports the carrying value of the loan.

With respect to potential problem loans, an evaluation of the borrower's overall financial condition is made to determine the need, if any, for possible writedowns or appropriate additions to the allowance for credit losses.

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An aging analysis of past due loans, segregated by category of loan, is presented below:

	September 30, 2016					
	Loans Past Due and Still Accruing		Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	30-89 Days	90 or More Days				
Construction, land development and other land loans	\$4,699	\$ 254	\$ 4,953	\$ 279	\$1,200,588	\$1,205,820
Agriculture and agriculture real estate (includes farmland)	591	—	591	248	663,241	664,080
1-4 family (includes home equity) (1)	2,667	—	2,667	3,311	2,701,474	2,707,452
Commercial real estate (includes multi-family residential)	5,068	145	5,213	12,984	3,140,372	3,158,569
Commercial and industrial	9,020	—	9,020	26,426	1,506,613	1,542,059
Consumer and other	2,153	—	2,153	203	267,978	270,334
Total	\$24,198	\$ 399	\$ 24,597	\$ 43,451	\$9,480,266	\$9,548,314

	December 31, 2015					
	Loans Past Due and Still Accruing		Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	30-89 Days	90 or More Days				
Construction, land development and other land loans	\$4,097	\$ —	\$ 4,097	\$ 134	\$1,068,967	\$1,073,198
Agriculture and agriculture real estate (includes farmland)	946	—	946	208	647,664	648,818
1-4 family (includes home equity) (1)	4,748	220	4,968	1,894	2,633,803	2,640,665
Commercial real estate (includes multi-family residential)	12,922	—	12,922	15,535	3,102,626	3,131,083
Commercial and industrial	4,793	394	5,187	21,692	1,665,367	1,692,246
Consumer and other	1,274	—	1,274	248	251,057	252,579
Total	\$28,780	\$ 614	\$ 29,394	\$ 39,711	\$9,369,484	\$9,438,589

(1)

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Includes \$29.5 million and \$23.9 million of residential mortgage loans held for sale at September 30, 2016 and December 31, 2015, respectively.

The following table presents information regarding nonperforming assets as of the dates indicated:

	September 30, 2016	December 31, 2015		
	(Dollars in thousands)			
Nonaccrual loans (1)	\$43,451	\$ 39,711		
Accruing loans 90 or more days past due	399	614		
Total nonperforming loans	43,850	40,325		
Repossessed assets	36	171		
Other real estate	16,280	2,963		
Total nonperforming assets	\$60,166	\$ 43,459		
Nonperforming assets to total loans and other real estate	0.63	%	0.46	%

(1) Includes troubled debt restructurings of \$318 thousand and \$681 thousand as of September 30, 2016 and December 31, 2015, respectively.

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The Company had \$60.2 million in nonperforming assets at September 30, 2016 compared with \$43.5 million at December 31, 2015. This increase was primarily due to two commercial real estate loans and two commercial and industrial loans. Nonperforming assets were 0.63% of total loans and other real estate at September 30, 2016 compared with 0.46% of total loans and other real estate at December 31, 2015. These low nonperforming assets to total loans and other real estate ratios are reflective of the Company's conservative lending approach.

If interest on nonaccrual loans had been accrued under the original loan terms, approximately \$2.2 million and \$2.8 million would have been recorded as income for the nine months ended September 30, 2016 and 2015, respectively.

Acquired Loans. Acquired loans were preliminarily recorded at fair value based on a discounted cash flow valuation methodology that considers, among other things, interest rates, projected default rates, loss given default, and recovery rates (no allowance for credit losses was carried over from the acquisition completed during 2016). During the valuation process, the Company identified Purchased Credit-Impaired ("PCI") and Non-PCI loans in the acquired loan portfolios. Loans acquired with evidence of credit quality deterioration at acquisition for which it was probable that the Company would not be able to collect all contractual amounts due were accounted for as PCI. PCI loan identification considers the following factors: payment history and past due status, debt service coverage, loan grading, collateral values and other factors that may indicate deterioration of credit quality since origination. Non-PCI loan identification considers the following factors: account types, remaining terms, annual interest rates or coupons, current market rates, interest types, past delinquencies, timing of principal and interest payments, loan to value ratios, loss exposures and remaining balances. Accretion of purchased discounts on PCI loans will be based on estimated future cash flows, regardless of contractual maturities. Accretion of purchased discounts on Non-PCI loans will be recognized on a level-yield basis based on contractual maturity of individual loans.

PCI Loans. The carrying amount of PCI loans included in the consolidated balance sheet and the related outstanding balance as of the dates indicated are presented in the table below. The outstanding balance represents the total amount owed as of September 30, 2016 and December 31, 2015.

	September 30, 2016	December 31, 2015
	(Dollars in thousands)	
PCI loans:		
Outstanding balance	\$61,570	\$ 79,802
Less: discount	28,155	39,976
Recorded investment	\$33,415	\$ 39,826

Changes in the accretable yield for acquired PCI loans for the three and nine months ended September 30, 2016 and 2015 were as follows:

	Three Months		Nine Months Ended	
	Ended September 30, 2016	2015	2016	2015
	(Dollars in thousands)			
Balance at beginning of period	\$12,015	\$6,351	\$5,664	\$9,867
Additions	—	—	10,222	—
Reclassifications from nonaccretable	1,378	3,940	8,809	12,572
Accretion	(2,324)	(3,974)	(13,626)	(16,122)
Balance at September 30	\$11,069	\$6,317	\$11,069	\$6,317

Income recognition on PCI loans is subject to the Company's ability to reasonably estimate both the timing and amount of future cash flows. PCI loans for which the Company is accruing interest income are not considered non-performing or impaired. The non-accretable difference represents contractual principal and interest the Company does not expect to collect.

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Non-PCI Loans. The carrying amount of Non-PCI loans included in the consolidated balance sheet and the related outstanding balance as of the dates indicated are presented in the table below. The outstanding balance represents the total amount owed as of September 30, 2016 and December 31, 2015, including accrued but unpaid interest.

	September 30, 2016	December 31, 2015
	(Dollars in thousands)	
Non-PCI loans:		
Outstanding balance	\$ 1,236,411	\$ 1,430,501
Less: discount	39,360	54,734
Recorded investment	\$ 1,197,051	\$ 1,375,767

Changes in the discount accretion for Non-PCI loans for the three and nine months ended September 30, 2016 and 2015 were as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(Dollars in thousands)			
Balance at beginning of period	\$44,672	\$67,895	\$54,734	\$89,105
Additions	—	—	3,491	—
Accretion charge-offs	(16)	(16)	(1,073)	(125)
Accretion	(5,296)	(7,060)	(17,792)	(28,161)
Balance at September 30	\$39,360	\$60,819	\$39,360	\$60,819

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

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Impaired loans are set forth in the following tables. No interest income was recognized on impaired loans subsequent to their classification as impaired. The average recorded investment presented in the tables below is reported on a year-to-date basis.

	September 30, 2016			
	Recorded Investment	Unpaid Contractual Balance	Related Allowance	Average Recorded Investment
	(Dollars in thousands)			
With no related allowance recorded:				
Construction, land development and other land loans	\$ 177	\$ 494	\$ —	\$ 105
Agriculture and agriculture real estate (includes farmland)	10	15	—	15
1-4 family (includes home equity)	1,822	2,024	—	1,514
Commercial real estate (includes multi-family residential)	12,820	12,936	—	13,968
Commercial and industrial	10,663	10,957	—	6,009
Consumer and other	89	179	—	74
Total	25,581	26,605	—	21,685
With an allowance recorded:				
Construction, land development and other land loans	—	—	—	4
Agriculture and agriculture real estate (includes farmland)	238	262	102	214
1-4 family (includes home equity)	459	482	140	419
Commercial real estate (includes multi-family residential)	69	69	13	166
Commercial and industrial	14,021	15,418	5,554	14,308
Consumer and other	74	107	46	128
Total	14,861	16,338	5,855	15,239
Total:				
Construction, land development and other land loans	177	494	—	109
Agriculture and agriculture real estate (includes farmland)	248	277	102	229
1-4 family (includes home equity)	2,281	2,506	140	1,933
Commercial real estate (includes multi-family residential)	12,889	13,005	13	14,134
Commercial and industrial	24,684	26,375	5,554	20,317
Consumer and other	163	286	46	202
	\$40,442	\$ 42,943	\$ 5,855	\$ 36,924

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	December 31, 2015			
	Recorded	Unpaid Contractual	Related	Average
	Investment	Balance	Allowance	Recorded
	(Dollars in thousands)			
With no related allowance recorded:				
Construction, land development and other land loans	\$33	\$ 346	\$ —	\$ 142
Agriculture and agriculture real estate (includes farmland)	20	23	—	10
1-4 family (includes home equity)	1,206	1,365	—	1,458
Commercial real estate (includes multi-family residential)	15,115	15,398	—	10,104
Commercial and industrial	1,354	1,630	—	5,419
Consumer and other	58	131	—	4,101
Total	17,786	18,893	—	21,234
With an allowance recorded:				
Construction, land development and other land loans	7	11	2	141
Agriculture and agriculture real estate (includes farmland)	189	201	52	118
1-4 family (includes home equity)	379	386	93	902
Commercial real estate (includes multi-family residential)	262	1,857	262	162
Commercial and industrial	14,594	16,413	7,082	8,524
Consumer and other	181	220	44	208
Total	15,612	19,088	7,535	10,055
Total:				
Construction, land development and other land loans	40	357	2	283
Agriculture and agriculture real estate (includes farmland)	209	224	52	128
1-4 family (includes home equity)	1,585	1,751	93	2,360
Commercial real estate (includes multi-family residential)	15,377	17,255	262	10,266
Commercial and industrial	15,948	18,043	7,082	13,943
Consumer and other	239	351	44	4,309
	\$33,398	\$ 37,981	\$ 7,535	\$ 31,289

Credit Quality Indicators. As part of the on-going monitoring of the credit quality of the Company's loan portfolio and methodology for calculating the allowance for credit losses, management assigns and tracks loan grades to be used as credit quality indicators. The following is a general description of the loan grades used:

Grade 1—Credits in this category have risk potential that is virtually nonexistent. These loans may be secured by insured certificates of deposit, insured savings accounts, U.S. Government securities and highly rated municipal bonds.

Grade 2—Credits in this category are of the highest quality. These borrowers represent top rated companies and individuals with unquestionable financial standing with excellent global cash flow coverage, net worth, liquidity and collateral coverage.

Grade 3—Credits in this category are not immune from risk but are well protected by the collateral and paying capacity of the borrower. These loans may exhibit a minor unfavorable credit factor, but the overall credit is sufficiently strong to minimize the possibility of loss.

Grade 4—Credits in this category are considered to be of acceptable credit quality with moderately greater risk than Grade 3 and receiving closer monitoring. Loans in this category have sources of repayment that remain sufficient to preclude a larger than normal probability of default and secondary sources are likewise currently of sufficient quantity, quality, and liquidity to protect the Company against loss of principal and interest. These borrowers have specific risk factors, but the overall strength of the credit is acceptable based on other mitigating credit and/or collateral factors and can repay the debt in the normal course of business.

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Grade 5—Credits in this category constitute an undue and unwarranted credit risk; however, the factors do not rise to a level of substandard. These credits have potential weaknesses and/or declining trends that, if not corrected, could expose the Bank to risk at a future date. These loans are monitored on the Bank’s internally-generated watch list and evaluated on a quarterly basis.

Grade 6—Credits in this category are considered “substandard” but “non-impaired” loans in accordance with regulatory guidelines. Loans in this category have well-defined weakness that, if not corrected, could make default of principal and interest possible. Loans in this category are still accruing interest and may be dependent upon secondary sources of repayment and/or collateral liquidation.

Grade 7—Credits in this category are deemed “substandard” and “impaired” pursuant to regulatory guidelines. As such, the Bank has determined that it is probable that less than 100% of the contractual principal and interest will be collected. These loans are individually evaluated for a specific reserve and will typically have the accrual of interest stopped.

Grade 8—Credits in this category include “doubtful” loans in accordance with regulatory guidance. Such loans are no longer accruing interest and factors indicate a loss is imminent. These loans are also deemed “impaired.” While a specific reserve may be in place while the loan and collateral is being evaluated, these loans are typically charged down to an amount the Bank estimates is collectible.

Grade 9—Credits in this category are deemed a “loss” in accordance with regulatory guidelines and have been charged off or charged down. The Bank may continue collection efforts and may have partial recovery in the future.

The following table presents risk grades and PCI loans by category of loan at September 30, 2016. Impaired loans include loans in risk grades 7, 8 and 9, as well as any PCI loan that has a specific reserve allocated to it.

	Construction, Land Development Other Land	Agriculture and Ranch (includes Farm land)	Real Estate (includes Home Equity)	Commercial Real Estate (includes Multi-Family and Industrial)	Commercial and Industrial	Consumer and Other	Total
Grade 1	\$—	\$ 14,055	\$ —	\$ —	\$ 59,625	\$ 40,858	\$ 114,538
Grade 2	2,196	4,593	23,773	6,646	12,162	8,457	57,827
Grade 3	1,138,839	561,473	2,609,138	2,829,626	1,129,900	204,153	8,473,129
Grade 4	56,519	74,216	58,215	229,146	177,319	12,269	607,684
Grade 5	3,331	7,937	2,739	41,643	66,833	2,189	124,672
Grade 6	3,287	1,165	5,596	20,913	63,824	2,245	97,030
Grade 7	177	248	2,251	12,820	23,683	163	39,342
Grade 8	—	—	30	69	578	—	677
Grade 9	—	—	—	—	—	—	—

PCI							
Loans (2)	1,471	393	5,710	17,706	8,135	—	33,415
Total	\$ 1,205,820	\$ 664,080	\$ 2,707,452	\$ 3,158,569	\$ 1,542,059	\$ 270,334	\$ 9,548,314

(1) Includes \$29.5 million of residential mortgage loans held for sale at September 30, 2016.

(2) Of the total PCI loans, \$3.2 million were classified as substandard at September 30, 2016, which includes \$423 thousand with specific reserves of \$224 thousand allocated to them.

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The following table presents risk grades and PCI loans by category of loan at December 31, 2015. Impaired loans include loans in risk grades 7, 8 and 9, as well as any PCI loan that has a specific reserve allocated to it.

	Construction, Land Development Other Land (Dollars in thousands)	Agriculture and Ranchland (includes Farm land)	Relocation Home Equity (includes Home Equity)	Commercial Real Estate (includes Multi-Family Residential)	Commercial Residential Other	Consumer and Other	Total
Grade 1	\$—	\$ 12,733	\$ —	\$ —	\$ 57,625	\$ 44,389	\$ 114,747
Grade 2	3,975	5,603	27,272	24,965	27,755	34,668	124,238
Grade 3	1,034,792	553,782	2,539,282	2,861,872	1,355,887	162,892	8,508,507
Grade 4	29,831	67,453	58,172	164,924	123,772	3,395	447,547
Grade 5	2,431	7,191	1,261	20,078	68,618	6,908	106,487
Grade 6	1,209	1,452	7,824	26,237	28,005	88	64,815
Grade 7	40	209	1,526	15,377	12,487	239	29,878
Grade 8	—	—	59	—	2,485	—	2,544
Grade 9	—	—	—	—	—	—	—
PCI							
Loans (2)	920	395	5,269	17,630	15,612	—	39,826
Total	\$ 1,073,198	\$ 648,818	\$ 2,640,665	\$ 3,131,083	\$ 1,692,246	\$ 252,579	\$ 9,438,589

(1) Includes \$23.9 million of residential mortgage loans held for sale at December 31, 2015.

(2) Of the total PCI loans, \$7.3 million were classified as substandard at December 31, 2015, which includes \$976 thousand with specific reserves of \$836 thousand allocated to them.

Allowance for Credit Losses. The allowance for credit losses is a valuation established through charges to earnings in the form of a provision for credit losses. Management has established an allowance for credit losses which it believes is adequate for estimated losses in the Company's loan portfolio. The amount of the allowance for credit losses is affected by the following: (1) charge offs of loans that occur when loans are deemed uncollectible and decrease the allowance, (2) recoveries on loans previously charged off that increase the allowance and (3) provisions for credit losses charged to earnings that increase the allowance. Based on an evaluation of the loan portfolio and consideration of the factors listed below, management presents a quarterly review of the allowance for credit losses to the Bank's Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. Although management believes it uses the best information available to make determinations with respect to the allowance for credit losses, future adjustments may be necessary if economic conditions or the borrower's performance differ from the assumptions used in making the initial determinations.

The Company's allowance for credit losses consists of two components: a specific valuation allowance based on probable losses on specifically identified loans and a general valuation allowance based on historical loan loss

experience, general economic conditions and other qualitative risk factors both internal and external to the Company.

In setting the specific valuation allowance, the Company follows a loan review program to evaluate the credit risk in the total loan portfolio and assigns risk grades to each loan. Through this loan review process, the Company maintains an internal list of impaired loans which, along with the delinquency list of loans, helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for credit losses. All loans that have been identified as impaired are reviewed on a quarterly basis in order to determine whether a specific reserve is required. For certain impaired loans, the Company allocates a specific loan loss reserve primarily based on the value of the collateral securing the impaired loan in accordance with ASC Topic 310-10, "Receivables." The specific reserves are determined on an individual loan basis. Loans for which specific reserves are provided are excluded from the general valuation allowance described below.

In connection with this review of the loan portfolio, the Company considers risk elements attributable to particular loan types or categories in assessing the quality of individual loans. Some of the risk elements include:

for 1-4 family residential mortgage loans, the borrower's ability to repay the loan, including a consideration of the debt to income ratio and employment and income stability, the loan to value ratio, and the age, condition and marketability of collateral;

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for commercial real estate loans and multifamily residential loans, the debt service coverage ratio (income from the property in excess of operating expenses compared to loan payment requirements), operating results of the owner in the case of owner-occupied properties, the loan to value ratio, the age and condition of the collateral and the volatility of income, property value and future operating results typical of properties of that type;

for construction, land development and other land loans, the perceived feasibility of the project including the ability to sell developed lots or improvements constructed for resale or the ability to lease property constructed for lease, the quality and nature of contracts for presale or prelease, if any, experience and ability of the developer and loan to value ratio;

for commercial and industrial loans, the operating results of the commercial, industrial or professional enterprise, the borrower's business, professional and financial ability and expertise, the specific risks and volatility of income and operating results typical for businesses in that category and the value, nature and marketability of collateral;

for agricultural real estate loans, the experience and financial capability of the borrower, projected debt service coverage of the operations of the borrower and loan to value ratio; and

for non-real estate agricultural loans, the operating results, experience and financial capability of the borrower, historical and expected market conditions and the value, nature and marketability of collateral.

In determining the amount of the general valuation allowance, management considers factors such as historical loan loss experience, concentration risk of specific loan types, the volume, growth and composition of the Company's loan portfolio, current economic conditions that may affect the borrower's ability to pay and the value of collateral, the evaluation of the Company's loan portfolio through its internal loan review process, general economic conditions and other qualitative risk factors both internal and external to the Company and other relevant factors in accordance with ASC Topic 450, "Contingencies." Based on a review of these factors for each loan type, the Company applies an estimated percentage to the outstanding balance of each loan type, excluding any loan that has a specific reserve allocated to it. The Company uses this information to establish the amount of the general valuation allowance.

In addition, for each category, the Company considers secondary sources of income and the financial strength and credit history of the borrower and any guarantors.

At September 30, 2016, the allowance for credit losses totaled \$85.6 million or 0.90% of total loans, including acquired loans with discounts. At December 31, 2015, the allowance for credit losses totaled \$81.4 million or 0.86% of total loans, including acquired loans with discounts.

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The following table details activity in the allowance for credit losses by category of loan for the three and nine months ended September 30, 2016 and 2015. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Construction, Land Development and Other Land Loans (Dollars in thousands)	Agriculture and Agriculture Real Estate (includes Farmland)	1-4 Family (includes Home Equity)	Commercial Real Estate (includes Multi-Family Residential)	Commercial and Industrial	Consumer and Other	Total
Allowance for credit losses:							
Three Months Ended							
Balance June 30, 2016	\$ 14,202	\$ 4,129	\$ 14,916	\$ 12,672	\$ 36,254	\$ 1,653	\$ 83,826
Provision for credit losses	(78)	(40)	167	(477)	1,753	675	2,000
Charge-offs	—	(1)	(63)	—	(24)	(946)	(1,034)
Recoveries	368	46	15	1	131	232	793
Net charge-offs	368	45	(48)	1	107	(714)	(241)
Balance September 30, 2016	\$ 14,492	\$ 4,134	\$ 15,035	\$ 12,196	\$ 38,114	\$ 1,614	\$ 85,585
Nine Months Ended							
Balance December 31, 2015	\$ 14,882	\$ 3,845	\$ 14,891	\$ 12,996	\$ 33,409	\$ 1,361	\$ 81,384
Provision for credit losses	(969)	6,551	144	(545)	13,103	3,716	22,000
Charge-offs	(7)	(7,026)	(114)	(257)	(10,641)	(4,371)	(22,416)
Recoveries	586	764	114	2	2,243	908	4,617
Net charge-offs	579	(6,262)	—	(255)	(8,398)	(3,463)	(17,799)
Balance September 30, 2016	\$ 14,492	\$ 4,134	\$ 15,035	\$ 12,196	\$ 38,114	\$ 1,614	\$ 85,585
Allowance for credit losses:							
Three Months Ended							
Balance June 30, 2015	\$ 16,909	\$ 3,771	\$ 16,593	\$ 13,002	\$ 29,205	\$ 1,492	\$ 80,972
Provision for credit losses	(1,506)	(79)	(1,386)	(742)	8,507	516	5,310
Charge-offs	(215)	(3)	(120)	(54)	(4,865)	(933)	(6,190)
Recoveries	42	43	10	1	439	376	911
Net charge-offs	(173)	40	(110)	(53)	(4,426)	(557)	(5,279)
Balance September 30, 2015	\$ 15,230	\$ 3,732	\$ 15,097	\$ 12,207	\$ 33,286	\$ 1,451	\$ 81,003

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Nine Months Ended

Balance December 31, 2014	\$ 15,825	\$ 3,722	\$ 16,377	\$ 12,744	\$ 30,002	\$ 2,092	\$ 80,762
Provision for credit losses	(279)	(173)	(1,072)	(337)	8,186	735	7,060
Charge-offs	(366)	(3)	(249)	(233)	(5,691)	(2,406)	(8,948)
Recoveries	50	186	41	33	789	1,030	2,129
Net charge-offs	(316)	183	(208)	(200)	(4,902)	(1,376)	(6,819)
Balance September 30, 2015	\$ 15,230	\$ 3,732	\$ 15,097	\$ 12,207	\$ 33,286	\$ 1,451	\$ 81,003

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The following table details the amount of the allowance for credit losses allocated to each category of loan as of September 30, 2016, December 31, 2015 and September 30, 2015, on the basis of the impairment methodology used by the Company.

	Construction, Land and Other Land Loans	Agriculture and Agriculture Real Estate (includes Farmland)	1-4 Family (includes Home Equity)	Commercial Real Estate (includes Multi-Family Residential)	Commercial and Industrial	Consumer and Other	Total
(Dollars in thousands)							
Allowance for credit losses related to:							
September 30, 2016							
Individually evaluated for impairment	\$—	\$ 102	\$ 140	\$ 13	\$ 5,330	\$ 46	\$5,631
Collectively evaluated for impairment	14,492	4,032	14,895	12,183	32,560	1,568	79,730
PCI loans	—	—	—	—	224	—	224
Total allowance for credit losses	\$14,492	\$ 4,134	\$ 15,035	\$ 12,196	\$ 38,114	\$ 1,614	\$85,585
December 31, 2015							
Individually evaluated for impairment	\$2	\$ 52	\$ 93	\$ 262	\$ 7,082	\$ 44	\$7,535
Collectively evaluated for impairment	14,880	3,793	14,798	12,734	25,491	1,317	73,013
PCI loans	—	—	—	—	836	—	836
Total allowance for credit losses	\$14,882	\$ 3,845	\$ 14,891	\$ 12,996	\$ 33,409	\$ 1,361	\$81,384
September 30, 2015							
Individually evaluated for impairment	\$2	\$ 123	\$ 111	\$ 292	\$ 6,550	\$ 43	\$7,121
Collectively evaluated for impairment	15,228	3,609	14,986	11,915	26,474	1,408	73,620
PCI loans	—	—	—	—	262	—	262
Total allowance for credit losses	\$15,230	\$ 3,732	\$ 15,097	\$ 12,207	\$ 33,286	\$ 1,451	\$81,003

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The following table details the recorded investment in loans as of September 30, 2016, December 31, 2015 and September 30, 2015, excluding \$29.5 million, \$23.9 million and \$12.6 million, respectively, of residential mortgage loans held for sale, related to each balance in the allowance for credit losses by category of loan.

	Construction, Land and Development and Other Land Loans (Dollars in thousands)	Agriculture and Agriculture Real Estate (includes Farmland)	1-4 Family (includes Home Equity)	Commercial Real Estate (includes Multi-Family Residential)	Commercial and Industrial	Consumer and Other	Total
Recorded investment in loans:							
September 30, 2016							
Individually evaluated for impairment	\$ 177	\$ 248	\$ 2,281	\$ 12,889	\$ 24,261	\$ 163	\$ 40,019
Collectively evaluated for impairment	1,204,172	663,439	2,670,004	3,127,974	1,509,663	270,171	9,445,423
PCI loans	1,471	393	5,710	17,706	8,135	—	33,415
Total loans evaluated for impairment	\$ 1,205,820	\$ 664,080	\$ 2,677,995	\$ 3,158,569	\$ 1,542,059	\$ 270,334	\$ 9,518,857
December 31, 2015							
Individually evaluated for impairment	\$ 40	\$ 209	\$ 1,585	\$ 15,377	\$ 15,948	\$ 239	\$ 33,398
Collectively evaluated for impairment	1,072,238	648,214	2,609,878	3,098,076	1,660,686	252,340	9,341,432
PCI loans	920	395	5,269	17,630	15,612	—	39,826
Total loans evaluated for impairment	\$ 1,073,198	\$ 648,818	\$ 2,616,732	\$ 3,131,083	\$ 1,692,246	\$ 252,579	\$ 9,414,656
September 30, 2015							
Individually evaluated for impairment	\$ 249	\$ 348	\$ 1,908	\$ 15,623	\$ 20,480	\$ 264	\$ 38,872
Collectively evaluated for impairment	1,071,693	617,739	2,576,497	2,959,065	1,612,067	275,033	9,112,094
PCI loans	1,043	476	5,616	18,038	16,285	—	41,458
	\$ 1,072,985	\$ 618,563	\$ 2,584,021	\$ 2,992,726	\$ 1,648,832	\$ 275,297	\$ 9,192,424

Total loans evaluated
for impairment

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Troubled Debt Restructurings. The restructuring of a loan is considered a “troubled debt restructuring” if both (1) the borrower is experiencing financial difficulties and (2) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. Under ASC topic 310-40 “Receivables—Troubled Debt Restructurings by Creditors,” the Company evaluates all loan modifications to identify whether the restructuring constitutes a troubled debt restructuring. As of September 30, 2016 and 2015, the Company had \$318 thousand and \$607 thousand, respectively, in outstanding troubled debt restructurings. The following table presents information regarding the recorded investment of loans modified in a troubled debt restructuring during the nine months ended September 30, 2016 and 2015:

	Nine Months Ended September 30, 2016		2015	
	Pre-Modification Number of Loans	Post-Modification Outstanding Recorded Investment	Pre-Modification Number of Loans	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings				
Construction, land development and other land loans	—	\$ —	1	\$ 390
Agriculture and agriculture real estate (includes farmland)	1	154	—	—
1-4 Family (includes home equity)	—	—	—	—
Commercial real estate (includes multi-family residential)	—	—	—	—
Commercial and industrial	—	—	—	—
Consumer and other	—	—	1	10
Total	1	\$ 154	2	\$ 400

As of September 30, 2016, there have been no defaults on any loans that were modified as troubled debt restructurings during the preceding twelve months. Default is determined at 90 or more days past due. For the nine months ended September 30, 2016, the Company added one loan totaling \$154 thousand as a new troubled debt restructuring, of which \$152 thousand was still outstanding at September 30, 2016. For the nine months ended September 30, 2015, the Company added two loans totaling \$400 thousand as new troubled debt restructurings, of which \$316 thousand was still outstanding at September 30, 2015. The modifications generally related to extending the amortization periods of the loans, which includes loans modified during bankruptcy. The Company did not grant principal reductions on any restructured loans. These modifications did not have a material impact on the Company’s determination of the

allowance for credit losses.

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6. FAIR VALUE

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair values represent the estimated price that would be received from selling an asset or paid to transfer a liability, otherwise known as an “exit price.” Securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record other assets at fair value on a nonrecurring basis such as certain loans including residential mortgage loans held for sale, goodwill and other intangible assets and other real estate owned. These nonrecurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or write downs of individual assets. ASC Topic 820 “Fair Value Measurements and Disclosures” establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Fair Value Hierarchy

The Company groups financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1—Quoted prices in active markets for identical assets or liabilities.
- Level 2—Other significant observable inputs (including quoted prices in active markets for similar assets or liabilities) or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability.

The fair value disclosures below represent the Company’s estimates based on relevant market information and information about the financial instruments. Fair value estimates are based on judgments regarding current economic conditions, risk characteristics of the various instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in the above methodologies and assumptions could significantly affect the estimates.

The following tables present fair values for assets and liabilities measured at fair value on a recurring basis:

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As of September 30, 2016

Level 1 Level 2 Level 3 Total

(Dollars in thousands)

Assets:				
Available for sale securities:				
	Level 1	Level 2	Level 3	Total
States and political subdivisions	\$—	\$2,580	\$ —	\$2,580
Collateralized mortgage obligations	—	21,133	—	21,133
Mortgage-backed securities	—	93,169	—	93,169
Other securities	12,795	—	—	12,795
Total	\$12,795	\$116,882	\$ —	\$129,677

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	As of December 31, 2015			
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Assets:				
Available for sale securities:				
States and political subdivisions	\$—	\$5,485	\$—	\$5,485
Collateralized mortgage obligations	—	25,916	—	25,916
Mortgage-backed securities	—	58,971	—	58,971
Other securities	12,692	—	—	12,692
Total	\$12,692	\$90,372	\$—	\$103,064

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). These instruments include other real estate owned, repossessed assets, held to maturity debt securities, loans held for sale and impaired loans, which are included as loans held for investment. For the three and nine months ended September 30, 2016, the Company had additions to other real estate owned of \$727 thousand and \$14.6 million, respectively, of which \$727 thousand and \$14.4 million were still outstanding as of September 30, 2016. For the three and nine months ended September 30, 2016, the Company had additions to impaired loans of \$15.0 million and \$38.9 million, respectively, of which \$15.0 million and \$31.5 million were still outstanding as of September 30, 2016. The remaining financial assets and liabilities measured at fair value on a non-recurring basis that were recorded in 2016 and remained outstanding at September 30, 2016 were not significant.

The following table presents carrying and fair value information of financial instruments as of the dates indicated:

	As of September 30, 2016				
	Carrying Amount	Estimated Fair Value			Total
		Level 1	Level 2	Level 3	
	(Dollars in thousands)				
Assets					
Cash and due from banks	\$341,483	\$341,483	\$—	\$—	\$341,483
Federal funds sold	630	630	—	—	630
Held to maturity securities	8,858,344	—	9,020,897	—	9,020,897
Loans held for sale	29,457	—	29,457	—	29,457
Loans held for investment, net of allowance	9,433,272	—	—	9,448,097	9,448,097
Other real estate owned	16,280	—	16,280	—	16,280
Liabilities					
Deposits:					

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Noninterest-bearing	\$5,159,333	\$—	\$5,159,333	\$—	\$5,159,333
Interest-bearing	11,762,076	—	11,766,996	—	11,766,996
Other borrowings	425,916	—	426,455	—	426,455
Securities sold under repurchase agreements	318,449	—	318,452	—	318,452

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	As of December 31, 2015				Total
	Carrying Amount	Estimated Fair Value		Level 3	
		Level 1	Level 2		
(Dollars in thousands)					
Assets					
Cash and due from banks	\$562,544	\$562,544	\$—	\$—	\$562,544
Federal funds sold	1,418	1,418	—	—	1,418
Held to maturity securities	9,399,363	—	9,393,175	—	9,393,175
Loans held for sale	23,933	—	23,933	—	23,933
Loans held for investment, net of allowance	9,333,272	—	—	9,365,758	9,365,758
Other real estate owned	2,963	—	2,963	—	2,963
Liabilities					
Deposits:					
Noninterest-bearing	\$5,136,579	\$—	\$5,136,579	\$—	\$5,136,579
Interest-bearing	12,544,540	—	12,548,050	—	12,548,050
Other borrowings	491,399	—	492,061	—	492,061
Securities sold under repurchase agreements	315,253	—	315,241	—	315,241

The following is a description of the fair value estimates, methods and assumptions that are used by the Company in estimating the fair values of financial instruments.

Cash and due from banks—For these short-term instruments, the carrying amount is a reasonable estimate of fair value. The Company classifies the estimated fair value of these instruments as Level 1.

Federal funds sold—For these short-term instruments, the carrying amount is a reasonable estimate of fair value. The Company classifies the estimated fair value of these instruments as Level 1.

Securities — Fair value measurements based upon quoted prices are considered Level 1 inputs. Level 1 securities consist of U.S. Treasury securities and certain equity securities which are included in the available for sale portfolio. For all other available for sale and held to maturity securities, if quoted prices are not available, fair values are measured using Level 2 inputs. For these securities, the Company generally obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. The Company reviews the prices supplied by the independent pricing service, as well as their underlying pricing methodologies, for reasonableness.

Securities available for sale are recorded at fair value on a recurring basis.

Loans held for sale— Loans held for sale are carried at the lower of cost or estimated fair value. Fair value for consumer mortgages held for sale is based on commitments on hand from investors or prevailing market prices. As such, the Company classifies loans subjected to nonrecurring fair value adjustments as Level 2.

Loans held for investment— The Company does not record loans at fair value on a recurring basis. As such, valuation techniques discussed herein for loans are primarily for estimating fair value disclosures. However, from time to time, the Company records nonrecurring fair value adjustments to impaired loans to reflect (1) partial write downs that are based on the observable market price or current appraised value of the collateral, or (2) the full charge off of the loan carrying value. Where appraisals are not available, estimated cash flows are discounted using a rate commensurate with the credit risk associated with those cash flows. Assumptions regarding credit risk, cash flows and discount rates are judgmentally determined using available market information and specific borrower information.

The estimated fair value approximates carrying value for variable-rate loans that reprice frequently and with no significant change in credit risk. The fair value of fixed-rate loans and variable-rate loans which reprice on an infrequent basis is estimated by discounting future cash flows using the current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality. An overall valuation adjustment is made for specific credit risks as well as general portfolio credit risk. The Company classifies the estimated fair value of loans held for investment as Level 3.

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Other real estate owned— Other real estate owned is primarily foreclosed properties securing residential loans and commercial real estate. Foreclosed assets are adjusted to fair value less estimated costs to sell upon transfer of the loans to other real estate owned. Subsequently, these assets are carried at the lower of carrying value or fair value less estimated costs to sell. Other real estate carried at fair value based on an observable market price or a current appraised value is classified by the Company as Level 2. When management determines that the fair value of other real estate requires additional adjustments, either as a result of a non-current appraisal or when there is no observable market price, the Company classifies the other real estate as Level 3.

Deposits—The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. Deposits fair value measurements utilize Level 2 inputs.

Other borrowings—Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of other borrowings using a discounted cash flows methodology and are measured utilizing Level 2 inputs.

Securities sold under repurchase agreements—The fair value of securities sold under repurchase agreements is the amount payable on demand at the reporting date and are measured utilizing Level 2 inputs.

Off-balance sheet financial instruments—The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and the present creditworthiness of the counterparties. The Company has reviewed the unfunded portion of commitments to extend credit as well as standby and other letters of credit, and has determined that the fair value of such financial instruments is not material. The Company classifies the estimated fair value of credit-related financial instruments as Level 3.

The fair value estimates presented herein are based on pertinent information available to management at September 30, 2016. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

7. GOODWILL AND CORE DEPOSIT INTANGIBLES

Changes in the carrying amount of the Company's goodwill and core deposit intangibles for the nine months ended September 30, 2016 and the year ended December 31, 2015 were as follows:

Goodwill

	Core Deposit Intangibles	
	(Dollars in thousands)	
Balance as of December 31, 2014	\$1,874,191	\$ 58,947
Less:		
Amortization	—	(9,530)
Add:		
Measurement period adjustments	(5,364)	—
Balance as of December 31, 2015	1,868,827	49,417
Less:		
Amortization	—	(6,974)
Add:		
Acquisition of Tradition Bancshares, Inc.	31,522	5,567
Measurement period adjustments	—	—
Balance as of September 30, 2016	\$1,900,349	\$ 48,010

Goodwill is recorded on the acquisition date of each entity. The Company may record subsequent adjustments to goodwill for amounts undeterminable at acquisition date, such as deferred taxes and real estate valuations, and therefore the goodwill amounts may change accordingly. The Company initially records the total premium paid on acquisitions as goodwill. After finalizing the valuation, core deposit intangibles are identified and reclassified from goodwill to core deposit intangibles on the balance sheet. This reclassification has no effect on total assets, liabilities, shareholders' equity, net income or cash flows. Management performs an evaluation annually, and more frequently if a triggering event occurs, of whether any impairment of the goodwill and core deposit intangibles has occurred. If any such impairment is determined, a write-down is recorded. As of September 30, 2016, there was no impairment recorded on goodwill and core deposit intangibles.

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The measurement period for the Company to determine the fair value of acquired identifiable assets and assumed liabilities will be at the end of the earlier of (1) twelve months from the date of acquisition or (2) as soon as the Company receives the information it was seeking about facts and circumstances that existed as of the date of acquisition.

Core deposit intangibles are being amortized on a non-pro rata basis over their estimated lives, which the Company believes is between 10 and 15 years. Amortization expense related to intangible assets totaled \$2.4 million for the three months ended September 30, 2016 and 2015, and \$7.0 million and \$7.2 million for the nine months ended September 30, 2016 and 2015, respectively. The estimated aggregate future amortization expense for core deposit intangibles remaining as of September 30, 2016 is as follows (dollars in thousands):

Remaining 2016	\$2,226
2017	6,942
2018	5,959
2019	5,051
2020	4,483
Thereafter	23,349
Total	\$48,010

8. STOCK-BASED COMPENSATION

At September 30, 2016, the Company had two stock-based employee compensation plans with awards outstanding. One of these plans adopted by the Company has expired and therefore no additional awards may be issued under that plan.

During 2004, Bancshares' Board of Directors established the Prosperity Bancshares, Inc. 2004 Stock Incentive Plan (the "2004 Plan") which was approved by Bancshares' shareholders and authorized the issuance of up to 1,250,000 shares of common stock upon the exercise of options granted under the 2004 Plan or upon the grant or exercise, as the case may be, of other awards granted under the 2004 Plan. The 2004 Plan provided for the granting of incentive and nonqualified stock options to employees and nonqualified stock options to directors who are not employees. The 2004 Plan also provided for the granting of shares of restricted stock, stock appreciation rights, phantom stock awards and performance awards on substantially similar terms. The 2004 Plan has expired and therefore no additional shares may be issued from the 2004 Plan.

During 2012, Bancshares' Board of Directors established the Prosperity Bancshares, Inc. 2012 Stock Incentive Plan (the "2012 Plan"), which was approved by Bancshares' shareholders and authorized the issuance of up to 1,250,000

shares of common stock upon the exercise of options granted under the 2012 Plan or pursuant to the grant or exercise, as the case may be, of other awards granted under the 2012 Plan, including restricted stock, stock appreciation rights, phantom stock awards and performance awards. A total of 327,801 shares have been granted under the 2012 Plan as of September 30, 2016.

The Company received \$469 thousand and \$667 thousand from the exercise of stock options during the three- and nine-month periods ended September 30, 2016, and \$155 thousand and \$223 thousand during the three- and nine-month periods ended September 30, 2015. There was no tax benefit realized from option exercises of the stock-based payment arrangements during the three- and nine-month periods ended September 30, 2016 and 2015.

As of September 30, 2016, there was \$19.4 million of total unrecognized compensation expense related to stock-based compensation arrangements. That cost is expected to be recognized over a weighted average period of 1.60 years.

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9. CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ITEMS

Contractual Obligations

The following table summarizes the Company's contractual obligations and other commitments to make future payments as of September 30, 2016 (other than deposit obligations and securities sold under repurchase agreements). The Company's future cash payments associated with its contractual obligations pursuant to its FHLB notes payable and operating leases as of September 30, 2016 are summarized below. Payments for FHLB notes payable include interest of \$760 thousand that will be paid over the future periods. Payments related to leases are based on actual payments specified in underlying contracts.

	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
	(Dollars in thousands)				
Federal Home Loan Bank notes payable	\$420,871	\$ 4,916	\$ 659	\$230	\$426,676
Operating leases	5,733	8,106	4,923	6,989	25,751
Total	\$426,604	\$ 13,022	\$ 5,582	\$7,219	\$452,427

Off-Balance Sheet Items

In the normal course of business, the Company enters into various transactions, which, in accordance with GAAP, are not included in its consolidated balance sheets. The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

The Company's commitments associated with outstanding standby letters of credit and commitments to extend credit expiring by periods as of September 30, 2016 are summarized below. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements.

	1 year or less	More than 1 year but less	3 years or more but less	5 years or more	Total
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	than 3 years		than 5 years		
	(Dollars in thousands)				
Standby letters of credit	\$63,168	\$ 7,227	\$ 226	\$20	\$70,641
Commitments to extend credit	1,018,584	314,222	83,258	568,608	1,984,672
Total	\$1,081,752	\$ 321,449	\$ 83,484	\$568,628	\$2,055,313

10. OTHER COMPREHENSIVE (LOSS) INCOME

The tax effects allocated to each component of other comprehensive loss were as follows:

	Three Months Ended September 30,					
	2016		2015			
	Before	Net of	Before	Net of		
	Tax	Tax	Tax	Tax		
	Amount	Effect	Amount	Effect	Amount	
	(Dollars in thousands)					
Other comprehensive loss:						
Securities available for sale:						
Change in unrealized gain during period	\$(186)	\$ 65	\$ (121)	\$(867)	\$ 303	\$ (564)
Total securities available for sale	(186)	65	(121)	(867)	303	(564)
Total other comprehensive loss	\$(186)	\$ 65	\$ (121)	\$(867)	\$ 303	\$ (564)

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	Nine Months Ended September 30,					
	2016		2015			
	Before	Net of	Before	Net of		
	Tax	Tax	Tax	Tax	Tax	
	Amount	Effect	Amount	Effect	Amount	
	(Dollars in thousands)					
Other comprehensive loss:						
Securities available for sale:						
Change in unrealized gain during period	\$(828)	\$ 290	\$(538)	\$(1,949)	\$ 682	\$(1,267)
Total securities available for sale	(828)	290	(538)	(1,949)	682	(1,267)
Total other comprehensive loss	\$(828)	\$ 290	\$(538)	\$(1,949)	\$ 682	\$(1,267)

Activity in accumulated other comprehensive income associated with securities available for sale, net of tax, was as follows:

	Accumulated	
	Securities Available for Sale	Other Comprehensive Income
	(Dollars in thousands)	
Balance at January 1, 2016	\$2,040	\$ 2,040
Other comprehensive loss	(538)	(538)
Balance at September 30, 2016	\$1,502	\$ 1,502
Balance at January 1, 2015	\$3,729	\$ 3,729
Other comprehensive loss	(1,267)	(1,267)
Balance at September 30, 2015	\$2,462	\$ 2,462

11. ACQUISITIONS

Acquisition of Tradition Bancshares, Inc. — On January 1, 2016, the Company completed the acquisition of Tradition and its wholly-owned subsidiary Tradition Bank, headquartered in Houston, Texas. Tradition Bank operated 7 banking offices in the Houston, Texas area, including its main office in Bellaire, 3 banking centers in Katy and 1 banking center in The Woodlands. The acquisition was not considered significant to the Company's financial statements and therefore pro forma financial data and related disclosures are not included.

Under the terms of the definitive agreement, Bancshares issued 679,528 shares of its common stock plus \$39.0 million in cash for all outstanding shares of Tradition capital stock, for total merger consideration of \$71.5 million, based on Bancshares' closing stock price of \$47.86 on December 31, 2015. As of September 30, 2016, total goodwill related to the Tradition acquisition was \$31.5 million, which does not include subsequent fair value adjustments that are still being finalized. Goodwill is calculated as the excess of both the consideration exchanged and liabilities assumed as compared to the fair value of identifiable assets acquired, none of which is expected to be deductible for tax purposes.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Special Cautionary Notice Regarding Forward-Looking Statements

Statements and financial discussion and analysis contained in this quarterly report on Form 10-Q that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on assumptions and involve a number of risks and uncertainties, many of which are beyond the Company's control. Many possible events or factors could affect the future financial results and performance of the Company and could cause such results or performance to differ materially from those expressed in the forward-looking statements. These possible events or factors include, but are not limited to:

- changes in the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations resulting in, among other things, a deterioration in credit quality or reduced demand for credit, including the result and effect on the Company's loan portfolio and allowance for credit losses;
- changes in interest rates and market prices, which could reduce the Company's net interest margins, asset valuations and expense expectations;
- changes in the levels of loan prepayments and the resulting effects on the value of the Company's loan portfolio;
 - changes in local economic and business conditions, including commodity prices, which adversely affect the Company's customers and their ability to transact profitable business with the Company, including the ability of the Company's borrowers to repay their loans according to their terms or a change in the value of the related collateral;
- increased competition for deposits and loans adversely affecting rates and terms;
- the timing, impact and other uncertainties of any future acquisitions, including the Company's ability to identify suitable future acquisition candidates, the success or failure in the integration of their operations, and the ability to enter new markets successfully and capitalize on growth opportunities;
- the possible impairment of goodwill associated with an acquisition and possible adverse short-term effects on the results of operations;
 - increased credit risk in the Company's assets and increased operating risk caused by a material change in commercial, consumer and/or real estate loans as a percentage of the total loan portfolio;
- the concentration of the Company's loan portfolio in loans collateralized by real estate;
- the failure of assumptions underlying the establishment of and provisions made to the allowance for credit losses;
- changes in the availability of funds resulting in increased costs or reduced liquidity;
- a deterioration or downgrade in the credit quality and credit agency ratings of the securities in the Company's securities portfolio;
- increased asset levels and changes in the composition of assets and the resulting impact on the Company's capital levels and regulatory capital ratios;
- the Company's ability to acquire, operate and maintain cost effective and efficient systems without incurring unexpectedly difficult or expensive but necessary technological changes;
- the loss of senior management or operating personnel and the potential inability to hire qualified personnel at reasonable compensation levels;
- government intervention in the U.S. financial system;
- changes in statutes and government regulations or their interpretations applicable to financial holding companies and the Company's present and future banking and other subsidiaries, including changes in tax requirements and tax rates;
- poor performance by external vendors;
 - the failure of analytical and forecasting models and tools used by the Company to estimate probable credit losses and to measure the fair value of financial instruments;
- additional risks from new lines of businesses or new products and services;
- claims or litigation related to intellectual property or fiduciary responsibilities;

the failure of the Company's enterprise risk management framework to identify or address risks adequately;
a failure in or breach of operational or security systems of the Company's infrastructure, or those of its third-party vendors and other service providers, including as a result of cyber attacks;
potential risk of environmental liability associated with lending activities;
acts of terrorism, an outbreak of hostilities or other international or domestic calamities, weather or other acts of God and other matters beyond the Company's control; and
other risks and uncertainties described in the Annual Report on Form 10-K or in the Company's other reports and documents filed with the Securities and Exchange Commission.

A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. The Company believes it has chosen these assumptions or bases in good faith and that they are reasonable. However, the Company cautions you that assumptions or bases almost always vary from actual results, and the differences between assumptions or bases and actual results can be material. Therefore, the Company cautions you not to place undue reliance on its forward-looking statements. The forward-looking statements speak only as of the date the statements are made. The Company undertakes no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Management's Discussion and Analysis of Financial Condition and Results of Operations analyzes the major elements of the Company's balance sheets and statements of income. This section should be read in conjunction with the Company's consolidated financial statements and accompanying notes included elsewhere in this report and with the consolidated financial statements and accompanying notes and other detailed information appearing elsewhere in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

OVERVIEW

Prosperity Bancshares, Inc., a Texas corporation, was formed in 1983 to acquire the former Allied First Bank in Edna, Texas, which was chartered in 1949 as The First National Bank of Edna and is now known as Prosperity Bank. The Company is a registered financial holding company that derives substantially all of its revenues and income from the operation of its bank subsidiary, Prosperity Bank[®]. The Bank provides a wide array of financial products and services to small and medium-sized businesses and consumers. As of September 30, 2016, the Bank operated 245 full-service banking locations; with 65 in the Houston area, including The Woodlands; 29 in the South Texas area including Corpus Christi and Victoria; 36 in the Dallas/Fort Worth area; 22 in the East Texas area; 29 in the Central Texas area including Austin and San Antonio; 34 in the West Texas area including Lubbock, Midland-Odessa and Abilene; 16 in the Bryan/College Station area, 6 in the Central Oklahoma area and 8 in the Tulsa, Oklahoma area. The Company's principal executive office is located at Prosperity Bank Plaza, 4295 San Felipe in Houston, Texas and its telephone number is (713) 693-9300. The Company's website address is www.prosperitybankusa.com. Information contained on the Company's website is not incorporated by reference into this quarterly report on Form 10-Q and is not part of this or any other report.

The Company generates the majority of its revenues from interest income on loans, service charges on customer accounts and income from investment in securities. The revenues are partially offset by interest expense paid on deposits and other borrowings and noninterest expenses such as administrative and occupancy expenses. Net interest income is the difference between interest income on earning assets such as loans and securities and interest expense on liabilities such as deposits and borrowings which are used to fund those assets. Net interest income is the Company's largest source of revenue. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and margin.

Three principal components of the Company's growth strategy are internal growth, stringent cost control practices and acquisitions, including strategic merger transactions. The Company focuses on continual internal growth. Each banking center is operated as a separate profit center, maintaining separate data with respect to its net interest income,

efficiency ratio, deposit growth, loan growth and overall profitability. Banking center presidents and managers are accountable for performance in these areas and compensated accordingly. The Company also focuses on maintaining stringent cost control practices and policies. The Company has centralized many of its critical operations, such as data processing and loan processing. Management believes that this centralized infrastructure can accommodate substantial additional growth and achieve necessary controls while enabling the Company to minimize operational costs through certain economies of scale. The Company also intends to continue to seek expansion opportunities. On January 1, 2016, the Company completed the acquisition of Tradition Bancshares, Inc. During 2014, the Company completed the acquisition of F&M Bancorporation Inc.

Total assets were \$21.40 billion at September 30, 2016 compared with \$22.04 billion at December 31, 2015, a decrease of \$633.2 million or 2.9%. Total loans were \$9.55 billion at September 30, 2016 compared with \$9.44 billion at December 31, 2015, an increase of \$109.7 million or 1.2%. Total deposits were \$16.92 billion at September 30, 2016 compared with \$17.68 billion at December 31, 2015, a decrease of \$759.7 million or 4.3%. Total shareholders' equity was \$3.59 billion at September 30, 2016 compared with \$3.46 billion at December 31, 2015, an increase of \$131.9 million or 3.8%.

CRITICAL ACCOUNTING POLICIES

The Company's significant accounting policies are integral to understanding the financial results reported. The Company's accounting policies are described in detail in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. The Company believes that of its significant accounting policies, the following may involve a higher degree of judgment and complexity:

Allowance for Credit Losses — The allowance for credit losses is a valuation established through charges to earnings in the form of a provision for credit losses. The Company's allowance for credit losses consists of two elements, (1) specific valuation allowances based on probable losses on impaired loans and (2) a general valuation allowance based on historical loan loss experience, general economic conditions and other qualitative risk factors both internal and external to the Company. The allowance for acquired credit losses is calculated as described under the heading "Accounting for Acquired Loans and the Allowance for Acquired Credit Losses" below. Management has established an allowance for credit losses which it believes is adequate for estimated losses in the Company's loan portfolio. Based on an evaluation of the portfolio, management presents a quarterly review of the allowance for credit losses to the Bank's Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. In making its evaluation, management considers factors such as historical loan loss experience, the amount of nonperforming assets and related collateral, the volume, growth and composition of the portfolio, current economic conditions that may affect the borrower's ability to pay and the value of collateral, the evaluation of the portfolio through its internal loan review process and other relevant factors. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. Charge-offs occur when loans are deemed to be uncollectible. For further discussion of the methodology used in the determination of the allowance for credit losses, see "Financial Condition – Allowance for Credit Losses" below.

Accounting for Acquired Loans and the Allowance for Acquired Credit Losses — The Company accounts for its acquisitions using the acquisition method of accounting. Accordingly, the assets, including loans, and liabilities of the acquired entity were recorded at their fair values at the acquisition date. No allowance for credit losses related to the acquired loans is recorded on the acquisition date, as the fair value of the acquired loans incorporates assumptions regarding credit risk. These fair value estimates associated with acquired loans, and based on a discounted cash flow model, include estimates related to market interest rates and undiscounted projections of future cash flows that incorporate expectations of prepayments and the amount and timing of principal, interest and other cash flows, as well as any shortfalls thereof.

At period-end after acquisition, the fair-valued acquired loans from each acquisition are reassessed to determine whether an addition to the allowance for credit losses is appropriate due to further credit quality deterioration. For further discussion of the methodology used in the determination of the allowance for credit losses for acquired loans, see "Financial Condition – Allowance for Credit Losses" below.

Goodwill and Intangible Assets—Goodwill and intangible assets that have indefinite useful lives are subject to an impairment test at least annually, or more often, if events or circumstances indicate that it is more likely than not that the fair value of the Company's reporting unit is below the carrying value of its equity. Under Accounting Standards

Codification (“ASC”) topic 350-20, “Intangibles—Goodwill and Other—Goodwill,” companies have the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining the need to perform step one of the annual test for goodwill impairment. An entity has an unconditional option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period.

If the Company bypasses the qualitative assessment, a two-step goodwill impairment test is performed. The two-step process begins with an estimation of the fair value of the Company’s reporting unit compared with its carrying value. If the carrying amount exceeds the fair value of the reporting unit, a second test is completed comparing the implied fair value of the reporting unit’s goodwill to its carrying value to measure the amount of impairment.

Estimating the fair value of the Company's reporting unit is a subjective process involving the use of estimates and judgments, particularly related to future cash flows of the reporting unit, discount rates (including market risk premiums) and market multiples. Material assumptions used in the valuation tools include the comparable public company price multiples used in the terminal value, future cash flows and the market risk premium component of the discount rate. The estimated fair values of the reporting unit is determined using a blend of two commonly used valuation techniques: the market approach and the income approach. The Company gives consideration to both valuation techniques, as either technique can be an indicator of value. For the market approach, valuations of the reporting unit were based on an analysis of relevant price multiples in market trades in companies with similar characteristics. For the income approach, estimated future cash flows (derived from internal forecasts and economic expectations) and terminal value (value at the end of the cash flow period, based on price multiples) were discounted. The discount rate was based on the imputed cost of equity capital.

The Company had no intangible assets with indefinite useful lives at September 30, 2016. Other identifiable intangible assets that are subject to amortization are being amortized on a non-pro rata basis over the years expected to be benefited, which the Company believes is between ten and fifteen years. These amortizable intangible assets are reviewed for impairment if circumstances indicate their value may not be recoverable based on a comparison of fair value to carrying value. Based on the Company's annual goodwill impairment test as of September 30, 2016, management does not believe any of its goodwill is impaired as of September 30, 2016 because the fair value of the Company's equity exceeded its carrying value. While the Company believes no impairment existed at September 30, 2016, under accounting standards applicable at that date, different conditions or assumptions, or changes in cash flows or profitability, if significantly negative or unfavorable, could have a material adverse effect on the outcome of the Company's impairment evaluation and financial condition or future results of operations.

Other-Than-Temporarily Impaired Securities—When the fair value of a security is below its amortized cost, and depending on the length of time the condition exists and the extent the fair market value is below amortized cost, additional analysis is performed to determine whether an impairment exists. Available for sale and held to maturity securities are analyzed quarterly for possible other-than-temporary impairment. The analysis considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. Often, the information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the security may be different than previously estimated, which could have a material effect on the Company's results of operations and financial condition.

Fair Values of Financial Instruments—The Company determines the fair market values of financial instruments based on the fair value hierarchy established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value. Level 1 inputs include quoted market prices, where available. If such quoted market prices are not available Level 2 inputs are used. These inputs are based upon internally developed analytical tools that primarily use observable market-based parameters. Level 3 inputs are unobservable inputs which are typically based on an entity's own assumptions, as there is little, if any, related market activity. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

RECENT ACQUISITIONS

Acquisition of Tradition Bancshares, Inc. – On January 1, 2016, the Company completed the acquisition of Tradition Bancshares, Inc. ("Tradition") and its wholly-owned subsidiary Tradition Bank headquartered in Houston, Texas.

Tradition Bank operated 7 banking offices in the Houston, Texas area, including its main office in Bellaire, 3 banking centers in Katy and 1 banking center in The Woodlands. As of December 31, 2015, Tradition, on a consolidated basis, reported total assets of \$548.0 million, total loans of \$253.3 million and total deposits of \$488.9 million, each at book value.

RESULTS OF OPERATIONS

Net income available to common shareholders was \$68.7 million (\$0.99 per common share on a diluted basis) for the quarter ended September 30, 2016 compared with \$70.6 million (\$1.01 per common share on a diluted basis) for the quarter ended September 30, 2015, a decrease in net income of \$1.9 million or 2.8%. The Company posted annualized returns on average common equity of 7.66% and 8.31%, annualized returns on average assets of 1.27% and 1.30% and efficiency ratios of 43.26% and 40.72% for the quarters ended September 30, 2016 and 2015, respectively. The efficiency ratio is calculated by dividing total non-interest expense, excluding credit loss provisions, by net interest income plus non-interest income, excluding net gains and losses on the sale of assets. Additionally, taxes are not part of this calculation.

For the nine months ended September 30, 2016, net income available to common shareholders was \$205.7 million (\$2.95 per common share on a diluted basis) compared with \$216.2 million (\$3.09 per common share on a diluted basis) for the same period in 2015, a decrease in net income of \$10.5 million or 4.9%. The Company posted annualized returns on average common equity of 7.74% and 8.63%, annualized returns on average assets of 1.25% and 1.33% and efficiency ratios of 42.24% and 41.64% for the nine months ended September 30, 2016 and 2015, respectively.

Net Interest Income

The Company's net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as a "volume change." It is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and other borrowed funds, referred to as a "rate change."

For the three months ended September 30, 2016

Net interest income before the provision for credit losses was \$154.1 million for the quarter ended September 30, 2016, a decrease of \$2.0 million or 1.3%, compared with \$156.1 million for the same period in 2015. The decrease in net interest income was primarily due to a decrease in loan discount accretion of \$3.4 million for the three months ended September 30, 2016.

Interest income on loans was \$116.2 million for the quarter ended September 30, 2016, a decrease of \$664 thousand or 0.6%, compared with \$116.9 million for the same period in 2015. This was primarily due to a decrease in loan discount accretion of \$3.4 million, partially offset by an increase in average loans of 4.9% for the three months ended September 30, 2016.

Interest income on securities was \$48.1 million for the quarter ended September 30, 2016, a decrease of \$478 thousand or 1.0%, compared with \$48.6 million for the same period in 2015. This was primarily due to a decrease in average securities of 5.2%, partially offset by a 9 basis point increase in the average yield earned on securities for the three months ended September 30, 2016.

Average interest-bearing liabilities were \$12.83 billion for the quarter ended September 30, 2016, a decrease of \$233.3 million or 1.8%, compared with \$13.06 billion for the same period in 2015. The net interest margin on a tax-equivalent basis decreased from 3.30% for the quarter ended September 30, 2015 to 3.29% for the quarter ended September 30, 2016. This was primarily due to a decrease in loan discount accretion of \$3.4 million for the three months ended September 30, 2016.

For the nine months ended September 30, 2016

Net interest income before the provision for credit losses was \$478.8 million for the nine months ended September 30, 2016, an increase of \$1.5 million or 0.3%, compared with \$477.3 million for the same period in 2015. The increase in net interest income was primarily attributable to a 1.6% increase in average interest-earning assets, partially offset by a decrease in loan discount accretion of \$12.9 million for the nine months ended September 30, 2016.

Interest income on loans was \$359.1 million for the nine months ended September 30, 2016, a decrease of \$2.1 million or 0.6%, compared with \$361.2 million for the same period in 2015. This was primarily due to a decrease in loan discount accretion of \$12.9 million and a decrease in the average yield earned on loans, partially offset by an increase in average loans of 5.4% for the nine months ended September 30, 2016. The Company had \$67.5 million of total outstanding discounts on acquired loans, of which \$50.4 million was accretable at September 30, 2016.

Interest income on securities was \$151.8 million for the nine months ended September 30, 2016, an increase of \$6.1 million or 4.2%, compared with \$145.7 million for the same period in 2015. This was primarily due to an 11 basis point increase in the average yield earned on securities for the nine months ended September 30, 2016.

Average interest-bearing liabilities were \$13.17 billion for the nine months ended September 30, 2016, an increase of \$12.5 million or 0.1%, compared with \$13.16 billion for the same period in 2015. The net interest margin on a tax-equivalent basis decreased 4 basis points from 3.42% for the nine months ended September 30, 2015 to 3.38% for the nine months ended September 30, 2016. This was primarily due to a decrease in loan discount accretion of \$12.9 million for the nine months ended September 30, 2016.

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The following tables present, for the periods indicated, the total dollar amount of average balances, interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates. Except as indicated in the footnotes, no tax-equivalent adjustments were made and all average balances are daily average balances. Any nonaccruing loans have been included in the table as loans carrying a zero yield.

	Three Months Ended September 30,							
	2016				2015			
	Average Outstanding Balance	Interest Earned/Interest Paid	Average Yield/Rate (%)		Average Outstanding Balance	Interest Earned/Interest Paid	Average Yield/Rate (%)	
	(Dollars in thousands)							
Assets								
Interest-Earning Assets:								
Loans	\$9,601,628	\$ 116,247	4.82	%	\$9,156,679	\$ 116,911	5.07	%
Investment securities	9,203,253	48,132	2.08	%	9,706,373	48,610	1.99	%
Federal funds sold and other earning assets	72,171	81	0.45	%	55,000	22	0.16	%
Total interest-earning assets	18,877,052	164,460	3.47	%	18,918,052	165,543	3.47	%
Allowance for credit losses	(84,476)				(80,793)			
Noninterest-earning assets	2,804,773				2,819,150			
Total assets	\$21,597,349				\$21,656,409			
Liabilities and Shareholders' Equity								
Interest-Bearing Liabilities:								
Interest-bearing demand deposits	\$3,858,821	\$ 2,280	0.24	%	\$3,663,114	\$ 1,961	0.21	%
Savings and money market deposits	5,610,342	3,753	0.27	%	5,492,326	3,392	0.24	%
Certificates and other time deposits	2,492,889	3,363	0.54	%	2,685,346	3,400	0.50	%
Other borrowings	532,301	752	0.56	%	886,787	473	0.21	%
Securities sold under repurchase agreements	331,254	248	0.30	%	331,286	209	0.25	%
Junior subordinated debentures	—	—	—	—	—	—	—	—
Total interest-bearing liabilities	12,825,607	10,396	0.32	%	13,058,859	9,435	0.29	%
Noninterest-Bearing Liabilities:								
Noninterest-bearing demand deposits	5,070,094				5,078,234			
Other liabilities	118,881				121,360			
Total liabilities	18,014,582				18,258,453			
Shareholders' equity	3,582,767				3,397,956			
Total liabilities and shareholders' equity	\$21,597,349				\$21,656,409			
Net interest rate spread			3.15	%			3.18	%

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Net interest income and margin (2) (3)	\$ 154,064	3.25	%	\$ 156,108	3.27	%
Net interest income and margin (tax equivalent) (4)	\$ 155,994	3.29	%	\$ 157,571	3.30	%

(1) Annualized and based on average balances on an actual 365 day or 366 day basis for the three months ended September 30, 2016 and 2015.

(2) Yield is based on amortized cost and does not include any component of unrealized gains or losses.

(3) The net interest margin is equal to net interest income divided by average interest-earning assets.

(4) In order to make pretax income and resultant yields on tax-exempt investments and loans comparable to those on taxable investments and loans, a tax-equivalent adjustment has been computed using a federal income tax rate of 35%.

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	Nine Months Ended September 30, 2016			2015			Average Yield/Rate (1)	
	Average Outstanding Balance (Dollars in thousands)	Interest Earned/Interes Paid	Yield/Rate (1)	Average Outstanding Balance	Interest Earned/Interes Paid	Yield/Rate (1)		
Assets								
Interest-Earning Assets:								
Loans	\$9,653,891	\$ 359,066	4.97 %	\$9,159,775	\$ 361,193	5.27 %		
Investment securities	9,422,744	151,802	2.15 %	9,547,293	145,702	2.04 %		
Federal funds sold and other earning assets	73,608	242	0.44 %	133,331	234	0.23 %		
Total interest-earning assets	19,150,243	\$ 511,110	3.57 %	18,840,399	\$ 507,129	3.60 %		
Allowance for credit losses	(83,801)			(80,781)				
Noninterest-earning assets	2,856,117			2,835,450				
Total assets	\$21,922,559			\$21,595,068				
Liabilities and Shareholders' Equity								
Interest-Bearing Liabilities:								
Interest-bearing demand deposits	\$4,135,579	\$ 7,633	0.25 %	\$3,909,337	\$ 6,771	0.23 %		
Savings and money market deposits	5,721,341	11,470	0.27 %	5,503,597	10,171	0.25 %		
Certificates and other time deposits	2,529,353	10,544	0.56 %	2,819,822	10,557	0.50 %		
Other borrowings	461,491	1,944	0.56 %	550,743	967	0.23 %		
Securities sold under repurchase agreements	319,948	694	0.29 %	334,958	620	0.25 %		
Junior subordinated debentures	2,591	37	1.91 %	39,365	791	2.69 %		
Total interest-bearing liabilities	13,170,303	32,322	0.33 %	13,157,822	29,877	0.30 %		
Noninterest-Bearing Liabilities:								
Noninterest-bearing demand deposits	5,085,041			4,990,769				
Other liabilities	122,076			106,782				
Total liabilities	18,377,420			18,255,373				
Shareholders' equity	3,545,139			3,339,695				
Total liabilities and shareholders' equity	\$21,922,559			\$21,595,068				
Net interest rate spread			3.24 %			3.30 %		
Net interest income and margin (2) (3)		\$ 478,788	3.34 %		\$ 477,252	3.39 %		
Net interest income and margin (tax equivalent) (4)		\$ 484,522	3.38 %		\$ 481,942	3.42 %		

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- (1) Annualized and based on average balances on an actual 365 day or 366 day basis for the nine months ended September 30, 2016 and 2015.
- (2) Yield is based on amortized cost and does not include any component of unrealized gains or losses.
- (3) The net interest margin is equal to net interest income divided by average interest-earning assets.
- (4) In order to make pretax income and resultant yields on tax-exempt investments and loans comparable to those on taxable investments and loans, a tax-equivalent adjustment has been computed using a federal income tax rate of 35%.

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The following table presents information regarding the dollar amount of changes in interest income and interest expense for the periods indicated for each major component of interest-earning assets and interest-bearing liabilities and distinguishes between the changes attributable to changes in volume and changes in interest rates. For purposes of this table, changes attributable to both rate and volume which cannot be segregated have been allocated to rate.

	Three Months Ended September 30, 2016 vs. 2015			Nine Months Ended September 30, 2016 vs. 2015		
	Increase (Decrease) Due to Change in			Increase (Decrease) Due to Change in		
	Volume	Rate	Total	Volume	Rate	Total
	(Dollars in thousands)					
Interest-Earning Assets:						
Loans (1)	\$5,666	\$(6,330)	\$(664)	\$19,502	\$(21,629)	\$(2,127)
Investment securities (1)	(2,513)	2,035	(478)	(1,902)	8,002	6,100
Federal funds sold and other earning assets	7	52	59	(105)	113	8
Total increase (decrease) in interest income	3,160	(4,243)	(1,083)	17,495	(13,514)	3,981
Interest-Bearing Liabilities:						
Interest-bearing demand deposits	104	215	319	392	470	862
Savings and money market deposits	73	288	361	403	896	1,299
Certificates and other time deposits (1)	(243)	206	(37)	(1,088)	1,075	(13)
Other borrowings	(189)	468	279	(157)	1,134	977
Securities sold under repurchase agreements	(0)	39	39	(28)	102	74
Junior subordinated debentures	—	—	—	(740)	(14)	(754)
Total (decrease) increase in interest expense	(255)	1,216	961	(1,218)	3,663	2,445
Increase (decrease) in net interest income	\$3,415	\$(5,459)	\$(2,044)	\$18,713	\$(17,177)	\$1,536

(1) Includes impact of purchase accounting adjustments.

Provision for Credit Losses

Management actively monitors the Company's asset quality and provides specific loss provisions when necessary. Provisions for credit losses are charged to income to bring the total allowance for credit losses to a level deemed appropriate by management of the Company based on such factors as historical credit loss experience, industry diversification of the Company's commercial loan portfolio, the amount of nonperforming loans and related collateral, the volume growth and composition of the loan portfolio, current economic conditions that may affect the borrower's ability to pay and the value of collateral, the evaluation of the loan portfolio through the internal loan review process and other relevant factors.

Loans are charged off against the allowance for credit losses when appropriate. Although management believes it uses the best information available to make determinations with respect to the provision for credit losses, future adjustments may be necessary if economic conditions differ from the assumptions used in making the initial determinations.

The Company recorded a \$2.0 million provision for credit losses for the quarter ended September 30, 2016 and a \$5.3 million provision for the quarter ended September 30, 2015. Net charge-offs were \$241 thousand for the quarter ended September 30, 2016 compared with net charge-offs of \$5.3 million for the quarter ended September 30, 2015. The Company made a \$22.0 million provision for credit losses for the nine months ended September 30, 2016 and a \$7.1 million provision for the nine months ended September 30, 2015. Net charge-offs were \$17.8 million for the nine months ended September 30, 2016 compared with \$6.8 million for the nine months ended September 30, 2015. This was primarily due to the charge-offs related to three energy loans and one agricultural loan during the nine months ended September 30, 2016. See "Financial Condition – Allowance for Credit Losses" below for more information.

Noninterest Income

The Company's primary sources of recurring noninterest income are NSF fees, credit, debit and ATM card income and service charges on deposit accounts. Noninterest income does not include loan origination fees which are recognized over the life of the related loan as an adjustment to yield using the interest method. Noninterest income totaled \$29.7 million for the three months ended September 30, 2016 compared with \$31.8 million for the same period in 2015, a decrease of \$2.1 million or 6.6%. This was primarily

due to a decrease in brokerage income, NSF fees and other noninterest income, partially offset by an increase in mortgage income for the three months ended September 30, 2016. Noninterest income totaled \$89.0 million for the nine months ended September 30, 2016 compared with \$90.5 million for the same period in 2015, a decrease of \$1.5 million or 1.7%. This was primarily due to a decrease in brokerage income, net gain on sale of assets and other noninterest income, partially offset by an increase in service charges on deposit accounts and mortgage income for the nine months ended September 30, 2016.

The following table presents, for the periods indicated, the major categories of noninterest income:

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
	2016	2015	2016	2015
	(Dollars in thousands)			
Nonsufficient funds (NSF) fees	\$8,764	\$9,082	\$24,984	\$25,310
Credit card, debit card and ATM card income	5,903	5,955	17,659	17,596
Service charges on deposit accounts	4,698	4,438	13,898	12,806
Trust income	1,851	1,986	5,640	6,042
Mortgage income	2,143	1,770	5,386	4,431
Brokerage income	1,213	1,596	3,789	4,546
Bank owned life insurance income	1,417	1,384	4,273	4,154
Net gain on sale of assets	37	173	1,389	1,822
Other	3,658	5,396	11,932	13,791
Total noninterest income	\$29,684	\$31,780	\$88,950	\$90,498

Noninterest Expense

Noninterest expense totaled \$79.5 million for the quarter ended September 30, 2016 compared with \$76.4 million for the quarter ended September 30, 2015, an increase of \$3.0 million or 4.0%. This was primarily due to an increase in salaries and benefits expense, professional fees and other noninterest expense. Noninterest expense totaled \$239.2 million for the nine months ended September 30, 2016 compared with \$235.6 million for the nine months ended September 30, 2015, an increase of \$3.6 million or 1.5%. This was primarily due to an increase in salaries and benefits expense, software amortization and professional fees, partially offset by a decrease in FDIC insurance assessments for the nine months ended September 30, 2016.

The following table presents, for the periods indicated, the major categories of noninterest expense:

	Three Months		Nine Months Ended	
	Ended September 30, 2016	2015	September 30, 2016	2015
	(Dollars in thousands)			
Salaries and employee benefits (1)	\$48,328	\$46,587	\$146,666	\$144,372
Non-staff expenses:				
Net occupancy and equipment	5,997	6,088	17,362	17,864
Credit and debit card, data processing and software amortization	4,207	3,924	12,801	11,786
Regulatory assessments and FDIC insurance	3,434	3,366	10,311	11,973
Core deposit intangibles amortization	2,418	2,356	6,974	7,235
Depreciation	3,289	3,313	9,924	9,649
Communications (2)	2,870	2,663	8,790	8,307
Other real estate expense	44	123	136	384
Professional fees	1,144	746	3,396	2,058
Printing and supplies	579	536	1,709	1,551
Other	7,166	6,728	21,170	20,448
Total noninterest expense	\$79,476	\$76,430	\$239,239	\$235,627

(1) Includes stock-based compensation expense of \$2.1 million and \$2.8 million for the three months ended September 30, 2016 and 2015, respectively, and \$7.2 million and \$8.5 million for the nine months ended September 30, 2016 and 2015, respectively.

(2) Communications expense includes telephone, data circuits, postage and courier expenses.

Income Taxes

Income tax expense decreased \$1.9 million or 5.4%, to \$33.6 million, for the quarter ended September 30, 2016 compared with \$35.6 million for the same period in 2015. This decrease was primarily attributable to lower pre-tax net earnings for the three months ended September 30, 2016. For the nine months ended September 30, 2016, income tax expense totaled \$100.8 million, a decrease of \$8.1 million or 7.4%, compared with \$108.9 million for the same period in 2015. This decrease was primarily attributable to lower pre-tax net earnings for the nine months ended September 30, 2016. The Company's effective tax rate for the three and nine months ended September 30, 2016 and 2015 was 32.9% and 33.5%, respectively.

FINANCIAL CONDITION

Loan Portfolio

The Company separates its loan portfolio into two general categories of loans: (1) "legacy loans," which are loans originated by Prosperity Bank and made pursuant to the Company's loan policy and procedures in effect at the time the loan was made, and (2) "acquired loans," which are loans acquired in a business combination and preliminarily recorded at fair value at acquisition date. Those acquired loans that are renewed or substantially modified after the date of the business combination, which therefore causes them to become subject to the Company's allowance for credit losses methodology, are referred to as "acquired legacy loans." If a renewal or substantial modification of an acquired loan is underwritten by the Company with a new credit analysis, the loan will no longer be categorized as an acquired loan.

For example, acquired loans to one borrower may be combined into a new loan with a new loan number and categorized as a legacy loan. Acquired loans with a fair value discount or premium at the date of the business combination that remained at the reporting date are referred to as “fair-valued acquired loans.” All fair-valued acquired loans are further categorized into “PCI loans” (purchased credit-impaired loans) and “Non-PCI loans.” Acquired loans with evidence of credit quality deterioration at acquisition for which it is probable that the Company would not be able to collect all contractual amounts due are PCI loans.

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The following tables summarize the Company's legacy and acquired loan portfolios broken out into legacy loans, acquired legacy loans, Non-PCI loans and PCI loans, as of the dates indicated.

	September 30, 2016				
	Acquired Loans				
	Acquired				
	Legacy Loans	Legacy Loans	Non-PCI Loans	PCI Loans	Total Loans
	(Dollars in thousands)				
Residential mortgage loans held for sale	\$29,457	\$—	\$—	\$—	\$29,457
Commercial and industrial	1,082,718	309,658	141,548	8,135	1,542,059
Real estate:					
Construction, land development and other land loans	1,074,386	53,824	76,139	1,471	1,205,820
1-4 family residential (includes home equity)	2,251,114	84,553	336,618	5,710	2,677,995
Commercial real estate (includes multi-family residential)	2,288,983	306,836	545,044	17,706	3,158,569
Farmland	383,090	19,502	70,977	388	473,957
Agriculture	147,701	39,846	2,571	5	190,123
Consumer and other	214,494	31,686	24,154	—	270,334
Total loans held for investment	7,442,486	845,905	1,197,051	33,415	9,518,857
Total	\$7,471,943	\$845,905	\$1,197,051	\$33,415	\$9,548,314

	December 31, 2015				
	Acquired Loans				
	Acquired				
	Legacy Loans	Legacy Loans	Non-PCI Loans	PCI Loans	Total Loans
	(Dollars in thousands)				
Residential mortgage loans held for sale	\$23,933	\$—	\$—	\$—	\$23,933
Commercial and industrial	1,038,118	419,932	218,583	15,613	1,692,246
Real estate:					
Construction, land development and other land loans	954,587	64,158	53,533	920	1,073,198
1-4 family residential (includes home equity)	2,115,857	88,852	406,754	5,269	2,616,732
Commercial real estate (includes multi-family residential)	2,204,662	327,192	581,599	17,630	3,131,083
Farmland	335,689	18,188	80,082	390	434,349
Agriculture	143,265	66,415	4,785	4	214,469
Consumer and other	196,859	25,289	30,431	—	252,579
Total loans held for investment	6,989,037	1,010,026	1,375,767	39,826	9,414,656
Total	\$7,012,970	\$1,010,026	\$1,375,767	\$39,826	\$9,438,589

At September 30, 2016, total loans were \$9.55 billion, an increase of \$109.7 million or 1.2%, compared with \$9.44 billion at December 31, 2015. Loans at September 30, 2016 included \$29.5 million of loans held for sale compared with \$23.9 million at December 31, 2015. At September 30, 2016, loans represented 44.6% of total assets compared

with 42.8% of total assets at December 31, 2015.

The loan portfolio consist of various types of loans categorized by major type as follows:

(i) Commercial and Industrial Loans. In nearly all cases, the Company's commercial loans are made in the Company's market areas and are underwritten on the basis of the borrower's ability to service the debt from income. As a general practice, the Company takes as collateral a lien on any available real estate, equipment or other assets owned by the borrower and obtains a personal guaranty of the borrower or principal. Working capital loans are primarily collateralized by short-term assets whereas term loans are primarily collateralized by long-term assets. In general, commercial loans involve more credit risk than residential mortgage loans and commercial mortgage loans and, therefore, usually yield a higher return. The increased risk in commercial loans is due to the type of collateral securing these loans as well as the expectation that commercial loans generally will be serviced principally from the operations of the business, and those operations may not be successful. Historical trends have shown these types of loans to have higher delinquencies than mortgage loans. As a result of these additional complexities, variables and risks, commercial loans require more thorough underwriting and servicing than other types of loans.

Included in commercial and industrial loans are commitments to oil and gas producers secured by proven, developed and producing reserves and commitments to service, equipment and midstream companies secured mainly by accounts receivable, inventory and equipment. Mineral reserve values supporting commitments to producers are normally re-determined semi-annually using reserve studies prepared by a third-party or the Company's oil and gas engineer. Accounts receivable and inventory borrowing bases for service companies are typically re-determined monthly. Funding requests by both producers and service companies are monitored relative to the most recently determined borrowing base. As of September 30, 2016, oil and gas loans totaled \$308.9 million or 3.2% of total loans, of which \$139.9 million were to production companies and \$169.0 million were to service companies. This compares with total oil and gas loans of \$399.1 million or 4.2% of total loans as of December 31, 2015, of which \$178.6 million were to production companies and \$220.5 million were to service companies. In addition, as of September 30, 2016, the Company had total unfunded commitments to oil and gas companies of \$154.2 million, of which \$70.5 million were to production companies and \$83.7 million were to service companies. This compares with total unfunded commitments to oil and gas companies of \$196.4 million as of December 31, 2015, of which \$80.3 million were to production companies and \$116.1 million were to service companies. Total unfunded commitments to producers include letters of credit issued in lieu of oil well plugging bonds.

(ii) Commercial Real Estate. The Company makes commercial real estate loans collateralized by owner-occupied and nonowner-occupied real estate to finance the purchase of real estate. The Company's commercial real estate loans are collateralized by first liens on real estate, typically have variable interest rates (or five year or less fixed rates) and amortize over a 15- to 20-year period. Payments on loans secured by nonowner-occupied properties are often dependent on the successful operation or management of the properties. Accordingly, repayment of these loans may be subject to adverse conditions in the real estate market or the economy to a greater extent than other types of loans. The Company seeks to minimize these risks in a variety of ways, including giving careful consideration to the property's operating history, future operating projections, current and projected occupancy, location and physical condition in connection with underwriting these loans. The underwriting analysis also includes credit verification, analysis of global cash flow, appraisals and a review of the financial condition of the borrower. At September 30, 2016, approximately 40.2% of the outstanding principal balance of the Company's commercial real estate loans including farmland were secured by owner-occupied properties.

(iii) 1-4 Family Residential Loans. The Company's lending activities also include the origination of 1-4 family residential mortgage loans (including home equity loans) collateralized by owner-occupied residential properties located in the Company's market areas. The Company offers a variety of mortgage loan portfolio products which generally are amortized over five to 25 years. Loans collateralized by 1-4 family residential real estate generally have been originated in amounts of no more than 89% of appraised value or have mortgage insurance. The Company requires mortgage title insurance and hazard insurance. The Company retains these portfolio loans for its own account rather than selling them into the secondary market. By doing so, the Company incurs interest rate risk as well as the risks associated with nonpayments on such loans. The Company's Home Loan Center offers a variety of mortgage loan products which are generally amortized over 30 years, including FHA and VA loans. The Company sells the loans originated by the Home Loan Center into the secondary market.

(iv) Construction, Land Development and Other Land Loans. The Company makes loans to finance the construction of residential and, to a lesser extent, nonresidential properties. Construction loans generally are collateralized by first liens on real estate and have floating interest rates. The Company conducts periodic inspections, either directly or through an agent, prior to approval of periodic draws on these loans. Underwriting guidelines similar to those described above are also used in the Company's construction lending activities. Construction loans involve additional risks attributable to the fact that loan funds are advanced upon the security of a project under construction, and the project is of uncertain value prior to its completion. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a

result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If the Company is forced to foreclose on a project prior to completion, the Company may not be able to recover all of the unpaid portion of the loan. In addition, the Company may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. Although the Company has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, these procedures may not prevent losses from the risks described above.

(v) Agriculture Loans. The Company provides agriculture loans for short-term beef and crop production, including rice, cotton, milo and corn, farm equipment financing and agriculture real estate financing. The Company evaluates agriculture borrowers primarily based on their historical profitability, level of experience in their particular agriculture industry, overall financial capacity and the availability of secondary collateral to withstand economic and natural variations common to the industry. Because agriculture loans present a higher level of risk associated with events caused by nature, the Company routinely makes on-site visits and inspections in order to identify and monitor such risks.

(vi) Consumer Loans. Consumer loans made by the Company include direct “A”-credit automobile loans, recreational vehicle loans, boat loans, home improvement loans, personal loans (collateralized and uncollateralized), credit cards and deposit account collateralized loans. The terms of these loans typically range from 12 to 180 months and vary based upon the nature of collateral and size of loan. Generally, consumer loans entail greater risk than do real estate secured loans, particularly in the case of consumer loans that are unsecured or collateralized by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan balance. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower’s continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws may limit the amount which can be recovered on such loans.

The Company maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company’s policies and procedures.

Nonperforming Assets

Nonperforming assets include loans on nonaccrual status, accruing loans 90 days past due or more and real estate which has been acquired through foreclosure and is awaiting disposition. Nonperforming assets do not include PCI loans unless the timing and amount of projected cash flows can no longer be reasonably estimated. PCI loans become subject to the Company's allowance for credit losses methodology when a deterioration in projected cash flows is identified.

The Company generally places a loan on nonaccrual status and ceases accruing interest when the payment of principal or interest is delinquent for 90 days, or earlier in some cases, unless the loan is in the process of collection and the underlying collateral fully supports the carrying value of the loan.

Nonperforming assets increased \$16.7 million or 38.4%, to \$60.2 million, at September 30, 2016 compared with \$43.5 million at December 31, 2015, of which \$32.3 million and \$22.0 million, respectively, were attributable to acquired loans. This increase was primarily attributable to two commercial real estate loans and two commercial and industrial loans.

The following tables present information regarding nonperforming assets differentiated among legacy loans, acquired legacy loans, Non-PCI loans and PCI loans, as of the dates indicated:

	September 30, 2016				
	Acquired Loans			PCI Loans	Total
	Legacy Loans	Non-PCI Loans	Acquired Legacy Loans		
	Legacy Loans	Non-PCI Loans	Acquired Legacy Loans	PCI Loans	Total
	(Dollars in thousands)				
Nonaccrual loans (1)	\$13,246	\$21,701	\$ 5,301	\$ 3,203	\$43,451
Accruing loans 90 or more days past due	254	145	—	—	399
Total nonperforming loans	13,500	21,846	5,301	3,203	43,850
Repossessed assets	25	—	11	—	36
Other real estate	14,326	1,178	340	436	16,280

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Total nonperforming assets	\$27,851	\$23,024	\$ 5,652	\$ 3,639	\$60,166
Nonperforming assets to total loans and other real estate by category	0.37 %	2.72 %	0.47 %	10.75 %	0.63 %

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	December 31, 2015									
	Acquired Loans		Acquired Legacy		Total					
	Legacy Loans	Loans	Non-PCI Loans	PCI Loans						
	(Dollars in thousands)									
Nonaccrual loans (1)	\$20,800	\$7,361	\$ 4,254	\$ 7,296	\$39,711					
Accruing loans 90 or more days past due	—	614	—	—	614					
Total nonperforming loans	20,800	7,975	4,254	7,296	40,325					
Repossessed assets	5	10	56	100	171					
Other real estate	657	110	1,743	453	2,963					
Total nonperforming assets	\$21,462	\$8,095	\$ 6,053	\$ 7,849	\$43,459					
Nonperforming assets to total loans and other real estate by category	0.31	%	0.80	%	0.44	%	19.49	%	0.46	%

(1) Includes troubled debt restructurings of \$318 thousand and \$681 thousand as of September 30, 2016 and December 31, 2015, respectively.

Nonperforming assets were 0.63% of total loans and other real estate at September 30, 2016 compared with 0.46% of total loans and other real estate at December 31, 2015. Nonperforming assets attributable to legacy loans were 0.37% of total legacy loans and other real estate at September 30, 2016 compared with 0.31% of total legacy loans and other real estate at December 31, 2015. Nonperforming assets attributable to acquired legacy loans were 2.72% of total acquired legacy loans and other real estate at September 30, 2016 compared with 0.80% of total acquired legacy loans and other real estate at December 31, 2015. Nonperforming assets attributable to Non-PCI loans were 0.47% of total Non-PCI loans and other real estate at September 30, 2016 compared with 0.44% of total Non-PCI loans and other real estate at December 31, 2015. Nonperforming assets attributable to PCI loans were 10.75% of total PCI loans and other real estate at September 30, 2016 compared with 19.49% of total PCI loans and other real estate at December 31, 2015. The allowance for credit losses as a percentage of total nonperforming loans was 195.2% at September 30, 2016 and 201.8% at December 31, 2015. For the nine months ended September 30, 2016, the Company had one loan modified in troubled debt restructurings (TDRs) with a balance of \$154 thousand at the date of restructure and a remaining recorded investment of \$152 thousand at September 30, 2016. Total TDRs outstanding totaled \$318 thousand at September 30, 2016.

Allowance for Credit Losses

The following table presents, as of and for the periods indicated, an analysis of the allowance for credit losses and other related data:

	As of and for the Nine Months Ended	
	September 30, 2016	2015
	(Dollars in thousands)	
Average loans outstanding	\$9,653,891	\$9,159,775
Gross loans outstanding at end of period	\$9,548,314	\$9,204,988
Allowance for credit losses at beginning of period	\$81,384	\$80,762
Provision for credit losses	22,000	7,060

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Charge-offs:			
Commercial and industrial	(10,641)	(5,691)	
Real estate and agriculture	(7,404)	(851)	
Consumer and other	(4,371)	(2,406)	
Recoveries:			
Commercial and industrial	2,243	789	
Real estate and agriculture	1,466	310	
Consumer and other	908	1,030	
Net charge-offs	(17,799)	(6,819)	
Allowance for credit losses at end of period	\$85,585	\$81,003	
Ratio of allowance to end of period loans	0.90	%	0.88 %
Ratio of net charge-offs to average loans (annualized)	0.25	%	0.10 %
Ratio of allowance to end of period nonperforming loans	195.2	%	179.2 %

The allowance for credit losses is a valuation established through charges to earnings in the form of a provision for credit losses. Management has established an allowance for credit losses which it believes is adequate for estimated losses in the Company's loan portfolio. The amount of the allowance for credit losses is affected by the following: (1) charge offs of loans that occur when loans are deemed uncollectible and decrease the allowance, (2) recoveries on loans previously charged off that increase the allowance and (3) provisions for credit losses charged to earnings that increase the allowance. Based on an evaluation of the loan portfolio and consideration of the factors listed below, management presents a quarterly review of the allowance for credit losses to the Bank's Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. Although management believes it uses the best information available to make determinations with respect to the allowance for credit losses, future adjustments may be necessary if economic conditions or the borrower's performance differ from the assumptions used in making the initial determinations.

The Company's allowance for credit losses consists of two components: a specific valuation allowance based on probable losses on specifically identified loans and a general valuation allowance based on historical loan loss experience, general economic conditions and other qualitative risk factors both internal and external to the Company.

In setting the specific valuation allowance, the Company follows a loan review program to evaluate the credit risk in the total loan portfolio and assigns risk grades to each loan. Through this loan review process, the Company maintains an internal list of impaired loans which, along with the delinquency list of loans, helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for credit losses. All loans that have been identified as impaired are reviewed on a quarterly basis in order to determine whether a specific reserve is required. For certain impaired loans, the Company allocates a specific loan loss reserve primarily based on the value of the collateral securing the impaired loan. The specific reserves are determined on an individual loan basis. Loans for which specific reserves are provided are excluded from the general valuation allowance described below.

In determining the amount of the general valuation allowance, management considers factors such as historical loan loss experience, concentration risk of specific loan types, the volume, growth and composition of the Company's loan portfolio, current economic conditions that may affect the borrower's ability to pay and the value of collateral, the evaluation of the Company's loan portfolio through its internal loan review process, general economic conditions and other qualitative risk factors both internal and external to the Company and other relevant factors. Based on a review of these factors for each loan type, the Company applies an estimated percentage to the outstanding balance of each loan type, excluding any loan that has a specific reserve allocated to it. The Company uses this information to establish the amount of the general valuation allowance.

A change in the allowance for credit losses can be attributable to several factors, most notably (1) specific reserves identified for impaired loans, (2) historical credit loss information, (3) changes in environmental factors and (4) growth in the balance of legacy loans and the re-categorization of fair-valued acquired loans to acquired legacy loans, which subjects such loans to the allowance methodology.

Changes in the Company's asset quality are reflected in the allowance in several ways. Specific reserves that are calculated on a loan-by-loan basis and the qualitative assessment of all other loans reflect current changes in the credit quality of the loan portfolio. Historical credit losses, on the other hand, are based on a three-year look back period, which are then applied to estimate current credit losses inherent in the loan portfolio. A deterioration in the credit quality of the loan portfolio in the current period would increase the historical credit loss factor to be applied in future periods, just as an improvement in credit quality would decrease the historical credit loss factor.

The allowance for credit losses is further determined by the size of the loan portfolio subject to the allowance methodology and environmental factors that include Company-specific risk indicators and general economic conditions, both of which are constantly changing. The Company evaluates the economic and portfolio-specific

factors on a quarterly basis to determine a qualitative component of the general valuation allowance. The factors include economic metrics, business conditions, delinquency trends, credit concentrations, nature and volume of the portfolio and other adjustments for items not covered by specific reserves and historical loss experience. Management's assessment of qualitative factors is a statistically based approach to determine the inherent probable loss associated with such factors. Based on the Company's actual historical loan loss experience relative to economic and loan portfolio-specific factors at the time the losses occurred, management is able to identify the probabilities of default and loss severity based on current economic conditions. The correlation of historical loss experience with current economic conditions provides an estimate of inherent and probable losses that has not been previously factored into the general valuation allowance by the determination of specific reserves and recent historical losses. Additionally, the Company considers qualitative factors not easily quantified and the possibility of model imprecision.

Utilizing the aggregation of specific reserves, historical loss experience and a qualitative component, management is able to determine the valuation allowance to reflect the full inherent probable loss.

In determining the allowance for credit losses, management also considers the type of loan (legacy or acquired) and the credit quality of the loan. The Company delineates between legacy loans and acquired legacy loans, which are accounted for under the contractual yield method, and fair-valued acquired loans consisting of Non-PCI loans and PCI loans, which are accounted for as purchased loans.

Loans acquired in business combinations are initially recorded at fair value, which includes an estimate of inherent credit losses expected to be realized over the remaining lives of the loans, and therefore no corresponding allowance for credit losses is recorded for these loans at acquisition. When a fair-valued acquired loan is renewed at its maturity date, the loan is re-categorized as an acquired legacy loan. When a fair-valued acquired loan is modified after acquisition, the loan is independently evaluated subsequent to the modification decision to determine whether the modification was substantial, and therefore, requires that the loan be re-categorized as an acquired legacy loan. This determination is based on a discounted cash-flow analysis. Generally, when a change in discounted cash-flow of greater than 10% is identified, the fair-valued acquired loan becomes categorized as an acquired legacy loan. If and when a fair-valued acquired loan becomes an acquired legacy loan, the acquired legacy loan is evaluated at the time of renewal or modification in accordance with the Company's allowance for credit losses methodology described above.

Non-PCI loans which were not deemed impaired subsequent to the acquisition date are considered non-impaired and are evaluated as part of the general valuation allowance. Non-PCI loans that have not become impaired subsequent to acquisition are segregated into a pool for each acquisition for allowance calculation purposes. For each pool, the Company estimates a hypothetical allowance for credit losses also referred to as an "indicated reserve" that is calculated in accordance with GAAP requirements. The Company uses the acquired bank's past loss history adjusted for qualitative factors to establish the indicated reserve. The indicated reserve for each pool of Non-PCI loans is compared with the remaining discount for the respective pool to test for credit quality deterioration and the possible need for a loan loss provision. To the extent the remaining discount of the pool is greater than the indicated reserve, no additional allowance is necessary. In the event that the remaining discount of the pool is less than the indicated reserve, the difference results in an increase to the allowance recorded through a provision for credit losses.

Non-PCI loans that have deteriorated to an impaired status subsequent to acquisition are evaluated for a specific reserve on a quarterly basis which, when identified, is added to the allowance for credit losses. The Company reviews impaired Non-PCI loans on a loan-by-loan basis and determines the specific reserve based on the difference between the recorded investment in the loan and one of three factors: expected future cash flows, observable market price or fair value of the collateral. Because essentially all of the Company's impaired Non-PCI loans have been collateral-dependent, the amount of the specific reserve historically has been determined by comparing the fair value of the collateral securing the Non-PCI loan with the recorded investment in such loan. In the future, the Company will continue to analyze impaired Non-PCI loans on a loan-by-loan basis and may use an alternative measurement method to determine the specific reserve, as appropriate and in accordance with applicable accounting standards.

PCI loans are individually monitored on a quarterly basis to assess for deterioration subsequent to acquisition and are only subject to the Company's allowance methodology when a deterioration in projected cash flows is identified. In the event that a deterioration in projected cash flows is identified, an additional provision for credit losses is made. PCI loans were recorded at their acquisition date fair values, which were based on expected cash flows and included estimates of expected future credit losses. The Company's estimates of loan fair values at the acquisition date may be adjusted for a period of up to one year as the Company continues to evaluate its estimate of expected future cash flows at the acquisition date. If the Company determines that losses arose after the acquisition date, the additional losses will be reflected as a provision for credit losses. An allowance for credit losses is not calculated for PCI loans that have not experienced deterioration subsequent to the acquisition date. See "Critical Accounting Policies" above for more information.

As described in the section captioned “Critical Accounting Policies” above, the Company’s determination of the allowance for credit losses involves a high degree of judgment and complexity. The Company’s analysis of qualitative, or environmental, factors on pools of loans with common risk characteristics, in combination with the quantitative historical loss information and specific reserves, provides the Company with an estimate of inherent losses. The allowance must reflect changes in the balance of loans subject to the allowance methodology, as well as the estimated imminent losses associated with those loans.

The following tables present, as of and for the periods indicated, information regarding the allowance for credit losses differentiated between legacy loans and acquired loans. The charge-offs and recoveries with respect to the acquired loans shown below are primarily from acquired legacy loans. Reported net charge-offs may include those from Non-PCI loans and PCI loans, but only if the total charge-off required is greater than the remaining discount.

	As of and for the Nine Months Ended September 30, 2016		
	Acquired		Total
	Legacy Loans	Loans	
	(Dollars in thousands)		
Average loans outstanding	\$7,351,260	\$2,302,631	\$9,653,891
Gross loans outstanding at end of period	\$7,471,943	\$2,076,371	\$9,548,314
Allowance for credit losses at beginning of period	\$64,909	\$16,475	\$81,384
Provision for credit losses	18,367	3,633	22,000
Charge-offs:			
Commercial and industrial	(3,409)	(7,232)	(10,641)
Real estate and agriculture	(7,283)	(121)	(7,404)
Consumer and other	(4,273)	(98)	(4,371)
Recoveries:			
Commercial and industrial	928	1,315	2,243
Real estate and agriculture	1,451	15	1,466
Consumer and other	902	6	908
Net charge-offs	(11,684)	(6,115)	(17,799)
Allowance for credit losses at end of period	\$71,592	\$13,993	\$85,585
Ratio of allowance to end of period loans	0.96	% 0.67	% 0.90
Ratio of net charge-offs to average loans (annualized)	0.21	% 0.35	% 0.25
Ratio of allowance to end of period nonperforming loans	530.3	% 46.1	% 195.2

	As of and for the Nine Months Ended September 30, 2015		
	Acquired		Total
	Legacy Loans	Loans	
	(Dollars in thousands)		
Average loans outstanding	\$6,261,400	\$2,898,375	\$9,159,775
Gross loans outstanding at end of period	\$6,663,127	\$2,541,861	\$9,204,988
Allowance for credit losses at beginning of period	\$61,745	\$19,017	\$80,762
Provision for credit losses	5,311	1,749	7,060
Charge-offs:			
Commercial and industrial	(2,483)	(3,208)	(5,691)
Real estate and agriculture	(414)	(437)	(851)
Consumer and other	(2,333)	(73)	(2,406)
Recoveries:			
Commercial and industrial	610	179	789
Real estate and agriculture	309	1	310
Consumer and other	1,027	3	1,030
Net charge-offs	(3,284)	(3,535)	(6,819)

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Allowance for credit losses at end of period	\$63,772		\$17,231		\$81,003	
Ratio of allowance to end of period loans	0.96	%	0.68	%	0.88	%
Ratio of net charge-offs to average loans (annualized)	0.07	%	0.16	%	0.10	%
Ratio of allowance to end of period nonperforming loans	295.9	%	72.9	%	179.2	%

The Company had gross charge-offs on legacy loans of \$15.0 million during the nine months ended September 30, 2016. Partially offsetting these charge-offs were recoveries on legacy loans of \$3.3 million. Total charge-offs for the nine months ended September 30, 2016 were \$22.4 million, partially offset by total recoveries of \$4.6 million.

The following tables show the allocation of the allowance for credit losses among various categories of loans disaggregated between legacy loans, acquired legacy loans, Non-PCI loans and PCI loans at the dates indicated. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any loan category, regardless of whether allocated to a legacy loan or an acquired loan.

	September 30, 2016				Total	Percent of Loans to	
	Acquired Loans					Allowance	Total Loans
	Legacy Loans	Acquired Legacy Loans	Non-PCI Loans	PCI Loans			
	(Dollars in thousands)						
Balance of allowance for credit losses applicable to:							
Commercial and industrial	\$27,769	\$10,084	\$ 37	\$ 224	\$ 38,114	16.1	%
Real estate	39,026	2,645	52	—	41,723	74.1	%
Agriculture and agriculture real estate	3,226	873	35	—	4,134	7.0	%
Consumer and other	1,571	43	—	—	1,614	2.8	%
Total allowance for credit losses	\$71,592	\$13,645	\$ 124	\$ 224	\$ 85,585	100.0	%

	December 31, 2015				Total	Percent of Loans to	
	Acquired Loans					Allowance	Total Loans
	Legacy Loans	Acquired Legacy Loans	Non-PCI Loans	PCI Loans			
	(Dollars in thousands)						
Balance of allowance for credit losses applicable to:							
Commercial and industrial	\$21,660	\$8,969	\$ 1,944	\$ 836	\$ 33,409	17.9	%
Real estate	39,321	3,133	315	—	42,769	72.5	%
Agriculture and agriculture real estate	2,645	1,162	38	—	3,845	6.9	%
Consumer and other	1,283	59	19	—	1,361	2.7	%
Total allowance for credit losses	\$64,909	\$13,323	\$ 2,316	\$ 836	\$ 81,384	100.0	%

At September 30, 2016, the allowance for credit losses totaled \$85.6 million compared with \$81.4 million at December 31, 2015, an increase of \$4.2 million or 5.2%. The allowance for credit losses at September 30, 2016 totaled 0.90% of total loans compared with 0.86% of total loans at December 31, 2015.

At September 30, 2016, \$71.6 million of the allowance was attributable to legacy loans, an increase of \$6.7 million or 10.3%, compared with the allowance of \$64.9 million attributable to legacy loans at December 31, 2015. This increase was primarily attributable to an increase in the legacy loan balance. At September 30, 2016, \$13.6 million of the allowance for credit losses was attributable to acquired legacy loans compared with \$13.3 million of the allowance at December 31, 2015, an increase of \$322 thousand or 2.4%. This increase was primarily attributable to specific reserves identified for loans with deteriorated credit quality, partially offset by a decrease in the acquired legacy loan balance. At September 30, 2016, \$124 thousand of the allowance for credit losses was attributable to Non-PCI loans

compared with \$2.3 million of the allowance at December 31, 2015, a decrease of \$2.2 million or 94.6%. This decrease was primarily attributable to the charge off of loans that had specific reserves identified at December 31, 2015. At September 30, 2016, \$224 thousand of the allowance for credit losses was attributable to PCI loans compared with \$836 thousand of the allowance at December 31, 2015, a decrease of \$612 thousand or 73.2%. This decrease was primarily attributable to the charge off of one loan that had specific reserves identified at December 31, 2015.

At September 30, 2016, the Company had \$67.5 million of total outstanding discounts on Non-PCI and PCI loans, of which \$50.4 million was accretable.

The Company believes that the allowance for credit losses at September 30, 2016 is adequate to cover estimated losses in the loan portfolio as of such date. Nevertheless, the Company could sustain losses in future periods, which could be substantial in relation to the size of the allowance at September 30, 2016.

Securities

The carrying cost of securities totaled \$8.99 billion at September 30, 2016 compared with \$9.50 billion at December 31, 2015, a decrease of \$514.4 million or 5.4%. At September 30, 2016, securities represented 42.0% of total assets compared with 43.1% of total assets at December 31, 2015.

The amortized cost and fair value of investment securities were as follows:

	September 30, 2016			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
(Dollars in thousands)				
Available for Sale				
States and political subdivisions	\$2,574	\$ 6	\$ —	\$2,580
Collateralized mortgage obligations	21,427	13	(307)	21,133
Mortgage-backed securities	90,777	2,566	(174)	93,169
Other securities	12,588	253	(46)	12,795
Total	\$127,366	\$ 2,838	\$ (527)	\$129,677
Held to Maturity				
U.S. Treasury securities and obligations of U.S. Government agencies	\$33,479	\$ 1,028	\$ —	\$34,507
States and political subdivisions	389,555	8,801	(45)	398,311
Collateralized mortgage obligations	903	17	(4)	916
Mortgage-backed securities	8,434,307	154,373	(1,617)	8,587,063
Other securities	100	—	—	100
Total	\$8,858,344	\$ 164,219	\$ (1,666)	\$9,020,897
December 31, 2015				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale				
States and political subdivisions	\$5,463	\$ 22	\$ —	\$5,485
Collateralized mortgage obligations	25,991	25	(100)	25,916
Mortgage-backed securities	55,884	3,098	(11)	58,971
Other securities	12,588	150	(46)	12,692
Total	\$99,926	\$ 3,295	\$ (157)	\$103,064
Held to Maturity				
U.S. Treasury securities and obligations of U.S. Government agencies	\$47,598	\$ 798	\$ —	\$48,396
States and political subdivisions	363,505	7,080	(542)	370,043
Collateralized mortgage obligations	2,107	17	(2)	2,122
Mortgage-backed securities	8,986,153	68,868	(82,407)	8,972,614
Other securities	—	—	—	—
Total	\$9,399,363	\$ 76,763	\$ (82,951)	\$9,393,175

Management evaluates securities for other-than-temporary impairment (“OTTI”) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. In determining OTTI, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs under either model, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment’s amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis

less any current-period loss, the OTTI shall be separated into the amount representing the credit-related portion of the impairment loss (“credit loss”) and the noncredit portion of the impairment loss (“noncredit portion”). The amount of the total OTTI related to the credit loss is determined based on the difference between the present value of cash flows expected to be collected and the amortized cost basis and such difference is recognized in earnings. The amount of the total OTTI related to the noncredit portion is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings shall become the new amortized cost basis of the investment.

As of September 30, 2016, management does not have the intent to sell any of the securities classified as available for sale and believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of cost. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2016, management believes any impairment in the Company’s securities is temporary, and therefore no impairment loss has been realized in the Company’s consolidated statements of income.

Deposits

Total deposits were \$16.92 billion at September 30, 2016 compared with \$17.68 billion at December 31, 2015, a decrease of \$759.7 million or 4.3%. At September 30, 2016, noninterest-bearing deposits totaled \$5.16 billion compared with \$5.14 billion at December 31, 2015, an increase of \$22.8 million or 0.4%. Interest-bearing deposits totaled \$11.76 billion at September 30, 2016 compared with \$12.54 billion at December 31, 2015, a decrease of \$782.5 million or 6.2%.

Average deposits for the nine months ended September 30, 2016 were \$17.47 billion, an increase of \$247.8 million or 1.4%, compared with \$17.22 billion for the nine months ended September 30, 2015. Deposit growth was impacted by the acquisition of Tradition. Deposits for Tradition totaled \$488.9 million at acquisition date. The ratio of average interest-bearing deposits to total average deposits was 70.9% during the first nine months of 2016 compared to 71.0% during the first nine months of 2015.

The following table summarizes the daily average balances and weighted average rates paid on deposits for the periods indicated below:

	Nine Months Ended September 30,		2015		Average	
	Average Balance	Average Rate (1)	Average Balance	Average Rate (1)		
	(Dollars in thousands)					
Interest-bearing demand deposits	\$4,135,579	0.25	% \$3,909,337	0.23	%	
Regular savings	2,014,314	0.25	% 1,838,912	0.20	%	
Money market savings	3,707,027	0.28	% 3,664,685	0.27	%	
Certificates, IRAs and other time deposits	2,529,353	0.56	% 2,819,822	0.50	%	
Total interest-bearing deposits	12,386,273	0.32	% 12,232,756	0.30	%	
Noninterest-bearing deposits	5,085,041		4,990,769			
Total deposits	\$17,471,314	0.23	% \$17,223,525	0.21	%	

(1) Annualized and based on average balances on an actual 365 day or 366 day basis for the nine months ended September 30, 2016 and 2015.

Other Borrowings

The following table presents the Company's borrowings as of the dates indicated:

	September 30, 2016	December 31, 2015
	(Dollars in thousands)	
FHLB advances	\$420,000	\$ 485,000
FHLB long-term notes payable	5,916	6,399
Total other borrowings	425,916	491,399
Securities sold under repurchase agreements	318,449	315,253
Total	\$744,365	\$ 806,652

FHLB advances and long-term notes payable— The Company has an available line of credit with the FHLB of Dallas, which allows the Company to borrow on a collateralized basis. FHLB advances are considered short-term, overnight borrowings and are used to manage liquidity as needed. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At September 30, 2016, the Company had total funds of \$5.37 billion available under this agreement, of which \$425.9 million was outstanding. Short-term overnight FHLB advances of \$420.0 million were outstanding at September 30, 2016, at a weighted average rate of 0.46%. Long-term notes payable were \$5.9 million at September 30, 2016, with a weighted average rate of 5.65%. The maturity dates on the FHLB notes payable range from the years 2018 to 2027 and have interest rates ranging from 4.51% to 6.10%.

Securities sold under repurchase agreements— At September 30, 2016, the Company had \$318.4 million in securities sold under repurchase agreements with banking customers compared with \$315.3 million at December 31, 2015, an increase of \$3.2 million or 1.0%. Repurchase agreements are generally settled on the following business day; however, approximately \$6.2 million of the repurchase agreements outstanding at September 30, 2016 have maturity dates ranging from 12 to 24 months. All securities sold under agreements to repurchase are collateralized by certain pledged securities.

Liquidity

Liquidity involves the Company's ability to raise funds to support asset growth or reduce assets to meet deposit withdrawals and other payment obligations, to maintain reserve requirements and otherwise to operate the Company on an ongoing basis. The Company's largest source of funds is deposits and its largest use of funds is loans. The Company does not expect a change in the source or use of its funds in the future. Although access to purchased funds from correspondent banks is available and has been utilized on occasion to take advantage of investment opportunities, the Company does not generally rely on these external funding sources. The cash and federal funds sold position, supplemented by amortizing investment and loan portfolios, has generally created an adequate liquidity position.

As of September 30, 2016, the Company had outstanding \$1.98 billion in commitments to extend credit and \$70.6 million in commitments associated with outstanding standby letters of credit. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the total outstanding may not necessarily reflect the actual future cash funding requirements.

The Company has no exposure to future cash requirements associated with known uncertainties or capital expenditures of a material nature.

Asset liquidity is provided by cash and assets which are readily marketable or which will mature in the near future. As of September 30, 2016, the Company had cash and cash equivalents of \$342.1 million compared with \$564.0 million at December 31, 2015, a decrease of \$221.8 million or 39.3%. The decrease was primarily due to the net decrease in deposits of \$1.25 billion and the purchase of held to maturity securities of \$655.9 million, partially offset by proceeds from maturities and principal paydowns of held to maturity securities of \$1.41 billion and net income of \$205.7 million.

Contractual Obligations

The following table summarizes the Company's contractual obligations and other commitments to make future payments as of September 30, 2016 (other than deposit obligations). The payments do not include pre-payment options that may be available to the Company. The Company's future cash payments associated with its contractual obligations pursuant to its FHLB borrowings and operating leases as of September 30, 2016 are summarized below.

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Payments for FHLB borrowings include interest of \$760 thousand that will be paid over the future periods. Payments related to leases are based on actual payments specified in underlying contracts.

	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
	(Dollars in thousands)				
Federal Home Loan Bank notes payable	\$420,871	\$ 4,916	\$ 659	\$230	\$426,676
Operating leases	5,733	8,106	4,923	6,989	25,751
Total	\$426,604	\$ 13,022	\$ 5,582	\$7,219	\$452,427

Off-Balance Sheet Items

In the normal course of business, the Company enters into various transactions, which, in accordance with U.S. generally accepted accounting principles (“GAAP”), are not included in its consolidated balance sheets. The Company enters into these

transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

The Company's commitments associated with outstanding standby letters of credit and commitments to extend credit as of September 30, 2016 are summarized below. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
	(Dollars in thousands)				
Standby letters of credit	\$63,168	\$ 7,227	\$ 226	\$20	\$70,641
Commitments to extend credit	1,018,584	314,222	83,258	568,608	1,984,672
Total	\$1,081,752	\$ 321,449	\$ 83,484	\$568,628	\$2,055,313

Capital Resources

Total shareholders' equity was \$3.59 billion at September 30, 2016 compared with \$3.46 billion at December 31, 2015, an increase of \$131.9 million or 3.8%. The increase was primarily the result of net income of \$205.7 million and common stock issued in connection with the Tradition acquisition of \$32.5 million, partially offset by dividends paid on common stock of \$62.6 million and common stock repurchases of \$51.1 million for the nine months ended September 30, 2016.

The Basel III Capital Rules adopted by the federal regulatory authorities in 2013 substantially revised the risk-based capital requirements applicable to the Company and the Bank. The Basel III Capital Rules became effective for the Company on January 1, 2015, subject to a phase-in period for certain provisions. Among other things, the Basel III Capital Rules introduced a new capital measure called "Common Equity Tier 1," which is a comparison of the sum of certain equity capital components to total risk-weighted assets, and revised the risk-weighting approach of the capital ratios with a more risk-sensitive approach that expanded the risk-weighting categories from the previous Basel I-derived categories to a much larger and more risk-sensitive number of categories, depending on the nature of the assets.

Additionally, the Basel III Capital Rules introduced a capital conservation buffer with respect to each of the Common Equity Tier 1, Tier 1 risk-based and total risk-based capital ratios, which provides for capital levels that exceed the minimum risk-based capital adequacy requirements. The capital conservation buffer is subject to a three year phase-in period that began on January 1, 2016 and will be fully phased-in on January 1, 2019 at 2.5%. The required phase-in capital conservation buffer during 2016 is 0.625%. A financial institution with a conservation buffer of less than the required amount will be subject to limitations on capital distributions, including dividend payments and stock repurchases, and certain discretionary bonus payments to executive officers.

Financial institutions are categorized by the FDIC based on minimum Common Equity Tier 1, Tier 1 risk-based, total risk-based and Tier 1 leverage ratios. As of September 30, 2016, the Bank's capital ratios were above the levels required for the Bank to be designated as "well capitalized."

The following table provides a comparison of the Company's and the Bank's risk-weighted and leverage capital ratios to the minimum and well-capitalized regulatory standards as of September 30, 2016:

	Minimum Required For Capital Adequacy Purposes		Minimum Required Plus Capital Conservation Buffer for 2016	To Be Categorized As Well Capitalized Underas of Prompt Corrective Action Provisions	Actual Ratio September 30, 2016
The Company					
CET1 capital (to risk weighted assets)	4.50	%	5.125	% N/A	14.41 %
Tier 1 capital (to risk weighted assets)	6.00	%	6.625	% N/A	14.41 %
Total capital (to risk weighted assets)	8.00	%	8.625	% N/A	15.14 %
Tier 1 capital (to average assets)	4.00	%(1)	4.000	% N/A	8.50 %
The Bank					
CET1 capital (to risk weighted assets)	4.50	%	5.125	% 6.50	% 13.57 %
Tier 1 capital (to risk weighted assets)	6.00	%	6.625	% 8.00	% 13.57 %
Total capital (to risk weighted assets)	8.00	%	8.625	% 10.00	% 14.31 %
Tier 1 capital (to average assets)	4.00	%(2)	4.000	% 5.00	% 8.01 %

(1)The Federal Reserve Board may require the Company to maintain a leverage ratio above the required minimum.

(2)The FDIC may require the Bank to maintain a leverage ratio above the required minimum.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company manages market risk, which for the Company is primarily interest rate risk, through its Asset Liability Committee which is composed of senior officers of the Company, in accordance with policies approved by the Company's Board of Directors.

The Company uses simulation analysis to examine the potential effects of market changes on net interest income and market value. The Company considers macroeconomic variables, Company strategy, liquidity and other factors as it quantifies market risk. See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations—Interest Rate Sensitivity and Liquidity" in the Company's Annual Report on Form 10-K for the year ended December 31, 2015, filed on February 29, 2016, for further discussion.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls

and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) were effective as of the end of the period covered by this report.

Changes in internal control over financial reporting. There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company and the Bank are defendants, from time to time, in legal actions arising from transactions conducted in the ordinary course of business. The Company and Bank believe, after consultations with legal counsel, that the ultimate liability, if any, arising from such actions will not have a material adverse effect on their financial statements.

ITEM 1A. RISK FACTORS

There have been no material changes in the Company's risk factors from those disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

a. None.

b. None.

c. The Company did not repurchase any shares of its common stock during the three months ended September 30, 2016.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit

Number Description of Exhibit

- 3.1 Amended and Restated Articles of Incorporation of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 (Registration No. 333-63267) (the "Registration Statement"))
- 3.2 Articles of Amendment to Amended and Restated Articles of Incorporation of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006)
- 3.3 Amended and Restated Bylaws of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on April 23, 2015)
- 4.1 Form of certificate representing shares of the Company's common stock (incorporated by reference to Exhibit 4 to the Registration Statement)
- 31.1* Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
- 31.2* Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
- 32.1** Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2** Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101* Interactive Financial Data

*Filed with this Quarterly Report on Form 10-Q.

**Furnished with this Quarterly Report on Form 10-Q.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PROSPERITY
BANCSHARES, INC. ®

(Registrant)

Date: 11/07/16

/S/ DAVID
ZALMAN
David Zalman
Chairman and Chief
Executive Officer

Date: 11/07/16

/S/ DAVID
HOLLAWAY
David Hollaway
Chief Financial Officer