

PROSPERITY BANCSHARES INC

Form 10-K

February 29, 2012

[Table of Contents](#)

[Index to Financial Statements](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For The Fiscal Year Ended December 31, 2011

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number 001-35388

PROSPERITY BANCSHARES, INC.[®]

(Exact name of registrant as specified in its charter)

Texas
(State or other jurisdiction of
incorporation or organization)

74-2331986
(I.R.S. Employer
Identification No.)

Prosperity Bank Plaza

4295 San Felipe

Houston, Texas
(Address of principal executive offices)

77027
(Zip Code)

Registrant's Telephone Number, Including Area Code: (713) 693-9300

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value
\$1.00 per share
(Title of each class)

New York Stock Exchange, Inc.
(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K. ☒

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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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One):

Large Accelerated Filer ☒ Accelerated Filer ☐ Non-accelerated Filer ☐ 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 ☒

The aggregate market value of the shares of common stock held by non-affiliates as of June 30, 2011, based on the closing price of the common stock on the NASDAQ Global Select Market on June 30, 2011 was approximately \$1.89 billion.

As of February 15, 2012, the number of outstanding shares of common stock was 47,233,431.

Documents Incorporated by Reference:

Portions of the Company's Proxy Statement relating to the 2012 Annual Meeting of Shareholders, which will be filed within 120 days after December 31, 2011, are incorporated by reference into Part III, Items 10-14 of this Annual Report on Form 10-K.

Table of Contents

Index to Financial Statements

PROSPERITY BANCSHARES, INC.®

2011 ANNUAL REPORT ON FORM 10-K

TABLE OF CONTENTS

PART I

Item 1.	<u>Business</u>	1
	<u>General</u>	1
	<u>Pending and Recent Acquisitions</u>	1
	<u>Available Information</u>	3
	<u>Officers and Associates</u>	4
	<u>Banking Activities</u>	4
	<u>Business Strategies</u>	5
	<u>Competition</u>	6
	<u>Supervision and Regulation</u>	6
Item 1A.	<u>Risk Factors</u>	19
Item 1B.	<u>Unresolved Staff Comments</u>	28
Item 2.	<u>Properties</u>	28
Item 3.	<u>Legal Proceedings</u>	28
Item 4.	<u>Mine Safety Disclosures</u>	28

PART II

Item 5.	<u>Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</u>	29
Item 6.	<u>Selected Consolidated Financial Data</u>	32
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	35
	<u>Overview</u>	36
	<u>Recent Developments</u>	37
	<u>Critical Accounting Policies</u>	38
	<u>Results of Operations</u>	39
	<u>Financial Condition</u>	45
Item 7A.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	66
Item 8.	<u>Financial Statements and Supplementary Data</u>	67
Item 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	68
Item 9A.	<u>Controls and Procedures</u>	68
Item 9B.	<u>Other Information</u>	71

PART III

Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	71
Item 11.	<u>Executive Compensation</u>	71
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u>	71
Item 13.	<u>Certain Relationships and Related Transactions and Director Independence</u>	71
Item 14.	<u>Principal Accountant Fees and Services</u>	71

PART IV

Item 15.	<u>Exhibits and Financial Statement Schedules</u>	72
	<u>Signatures</u>	75

Table of Contents

Index to Financial Statements

PART I

ITEM 1. BUSINESS

General

Prosperity Bancshares, Inc.[®], a Texas corporation (the "Company"), was formed in 1983 as a vehicle to acquire the former Allied 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[®] ("Prosperity Bank" or the "Bank"). The Bank provides a broad line of financial products and services to small and medium-sized businesses and consumers. As of December 31, 2011, the Bank operated one hundred seventy-five (175) full-service banking locations; with sixty (60) in the Houston area, twenty (20) in the South Texas area including Corpus Christi and Victoria, thirty-three (33) in Central Texas, ten (10) in the Bryan/College Station area, twenty-one (21) in East Texas and thirty-one (31) in the Dallas/Fort Worth, Texas area. The Company's headquarters are located at Prosperity Bank Plaza, 4295 San Felipe in Houston, Texas and its telephone number is (281) 269-7199. The Company's website address is www.prosperitybanktx.com.

The Company's market consists of the communities served by its banking centers. The diverse nature of the economies in each local market served by the Company provides the Company with a varied customer base and allows the Company to spread its lending risk throughout a number of different industries including professional service firms and their principals, manufacturing, tourism, recreation, petrochemicals, farming and ranching. The Company's market areas outside of Houston, Dallas, Corpus Christi, San Antonio and Austin are dominated by either small community banks or branches of large regional banks. Management believes that the Company, as one of the few mid-sized financial institutions that combines responsive community banking with the sophistication of a regional bank holding company, has a competitive advantage in its market areas and excellent growth opportunities through acquisitions, including acquisitions of failed financial institutions, new banking center locations and additional business development.

Operating under a community banking philosophy, the Company seeks to develop broad customer relationships based on service and convenience while maintaining its conservative approach to lending and sound asset quality. The Company has grown through a combination of internal growth, the acquisition of community banks and branches of banks and the opening of new banking centers. Utilizing a low cost of funds and employing stringent cost controls, the Company has been profitable in every full year of its existence, including the period of adverse economic conditions in Texas in the late 1980s and more recently in 2009 and 2010. From 1988 to 1992 as a sound and profitable institution, the Company took advantage of this economic downturn and acquired the deposits and certain assets of failed banks in West Columbia, El Campo and Cuero, Texas and two failed banks in Houston, which diversified the Company's franchise and increased its core deposits. The Company opened a full-service banking center in Victoria, Texas in 1993 and the following year established a banking center in Bay City, Texas. The Company expanded its Bay City presence in 1996 with the acquisition of an additional branch location from Norwest Bank Texas (now Wells Fargo), and in 1997, the Company acquired the Angleton, Texas branch of Wells Fargo Bank. In 1998, the Company enhanced its West Columbia Banking Center with the purchase of a commercial bank branch located in West Columbia and acquired Union State Bank in East Bernard, Texas.

Table of Contents

Index to Financial Statements

From December 31, 1998 through December 31, 2011, the Company grew through internal growth and the completion of the following acquisitions:

Acquired Entity	Acquired Bank	Completion Date	Number of Banking Centers As of December 31, 2011 ⁽¹⁾
South Texas Bancshares, Inc.	Commercial National Bank	1999	3
Compass Bank (5 branches)	N/A	2000	4
Commercial Bancshares, Inc.	Heritage Bank	2001	12
Texas Guaranty Bank, N.A.	Same	2002	2
The First State Bank of Needville	Same	2002	(2)
Paradigm Bancorporation, Inc.	Paradigm Bank Texas	2002	8
Southwest Bank Holding Company	Bank of the Southwest	2002	2
First National Bank of Bay City	Same	2002	(2)
Abrams Centre Bancshares, Inc.	Abrams Centre National Bank	2003	1
Dallas Bancshares, Inc.	BankDallas	2003	1
MainBancorp, Inc.	main bank, n.a.	2003	3
First State Bank of North Texas	Same	2003	3
Liberty Bancshares, Inc.	Liberty Bank, S.S.B.	2004	4
Village Bank and Trust, s.s.b	Same	2004	1
First Capital Bankers, Inc.	FirstCapital Bank, s.s.b.	2005	20
Grapeland Bancshares, Inc.	First State Bank of Grapeland	2005	2
SNB Bancshares, Inc	Southern National Bank of Texas	2006	6 ⁽³⁾
Texas United Bancshares, Inc	State Bank, GNB Financial, n.a., Gateway National Bank and Northwest Bank	2007	34
The Bank of Navasota	Same	2007	1
Banco Popular, NA (6 branches)	N/A	2008	5
1 st Choice Bancorp	1 st Choice Bank	2008	1
Franklin Bank (from FDIC, as receiver) ⁽⁴⁾	N/A	2008	33
U.S. Bank (3 branches)	N/A	2010	3
First Bank (19 branches)	N/A	2010	15

- (1) The number of banking centers added does not include any locations of the acquired entity that were closed and consolidated with existing banking centers of the Company upon consummation of the transaction or closed after consummation of the transaction.
- (2) The only banking center of the acquired entity was closed and consolidated into an existing banking center of the Company.
- (3) Included one banking center under construction at the time of consummation.
- (4) Assumed approximately \$3.6 billion of deposits and acquired certain assets, including thirty-three (33) banking centers, from the FDIC, acting in its capacity as receiver for Franklin Bank.

Pending and Recent Acquisitions

Pending Acquisition of American State Financial Corporation On February 27, 2012, the Company announced the signing of a definitive agreement to acquire American State Financial Corporation and its wholly owned subsidiary, American State Bank (ASB), through the merger of American State Financial with and into the Company. ASB operates thirty-seven (37) banking offices in eighteen (18) counties across West Texas. As of December 31, 2011, American State Financial, on a consolidated basis, reported total assets of \$3.08 billion, total loans of \$1.21 billion and total deposits of \$2.46 billion. Under the terms of the definitive agreement, the Company will issue up to 8,525,000 shares of its common stock plus \$178.5 million in cash for all outstanding shares of American State Financial capital stock, subject to certain conditions and potential adjustment.

Table of Contents

Index to Financial Statements

The merger has been approved by the Boards of Directors of both companies and is expected to close during the third quarter of 2012, although delays may occur. The transaction is subject to certain conditions, including the approval by American State Financial's shareholders and customary regulatory approvals. Operational integration is anticipated to begin during the third quarter of 2012.

Pending Acquisition of The Bank Arlington On January 19, 2012, the Company entered into a definitive agreement to acquire The Bank Arlington. The Bank Arlington operates one (1) banking office in Arlington, Texas, in the Dallas/Fort Worth CMSA. As of December 31, 2011, The Bank Arlington reported total assets of \$37.3 million, total loans of \$21.2 million and total deposits of \$32.8 million.

Under the terms of the definitive agreement, the Company will issue up to 138,600 shares of Company common stock for all outstanding shares of The Bank Arlington capital stock, subject to certain conditions and potential adjustments. The transaction is subject to customary closing conditions, including the receipt of regulatory approvals and approval of the shareholders of The Bank Arlington. The transaction is expected to close during the second quarter of 2012, although delays could occur.

Pending Acquisition of East Texas Financial Services, Inc. On December 8, 2011, the Company entered into a definitive agreement to acquire East Texas Financial Services, Inc. (OTC BB: FFBT) and its wholly-owned subsidiary, First Federal Bank Texas (Firstbank). First Bank operates four (4) banking offices in the Tyler MSA, including three (3) locations in Tyler, Texas and one (1) location in Gilmer, Texas. As of December 31, 2011, East Texas Financial Services reported total assets of \$210.5 million, total loans of \$163.1 million and total deposits of \$126.7 million.

Under the terms of the definitive agreement, the Company will issue up to 531,000 shares of Company common stock for all outstanding shares of East Texas Financial Services capital stock, subject to certain conditions and potential adjustments. The transaction is subject to customary closing conditions, including the receipt of regulatory approvals and approval of the stockholders of East Texas Financial Services. The transaction is expected to close during the second quarter of 2012, although delays could occur.

Acquisition of Texas Bankers, Inc. On January 1, 2012, the Company completed the previously announced acquisition of Texas Bankers, Inc. and its wholly-owned subsidiary, Bank of Texas, Austin, Texas. The transaction continues the Company's strategic growth and expansion of the franchise in Central Texas.

The three (3) Bank of Texas banking offices in the Austin, Texas CMSA consist of a location in Rollingwood, which upon operational integration will be consolidated with the Company's Westlake location and remain in Bank of Texas' Rollingwood banking office; one banking center in downtown Austin, which upon operational integration will be consolidated into the Company's downtown Austin location; and another banking center in Thorndale. Following the acquisition, the Company operates thirty-four (34) banking centers in the Central Texas area including Austin and San Antonio.

Texas Bankers, Inc. reported total assets of \$77.0 million, total loans of \$27.6 million and total deposits of \$70.4 million as of December 31, 2011. Under the terms of the agreement, the Company issued 314,953 shares of Company common stock for all outstanding shares of Texas Bankers capital stock which resulted in a premium of \$5.2 million.

Available Information

The Company's website address is www.prosperitybanktx.com. The Company makes available free of charge on or through its website its Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (Exchange Act), as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. Information contained on the Company's website is not incorporated by reference into this Annual Report on Form 10-K and is not part of this or any other report.

Table of Contents

Index to Financial Statements

Officers and Associates

The Company's directors and officers are important to the Company's success and play a key role in the Company's business development efforts by actively participating in civic and public service activities in the communities served by the Company.

The Company has invested heavily in its officers and associates by recruiting talented officers in its market areas and providing them with economic incentive in the form of stock-based compensation and bonuses based on cross-selling performance. The senior management team has substantial experience in the Houston, Dallas, Austin, Bryan/College Station, East Texas, Corpus Christi and San Antonio markets and the surrounding communities in which the Company has a presence. Each banking center location is administered by a local president or manager with knowledge of the community and lending expertise in the specific industries found in the community. The Company entrusts its banking center presidents and managers with authority and flexibility within general parameters with respect to product pricing and decision making in order to avoid the bureaucratic structure of larger banks. The Company operates each banking center as a separate profit center, maintaining separate data with respect to each banking center's 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's local banking centers have no 1-800 telephone numbers. Each banking center has its own listed local business telephone number. Customers are served by a local banker with decision making authority.

As of December 31, 2011, the Company and the Bank had 1,664 full-time equivalent associates, 671 of whom were officers of the Bank. The Company provides medical and hospitalization insurance to its full-time associates. The Company considers its relations with associates to be excellent. Neither the Company nor the Bank is a party to any collective bargaining agreement.

Banking Activities

The Company, through the Bank, offers a variety of traditional loan and deposit products to its customers, which consist primarily of consumers and small and medium-sized businesses. The Bank tailors its products to the specific needs of customers in a given market. At December 31, 2011, the Bank maintained approximately 366,000 separate deposit accounts including certificates of deposit, 33,000 separate loan accounts and 24.5% of the Bank's total deposits were noninterest-bearing demand deposits. For the year ended December 31, 2011, the Company's average cost of funds was 0.56% and the Company's average cost of deposits (excluding all borrowings) was 0.53%.

The Company has been an active real estate lender, with commercial mortgage and 1-4 family residential loans comprising 35.9% and 26.7% of the Company's total loans as of December 31, 2011, respectively. The Company also offers commercial loans, loans for automobiles and other consumer durables, home equity loans, debit cards, internet banking and other cash management services and automated telephone banking. By offering certificates of deposit, interest checking accounts, savings accounts and overdraft protection at competitive rates, the Company gives its depositors a full range of traditional deposit products.

The businesses targeted by the Company in its lending efforts are primarily those that require loans in the \$100,000 to \$8.0 million range. The Company offers these businesses a broad array of loan products including term loans, lines of credit and loans for working capital, business expansion and the purchase of equipment and machinery, interim construction loans for builders and owner-occupied commercial real estate loans.

Table of Contents

Index to Financial Statements

Business Strategies

The Company's main objective is to increase deposits and loans internally, as well as through additional expansion opportunities, while maintaining efficiency and individualized customer service and maximizing profitability. To achieve this objective, the Company has employed the following strategic goals:

Continue Community Banking Emphasis. The Company intends to continue operating as a community banking organization focused on meeting the specific needs of consumers and small and medium-sized businesses in its market areas. The Company provides a high degree of responsiveness combined with a wide variety of banking products and services. The Company staffs its banking centers with experienced bankers with lending expertise in the specific industries found in the given community, and gives them authority to make certain pricing and credit decisions, avoiding the bureaucratic structure of larger banks.

Expand Market Share Through Internal Growth and a Disciplined Acquisition Strategy. The Company intends to continue seeking opportunities, both inside and outside its existing markets, to expand either by acquiring existing banks or branches of banks, including FDIC assisted purchases, or by establishing new banking centers. All of the Company's acquisitions have been accretive to earnings within 12 months after acquisition date and generally have supplied the Company with relatively low-cost deposits which have been used to fund the Company's lending and investing activities. However, the Company makes no guarantee that future acquisitions, if any, will be accretive to earnings within any particular time period. Factors used by the Company to evaluate expansion opportunities include (i) the similarity in management and operating philosophies, (ii) whether the acquisition will be accretive to earnings and enhance shareholder value, (iii) the ability to improve the efficiency ratio through economies of scale, (iv) whether the acquisition will strategically expand the Company's geographic footprint, and (v) the opportunity to enhance the Company's market presence in existing market areas.

Increase Loan Volume and Diversify Loan Portfolio. While maintaining its conservative approach to lending, the Company has emphasized both new and existing loan products, focusing on managing its commercial mortgage and commercial loan portfolios. During the one year period from December 31, 2010 to December 31, 2011, the Company's commercial and industrial loans decreased from \$409.4 million to \$406.4 million, or 0.7%, and represented 11.7% and 10.8% of the total portfolio, respectively. Commercial mortgages increased from \$1.29 billion to \$1.35 billion, or 5.0%, and represented 37.0% and 35.9% of the total portfolio, respectively, for the same period. In addition, the Company targets professional service firms, including legal and medical practices, for both loans secured by owner-occupied premises and personal loans to their principals.

Maintain Sound Asset Quality. The Company continues to maintain the sound asset quality that has been representative of its historical loan portfolio. As the Company continues to diversify and increase its lending activities and acquire loans in acquisitions, it may face higher risks of nonpayment and increased risks in the event of continued economic downturns. The Company intends to continue to employ the strict underwriting guidelines and comprehensive loan review process that have contributed to its low incidence of nonperforming assets and its minimal charge-offs in relation to its size.

Continue Focus on Efficiency. The Company plans to maintain its stringent cost control practices and policies. The Company has invested significantly in the infrastructure required to centralize many of its critical operations, such as data processing and loan processing. For its banking centers, which the Company operates as independent profit centers, the Company supplies complete support in the areas of loan review, internal audit, compliance and training. Management believes that this centralized infrastructure can accommodate additional growth while enabling the Company to minimize operational costs through economies of scale.

Enhance Cross-Selling. The Company recognizes that its customer base provides significant opportunities to cross-sell various products and it seeks to develop broader customer relationships by identifying cross-selling opportunities. The Company uses incentives and friendly competition to encourage cross-selling efforts and increase cross-selling results among its associates. Officers and associates have access to each customer's

Table of Contents

Index to Financial Statements

existing and related account relationships and are better able to inform customers of additional products when customers visit or call the various banking centers or use their drive-in facilities. In addition, the Company includes product information in monthly statements and other mailings.

Competition

The banking business is highly competitive, and the profitability of the Company depends principally on its ability to compete in its market areas. The Company competes with other commercial banks, savings banks, savings and loan associations, credit unions, finance companies, mutual funds, insurance companies, brokerage and investment banking firms, asset-based nonbank lenders and certain other nonfinancial entities, including retail stores which may maintain their own credit programs and certain governmental organizations which may offer more favorable financing than the Company. The Company believes it has been able to compete effectively with other financial institutions by emphasizing customer service, technology and responsive decision-making with respect to loans, by establishing long-term customer relationships and building customer loyalty and by providing products and services designed to address the specific needs of its customers.

Supervision and Regulation

The supervision and regulation of bank holding companies and their subsidiaries is intended primarily for the protection of depositors, the Deposit Insurance Fund (DIF) of the FDIC and the banking system as a whole, and not for the protection of the bank holding company's shareholders or creditors. The banking agencies have broad enforcement power over bank holding companies and banks including the power to impose substantial fines and other penalties for violations of laws and regulations.

The following description summarizes some of the laws to which the Company and the Bank are subject. References in this Annual Report on Form 10-K to applicable statutes and regulations are brief summaries thereof, do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations.

The Company

The Company is a financial holding company pursuant to the Gramm-Leach-Bliley Act and a bank holding company registered under the Bank Holding Company Act of 1956, as amended (BHCA). Accordingly, the Company is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System (Federal Reserve Board). The Gramm-Leach-Bliley Act, the BHCA and other federal laws subject financial and bank holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations.

Regulatory Restrictions on Dividends; Source of Strength. The Company is regarded as a legal entity separate and distinct from the Bank. The principal source of the Company's revenues is dividends received from the Bank. As described in more detail below, federal law places limitations on the amount that state banks may pay in dividends, which the Bank must adhere to when paying dividends to the Company. It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries.

Under Federal Reserve Board policy, a bank holding company has historically been required to act as a source of financial strength to each of its banking subsidiaries. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) codified this policy as a statutory requirement. Under this requirement, the Company is expected to commit resources to support the Bank, including at times when the Company may not be in a financial position to provide such resources. Any capital loans by a bank holding

Table of Contents

Index to Financial Statements

company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. As discussed below, a bank holding company, in certain circumstances, could be required to guarantee the capital plan of an undercapitalized banking subsidiary.

In the event of a bank holding company's bankruptcy under Chapter 11 of the U.S. Bankruptcy Code, the trustee will be deemed to have assumed and is required to cure immediately any deficit under any commitment by the debtor holding company to any of the federal banking agencies to maintain the capital of an insured depository institution. Any claim for breach of such obligation will generally have priority over most other unsecured claims.

Scope of Permissible Activities. Under the BHCA, bank holding companies generally may not acquire a direct or indirect interest in or control of more than 5% of the voting shares of any company that is not a bank or bank holding company or from engaging in activities other than those of banking, managing or controlling banks or furnishing services to or performing services for its subsidiaries, except that it may engage in, directly or indirectly, certain activities that the Federal Reserve Board has determined to be so closely related to banking or managing and controlling banks as to be a proper incident thereto. In approving acquisitions or the addition of activities, the Federal Reserve Board considers, among other things, whether the acquisition or the additional activities can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh such possible adverse effects as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices.

Notwithstanding the foregoing, the Gramm-Leach-Bliley Act, effective March 11, 2000, eliminated the barriers to affiliations among banks, securities firms, insurance companies and other financial service providers and permits bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. The Gramm-Leach-Bliley Act defines "financial in nature" to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve Board has determined to be closely related to banking. No regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board.

A bank holding company may become a financial holding company by filing a declaration with the Federal Reserve Board if each of its subsidiary banks is well capitalized under the Federal Deposit Insurance Corporation Improvement Act of 1991 (the "FDICIA") prompt-corrective-action provisions, is well managed, and has at least a satisfactory rating under the Community Reinvestment Act of 1977 ("CRA"). The Company became a financial holding company on April 18, 2000.

Since July 2011, the Company's financial holding company status depends upon it maintaining its status as "well capitalized" and "well managed" under applicable Federal Reserve Board regulations. If a financial holding company ceases to meet these requirements, the Federal Reserve Board may impose corrective capital and/or managerial requirements on the financial holding company and place limitations on its ability to conduct the broader financial activities permissible for financial holding companies. In addition, the Federal Reserve Board may require divestiture of the holding company's depository institutions and/or its non-bank subsidiaries if the deficiencies persist.

While the Federal Reserve Board is the "umbrella" regulator for financial holding companies and has the power to examine banking organizations engaged in new activities, regulation and supervision of activities which are financial in nature or determined to be incidental to such financial activities will be handled along functional lines. Accordingly, activities of subsidiaries of a financial holding company will be regulated by the agency or authorities with the most experience regulating that activity as it is conducted in a financial holding company.

Table of Contents

Index to Financial Statements

Safe and Sound Banking Practices. Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve Board's Regulation Y, for example, generally requires a holding company to give the Federal Reserve Board prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company's consolidated net worth. The Federal Reserve Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. Depending upon the circumstances, the Federal Reserve Board could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

The Federal Reserve Board has broad authority to prohibit activities of bank holding companies and their nonbanking subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as \$1.0 million for each day the activity continues.

Anti-Tying Restrictions. Bank holding companies and their affiliates are prohibited from tying the provision of certain services, such as extensions of credit, to other services offered by a holding company or its affiliates.

Capital Adequacy Requirements. The Federal Reserve Board has adopted a system using risk-based capital guidelines under a two-tier capital framework to evaluate the capital adequacy of bank holding companies. Tier 1 capital generally consists of common stockholders' equity, retained earnings, a limited amount of qualifying perpetual preferred stock, qualifying trust preferred securities and noncontrolling interests in the equity accounts of consolidated subsidiaries, less goodwill and certain intangibles. Tier 2 capital generally consists of certain hybrid capital instruments and perpetual debt, mandatory convertible debt securities and a limited amount of subordinated debt, qualifying preferred stock, loan loss allowance, and unrealized holding gains on certain equity securities.

Under the guidelines, specific categories of assets are assigned different risk weights, based generally on the perceived credit risk of the asset. These risk weights are multiplied by corresponding asset balances to determine a risk-weighted asset base. The guidelines require a minimum ratio of total capital to total risk-weighted assets of 8.0% (of which at least 4.0% is required to consist of Tier 1 capital elements). Total capital is the sum of Tier 1 and Tier 2 capital. As of December 31, 2011, the Company's ratio of Tier 1 capital to total risk-weighted assets was 15.90% and its ratio of total capital to total risk-weighted assets was 17.09%. Risk-weighted assets exclude intangible assets such as goodwill and core deposit intangibles.

In addition to the risk-based capital guidelines, the Federal Reserve Board uses a leverage ratio as an additional tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company's Tier 1 capital divided by its average total consolidated assets. Certain highly rated bank holding companies may maintain a minimum leverage ratio of 3.0%, but other bank holding companies are required to maintain a leverage ratio of 4.0%. As of December 31, 2011, the Company's leverage ratio was 7.89%.

The federal banking agencies' risk-based and leverage capital ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria. Banking organizations not meeting these criteria are expected to operate with capital positions well above the minimum ratios. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve Board guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

Proposed Revisions to Capital Adequacy Requirements. The Dodd-Frank Act requires the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC) and the FDIC to adopt regulations imposing a continuing floor of the 1988 capital accord (Basel I) of the Basel Committee on Banking Supervision (the Basel Committee) capital requirements in cases where the 2004 Basel Committee capital accord (Basel II)

Table of Contents

Index to Financial Statements

capital requirements and any changes in capital regulations resulting from Basel III (defined below) otherwise would permit lower requirements. In December 2010, the Federal Reserve Board, the OCC and the FDIC issued a joint notice of proposed rulemaking that would implement this requirement.

On December 16, 2010, the Basel Committee released its final framework for strengthening international capital and liquidity regulation (Basel III). Basel III, when implemented by the U.S. banking agencies and fully phased-in, will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity. The timing for the U.S. banking agencies publication of proposed rules to implement the Basel III capital framework and the implementation schedule is uncertain, but the U.S. banking agencies have indicated informally that regulations implementing the Basel III capital framework will be published for comment during the first half of 2012. Notwithstanding its release of the Basel III framework, the Basel Committee is considering further amendments to Basel III, including the imposition of additional capital surcharges on globally and systemically important financial institutions. In addition to Basel III, the Dodd-Frank Act requires or permits the U.S. banking agencies to adopt regulations affecting banking institutions' capital requirements in a number of respects. Accordingly, the regulations ultimately adopted and made applicable to the Company may be substantially different from the Basel III final framework as published in December 2010.

The Basel III final capital framework, among other things, (i) introduces as a new capital measure Common Equity Tier 1 (CET1), (ii) specifies that Tier 1 capital consists of CET1 and Additional Tier 1 capital instruments meeting specified requirements, (iii) defines CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expands the scope of the adjustments as compared to existing regulations.

When fully phased in on January 1, 2019, Basel III will require banks to maintain (i) as a newly adopted international standard, a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% capital conservation buffer (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) as a newly adopted international standard, a minimum leverage ratio of 3%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter). Basel III also provides for a countercyclical capital buffer, that would be added to the capital conservation buffer generally to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk.

Proposed Liquidity Requirements. Historically, regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III final framework will require banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward will be required by regulation. One test, referred to as the liquidity coverage ratio (LCR), is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity's expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other, referred to as the net stable funding ratio (NSFR), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will incent banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source. The Basel III liquidity framework contemplates that the LCR and NSFR will be subject to observation periods continuing through mid-2013 and mid-2016, respectively, and subject to any revisions resulting from the analyses conducted and data collected during the observation period, the LCR and NSFR will be implemented as minimum standards

Table of Contents

Index to Financial Statements

on January 1, 2015 and by January 1, 2018, respectively. The proposed liquidity requirements will likely apply to bank holding companies with total assets of \$50 billion or greater. These new standards are subject to further rulemaking and their terms could change before implementation.

Imposition of Liability for Undercapitalized Subsidiaries. Bank regulators are required to take prompt corrective action to resolve problems associated with insured depository institutions whose capital declines below certain levels. In the event an institution becomes undercapitalized, it must submit a capital restoration plan. The capital restoration plan will not be accepted by the regulators unless each company having control of the undercapitalized institution guarantees the subsidiary's compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institution's holding company is entitled to a priority of payment in bankruptcy.

The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5% of the institution's assets at the time it became undercapitalized or the amount necessary to cause the institution to be adequately capitalized. The bank regulators have greater power in situations where an institution becomes significantly or critically undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to obtain prior Federal Reserve Board approval of proposed dividends, or might be required to consent to a consolidation or to divest the troubled institution or other affiliates.

Acquisitions by Bank Holding Companies. The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve Board before it may acquire all or substantially all of the assets of any bank, or ownership or control of any voting shares of any bank, if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. In approving bank acquisitions by bank holding companies, the Federal Reserve Board is required to consider, among other things, the financial and managerial resources and future prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served and various competitive factors.

Control Acquisitions. The Change in Bank Control Act (CBCA) prohibits a person or group of persons from acquiring control of a bank holding company unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Exchange Act, such as the Company, would, under the circumstances set forth in the presumption, constitute acquisition of control of the Company.

In addition, the CBCA prohibits any entity from acquiring 25% (5% in the case of an acquiror that is a bank holding company) or more of a bank holding company's or bank's voting securities, or otherwise obtaining control or a controlling influence over a bank holding company or bank without the approval of the Federal Reserve Board. In most circumstances, an entity that owns 25% or more of the voting securities of a banking organization owns enough of the capital resources to have a controlling influence over such banking organization for purposes of the CBCA. On September 22, 2008, the Federal Reserve Board issued a policy statement on equity investments in bank holding companies and banks, which allows the Federal Reserve Board to generally be able to conclude that an entity's investment is not controlling if the entity does not own in excess of 15% of the voting power and 33% of the total equity of the bank holding company or bank. Depending on the nature of the overall investment and the capital structure of the banking organization, the Federal Reserve Board will permit, based on the policy statement, noncontrolling investments in the form of voting and nonvoting shares that represent in the aggregate (i) less than one-third of the total equity of the banking organization (and less than one-third of any class of voting securities, assuming conversion of all convertible nonvoting securities held by the entity) and (ii) less than 15% of any class of voting securities of the banking organization.

Table of Contents

Index to Financial Statements

The Bank

The Bank is a Texas-chartered banking association, the deposits of which are insured by the DIF of the FDIC. The Bank is not a member of the Federal Reserve System; therefore, the Bank is subject to supervision and regulation by the FDIC and the Texas Department of Banking. Such supervision and regulation subject the Bank to special restrictions, requirements, potential enforcement actions and periodic examination by the FDIC and the Texas Department of Banking. Because the Federal Reserve Board regulates the Company, the Federal Reserve Board also has supervisory authority which directly affects the Bank.

Equivalence to National Bank Powers. The Texas Constitution, as amended in 1986, provides that a Texas-chartered bank has the same rights and privileges that are or may be granted to national banks domiciled in Texas. To the extent that the Texas laws and regulations may have allowed state-chartered banks to engage in a broader range of activities than national banks, the FDICIA has operated to limit this authority. FDICIA provides that no state bank or subsidiary thereof may engage as principal in any activity not permitted for national banks, unless the institution complies with applicable capital requirements and the FDIC determines that the activity poses no significant risk to the DIF. In general, statutory restrictions on the activities of banks are aimed at protecting the safety and soundness of depository institutions.

Financial Modernization. Under the Gramm-Leach-Bliley Act, a national bank may establish a financial subsidiary and engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting as principal, insurance company portfolio investment, real estate development, real estate investment, annuity issuance and merchant banking activities. To do so, a bank must be well capitalized, well managed and have a CRA rating of satisfactory or better. Subsidiary banks of a financial holding company or national banks with financial subsidiaries must remain well capitalized and well managed in order to continue to engage in activities that are financial in nature without regulatory actions or restrictions, which could include divestiture of the financial in nature subsidiary or subsidiaries. In addition, a financial holding company or a bank may not acquire a company that is engaged in activities that are financial in nature unless each of the subsidiary banks of the financial holding company or the bank has a CRA rating of satisfactory or better.

Although the powers of state chartered banks are not specifically addressed in the Gramm-Leach-Bliley Act, Texas-chartered banks such as the Bank, will have the same if not greater powers as national banks through the parity provision contained in the Texas Constitution.

Branching. Texas law provides that a Texas-chartered bank can establish a branch anywhere in Texas provided that the branch is approved in advance by the Texas Department of Banking. The branch must also be approved by the FDIC, which considers a number of factors, including financial history, capital adequacy, earnings prospects, character of management, needs of the community and consistency with corporate powers.

Restrictions on Transactions with Affiliates and Insiders. Transactions between the Bank and its nonbanking affiliates, including the Company, are subject to Section 23A of the Federal Reserve Act. In general, Section 23A imposes limits on the amount of such transactions to 10% of the Bank's capital stock and surplus and requires that such transactions be secured by designated amounts of specified collateral. It also limits the amount of advances to third parties which are collateralized by the securities or obligations of the Company or its subsidiaries. The Dodd-Frank Act significantly expanded the coverage and scope of the limitations on affiliate transactions within a banking organization. For example, it requires that the 10% of capital limit on covered transactions begin to apply to financial subsidiaries. Covered transactions are defined by statute to include a loan or extension of credit, as well as a purchase of securities issued by an affiliate, a purchase of assets (unless otherwise exempted by the Federal Reserve Board) from the affiliate, certain derivative transactions that create a credit exposure to an affiliate, the acceptance of securities issued by the affiliate as collateral for a loan, and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

Affiliate transactions are also subject to Section 23B of the Federal Reserve Act which generally requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to

Table of Contents

Index to Financial Statements

the Bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated persons. The Federal Reserve Board has also issued Regulation W which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretive guidance with respect to affiliate transactions.

The restrictions on loans to directors, executive officers, principal shareholders and their related interests (collectively referred to herein as insiders) contained in the Federal Reserve Act and Regulation O apply to all insured institutions and their subsidiaries and holding companies. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to insiders and their related interests. These loans cannot exceed the institution's total unimpaired capital and surplus, and the FDIC may determine that a lesser amount is appropriate. Insiders are subject to enforcement actions for knowingly accepting loans in violation of applicable restrictions.

Restrictions on Distribution of Subsidiary Bank Dividends and Assets. Dividends paid by the Bank have provided a substantial part of the Company's operating funds and for the foreseeable future it is anticipated that dividends paid by the Bank to the Company will continue to be the Company's principal source of operating funds. Capital adequacy requirements serve to limit the amount of dividends that may be paid by the Bank. Under federal law, the Bank cannot pay a dividend if, after paying the dividend, the Bank will be undercapitalized. The FDIC may declare a dividend payment to be unsafe and unsound even though the Bank would continue to meet its capital requirements after the dividend. Because the Company is a legal entity separate and distinct from its subsidiaries, its right to participate in the distribution of assets of any subsidiary upon the subsidiary's liquidation or reorganization will be subject to the prior claims of the subsidiary's creditors. In the event of a liquidation or other resolution of an insured depository institution, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of any obligation of the institution to its shareholders, including any depository institution holding company (such as the Company) or any shareholder or creditor thereof.

Examinations. The FDIC periodically examines and evaluates state member banks. Based on such an evaluation, the FDIC may revalue the assets of the institution and require that it establish specific reserves to compensate for the difference between the FDIC-determined value and the book value of such assets. The Texas Department of Banking also conducts examinations of state banks but may accept the results of a federal examination in lieu of conducting an independent examination. In addition, the FDIC and Texas Department of Banking may elect to conduct a joint examination.

Audit Reports. Insured institutions with total assets of \$500 million or more must submit annual audit reports prepared by independent auditors to federal and state regulators. In some instances, the audit report of the institution's holding company can be used to satisfy this requirement. Auditors must receive examination reports, supervisory agreements and reports of enforcement actions. For institutions with total assets of \$1 billion or more, financial statements prepared in accordance with generally accepted accounting principles, management's certifications concerning responsibility for the financial statements, internal controls and compliance with legal requirements designated by the FDIC, and an attestation by the auditor regarding the statements of management relating to the internal controls must be submitted. For institutions with total assets of more than \$3 billion, independent auditors may be required to review quarterly financial statements. FDICIA requires that independent audit committees be formed, consisting of outside directors only. The committees of such institutions must include members with experience in banking or financial management, must have access to outside counsel, and must not include representatives of large customers.

Capital Adequacy Requirements. The FDIC has adopted regulations establishing minimum requirements for the capital adequacy of insured institutions. The FDIC may establish higher minimum requirements if, for example, a bank has previously received special attention or has a high susceptibility to interest rate risk.

The FDIC's risk-based capital guidelines generally require state banks to have a minimum ratio of Tier 1 capital to total risk-weighted assets of 4.0% and a ratio of total capital to total risk-weighted assets of 8.0%. The

Table of Contents

Index to Financial Statements

capital categories have the same definitions for the Bank as for the Company. As of December 31, 2011, the Bank's ratio of Tier 1 capital to total risk-weighted assets was 15.62% and its ratio of total capital to total risk-weighted assets was 16.81%.

The FDIC's leverage guidelines require state banks to maintain Tier 1 capital of no less than 4.0% of average total assets, except in the case of certain highly rated banks for which the requirement is 3.0% of average total assets. The Texas Department of Banking has issued a policy which generally requires state chartered banks to maintain a leverage ratio (defined in accordance with federal capital guidelines) of 5.0%. As of December 31, 2011, the Bank's ratio of Tier 1 capital to average total assets (leverage ratio) was 7.75%.

Corrective Measures for Capital Deficiencies. The federal banking regulators are required to take prompt corrective action with respect to capital-deficient institutions. Agency regulations define, for each capital category, the levels at which institutions are well-capitalized, adequately capitalized, under capitalized, significantly under capitalized and critically under capitalized. A well-capitalized bank has a total risk-based capital ratio of 10.0% or higher; a Tier 1 risk-based capital ratio of 6.0% or higher; a leverage ratio of 5.0% or higher; and is not subject to any written agreement, order or directive requiring it to maintain a specific capital level for any capital measure. An adequately capitalized bank has a total risk-based capital ratio of 8.0% or higher; a Tier 1 risk-based capital ratio of 4.0% or higher; a leverage ratio of 4.0% or higher (3.0% or higher if the bank was rated a composite 1 in its most recent examination report and is not experiencing significant growth); and does not meet the criteria for a well capitalized bank. A bank is under capitalized if it fails to meet any one of the ratios required to be adequately capitalized. At December 31, 2011, the Bank was classified as well-capitalized for purposes of the FDIC's prompt corrective action regulations.

In addition to requiring undercapitalized institutions to submit a capital restoration plan, agency regulations contain broad restrictions on certain activities of undercapitalized institutions including asset growth, acquisitions, branch establishment and expansion into new lines of business. With certain exceptions, an insured depository institution is prohibited from making capital distributions, including dividends, and is prohibited from paying management fees to control persons if the institution would be undercapitalized after any such distribution or payment.

As an institution's capital decreases, the FDIC's enforcement powers become more severe. A significantly undercapitalized institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management and other restrictions. The FDIC has only very limited discretion in dealing with a critically undercapitalized institution and is virtually required to appoint a receiver or conservator.

Banks with risk-based capital and leverage ratios below the required minimums may also be subject to certain administrative actions, including the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing in the event the institution has no tangible capital.

Deposit Insurance Assessments. Substantially all of the deposits of the Bank are insured up to applicable limits by the DIF of the FDIC and the Bank must pay deposit insurance assessments to the FDIC for such deposit insurance protection. The FDIC maintains the DIF by designating a required reserve ratio. If the reserve ratio falls below the designated level, the FDIC must adopt a restoration plan that provides that the DIF will return to an acceptable level generally within 5 years. The designated reserve ratio is currently set at 2.00%. The FDIC has the discretion to price deposit insurance according to the risk for all insured institutions regardless of the level of the reserve ratio.

The DIF reserve ratio is maintained by assessing depository institutions an insurance premium based upon statutory factors. Under its current regulations, the FDIC imposes assessments for deposit insurance according to a depository institution's ranking in one of four risk categories based upon supervisory and capital evaluations. The assessment rate for an individual institution is determined according to a formula based on a combination of weighted average CAMELS component ratings, financial ratios and, for institutions that have long-term debt ratings, the average ratings of its long-term debt. Well-capitalized institutions (generally those with CAMELS

Table of Contents

Index to Financial Statements

composite ratings of 1 or 2) are grouped in Risk Category I and the initial base assessment rate for deposit insurance is set at an annual rate of between 12 and 16 basis points. The initial base assessment rate for institutions in Risk Categories II, III and IV is set at annual rates of 22, 32 and 50 basis points, respectively. These initial base assessment rates are adjusted to determine an institution's final assessment rate based on its brokered deposits, secured liabilities and unsecured debt. Total base assessment rates after adjustments range from 7 to 24 basis points for Risk Category I, 17 to 43 basis points for Risk Category II, 27 to 58 basis points for Risk Category III, and 40 to 77.5 basis points for Risk Category IV.

In November, 2009, the FDIC adopted a rule that required all insured institutions with limited exceptions, to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012. The assessment, which for the Company totaled \$35.6 million, was calculated by taking the institution's actual September 30, 2009 assessment base and adjusting it quarterly by an estimated 5% annual growth rate through the end of 2012. Each institution records the entire amount of its prepaid assessment as a prepaid expense, an asset on its balance sheet, as of December 30, 2009. As of December 31, 2009, and each quarter thereafter, each institution records an expense, or a charge to earnings, for its quarterly assessment invoiced on its quarterly statement and an offsetting credit to the prepaid assessment until the asset is exhausted.

On February 7, 2011, the FDIC approved a final rule that amends its existing DIF restoration plan and implements certain provisions of the Dodd-Frank Act. As of April 1, 2011 the assessment base is determined using average consolidated total assets minus average tangible equity rather than the current assessment base of adjusted domestic deposits. Since the change resulted in a much larger assessment base, the final rule also lowers the assessment rates in order to keep the total amount collected from financial institutions relatively unchanged from the amounts currently being collected. The new assessment rates, calculated on the revised assessment base, generally range from 2.5 to 9 basis points for Risk Category I institutions, 9 to 24 basis points for Risk Category II institutions, 18 to 33 basis points for Risk Category III institutions, and 30 to 45 basis points for Risk Category IV institutions. For large institutions (generally those with total assets of \$10 billion or more), which as of December 31, 2011 did not include the Bank, the initial base assessment rate ranges from 5 to 35 basis points on an annualized basis. After the effect of potential base-rate adjustments, the total base assessment rate could range from 2.5 to 45 basis points on an annualized basis. Assessment rates for large institutions are calculated using a scorecard that combines CAMELS ratings and certain forward-looking financial measures to assess the risk a large institution poses to the DIF. The new assessment rates were calculated for the quarter beginning April 1, 2011 and reflected in invoices for assessments due September 30, 2011.

Brokered Deposit Restrictions. Adequately capitalized institutions cannot accept, renew or roll over brokered deposits except with a waiver from the FDIC, and are subject to restrictions on the interest rates that can be paid on any deposits. Undercapitalized institutions may not accept, renew, or roll over brokered deposits.

Concentrated Commercial Real Estate Lending Regulations. The federal banking agencies, including the FDIC, have promulgated guidance governing financial institutions with concentrations in commercial real estate lending. The guidance provides that a bank has a concentration in commercial real estate lending if (i) total reported loans for construction, land development, and other land represent 100% or more of total capital or (ii) total reported loans secured by multifamily and non-farm residential properties and loans for construction, land development, and other land represent 300% or more of total capital and the bank's commercial real estate loan portfolio has increased 50% or more during the prior 36 months. Owner occupied loans are excluded from this second category. If a concentration is present, management must employ heightened risk management practices that address the following key elements: including board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending.

Cross-Guarantee Provisions. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) contains a cross-guarantee provision which generally makes commonly controlled insured depository institutions liable to the FDIC for any losses incurred in connection with the failure of a commonly controlled depository institution.

Table of Contents

Index to Financial Statements

Community Reinvestment Act. The CRA and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their service area, including low and moderate income neighborhoods, consistent with the safe and sound operations of the banks. These regulations also provide for regulatory assessment of a bank's record in meeting the needs of its service area when considering applications to establish branches, merger applications and applications to acquire the assets and assume the liabilities of another bank. FIRREA requires federal banking agencies to make public a rating of a bank's performance under the CRA. In the case of a bank holding company, the CRA performance record of the banks involved in the transaction are reviewed in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or to merge with any other bank holding company. An unsatisfactory record can substantially delay or block the transaction.

Consumer Laws and Regulations. In addition to the laws and regulations discussed herein, the Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, and the Fair Housing Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. The Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations.

Anti-Money Laundering and Anti-Terrorism Legislation. A major focus of governmental policy on financial institutions in recent years has been aimed at combating money laundering and terrorist financing. The USA PATRIOT Act of 2001 (the "USA Patriot Act") substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The United States Treasury Department has issued and, in some cases, proposed a number of regulations that apply various requirements of the USA Patriot Act to financial institutions. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers. Certain of those regulations impose specific due diligence requirements on financial institutions that maintain correspondent or private banking relationships with non-U.S. financial institutions or persons. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution.

Office of Foreign Assets Control Regulation. The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the "OFAC" rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control ("OFAC"). The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on U.S. persons engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

Privacy. In addition to expanding the activities in which banks and bank holding companies may engage, the Gramm-Leach-Bliley Act also imposed new requirements on financial institutions with respect to customer privacy. The Gramm-Leach-Bliley Act generally prohibits disclosure of customer information to non-affiliated third parties unless the customer has been given the opportunity to object and has not objected to such disclosure.

Table of Contents

Index to Financial Statements

Financial institutions are further required to disclose their privacy policies to customers annually. Financial institutions, however, will be required to comply with state law if it is more protective of customer privacy than the Gramm-Leach-Bliley Act.

Legislative Initiatives

In light of current conditions and the market outlook for continuing weak economic conditions, regulators have increased their focus on the regulation of financial institutions. A number of government initiatives designed to respond to the current conditions have been introduced recently and proposals for legislation that could substantially intensify the regulation of financial institutions have been adopted by Congress and state legislatures. Such initiatives may change banking statutes and the operating environment of the Company and the Bank in substantial and unpredictable ways. The Company cannot determine the ultimate effect that any potential legislation, if enacted, or implementing regulations with respect thereto, would have, upon the financial condition or results of operations of the Company or the Bank. A change in statutes, regulations or regulatory policies applicable to the Company or the Bank could have a material effect on the financial condition, results of operations or business of the Company and the Bank.

Dodd-Frank Act. In July 2010, Congress enacted the Dodd-Frank Act regulatory reform legislation, which the President signed into law on July 21, 2010. Many aspects of the Dodd Frank Act are subject to further rulemaking and will take effect over several years, making it difficult for the Company to anticipate the overall financial impact to it or across the industry. This new law broadly affects the financial services industry by implementing changes to the financial regulatory landscape aimed at strengthening the sound operation of the financial services sector, including provisions that, among other things:

Create a new agency, the Consumer Financial Protection Bureau (CFPB), responsible for implementing, examining and enforcing compliance with federal consumer protection laws;

Apply the same leverage and risk based capital requirements that apply to insured depository institutions to most bank holding companies, which, among other things, will require the Company to deduct all trust preferred securities issued on or after May 19, 2010 from the Company's Tier 1 capital (existing trust preferred securities issued prior to May 19, 2010 for all bank holding companies with less than \$15.0 billion in total consolidated assets as of December 31, 2009 are exempt from this requirement);

Broaden the base for FDIC insurance assessments from the amount of insured deposits to average total consolidated assets less average tangible equity during the assessment period;

Permanently increase FDIC deposit insurance to \$250,000 and provide unlimited FDIC deposit insurance beginning December 31, 2010 until January 1, 2013 for noninterest bearing demand transaction accounts at all insured depository institutions;

Permit banks to engage in de novo interstate branching if the laws of the state where the new branch is to be established would permit the establishment of the branch if it were chartered by such state;

Repeal the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts;

Require financial holding companies, such as the Company, to be well capitalized and well managed as of July 21, 2011. Bank holding companies and banks must also be both well capitalized and well managed in order to acquire banks located outside their home state;

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Eliminate the ceiling on the size of the DIF and increase the floor of the size of the DIF;

Implement corporate governance revisions, including with regard to executive compensation and proxy access by shareholders, that apply to all public companies, not just financial institutions;

Amend the Electronic Fund Transfer Act (EFTA) to, among other things, give the Federal Reserve Board the authority to establish rules regarding interchange fees charged for electronic debit transactions

Table of Contents

Index to Financial Statements

by payment card issuers, such as the Bank, having assets over \$10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer through regulations adopted by the Federal Reserve Board in June 2011, which set a maximum permissible interchange fee; and

Increase the authority of the Federal Reserve Board to examine the Company and its non-bank subsidiaries.

The Dodd-Frank Act also authorized the Federal Reserve Board to adopt enhanced supervision and prudential standards for, among others, bank holding companies with total consolidated assets of \$50 billion or more (often referred to as systemically important financial institutions or SIFI), and authorized the Federal Reserve Board to establish such standards either on its own or upon the recommendations of the Financial Stability Oversight Council (FSOC), a new systemic risk oversight body created by the Dodd-Frank Act. In December 2011, the Federal Reserve Board issued for public comment a notice of proposed rulemaking establishing enhanced prudential standards responsive to these provisions for (i) risk-based capital requirements and leverage limits, (ii) stress testing of capital, (iii) liquidity requirements (iv) overall risk management requirements (v) resolution plan and credit exposure reporting and (vi) concentration/credit exposure limits. Comments on these proposed rules (the Proposed SIFI Rules), are due by March 31, 2012. The Proposed SIFI Rules address a wide, diverse array of regulatory areas, each of which is highly complex. Most of the Proposed SIFI Rules will not apply to the Company as its total consolidated assets remain below \$50 billion. However, two aspects of the Proposed SIFI Rules apply to bank holding companies with total consolidated assets of \$10 billion or more (a) requirements for annual stress testing of capital under one base and two stress scenarios and (b) certain corporate governance provisions requiring, among other things, that each bank holding company establish a risk committee of its board of directors and that that committee include a risk expert. While the Company and the Bank did not have total assets in excess of \$10 billion as of December 31, 2011, the Company may reach that threshold in the future due to its organic growth.

The Dodd-Frank Act established the CFPB, which has supervisory authority over depository institutions with total assets of \$10 billion or greater. The CFPB will focus their supervision and regulatory efforts on (i) risks to consumers and compliance with the federal consumer financial laws, when it evaluates the policies and practices of a financial institution; (ii) the markets in which firms operate and risks to consumers posed by activities in those markets; (iii) depository institutions that offer a wide variety of consumer financial products and services; depository institutions with a more specialized focus; and (iv) non-depository companies that offer one or more consumer financial products or services. While the Company and the Bank did not have total assets in excess of \$10 billion as of December 31, 2011, over the course of the next year, the Company and the Bank may become subject to the CFPB's supervision through organic growth.

The Company's management continues to review actively the provisions of the Dodd-Frank Act and assess its probable impact on its business, financial condition, and results of operations. Provisions in the legislation that affect deposit insurance assessments and payment of interest on demand deposits could increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate. Provisions in the legislation that revoke the Tier 1 capital treatment of newly issued trust preferred securities could require the Company to seek other sources of capital in the future. Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company, its customers or the financial industry more generally.

Incentive Compensation. In June 2010, the Federal Reserve Board, OCC and FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage

Table of Contents

Index to Financial Statements

risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. Also, on April 14, 2011 the FDIC published a proposed interagency rule to implement certain incentive compensation requirements of the Dodd-Frank Act. Under the proposed rule, financial institutions must prohibit incentive-based compensation arrangements that encourage inappropriate risk taking that are deemed excessive or that may lead to material losses.

The Federal Reserve Board will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not large, complex banking organizations. These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Enforcement Powers of Federal and State Banking Agencies

The federal banking agencies have broad enforcement powers, including the power to terminate deposit insurance, impose substantial fines and other civil and criminal penalties, and appoint a conservator or receiver. Failure to comply with applicable laws, regulations, and supervisory agreements could subject the Company or the Bank and their subsidiaries, as well as officers, directors, and other institution-affiliated parties of these organizations, to administrative sanctions and potentially substantial civil money penalties. In addition to the grounds discussed above under "The Bank's Corrective Measures for Capital Deficiencies," the appropriate federal banking agency may appoint the FDIC as conservator or receiver for a banking institution (or the FDIC may appoint itself, under certain circumstances) if any one or more of a number of circumstances exist, including, without limitation, the fact that the banking institution is undercapitalized and has no reasonable prospect of becoming adequately capitalized; fails to become adequately capitalized when required to do so; fails to submit a timely and acceptable capital restoration plan; or materially fails to implement an accepted capital restoration plan. The Texas Department of Banking also has broad enforcement powers over the Bank, including the power to impose orders, remove officers and directors, impose fines and appoint supervisors and conservators.

Effect on Economic Environment

The policies of regulatory authorities, including the monetary policy of the Federal Reserve Board, have a significant effect on the operating results of bank holding companies and their subsidiaries. Among the means available to the Federal Reserve Board to affect the money supply are open market operations in U.S. government securities, changes in the discount rate on member bank borrowings, and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid for deposits.

Federal Reserve Board monetary policies have materially affected the operating results of commercial banks in the past and are expected to continue to do so in the future. The nature of future monetary policies and the effect of such policies on the business and earnings of the Company and its subsidiaries cannot be predicted.

Table of Contents

Index to Financial Statements

ITEM 1A. RISK FACTORS

An investment in the Company's common stock involves risks. The following is a description of the material risks and uncertainties that the Company believes affect its business and an investment in the common stock. Additional risks and uncertainties that the Company is unaware of, or that it currently deems immaterial, also may become important factors that affect the Company and its business. If any of the risks described in this Annual Report on Form 10-K were to occur, the Company's financial condition, results of operations and cash flows could be materially and adversely affected. If this were to happen, the value of the common stock could decline significantly and you could lose all or part of your investment.

Risks Associated with the Company's Business

If the Company is not able to continue its historical levels of growth, it may not be able to maintain its historical earnings trends.

To achieve its past levels of growth, the Company has focused on both internal growth and acquisitions. The Company may not be able to sustain its historical rate of growth or may not be able to grow at all. In addition, the Company may not be able to obtain the financing necessary to fund additional growth and may not be able to find suitable candidates for acquisition. Various factors, such as economic conditions and competition, may impede or prohibit the opening of new banking centers. Further, the Company may be unable to attract and retain experienced bankers, which could adversely affect its internal growth. If the Company is not able to continue its historical levels of growth, it may not be able to maintain its historical earnings trends.

If the Company is unable to manage its growth effectively, its operations could be negatively affected.

Companies that experience rapid growth face various risks and difficulties, including:

finding suitable markets for expansion;

finding suitable candidates for acquisition;

attracting funding to support additional growth;

maintaining asset quality;

attracting and retaining qualified management; and

maintaining adequate regulatory capital.

In addition, in order to manage its growth and maintain adequate information and reporting systems within its organization, the Company must identify, hire and retain additional qualified associates, particularly in the accounting and operational areas of its business.

If the Company does not manage its growth effectively, its business, financial condition, results of operations and future prospects could be negatively affected, and the Company may not be able to continue to implement its business strategy and successfully conduct its operations.

Difficult market conditions and economic trends have adversely affected the banking industry and could adversely affect the Company's business, financial condition, results of operations and cash flows.

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The Company is operating in a challenging and uncertain economic environment, including generally uncertain conditions nationally and locally in its markets. Financial institutions continue to be affected by declines in the real estate market that have negatively impacted the credit performance of 1-4 family residential, construction and land development and commercial real estate loans and resulted in significant write-downs of assets by many financial institutions. The Company retains direct exposure to the residential and commercial real estate markets, and it is affected by these events.

Table of Contents

Index to Financial Statements

The Company's ability to assess the creditworthiness of customers and to estimate the losses inherent in its loan portfolio is made more complex by these difficult market and economic conditions. A prolonged national economic recession or further deterioration of these conditions in the Company's markets could drive losses beyond that which is provided for in its allowance for credit losses and result in the following consequences:

increases in loan delinquencies;

increases in nonperforming assets and foreclosures;

decreases in demand for the Company's products and services, which could adversely affect its liquidity position; and

decreases in the value of the collateral securing the Company's loans, especially real estate, which could reduce customers' borrowing power.

While economic conditions in the State of Texas and the U.S. are showing signs of recovery, there can be no assurance that these difficult conditions will continue to improve. Continued declines in real estate values, home sales volumes and financial stress on borrowers as a result of the uncertain economic environment, including job losses, could have an adverse effect on the Company's borrowers or their customers, which could adversely affect the Company's business, financial condition, results of operations and cash flows.

Liquidity risk could impair the Company's ability to fund operations and jeopardize its financial condition.

Liquidity is essential to the Company's business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on its liquidity. The Company's access to funding sources in amounts adequate to finance its activities or on terms which are acceptable to it could be impaired by factors that affect the Company specifically or the financial services industry or economy in general. Factors that could detrimentally impact the Company's access to liquidity sources include a decrease in the level of its business activity as a result of a downturn in the markets in which its loans are concentrated or adverse regulatory action against it. The Company's ability to borrow could also be impaired by factors that are not specific to it, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of the recent turmoil faced by banking organizations and the continued deterioration in credit markets.

If the Company is unable to identify and acquire other financial institutions and successfully integrate its acquired businesses, its business and earnings may be negatively affected.

The market for acquisitions remains highly competitive, and the Company may be unable to find acquisition candidates in the future that fit its acquisition and growth strategy. To the extent that the Company is unable to find suitable acquisition candidates, an important component of its growth strategy may be lost.

Acquisitions of financial institutions involve operational risks and uncertainties and acquired companies may have unforeseen liabilities, exposure to asset quality problems, key employee and customer retention problems and other problems that could negatively affect the Company's organization. The Company may not be able to complete future acquisitions and, if completed, the Company may not be able to successfully integrate the operations, management, products and services of the entities that it acquires and eliminate redundancies. The integration process could result in the loss of key employees or disruption of the combined entity's ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect the Company's ability to maintain relationships with customers and employees or achieve the anticipated benefits of the transaction. The integration process may also require significant time and attention from the Company's management that they would otherwise direct at servicing existing business and developing new business. The Company's failure to successfully integrate the entities it acquires into its existing operations may increase its operating costs significantly and adversely affect its business and earnings.

Table of Contents

Index to Financial Statements

The Company's dependence on loans secured by real estate subjects it to risks relating to fluctuations in the real estate market and related interest rates and regulatory guidance that could require additional capital and could adversely affect its financial condition, results of operations and cash flows.

Approximately 85.3% of the Company's total loans as of December 31, 2011 consisted of loans included in the real estate loan portfolio with 12.8% in construction and land development, 30.6% in residential real estate and 41.9% in commercial real estate. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. A weakening of the real estate market in the Company's primary market areas could have an adverse effect on the demand for new loans, the ability of borrowers to repay outstanding loans, the value of real estate and other collateral securing the loans and the value of real estate owned by the Company. If real estate values decline, it is also more likely that the Company would be required to increase its allowance for credit losses, which could adversely affect its financial condition, results of operations and cash flows.

As of December 31, 2011, the Company had \$482.1 million or 12.8% of total loans in construction and land development loans. Construction loans are subject to risks during the construction phase that are not present in standard residential real estate and commercial real estate loans. These risks include:

the viability of the contractor;

the contractor's ability to complete the project, to meet deadlines and time schedules and to stay within cost estimates; and

concentrations of such loans with a single contractor and its affiliates.

Real estate construction loans also present risks of default in the event of declines in property values or volatility in the real estate market during the construction phase. If the Company is forced to foreclose on a project prior to completion, it may not be able to recover the entire unpaid portion of the loan, may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate amount of time. If any of these risks were to occur, it could adversely affect the Company's financial condition, results of operations and cash flows.

The federal banking agencies have issued guidance regarding high concentrations of commercial real estate loans within bank loan portfolios. The guidance requires financial institutions that exceed certain levels of commercial real estate lending compared with their total capital to maintain heightened risk management practices that address the following key elements: including board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending. If there is any deterioration in the Company's commercial mortgage or construction and land development portfolios or if its regulators conclude that the Company has not implemented appropriate risk management practices, it could adversely affect the Company's business and result in a requirement of increased capital levels, and such capital may not be available at that time.

The Company's commercial mortgage and commercial loans expose it to increased credit risks, and these risks will increase if the Company succeeds in increasing these types of loans.

The Company, while maintaining its conservative approach to lending, has emphasized both new and existing loan products, focusing on managing its commercial mortgage and commercial loan portfolios, and intends to continue to increase its lending activities and acquire loans in possible future acquisitions. As a result, commercial real estate and commercial loans as a proportion of its portfolio could increase. As of December 31, 2011, commercial real estate and commercial loans totaled \$1.76 billion. In general, commercial real estate loans and commercial loans yield higher returns and often generate a deposit relationship, but also pose greater credit risks than do owner-occupied residential real estate loans. As the Company's various commercial loan portfolios increase, the corresponding risks and potential for losses from these loans will also increase.

Table of Contents

Index to Financial Statements

The Company makes both secured and some unsecured commercial loans. Unsecured loans generally involve a higher degree of risk of loss than do secured loans because, without collateral, repayment is wholly dependent upon the success of the borrowers' businesses. Secured commercial loans are generally collateralized by accounts receivable, inventory, equipment or other assets owned by the borrower and include a personal guaranty of the business owner. Compared to real estate, that type of collateral is more difficult to monitor, its value is harder to ascertain, it may depreciate more rapidly and it may not be as readily saleable if repossessed. Further, commercial loans generally will be serviced primarily from the operation of the business, which may not be successful, and commercial mortgage loans generally will be serviced from income on the properties securing the loans.

The Company's business is subject to interest rate risk and fluctuations in interest rates may adversely affect its earnings and capital levels.

The majority of the Company's assets are monetary in nature and, as a result, the Company is subject to significant risk from changes in interest rates. Changes in interest rates can impact the Company's net interest income as well as the valuation of its assets and liabilities. The Company's earnings are significantly dependent on its net interest income. Net interest income is the difference between the interest income earned on loans, investments and other interest-earning assets and the interest expense paid on deposits, borrowings and other interest-bearing liabilities. Therefore, any change in general market interest rates, such as a change in the monetary policy of the Federal Reserve Board or otherwise, can have a significant effect on the Company's net interest income. The Company's assets and liabilities may react differently to changes in overall market rates or conditions because there may be mismatches between the repricing or maturity characteristics of the assets and liabilities.

The Company's profitability depends significantly on local economic conditions.

The Company's success depends primarily on the general economic conditions of the primary markets in Texas in which it operates and where its loans are concentrated. Unlike nationwide banks that are more geographically diversified, the Company provides banking and financial services to customers primarily in the greater Houston and Dallas/Fort Worth metropolitan areas and in the east, central, north central, south central and southeast areas of Texas. The local economic conditions in these areas have a significant impact on the Company's commercial, real estate and construction and land development loans, the ability of its borrowers to repay their loans and the value of the collateral securing these loans. In addition, if the population or income growth in the Company's market areas is slower than projected, income levels, deposits and housing starts could be adversely affected and could result in a reduction of the Company's expansion, growth and profitability. Although economic conditions in Texas have not deteriorated to the same extent as in other areas of the country, such conditions could decline further. If the Company's market areas experience a downturn or a recession for a prolonged period of time, the Company could experience significant increases in nonperforming loans, which could lead to operating losses, impaired liquidity and eroding capital. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, outbreaks of hostilities or other international or domestic calamities, unemployment or other factors could impact these local economic conditions and could negatively affect the Company's financial condition, results of operations and cash flows.

The Company's allowance for credit losses may not be sufficient to cover actual credit losses, which could adversely affect its earnings.

As a lender, the Company is exposed to the risk that its loan customers may not repay their loans according to the terms of these loans and the collateral securing the payment of these loans may be insufficient to fully compensate the Company for the outstanding balance of the loan plus the costs to dispose of the collateral. Management makes various assumptions and judgments about the collectability of the Company's loan portfolio, including the diversification by industry of its commercial loan portfolio, the amount of nonperforming assets and related collateral, the volume, growth and composition of its loan portfolio, the effects on the loan portfolio of current economic indicators and their probable impact on borrowers and the evaluation of its loan portfolio through its internal loan review process and other relevant factors.

Table of Contents

Index to Financial Statements

The Company maintains an allowance for credit losses in an attempt to cover estimated losses inherent in its loan portfolio. Additional credit losses will likely occur in the future and may occur at a rate greater than the Company has experienced to date. In determining the size of the allowance, the Company relies on an analysis of its loan portfolio, its historical loss experience and its evaluation of general economic conditions. Continuing deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of the Company's control, may require an increase in the allowance for credit losses. If the Company's assumptions prove to be incorrect or if it experiences significant loan losses in future periods, its current allowance may not be sufficient to cover actual loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in its loan portfolio. A material addition to the allowance could cause net income, and possibly capital, to decrease.

In addition, federal and state regulators periodically review the Company's allowance for credit losses and may require the Company to increase its provision for credit losses or recognize further charge-offs, based on judgments different than those of the Company's management. An increase in the Company's allowance for credit losses or charge-offs as required by these regulatory agencies could have a material adverse effect on the Company's operating results and financial condition.

The small to medium-sized businesses that the Company lends to may have fewer resources to weather a downturn in the economy, which may impair a borrower's ability to repay a loan to the Company that could materially harm the Company's operating results.

The Company targets its business development and marketing strategy primarily to serve the banking and financial services needs of small to medium-sized businesses. These small to medium-sized businesses frequently have smaller market share than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience significant volatility in operating results. Any one or more of these factors may impair the borrower's ability to repay a loan. In addition, the success of a small to medium-sized business often depends on the management talents and efforts of one or two persons or a small group of persons, and the death, disability or resignation of one or more of these persons could have a material adverse impact on the business and its ability to repay a loan. Economic downturns and other events that negatively impact the Company's market areas could cause the Company to incur substantial credit losses that could negatively affect the Company's results of operations and financial condition.

If the goodwill that the Company recorded in connection with a business acquisition becomes impaired, it could require charges to earnings, which would have a negative impact on the Company's financial condition and results of operations.

Goodwill represents the amount by which the acquisition cost exceeds the fair value of net assets the Company acquired in the purchase of another financial institution. The Company reviews goodwill for impairment at least annually, or more frequently if events or changes in circumstances indicate the carrying value of the asset might be impaired.

The Company determines impairment by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Any such adjustments are reflected in the Company's results of operations in the periods in which they become known. At December 31, 2011, the Company's goodwill totaled \$924.5 million. While the Company has not recorded any such impairment charges since it initially recorded the goodwill, there can be no assurance that the Company's future evaluations of goodwill will not result in findings of impairment and related write-downs, which may have a material adverse effect on its financial condition and results of operations.

Table of Contents

Index to Financial Statements

The Company may be required to pay higher FDIC deposit insurance assessments in the future.

Recent insured depository institution failures, as well as deterioration in banking and economic conditions generally, have significantly increased the loss provisions of the FDIC, resulting in a decline in the designated reserve ratio of the FDIC to historical lows. The FDIC expects a higher rate of insured depository institution failures in the next few years compared to recent years; thus, the reserve ratio may continue to decline. In addition, the deposit insurance limit on FDIC deposit insurance coverage generally has increased to \$250,000. These developments have resulted in increased FDIC assessments in 2009 and 2010 and may result in increased assessments in the future.

On February 7, 2011, the FDIC approved a final rule that amends its existing DIF restoration plan and implements certain provisions of the Dodd-Frank Act. Effective April 1, 2011 the assessment base is determined using average consolidated total assets minus average tangible equity rather than the previous assessment base of adjusted domestic deposits. The new assessment rates, calculated on the revised assessment base generally range from 2.5 to 9 basis points for Risk Category I institutions, 9 to 24 basis points for Risk Category II institutions, 18 to 33 basis points for Risk Category III institutions, and 30 to 45 basis points for Risk Category IV institutions. The new assessment rates were calculated for the quarter beginning April 1, 2011 and reflected in invoices for assessments due September 30, 2011.

The final rule provides the FDIC's board with the flexibility to adopt actual rates that are higher or lower than the total base assessment rates adopted on February 7, 2011 without notice and comment, if certain conditions are met. An increase in the assessment rates could have an adverse impact on the Company's results of operations. For the year ended December 31, 2011, the Company's FDIC insurance related costs were \$8.3 million compared with \$10.4 million for the year ended December 31, 2010.

The Company may be adversely affected by the soundness of other financial institutions.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. The Company has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose the Company to credit risk in the event of a default by a counterparty or client. In addition, the Company's credit risk may be exacerbated when the collateral held by the Company cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to the Company. Any such losses could have a material adverse effect on the Company's financial condition, results of operations and cash flows.

The Company may need to raise additional capital in the future and such capital may not be available when needed or at all.

The Company may need to raise additional capital in the future to provide it with sufficient capital resources and liquidity to meet its commitments and business needs. In addition, the Company may elect to raise additional capital to support its business or to finance acquisitions, if any. The Company's ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of its control, and its financial performance. Accordingly, the Company cannot assure you that such capital will be available to it on acceptable terms or at all. Any occurrence that may limit its access to the capital markets, such as a decline in the confidence of investors, depositors of Prosperity Bank or counterparties participating in the capital markets, may adversely affect the Company's capital costs and its ability to raise capital and, in turn, its liquidity. An inability to raise additional capital on acceptable terms when needed could subject the Company to increased regulatory supervision and the imposition of restrictions on its growth or business, which could have a material adverse effect on the Company's business, financial condition and results of operations.

Table of Contents

Index to Financial Statements

An interruption in or breach in security of the Company's information systems may result in a loss of customer business and have an adverse effect on the Company's results of operations, financial condition and cash flows.

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's customer relationship management, general ledger, deposits, servicing or loan origination systems. Although the Company has policies and procedures designed to prevent or minimize the effect of a failure, interruption or breach in security of its communications or information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur, or if they do occur, that they will be adequately addressed by the Company. The occurrence of any such failures, interruptions or security breaches could result in a loss of customer business and have a negative effect on the Company's results of operations, financial condition and cash flows.

The business of the Company is dependent on technology and the Company's inability to invest in technological improvements may adversely affect its results of operations, financial condition and cash flows.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. The Company's future success depends in part upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands for convenience as well as create additional efficiencies in its operations. Many of the Company's competitors have substantially greater resources to invest in technological improvements. The Company may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers, which may negatively affect the Company's results of operations, financial condition and cash flows.

The Company operates in a highly regulated environment and, as a result, is subject to extensive regulation and supervision; and changes in federal, state and local laws and regulations could adversely affect its financial performance.

The Company and the Bank are subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not the Company's shareholders. These regulations affect the Company's lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Any change in applicable regulations or federal or state legislation could have a substantial impact on the Company, the Bank and their respective operations.

The Dodd-Frank Act, enacted in July 2010, instituted major changes to the banking and financial institutions regulatory regimes in light of the recent performance of and government intervention in the financial services sector. Additional legislation and regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could significantly affect the Company's powers, authority and operations, or the powers, authority and operations of the Bank in substantial and unpredictable ways. Further, regulators have significant discretion and power to prevent or remedy unsafe or unsound practices or violations of laws by banks and bank holding companies in the performance of their supervisory and enforcement duties. The exercise of this regulatory discretion and power could have a negative impact on the Company. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company's business, financial condition and results of operations.

Table of Contents

Index to Financial Statements

The Company is subject to losses resulting from fraudulent and negligent acts on the part of loan applicants, correspondents or other third parties.

The Company relies heavily upon information supplied by third parties, including the information contained in credit applications, property appraisals, title information, equipment pricing and valuation and employment and income documentation, in deciding which loans the Company will originate, as well as the terms of those loans. If any of the information upon which the Company relies is misrepresented, either fraudulently or inadvertently, and the misrepresentation is not detected prior to asset funding, the value of the asset may be significantly lower than expected, or the Company may fund a loan that it would not have funded or on terms it would not have extended. Whether a misrepresentation is made by the applicant or another third party, the Company generally bears the risk of loss associated with the misrepresentation. A loan subject to a material misrepresentation is typically unsellable or subject to repurchase if it is sold prior to detection of the misrepresentation. The sources of the misrepresentations are often difficult to locate, and it is often difficult to recover any of the monetary losses the Company may suffer.

The recent repeal of federal prohibitions on payment of interest on demand deposits could increase the Company's interest expense.

All federal prohibitions on the ability of financial institutions to pay interest on demand deposit accounts were repealed as part of the Dodd-Frank Act. As a result, beginning on July 21, 2011, financial institutions can now offer interest on demand deposits to compete for clients. The Company's interest expense will increase and its net interest margin will decrease if it begins offering interest on demand deposits to attract additional customers or maintain current customers, which could have an adverse effect on the Company's business, financial condition and results of operations.

The Company is subject to environmental liability risk associated with lending activities.

A significant portion of the Company's loan portfolio is secured by real property. During the ordinary course of business, the Company may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Company may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Company to incur substantial expenses and may materially reduce the affected property's value or limit the Company's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase the Company's exposure to environmental liability. Although the Company has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on the Company's financial condition and results of operations.

Risks Associated with the Company's Common Stock

The Company's corporate organizational documents and the provisions of Texas law to which it is subject may delay or prevent a change in control of the Company that a shareholder may favor.

The Company's amended and restated articles of incorporation and amended and restated bylaws contain various provisions which may delay, discourage or prevent an attempted acquisition or change of control of the Company. These provisions include:

a board of directors classified into three classes of directors with the directors of each class having staggered three-year terms;

a provision that any special meeting of the Company's shareholders may be called only by the chairman of the board and chief executive officer, the president, a majority of the board of directors or the holders of at least 50% of the Company's shares entitled to vote at the meeting;

Table of Contents

Index to Financial Statements

a provision establishing certain advance notice procedures for nomination of candidates for election as directors and for shareholder proposals to be considered at an annual or special meeting of shareholders; and

a provision that denies shareholders the right to amend the Company's bylaws.

The Company's articles of incorporation provide for noncumulative voting for directors and authorize the board of directors to issue shares of its preferred stock without shareholder approval and upon such terms as the board of directors may determine. The issuance of the Company's preferred stock could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from acquiring, a controlling interest in the Company. In addition, certain provisions of Texas law, including a provision which restricts certain business combinations between a Texas corporation and certain affiliated shareholders, may delay, discourage or prevent an attempted acquisition or change in control of the Company.

There are restrictions on the Company's ability to pay dividends.

Holders of the Company's common stock are only entitled to receive such dividends as the Company's Board of Directors may declare out of funds legally available for such payments. Although the Company has historically declared cash dividends on its common stock, it is not required to do so and there can be no assurance that the Company will pay dividends in the future. Any declaration and payment of dividends on common stock will depend upon the Company's earnings and financial condition, liquidity and capital requirements, the general economic and regulatory climate, the Company's ability to service any equity or debt obligations senior to the common stock and other factors deemed relevant by the Board of Directors.

The Company's principal source of funds to pay dividends on the shares of common stock is cash dividends that the Company receives from the Bank. Various banking laws applicable to the Bank limit the payment of dividends and other distributions by the Bank to the Company, and may therefore limit the Company's ability to pay dividends on its common stock. Regulatory authorities could impose administratively stricter limitations on the ability of the Bank to pay dividends to the Company if such limits were deemed appropriate to preserve certain capital adequacy requirements. In addition, the Federal Reserve Board has indicated that bank holding companies should carefully review their dividend policy in relation to the organization's overall asset quality, level of current and prospective earnings and level, composition and quality of capital. The guidance provides that the Company inform and consult with the Federal Reserve Board prior to declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid or that could result in an adverse change to the Company's capital structure, including interest on the subordinated debentures underlying the Company's trust preferred securities. If required payments on the Company's outstanding junior subordinated debentures held by its unconsolidated subsidiary trusts are not made or are suspended, the Company will be prohibited from paying dividends on its common stock.

The holders of the Company's junior subordinated debentures have rights that are senior to those of the Company's shareholders.

As of December 31, 2011, the Company had \$85.1 million in junior subordinated debentures outstanding that were issued to the Company's unconsolidated subsidiary trusts. The subsidiary trusts purchased the junior subordinated debentures from the Company using the proceeds from the sale of trust preferred securities to third party investors. Payments of the principal and interest on the trust preferred securities are conditionally guaranteed by the Company to the extent not paid or made by each trust, provided the trust has funds available for such obligations.

The junior subordinated debentures are senior to the Company's shares of common stock. As a result, the Company must make interest payments on the junior subordinated debentures (and the related trust preferred securities) before any dividends can be paid on its common stock; and, in the event of the Company's bankruptcy, dissolution or liquidation, the holders of the debentures must be satisfied before any distributions can

Table of Contents**Index to Financial Statements**

be made to the holders of the common stock. Additionally, the Company has the right to defer periodic distributions on the junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time the Company would be prohibited from paying dividends on its common stock. The Company's ability to pay the future distributions depends upon the earnings of the Bank and dividends from the Bank to the Company, which may be inadequate to service the obligations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of December 31, 2011, the Company conducted business at one hundred seventy-five (175) full-service banking centers. The Company's headquarters are located at Prosperity Bank Plaza, 4295 San Felipe, in the Galleria area in Houston, Texas. The Company also owns or leases other facilities in which its banking centers are located as listed below by geographical market area. The expiration dates of the leases range from 2012 to 2025 and do not include renewal periods which may be available at the Company's option.

The following table sets forth specific information regarding the banking centers located in each of the Company's geographical market areas at December 31, 2011:

Geographical Area	Number of Banking Centers	Number of Leased Banking Centers	Deposits at December 31, 2011 (Dollars in thousands)
Bryan/College Station	10		\$ 577,391
Houston area	60	18	3,785,556
Central Texas area	33	7	1,070,620
Dallas/Fort Worth Texas area	31	9	1,144,226
East Texas area	21		664,919
South Texas area including Corpus Christi	20	5	817,542
Total	175	39	\$ 8,060,254

ITEM 3. 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 4. MINE SAFETY DISCLOSURES

None.

Table of Contents**Index to Financial Statements****PART II.****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Common Stock Market Prices**

The Company's common stock is listed on the New York Stock Exchange under the symbol PB. Prior to December 28, 2011, the Company's common shares were listed for trading under the symbol PRSP on the NASDAQ Global Select Market (NASDAQ). As of February 15, 2012, there were 47,233,431 shares outstanding and 1,925 shareholders of record. The number of beneficial owners is unknown to the Company at this time.

The following table presents the high and low intra-day sales prices for the common stock as reported by NASDAQ (through December 27, 2011) or the New York Stock Exchange (beginning December 28, 2011) during the two years ended December 31, 2011:

2011	High	Low
Fourth Quarter	\$ 41.74	\$ 31.31
Third Quarter	46.87	30.91
Second Quarter	46.75	40.83
First Quarter	42.92	38.23
2010	High	Low
Fourth Quarter	\$ 39.96	\$ 30.37
Third Quarter	36.05	28.27
Second Quarter	43.66	34.31
First Quarter	42.55	37.93

Dividends

Holders of common stock are entitled to receive dividends when, as and if declared by the Company's Board of Directors out of funds legally available therefore. While the Company has declared dividends on its common stock since 1994, and paid quarterly dividends aggregating \$0.72 per share in 2011 and \$0.64 per share in 2010, there is no assurance that the Company will continue to pay dividends in the future. Future dividends on the common stock will depend upon the Company's earnings and financial condition, liquidity and capital requirements, the general economic and regulatory climate, the Company's ability to service any equity or debt obligations senior to the common stock and other factors deemed relevant by the Board of Directors of the Company.

As a holding company, the Company is ultimately dependent upon its subsidiaries to provide funding for its operating expenses, debt service and dividends. Various banking laws applicable to the Bank limit the payment of dividends and other distributions by the Bank to the Company, and may therefore limit the Company's ability to pay dividends on its common stock. Regulatory authorities could impose administratively stricter limitations on the ability of the Bank to pay dividends to the Company if such limits were deemed appropriate to preserve certain capital adequacy requirements.

In addition, the Federal Reserve Board has indicated that bank holding companies should carefully review their dividend policy in relation to the organization's overall asset quality, level of current and prospective earnings and level, composition and quality of capital. The guidance provides that the Company inform and consult with the Federal Reserve Board prior to declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid or that could result in an adverse change to the Company's capital structure, including interest on the subordinated debentures underlying the Company's trust preferred securities.

Table of Contents

Index to Financial Statements

If required payments on the Company's outstanding junior subordinated debentures held by its unconsolidated subsidiary trusts are not made or suspended, the Company will be prohibited from paying dividends on its common stock.

The cash dividends declared per share by quarter (and paid on the first business day of the subsequent quarter except for the fourth quarter of 2010 which was paid on December 31, 2010) for the Company's last two fiscal years were as follows:

	2011	2010
Fourth quarter	\$ 0.1950	\$ 0.1750
Third quarter	0.1750	0.1550
Second quarter	0.1750	0.1550
First quarter	0.1750	0.1550

Recent Sales of Unregistered Securities

None.

Securities Authorized for Issuance under Equity Compensation Plans

As of December 31, 2011, the Company had outstanding stock options granted under three stock option plans, all of which were approved by the Company's shareholders. As of such date, the Company also had outstanding stock options granted under stock option plans that it assumed in connection with various acquisition transactions. The following table provides information as of December 31, 2011 regarding the Company's equity compensation plans under which the Company's equity securities are authorized for issuance:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	525,012 ⁽¹⁾	\$ 28.18	544,791
Equity compensation plans not approved by security holders			
Total	525,012	\$ 28.18	544,791

(1) Includes (a) 11,698 shares which may be issued upon exercise of options outstanding assumed by the Company in connection with the acquisition of SNB Bancshares, Inc. at a weighted average exercise price of \$16.39.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

Table of Contents

Index to Financial Statements

Performance Graph

The following Performance Graph compares the cumulative total shareholder return on the Company's common stock for the period beginning at the close of trading on December 31, 2006 to December 31, 2011, with the cumulative total return of the S&P 500 Total Return Index and the Nasdaq Bank Index for the same period. Dividend reinvestment has been assumed. The Performance Graph assumes \$100 invested on December 31, 2006 in the Company's common stock, the S&P 500 Total Return Index and the Nasdaq Bank Index. The historical stock price performance for the Company's common stock shown on the graph below is not necessarily indicative of future stock performance.

	12/06	12/07	12/08	12/09	12/10	12/11
Prosperity Bancshares, Inc.	100.00	86.37	88.49	123.29	121.80	127.45
S&P 500	100.00	105.49	66.46	84.05	96.71	98.75
NASDAQ Bank	100.00	76.94	64.14	53.93	61.47	54.83

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(www.researchdatagroup.com/S&P.htm)

Table of Contents**Index to Financial Statements****ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA**

The following selected consolidated financial data of the Company for, and as of the end of, each of the years in the five-year period ended December 31, 2011 is derived from and should be read in conjunction with the Company's consolidated financial statements and the notes thereto appearing elsewhere in this Annual Report on Form 10-K.

	2011 ⁽¹⁾	As of and for the Years Ended December 31, 2010 ⁽¹⁾ 2009 2008 2007 (Dollars in thousands, except per share data)			
Income Statement Data:					
Interest income	\$ 371,908	\$ 384,537	\$ 409,614	\$ 347,878	\$ 340,608
Interest expense	45,240	66,389	102,513	120,149	140,173
Net interest income	326,668	318,148	307,101	227,729	200,435
Provision for credit losses	5,200	13,585	28,775	9,867	760
Net interest income after provision for credit losses	321,468	304,563	278,326	217,862	199,675
Noninterest income	56,043	53,833	60,097	52,370	52,923
Noninterest expense	163,745	166,594	169,700	143,796	126,843
Income before taxes	213,766	191,802	168,723	126,436	125,755
Provision for income taxes	72,017	64,094	56,844	41,929	41,604
Net income	\$ 141,749	\$ 127,708	\$ 111,879	\$ 84,507 ⁽²⁾	\$ 84,151 ⁽²⁾
Per Share Data:					
Basic earnings per share	\$ 3.03	\$ 2.74	\$ 2.42	\$ 1.87 ⁽²⁾	\$ 1.96 ⁽²⁾
Diluted earnings per share	3.01	2.73	2.41	1.86 ⁽²⁾	1.94 ⁽²⁾
Book value per share	33.41	31.11	29.03	27.24	25.51
Cash dividends declared	0.72	0.64	0.57	0.51	0.46
Dividend payout ratio	23.80%	23.37%	23.45%	27.66%	24.15%
Weighted average shares outstanding (basic) (in thousands)	46,846	46,621	46,177	45,300	42,928
Weighted average shares outstanding (diluted) (in thousands)	47,017	46,832	46,354	45,479	43,310
Shares outstanding at end of period (in thousands)	46,910	46,684	46,541	46,080	44,188
Balance Sheet Data (at period end):					
Total assets	\$ 9,822,671	\$ 9,476,572	\$ 8,850,400	\$ 9,072,364	\$ 6,372,343
Securities	4,658,936	4,617,116	4,118,290	4,160,401	1,857,606
Loans	3,765,906	3,485,023	3,376,703	3,567,057	3,142,971
Allowance for credit losses	51,594	51,584	51,863	36,970	32,543
Total goodwill and intangibles	945,533	953,034	912,372	912,850	799,978
Other real estate owned	8,328	11,053	7,829	4,450	10,207
Total deposits	8,060,254	7,454,920	7,258,550	7,303,297	4,966,407
Borrowings and notes payable	12,790	374,433	98,736	325,412	116,047
Junior subordinated debentures	85,055 ⁽³⁾	92,265	92,265	92,265	112,885
Total shareholders' equity	1,567,265	1,452,339	1,351,245	1,255,106	1,127,431

(Table continued on next page)

Table of Contents

Index to Financial Statements

	2011 ⁽¹⁾	As of and for the Years Ended December 31,			2007
		2010 ⁽¹⁾	2009	2008	
(Dollars in thousands, except per share data)					
Average Balance Sheet Data:					
Total assets	\$ 9,628,884	\$ 9,278,380	\$ 8,851,694	\$ 7,025,418	\$ 6,094,064
Securities	4,625,833	4,508,918	4,052,989	2,409,758	1,849,613
Loans	3,648,701	3,394,502	3,455,761	3,250,447	3,092,797
Allowance for credit losses	51,871	52,151	42,279	33,004	34,705
Total goodwill and intangibles	949,273	940,080	914,384	842,580	759,733
Total deposits	7,751,196	7,532,739	7,212,015	5,471,441	4,727,519
Junior subordinated debentures	86,557	92,265	92,265	99,998	124,613
Total shareholders' equity	1,513,749	1,406,159	1,304,749	1,192,293	1,039,955
Performance Ratios:					
Return on average assets	1.47%	1.38%	1.26%	1.20% ⁽⁴⁾	1.38% ⁽⁵⁾
Return on average equity	9.36	9.08	8.57	7.09 ⁽⁴⁾	8.09 ⁽⁵⁾
Net interest margin (tax equivalent)	3.98	4.04	4.08	3.96	4.06
Efficiency ratio ⁽⁶⁾	42.76	44.83	46.27	46.51	46.19
Asset Quality Ratios⁽⁷⁾:					
Nonperforming assets to total loans and other real estate	0.32%	0.45%	0.48%	0.40%	0.49%
Net charge-offs to average loans	0.14	0.41	0.40	0.23	0.18
Allowance for credit losses to total loans	1.37	1.48	1.54	1.04	1.04
Allowance for credit losses to nonperforming loans ⁽⁸⁾	1,442.0	1,114.6	616.6	379.7	634.7
Capital Ratios⁽⁷⁾:					
Leverage ratio	7.89%	6.87%	6.47%	5.68%	8.09%
Average shareholders' equity to average total assets	15.72	15.16	14.74	16.97	17.07
Tier 1 risk-based capital ratio	15.90	13.64	12.61	10.27	13.13
Total risk-based capital ratio	17.09	14.87	13.86	11.17	14.11

- (1) The Company completed no acquisitions during the twelve months ended December 31, 2011 and completed the acquisition of three branches of U.S Bank on March 29, 2010 and the acquisition of nineteen branches of First Bank on April 30, 2010.
- (2) Net income for the year ended December 31, 2008 includes a \$14.0 million pre-tax, or \$9.1 million after-tax, impairment charge on write-down of securities which resulted in a decrease of basic and diluted earnings per share of \$0.20 for the year ended December 31, 2008. Net income for the year ended December 31, 2007 includes a \$10.0 million pre-tax, or \$6.5 million after-tax, impairment charge on write-down of securities, which resulted in a decrease of basic and diluted earnings per share of \$0.15 for the year ended December 31, 2007.
- (3) Consists of \$15.5 million of junior subordinated debentures of Prosperity Statutory Trust II due July 31, 2031, \$12.9 million of junior subordinated debentures of Prosperity Statutory Trust III due September 17, 2033, \$12.9 million of junior subordinated debentures of Prosperity Statutory Trust IV due December 30, 2033, \$10.3 million of junior subordinated debentures of SNB Capital Trust IV due September 25, 2033 (assumed by the Company on April 1, 2006), \$5.2 million of junior subordinated debentures of TXUI Statutory Trust II due December 19, 2033 (assumed by the Company on January 31, 2007), \$16.0 million of junior subordinated debentures of TXUI Statutory Trust III due December 15, 2035 (assumed by the Company on January 31, 2007) and \$12.4 million of junior subordinated debentures of TXUI Statutory Trust IV due June 30, 2036 (assumed by the Company on January 31, 2007).
- (4) Includes a \$14.0 million pre-tax, or \$9.1 million after-tax, impairment charge on write-down of securities, which resulted in a decrease of return on average assets of 13 basis points and a decrease of return on average equity of 76 basis points for the year ended December 31, 2008.

Table of Contents

Index to Financial Statements

- (5) Includes a \$10.0 million pre-tax, or \$6.5 million after-tax, impairment charge on write-down of securities, which resulted in a decrease of return on average assets of 11 basis points and a decrease of return on average equity of 63 basis points for the year ended December 31, 2007.
- (6) Calculated by dividing total noninterest expense, excluding credit loss provisions and impairment write-down on securities, by net interest income plus noninterest income, excluding net gains and losses on the sale of securities and assets. Additionally, taxes are not part of this calculation.
- (7) At period end, except for net charge-offs to average loans and average shareholders' equity to average total assets, which is for periods ended at such dates.
- (8) Nonperforming loans consist of nonaccrual loans, loans contractually past due 90 days or more, restructured loans and any other loan management deems to be nonperforming.

Table of Contents

Index to Financial Statements

ITEM 7. 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 Annual Report on Form 10-K that are not statements of historical fact constitute forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These 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 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;

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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;

Table of Contents

Index to Financial Statements

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;

increases in FDIC deposit insurance assessments;

potential risk of environmental liability associated with lending activities;

the potential payment of interest on demand deposit accounts in order to effectively compete for clients;

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 listed from time to time in the Company's 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 and other detailed information appearing elsewhere in this Annual Report on Form 10-K.

For the Years Ended December 31, 2011, 2010 and 2009

Overview

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. The Company has recognized increased net interest income due primarily to an increase in the volume of interest-earning assets.

Three principal components of the Company's growth strategy are internal growth, stringent cost control practices and acquisitions, including strategic merger transactions and FDIC assisted 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 while enabling the Company to minimize operational costs through certain economies of scale. The

Table of Contents

Index to Financial Statements

Company also intends to continue to seek expansion opportunities. On March 29, 2010, the Company purchased three (3) retail branches of U.S. Bank. The three banking centers acquired by the Company were the Texas locations U.S. Bank acquired from the FDIC on October 30, 2009 when U.S. Bank acquired the nine (9) subsidiary banks of FBOP Corporation. On April 30, 2010, the Company purchased nineteen (19) Texas retail branches of First Bank, and subsequently consolidated four (4) of these branches into nearby existing Company banking centers.

Net income was \$141.7 million, \$127.7 million and \$111.9 million for the years ended December 31, 2011, 2010 and 2009, respectively, and diluted earnings per share were \$3.01, \$2.73 and \$2.41, respectively, for these same periods. The change in net income during both 2011 and 2010 was principally due to an increase in net interest income resulting from balance sheet growth from acquisitions, including the acquisition of three (3) branches of U.S. Bank and the acquisition of nineteen (19) branches of First Bank in 2010. Net income growth during 2009 resulted principally from an increase in net interest income. The Company posted returns on average assets of 1.47%, 1.38% and 1.26% and returns on average equity of 9.36%, 9.08% and 8.57% for the years ended December 31, 2011, 2010 and 2009, respectively. The Company's efficiency ratio was 42.76% in 2011, 44.83% in 2010 and 46.27% in 2009. The efficiency ratio is calculated by dividing total noninterest expense (excluding credit loss provisions and impairment write-down on securities) by net interest income plus noninterest income (excluding net gains and losses on the sale of securities and assets). Additionally, taxes are not part of this calculation.

Total assets at December 31, 2011 and 2010 were \$9.823 billion and \$9.477 billion, respectively. Total deposits at December 31, 2011 and 2010 were \$8.060 billion and \$7.455 billion, respectively. Total loans were \$3.766 billion at December 31, 2011, an increase of \$280.9 million or 8.1% compared with \$3.485 billion at December 31, 2010. At December 31, 2011, the Company had \$3.6 million in nonperforming loans and its allowance for credit losses was \$51.6 million compared with \$4.6 million in nonperforming loans and an allowance for credit losses of \$51.6 million at December 31, 2010. Shareholders' equity was \$1.567 billion and \$1.452 billion at December 31, 2011 and 2010, respectively.

Recent Developments

Pending Acquisition of American State Financial Corporation On February 27, 2012, the Company announced the signing of a definitive agreement to acquire American State Financial Corporation and its wholly owned subsidiary, American State Bank (ASB), through the merger of American State Financial with and into the Company. ASB operates thirty-seven (37) banking offices in eighteen (18) counties across West Texas. As of December 31, 2011, American State Financial, on a consolidated basis, reported total assets of \$3.08 billion, total loans of \$1.21 billion and total deposits of \$2.46 billion. Under the terms of the definitive agreement, the Company will issue up to 8,525,000 shares of its common stock plus \$178.5 million in cash for all outstanding shares of American State Financial capital stock, subject to certain conditions and potential adjustment.

The merger has been approved by the Boards of Directors of both companies and is expected to close during the third quarter of 2012, although delays may occur. The transaction is subject to certain conditions, including the approval by American State Financial's shareholders and customary regulatory approvals. Operational integration is anticipated to begin during the third quarter of 2012.

Pending Acquisition of The Bank Arlington On January 19, 2012, the Company entered into a definitive agreement to acquire The Bank Arlington. The Bank Arlington operates one (1) banking office in Arlington, Texas, in the Dallas/Fort Worth CMSA.

Under the terms of the definitive agreement, the Company will issue up to 138,600 shares of Company common stock for all outstanding shares of The Bank Arlington capital stock, subject to certain conditions and potential adjustments. The transaction is expected to close during the second quarter of 2012, although delays could occur.

Table of Contents

Index to Financial Statements

Pending Acquisition of East Texas Financial Services, Inc. On December 8, 2011, the Company entered into a definitive agreement to acquire East Texas Financial Services, Inc. (OTC BB: FFBT) and its wholly-owned subsidiary, First Federal Bank Texas (Firstbank). Firstbank operates four (4) banking offices in the Tyler MSA, including three (3) locations in Tyler, Texas and one (1) location in Gilmer, Texas.

Under the terms of the definitive agreement, the Company will issue up to 531,000 shares of Company common stock for all outstanding shares of East Texas Financial Services capital stock, subject to certain conditions and potential adjustments. The transaction is expected to close during the second quarter of 2012, although delays could occur.

Acquisition of Texas Bankers, Inc. On January 1, 2012, the Company completed the previously announced acquisition of Texas Bankers, Inc. and its wholly-owned subsidiary, Bank of Texas, Austin, Texas. The three (3) Bank of Texas banking offices in the Austin, Texas CMSA consist of a location in Rollingwood, which upon operational integration will be consolidated with the Company's Westlake location and remain in Bank of Texas Rollingwood banking office; one banking center in downtown Austin, which upon operational integration will be consolidated into the Company's downtown Austin location; and another banking center in Thorndale.

Under the terms of the agreement, the Company issued 314,953 shares of Company common stock for all outstanding shares of Texas Bankers capital stock, which resulted in a premium of \$5.2 million.

Critical Accounting Policies

The Company's significant accounting policies are integral to understanding the results reported. The Company's accounting policies are described in detail in Note 1 to the consolidated financial statements, appearing elsewhere in this Annual Report on Form 10-K. 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 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. Based on an evaluation of the loan portfolio, management presents a monthly 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, industry diversification of the Company's commercial loan portfolio, the amount of nonperforming assets and related collateral, 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 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. The allowance for credit losses includes allowance allocations calculated in accordance with FASB ASC Topic 310, *Receivables*, and allowance allocations determined in accordance with FASB ASC Topic 450, *Contingencies*.

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 Prosperity Bank, the Company's only reporting unit with assigned goodwill, is below the carrying value of its equity. Goodwill is tested for impairment using a two-step process that 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. The Company estimated the fair value of its reporting unit through several valuation techniques that consider, among other things, the historical and current financial position and results of operations of the Company, general

Table of Contents

Index to Financial Statements

economic and market conditions and exit prices for recent market transactions. The Company had no intangible assets with indefinite useful lives at December 31, 2011. Other identifiable intangible assets that are subject to amortization are amortized on an accelerated basis over the years expected to be benefited, which the Company believes is between eight and ten 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, 2011, management does not believe any of its goodwill is impaired as of December 31, 2011 because the fair value of the Company's equity exceeded its carrying value. While the Company believes no impairment existed at December 31, 2011 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.

Stock-Based Compensation The Company accounts for stock-based employee compensation plans using the fair value-based method of accounting in accordance with FASB ASC Topic 718, *Stock Compensation*. ASC 718 was effective for companies in 2006; however, the Company had been recognizing compensation expense since January 1, 2003. The Company's results of operations reflect compensation expense for all employee stock-based compensation, including the unvested portion of stock options granted prior to 2003. ASC 718 requires that management make assumptions including stock price volatility and employee turnover that are utilized to measure compensation expense. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of subjective assumptions.

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 (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, (iii) whether the market decline was affected by macroeconomic conditions, and (iv) 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.

Results of Operations

Net Interest Income

The Company's operating results depend primarily on its net interest income, which is the difference between interest income on interest-earning assets, including securities and loans, and interest expense incurred on interest-bearing liabilities, including deposits and other borrowed funds. Interest rate fluctuations, as well as changes in the amount and type of earning assets and liabilities, combine to affect 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.

2011 versus 2010. Net interest income before the provision for credit losses for the year ended December 31, 2011 was \$326.7 million compared with \$318.1 million for the year ended December 31, 2010, an increase of \$8.5 million or 2.7%. The improvement in net interest income for 2011 was principally due to a \$349.0 million or 4.4% increase in average interest-earning assets to \$8.301 billion at December 31, 2011 compared with \$7.952 billion at December 31, 2010. The average rate paid on interest-bearing liabilities

Table of Contents

Index to Financial Statements

decreased 34 basis points from 1.06% for the year ended December 31, 2010 to 0.72% for the year ended December 31, 2011 and the average yield on interest-earning assets decreased 36 basis points from 4.84% at December 31, 2010 to 4.48% at December 31, 2011. At December 31, 2011, period end demand deposits represented an important component of funding and were 24.5% of total period end deposits compared with 22.4% at December 31, 2010.

Net interest margin on a tax equivalent basis, defined as net interest income divided by average interest-earning assets, for 2011 was 3.98%, a decrease of 6 basis points compared with 4.04% for 2010.

2010 versus 2009. Net interest income before the provision for credit losses for the year ended December 31, 2010 was \$318.1 million compared with \$307.1 million for the year ended December 31, 2009, an increase of \$11.0 million or 3.6%. The improvement in net interest income for 2010 was principally due to a \$366.3 million or 4.8% increase in average interest-earning assets to \$7.952 billion at December 31, 2010 compared with \$7.586 billion at December 31, 2009. The improvement in net interest income for 2010 was also partially due to the decrease in the yield on interest-earning assets being less than the decrease in rates paid on interest-bearing liabilities. The average rate paid on interest-bearing liabilities decreased 65 basis points from 1.71% for the year ended December 31, 2009 to 1.06% for the year ended December 31, 2010 and the average yield on interest-earning assets decreased 56 basis points from 5.40% at December 31, 2009 to 4.84% at December 31, 2010. At December 31, 2010, period end demand deposits represented an important component of funding and were 22.4% of total period end deposits compared with 20.6% at December 31, 2009.

Net interest margin on a tax equivalent basis, defined as net interest income divided by average interest-earning assets, for 2010 was 4.04%, a decrease of 4 basis points compared with 4.08% for 2009.

Table of Contents**Index to Financial Statements**

The following table presents, 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 both in 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.

	Years Ended December 31,								
	Average Outstanding Balance	2011 Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	2010 Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	2009 Interest Earned/ Paid	Average Yield/ Rate
(Dollars in thousands)									
Assets									
Interest-earning assets:									
Loans	\$ 3,648,701	\$ 214,273	5.87%	\$ 3,394,502	\$ 209,711	6.18%	\$ 3,455,761	\$ 219,320	6.35%
Securities ⁽¹⁾	4,625,833	157,580	3.41	4,508,918	174,707	3.87	4,052,989	190,106	4.69
Federal funds sold and other temporary investments	26,879	55	0.20	48,944	119	0.24	77,328	188	0.24
Total interest-earning assets	8,301,413	371,908	4.48%	7,952,364	384,537	4.84%	7,586,078	409,614	5.40%
Less allowance for credit losses	(51,871)			(52,151)			(42,279)		
Total interest-earning assets, net of allowance	8,249,542			7,900,213			7,543,799		
Noninterest-earning assets	1,379,342			1,378,167			1,307,895		
Total assets	\$ 9,628,884			\$ 9,278,380			\$ 8,851,694		
Liabilities and shareholders equity									
Interest-bearing liabilities:									
Interest-bearing demand deposits	\$ 1,393,501	\$ 7,416	0.53%	\$ 1,336,400	\$ 8,994	0.67%	\$ 1,082,332	\$ 8,587	0.79%
Savings and money market accounts	2,421,735	11,836	0.49	2,189,695	15,159	0.69	1,910,721	19,405	1.02
Certificates of deposit	2,135,858	21,723	1.02	2,438,968	37,356	1.53	2,730,263	67,842	2.48
Junior subordinated debentures	86,557	2,984	3.45	92,265	3,250	3.52	92,265	3,760	4.08
Securities sold under repurchase agreements	68,049	369	0.54	81,623	595	0.73	93,625	1,166	1.25
Other borrowings	152,716	912	0.60	109,260	1,035	0.95	75,747	1,753	2.31
Total interest-bearing liabilities	6,258,416	45,240	0.72%	6,248,211	66,389	1.06%	5,984,953	102,513	1.71%
Noninterest-bearing liabilities:									
Noninterest-bearing demand deposits	1,800,102			1,567,676			1,488,699		
Other liabilities	56,617			56,334			73,293		
Total liabilities	8,115,135			7,872,221			7,546,945		
Shareholders equity	1,513,749			1,406,159			1,304,749		
Total liabilities and shareholders equity	\$ 9,628,884			\$ 9,278,380			\$ 8,851,694		
Net interest rate spread			3.76%			3.78%			3.69%
Net interest income and margin ⁽²⁾		\$ 326,668	3.94%		\$ 318,148	4.00%		\$ 307,101	4.05%
		\$ 330,282	3.98%		\$ 321,049	4.04%		\$ 309,866	4.08%

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Net interest income and margin
(tax-equivalent basis)⁽³⁾

- (1) Yield is based on amortized cost and does not include any component of unrealized gains or losses.
- (2) The net interest margin is equal to net interest income divided by average interest-earning assets.
- (3) 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% for the years ended December 31, 2011, 2010 and 2009 and other applicable effective tax rates.

Table of Contents**Index to Financial Statements**

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.

	Years Ended December 31,					
	2011 vs. 2010			2010 vs. 2009		
	Increase (Decrease)		Total (Dollars in thousands)	Increase (Decrease)		Total
	Due to Change in			Due to Change in		
	Volume	Rate		Volume	Rate	
Interest-earning assets:						
Loans	\$ 15,704	\$ (11,142)	\$ 4,562	\$ (3,888)	\$ (5,721)	\$ (9,609)
Securities	4,530	(21,657)	(17,127)	21,385	(36,784)	(15,399)
Federal funds sold and other temporary investments	(54)	(10)	(64)	(69)		(69)
Total increase (decrease) in interest income	20,180	(32,809)	(12,629)	17,428	(42,505)	(25,077)
Interest-bearing liabilities:						
Interest-bearing demand deposits	384	(1,962)	(1,578)	2,016	(1,609)	407
Savings and money market accounts	1,606	(4,929)	(3,323)	2,833	(7,079)	(4,246)
Certificates of deposit	(4,643)	(10,990)	(15,633)	(7,238)	(23,248)	(30,486)
Junior subordinated debentures	(201)	(65)	(266)		(510)	(510)
Securities sold under repurchase agreements	(99)	(127)	(226)	(149)	(422)	(571)
Other borrowings	412	(535)	(123)	776	(1,494)	(718)
Total decrease in interest expense	(2,541)	(18,608)	(21,149)	(1,762)	(34,362)	(36,124)
Increase (decrease) in net interest income	\$ 22,721	\$ (14,201)	\$ 8,520	\$ 19,190	\$ (8,143)	\$ 11,047

Provision for Credit Losses

The Company's provision for credit losses is established through charges to income in the form of the provision in order to bring the Company's allowance for credit losses to a level deemed appropriate by management based on the factors discussed under Financial Condition Allowance for Credit Losses. The allowance for credit losses at December 31, 2011 was \$51.6 million, representing 1.37% of outstanding loans as of such date. The provision for credit losses for the year ended December 31, 2011 was \$5.2 million compared with \$13.6 million for the year ended December 31, 2010. Net charge-offs for each of the years ended December 31, 2011 and 2010 were \$5.2 million and \$13.9 million, respectively. The provision for credit losses for the year ended December 31, 2010 was \$13.6 million compared with \$28.8 million for the year ended December 31, 2009. Net charge-offs for the year ended December 31, 2009 were \$13.9 million.

Noninterest Income

The Company's primary sources of recurring noninterest income are NSF fees, 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. For the year ended December 31, 2011, noninterest income totaled \$56.0 million, an increase of \$2.2 million or 4.1% compared with \$53.8 million in 2010. The increase was primarily due to an increase in debit card and ATM card income and a reduction in net losses on sale of other real estate, partially offset by a decrease in NSF fees. Noninterest income for 2010 was \$53.8 million, a decrease of \$6.3 million or 10.4% compared with \$60.1 million in 2009.

Table of Contents**Index to Financial Statements**

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

	2011	Years Ended December 31, 2010	2009
	(Dollars in thousands)		
Non-sufficient Funds (NSF) fees	\$ 24,442	\$ 27,580	\$ 31,094
Debit card and ATM card income	15,391	12,581	10,795
Service charges on deposit accounts	9,981	10,089	9,853
Banking related service fees	2,184	2,166	2,009
Bank Owned Life Insurance income (BOLI)	1,382	1,658	1,344
Net (losses) gains on sales of assets	(527) ⁽¹⁾	(3,860) ⁽²⁾	839 ⁽³⁾
Net losses on sale of securities	(581)		
Other	3,771	3,619	4,163
Total noninterest income	\$ 56,043	\$ 53,833	\$ 60,097

- (1) Includes net losses on the sale of various other real estate properties of \$904,000 and gains on the sale of real estate.
(2) Includes net losses on the sale of various other real estate properties of \$4.3 million and gains on the sale of real estate.
(3) Includes net gains on the sale of various other real estate properties of \$417,000 and gains on the sale of real estate.

Noninterest Expense

For the year ended December 31, 2011, noninterest expense totaled \$163.7 million, a decrease of \$2.8 million or 1.7% compared with \$166.6 million for the same period in 2010. This decrease was principally due to reductions in FDIC assessments, reductions in ORE expenses and a decrease in core deposit intangibles amortization. For the year ended December 31, 2010, noninterest expense totaled \$166.6 million, a decrease of \$3.1 million or 1.8% compared with \$169.7 million for the same period in 2009. This decrease was principally due to reductions in FDIC assessments and a decrease in core deposit intangibles amortization, partially offset by increases in salaries and employee benefits. These items and other changes in the various components of noninterest expense are discussed in more detail below.

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

	2011	Years Ended December 31, 2010	2009
	(Dollars in thousands)		
Salaries and employee benefits ⁽¹⁾	\$ 92,057	\$ 86,980	\$ 84,395
Non-staff expenses:			
Net occupancy	14,634	15,153	14,910
Depreciation	8,150	8,313	8,226
Debit card, data processing and software amortization	6,823	6,222	6,449
Regulatory assessments and FDIC insurance	8,901	11,039	13,662
Ad valorem and franchise taxes	3,823	3,947	3,561
Core deposit intangibles amortization	7,780	9,016	10,076
Communications ⁽²⁾	6,946	7,781	8,466
Other real estate	1,501	3,483	3,205
Professional fees	2,598	3,099	4,419
Printing and supplies	1,807	1,951	2,250
Other	8,725	9,610	10,081

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Total noninterest expense	\$ 163,745	\$ 166,594	\$ 169,700
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- (1) Total salaries and employee benefits includes \$3.6 million, \$3.0 million and \$1.5 million in 2011, 2010 and 2009, respectively, in stock-based compensation expense.
- (2) Communications expense includes telephone, data circuits, postage and courier expenses.

Table of Contents

Index to Financial Statements

Salaries and Employee Benefits. Salaries and employee benefits increased \$5.1 million to \$92.1 million at December 31, 2011 compared with \$87.0 million at December 31, 2010 primarily due to the full year effect of the U.S. Bank and First Bank acquisitions and increases in incentive pay. The number of associates employed by the Company decreased from 1,708 at December 31, 2010 to 1,664 at December 31, 2011. Salaries and employee benefits increased \$2.6 million to \$87.0 million at December 31, 2010 compared with \$84.4 million at December 31, 2009 primarily due to the U.S. Bank and First Bank acquisitions. The number of associates employed by the Company increased from 1,594 at December 31, 2009 to 1,708 at December 31, 2010. Total noninterest expense for the year ended December 31, 2011 includes \$3.6 million in stock-based compensation expense compared with \$3.0 million and \$1.5 million recorded for each of the years ended December 31, 2010 and 2009, respectively.

Regulatory Assessments and FDIC Insurance. Regulatory assessments and FDIC insurance assessments were \$8.9 million for the year ended December 31, 2011 compared with \$11.0 million and \$13.7 million for the years ended December 31, 2010 and 2009. This was a decrease of \$2.1 million or 19.4% in 2011. Regulatory assessments and FDIC insurance assessments decreased \$2.6 million or 19.2% from \$13.7 million for the year ended December 31, 2009 to \$11.0 million for the year ended December 31, 2010. In 2009, the FDIC assessments of \$13.7 million were due to higher FDIC assessment rates and an increase in the amount of the Company's deposits in connection with its 2008 acquisitions and a one-time special assessment of \$4.2 million in the second quarter of 2009. On February 7, 2011, the FDIC approved a final rule that amends its existing DIF restoration plan and implements certain provisions of the Dodd-Frank Act. Effective April 1, 2011 the assessment base is determined using average consolidated total assets minus average tangible equity rather than the assessment base of adjusted domestic deposits and the assessments rates were lowered to account for the larger assessment base. Additional information is discussed under the section captioned "Supervision and Regulation The Bank Deposit Insurance Assessments" in Part I, Item 1 of this Annual Report on Form 10-K.

Core Deposit Intangibles Amortization. Core deposit intangibles (CDI) amortization decreased \$1.2 million or 13.7% from \$9.0 million for the year ended December 31, 2010 to \$7.8 million for the year ended December 31, 2011. The decrease was primarily attributed to certain CDI that fully amortized in 2011. CDI amortization decreased \$1.1 million or 10.5% from \$10.1 million for the year December 31, 2009 to \$9.0 million for the year ended December 31, 2010. The decrease was primarily attributed to certain CDI that fully amortized in 2010. Core deposit intangibles are being amortized on an accelerated basis over an estimated life of eight to ten years.

Other real estate. Other real estate expense decreased \$2.0 million or 56.9% from \$3.5 million for the year ended December 31, 2010 to \$1.5 million for the year ended December 31, 2011. The decrease was primarily due to reduced ORE property recorded by the Company. Other real estate expense increased \$278,000 or 8.7% from \$3.2 million for the year ended December 31, 2009 to \$3.5 million for the year ended December 31, 2010.

Efficiency Ratio. The efficiency ratio is a supplemental financial measure utilized in management's internal evaluation of the Company and is not defined under generally accepted accounting principles. The efficiency ratio is calculated by dividing total noninterest expense, excluding credit loss provisions and impairment write-down on available for sale securities, by net interest income plus noninterest income, excluding net gains and losses on the sale of securities and on the sale of assets. Taxes are not part of this calculation. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same volume of income, while a decrease would indicate a more efficient allocation of resources. The Company's efficiency ratio was 42.76% for the year ended December 31, 2011, compared with 44.83% for the year ended December 31, 2010. The Company's efficiency ratio was 46.27% for the year ended December 31, 2009.

Income Taxes

The amount of federal income tax expense is influenced by the amount of pre-tax income, the amount of tax-exempt income, the amount of nondeductible interest expense and the amount of other nondeductible

Table of Contents

Index to Financial Statements

expenses. For the year ended December 31, 2011, income tax expense was \$72.0 million compared with \$64.1 million for the year ended December 31, 2010 and \$56.8 million for the year ended December 31, 2009. The increases were primarily attributable to higher pretax net earnings which resulted primarily from an increase in net interest income for the year ended December 31, 2011 compared with the same period in 2010 and 2009. The effective tax rate for the years ended December 31, 2011, 2010 and 2009 was 33.7%, 33.4% and 33.7%, respectively. The effective income tax rates differed from the U.S. statutory rate of 35% during the comparable periods primarily due to the effect of tax-exempt income from loans and securities.

Impact of Inflation

The Company's consolidated financial statements and related notes included in this Annual Report on Form 10-K have been prepared in accordance with generally accepted accounting principles. These require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative value of money over time due to inflation or recession.

Unlike many industrial companies, substantially all of the Company's assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on the Company's performance than the effects of general levels of inflation. Interest rates may not necessarily move in the same direction or in the same magnitude as the prices of goods and services. However, other operating expenses do reflect general levels of inflation.

Financial Condition

Loan Portfolio

At December 31, 2011, total loans were \$3.766 billion, an increase of \$280.9 million or 8.1% compared with \$3.485 billion at December 31, 2010. The increase was due to internal growth. At December 31, 2011, total loans were 46.7% of deposits and 38.3% of total assets. At December 31, 2010, total loans were \$3.485 billion, an increase of \$108.3 million or 3.2% compared with \$3.377 billion at December 31, 2009. The increase was primarily attributable to U.S. Bank and First Bank acquisitions which added \$28.4 million and \$54.0 million in loans at December 31, 2010, respectively. At December 31, 2010, total loans were 46.7% of deposits and 36.8% of total assets.

The following table summarizes the Company's loan portfolio by type of loan as of the dates indicated:

	2011		2010		December 31, 2009		2008		2007	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Commercial and industrial	\$ 406,433	10.8%	\$ 409,426	11.7%	\$ 392,975	11.6%	\$ 482,476	13.5%	\$ 436,338	13.9%
Real estate:										
Construction and land development	482,140	12.8	502,327	14.4	557,245	16.5	666,081	18.7	683,171	21.7
1-4 family residential	1,007,266	26.7	824,057	23.7	709,101	21.0	668,097	18.7	526,338	16.7
Home equity	146,999	3.9	118,781	3.4	117,661	3.5	107,048	3.0	93,877	3.0
Commercial mortgage ⁽¹⁾	1,351,986	35.9	1,288,023	37.0	1,261,267	37.4	1,268,340	35.6	1,075,285	34.3
Farmland	136,008	3.6	98,871	2.8	93,288	2.8	96,970	2.7	63,873	2.0
Multifamily residential	89,240	2.4	82,626	2.4	77,952	2.3	75,063	2.1	73,424	2.3
Agriculture	34,226	0.9	41,881	1.2	42,241	1.3	48,679	1.3	50,146	1.6
Consumer (net of unearned discount)	78,187	2.1	87,977	2.5	102,436	3.0	137,639	3.9	123,213	3.9
Other	33,421	0.9	31,054	0.9	22,537	0.6	16,664	0.5	17,306	0.6
Total loans ⁽²⁾	\$ 3,765,906	100.0%	\$ 3,485,023	100.0%	\$ 3,376,703	100.0%	\$ 3,567,057	100.0%	\$ 3,142,971	100.0%

(1)

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Commercial mortgage loans include approximately \$602.8 million and \$641.8 million of owner-occupied loans for the years ended December 31, 2011 and 2010, respectively.

(2) Includes loans held for sale for in 2008 and 2007.

Table of Contents

Index to Financial Statements

The Company's commercial mortgages increased from \$1.288 billion at December 31, 2010 to \$1.352 billion at December 31, 2011, an increase of \$64.0 million or 5.0%. The Company's commercial and industrial loans decreased from \$409.4 million at December 31, 2010 to \$406.4 million at December 31, 2011, a decrease of \$3.0 million or 0.7%. The Company offers a variety of commercial lending products including term loans and lines of credit. The Company offers a broad range of short to medium-term commercial loans, primarily collateralized, to businesses for working capital (including inventory and receivables), business expansion (including acquisitions of real estate and improvements) and the purchase of equipment and machinery. Historically, the Company has originated loans for its own account and has not securitized its loans. The purpose of a particular loan generally determines its structure. All loans in the 1-4 family residential category were originated by the Company.

All loans over \$500,000 and below \$2.5 million are evaluated and acted upon on a daily basis by two of the six company-wide loan concurrence officers. All loans above \$2.5 million are evaluated and acted upon by an officers' loan committee which meets weekly. In addition to the officers' loan committee evaluation, loans from \$15.0 million to \$25.0 million are evaluated and acted upon by the directors' loan committee which consists of three directors of the Bank and meets as necessary. Loans over \$25.0 million are evaluated and acted upon by the Bank's Board of Directors either at a regularly scheduled monthly board meeting or by teleconference or written consent.

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. The increased risk also derives from 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.

Commercial Mortgages. The Company makes commercial mortgage loans collateralized by owner-occupied and non-owner-occupied real estate to finance the purchase of real estate. The Company's commercial mortgage 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 such 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.

1-4 Family Residential Loans. The Company's lending activities also includes the origination of 1-4 family residential mortgage loans collateralized by owner-occupied residential properties located in the Company's market areas. The Company offers a variety of mortgage loan 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. Other than with respect to mortgage banking activities acquired in the TXUI acquisition, the Company has elected to keep all 1-4 family residential loans for its own account rather than selling such loans into the secondary market. By doing so, the Company is able to realize a higher yield on these loans; however, the Company also incurs interest rate risk as well as the risks associated with nonpayments on such loans.

Table of Contents

Index to Financial Statements

Construction and Land Development 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, there is no assurance that the Company will 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. While the Company has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, no assurance can be given that these procedures will prevent losses from the risks described above.

Agriculture Loans. The Company provides agriculture loans for short-term 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.

Consumer Loans. Consumer loans made by the Company include direct A -credit automobile loans, recreational vehicle loans, boat loans, home improvement loans, home equity loans, personal loans (collateralized and uncollateralized) and deposit account collateralized loans. The terms of these loans typically range from 12 to 120 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.

Table of Contents**Index to Financial Statements**

The contractual maturity ranges of the 1-4 family residential, home equity, commercial and industrial, commercial mortgage, construction and land development and agriculture portfolios and the amount of such loans with predetermined interest rates and floating rates in each maturity range as of December 31, 2011 are summarized in the following table:

	December 31, 2011			
	One Year or Less	After One Through Five Years	After Five Years	Total
	(Dollars in thousands)			
1-4 family residential and home equity	\$ 9,490	\$ 43,819	\$ 1,100,956	\$ 1,154,265
Commercial and industrial	154,649	144,070	107,714	406,433
Commercial mortgages	30,714	97,811	1,223,461	1,351,986
Construction and land development	93,174	55,445	333,521	482,140
Agriculture	22,946	10,992	288	34,226
Total	\$ 310,973	\$ 352,137	\$ 2,765,940	\$ 3,429,050
Loans with a predetermined interest rate	\$ 92,662	\$ 199,524	\$ 1,189,365	\$ 1,481,551
Loans with a floating interest rate	218,311	152,613	1,576,575	1,947,499
Total	\$ 310,973	\$ 352,137	\$ 2,765,940	\$ 3,429,050

Nonperforming Assets

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 and the Company also monitors its delinquency levels for any negative or adverse trends. There can be no assurance, however, that the Company's loan portfolio will not become subject to increasing pressures from deteriorating borrower credit due to general economic conditions.

As part of the on-going monitoring of the Company's loan portfolio and the methodology for calculating the allowance for credit losses, management grades each loan from 1 to 7. Depending on the grade, loans in the same grade are aggregated and a loss factor is applied to the total loans in the group to determine the allowance for credit losses. For certain loans in risk grades 5 to 7, a specific reserve may be taken.

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.

The Company requires appraisals on loans collateralized by real estate. 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.

The Company's conservative lending approach has resulted in sound asset quality. The Company had \$12.1 million in nonperforming assets at December 31, 2011 compared with \$15.8 million at December 31, 2010 and \$16.4 million at December 31, 2009. The nonperforming assets at December 31, 2011 consisted of ninety-nine (99) separate credits or ORE properties. If interest on nonaccrual loans had been accrued under the original loan terms, approximately \$253,000, \$701,000 and \$434,000 would have been recorded as income for the years ended December 31, 2011, 2010 and 2009, respectively.

Table of Contents**Index to Financial Statements**

The following table presents information regarding past due loans and nonperforming assets at the dates indicated:

	2011	2010	December 31, 2009 (Dollars in thousands)	2008	2007
Nonaccrual loans	\$ 3,578	\$ 4,439	\$ 6,079	\$ 2,142	\$ 1,035
Accruing loans 90 or more days past due		189	2,332	7,594	4,092
Total nonperforming loans	3,578	4,628	8,411	9,736	5,127
Reposessed assets	146	161	116	182	56
Other real estate	8,328	11,053	7,829	4,450	10,207
Total nonperforming assets	\$ 12,052	\$ 15,842	\$ 16,356	\$ 14,368	\$ 15,390
Nonperforming assets to total loans and other real estate	0.32%	0.45%	0.48%	0.40%	0.49%
Nonperforming assets to average earning assets	0.15%	0.20%	0.22%	0.25%	0.31%
<i>Allowance for Credit Losses</i>					

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

	2011	2010	Years Ended December 31, 2009 (Dollars in thousands)	2008	2007
Average loans outstanding	\$ 3,648,701	\$ 3,394,502	\$ 3,455,761	\$ 3,250,447	\$ 3,092,797
Gross loans outstanding at end of period	\$ 3,765,906	\$ 3,485,023	\$ 3,376,703	\$ 3,567,057	\$ 3,142,971
Allowance for credit losses at beginning of period	\$ 51,584	\$ 51,863	\$ 36,970	\$ 32,543	\$ 23,990
Balance acquired with acquisitions				2,182	13,386
Provision for credit losses	5,200	13,585	28,775	9,867	760
Charge-offs:					
Commercial and industrial	(1,694)	(2,863)	(3,816)	(2,799)	(1,045)
Real estate and agriculture	(3,927)	(10,549)	(8,585)	(3,650)	(4,143)
Consumer	(1,229)	(2,071)	(2,998)	(2,733)	(2,974)
Recoveries:					
Commercial and industrial	481	346	275	308	1,175
Real estate and agriculture	472	444	236	220	208
Consumer	707	829	1,006	1,032	1,186
Net charge-offs	(5,190)	(13,864)	(13,882)	(7,622)	(5,593)
Allowance for credit losses at end of period	\$ 51,594	\$ 51,584	\$ 51,863	\$ 36,970	\$ 32,543
Ratio of allowance to end of period loans	1.37%	1.48%	1.54%	1.04%	1.04%
Ratio of net charge-offs to average loans	0.14	0.41	0.40	0.23	0.18
Ratio of allowance to end of period nonperforming loans	1,442.0	1,114.6	616.6	379.7	634.7

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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: (i) charge-offs of loans that occur when loans are deemed uncollectible and decrease

Table of Contents

Index to Financial Statements

the allowance, (ii) recoveries on loans previously charged off that increase the allowance and (iii) 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.

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 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. 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, industry diversification of the Company's commercial loan portfolio, 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. 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 connection with its 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;

for commercial mortgage 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 and land development 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;

Table of Contents**Index to Financial Statements**

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 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 December 31, 2011, the allowance for credit losses totaled \$51.6 million, or 1.37% of total loans. At December 31, 2010, the allowance aggregated \$51.6 million or 1.48% of total loans and at December 31, 2009, the allowance was \$51.9 million or 1.54% of total loans.

The following tables show the allocation of the allowance for credit losses among various categories of loans and certain other information as of 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.

	2011		December 31, 2010	
	Amount	Percent of Loans to Total Loans (Dollars in thousands)	Amount	Percent of Loans to Total Loans
Balance of allowance for credit losses applicable to:				
Commercial and industrial	\$ 3,826	10.8%	\$ 3,891	11.7%
Real estate	46,587	85.3	46,446	83.7
Agriculture	123	0.9	92	1.2
Consumer and other	1,058	3.0	1,155	3.4
Total allowance for credit losses	\$ 51,594	100.0%	\$ 51,584	100.0%

	2009		December 31, 2008		2007	
	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans (Dollars in thousands)	Amount	Percent of Loans to Total Loans
Balance of allowance for credit losses applicable to:						
Commercial and industrial	\$ 5,107	11.6%	\$ 6,159	13.5%	\$ 4,790	13.9%
Real estate	44,799	83.4	27,953	80.8	22,505	80.0
Agriculture	221	1.3	313	1.3	506	1.6
Consumer and other	1,736	3.7	2,545	4.4	2,153	4.5
Unallocated					2,589	
Total allowance for credit losses	\$ 51,863	100.0%	\$ 36,970	100.0%	\$ 32,543	100.0%

The Company believes that the allowance for credit losses at December 31, 2011 is adequate to cover estimated losses in the loan portfolio as of such date. There can be no assurance, however, that the Company will not sustain losses in future periods, which could be substantial in relation to the size of the allowance at December 31, 2011.

Table of Contents**Index to Financial Statements***Securities*

The Company uses its securities portfolio as a source of income, as a source of liquidity for cash requirements and to manage interest rate risk. At December 31, 2011, the carrying amount of investment securities totaled \$4.659 billion, an increase of \$41.8 million or 0.9% compared with \$4.617 billion at December 31, 2010. At December 31, 2011, securities represented 47.4% of total assets compared with 48.7% of total assets at December 31, 2010.

At the date of purchase, the Company is required to classify debt and equity securities into one of three categories: held-to-maturity, trading or available-for-sale. At each reporting date, the appropriateness of the classification is reassessed. Investments in debt securities are classified as held-to-maturity and measured at amortized cost in the financial statements only if management has the positive intent and ability to hold those securities to maturity. Securities that are bought and held principally for the purpose of selling them in the near term are classified as trading and measured at fair value in the financial statements with unrealized gains and losses included in earnings. Investments not classified as either held-to-maturity or trading are classified as available-for-sale and measured at fair value in the financial statements with unrealized gains and losses reported, net of tax, in a separate component of shareholders' equity until realized.

The following table summarizes the amortized cost of securities as of the dates shown (available-for-sale securities are not adjusted for unrealized gains or losses):

	2011	2010	December 31, 2009 (Dollars in thousands)	2008	2007
U.S. Treasury securities and obligations of U.S. government agencies	\$ 8,696	\$ 10,996	\$ 41,715	\$ 151,147	\$ 229,119
70% non-taxable preferred stock					14,025
States and political subdivisions	74,974	76,031	82,174	84,569	87,517
Corporate debt securities	2,990	2,984	3,227	3,221	3,215
Collateralized mortgage obligations	282,565	444,827	296,923	179,389	223,952
Mortgage-backed securities	4,248,796	4,032,084	3,640,208	3,711,629	1,282,338
Qualified Zone Academy Bond (QZAB) ⁽¹⁾ and Qualified School Construction Bonds (QSCB)	12,900	20,900	20,900	8,000	8,000
Other	7,288	7,288	7,288	7,288	7,260
Total	\$ 4,638,209	\$ 4,595,110	\$ 4,092,435	\$ 4,145,243	\$ 1,855,426

(1) The Qualified Zone Academy Bond with an amortized cost of \$8.0 million, matured in December 2011.

Table of Contents**Index to Financial Statements**

The following table summarizes the contractual maturity of securities and their weighted average yields as of December 31, 2011. The contractual maturity of a mortgage-backed security is the date at which the last underlying mortgage matures. Available-for-sale securities are shown at fair value and held-to-maturity securities are shown at amortized cost. Other securities are included in the corporate debt securities category. For purposes of the table below, tax-exempt states and political subdivisions are calculated on a tax equivalent basis. The QZAB and QSCB bonds are not calculated on a tax equivalent basis and the bonds generate tax credits as follows: QZAB at 7.18% and the two QSCB at 6.11% and 5.95%. The tax credits are shown as a reduction to federal income tax expense.

	Within One Year		After One Year but Within Five Years		December 31, 2011 After Five Years but Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield
(Dollars in thousands)										
U.S. Treasury securities and obligations of U.S. government agencies	\$ 4,981	5.11%	\$ 3,715	5.15%	\$		\$		\$ 8,696	5.13%
States and political subdivisions	2,085	6.78	9,383	6.13	35,341	6.18%	30,181	6.18%	76,990	6.19
Corporate debt securities and other	7,656	3.41	3,113	7.64					10,769	5.39
Collateralized mortgage obligations			3,334	4.57	103,108	3.25	176,101	2.74	282,543	2.95
Mortgage-backed securities	77	4.91	74,492	4.33	2,510,671	3.29	1,681,798	3.36	4,267,038	3.33
Qualified School Construction Bonds (QSCB)							12,900	1.58	12,900	1.58
Total	\$ 14,799	4.46%	\$ 94,037	4.66%	\$ 2,649,120	3.32%	\$ 1,900,980	3.33%	\$ 4,658,936	3.41%

The contractual maturity of mortgage-backed securities and collateralized mortgage obligations is not a reliable indicator of their expected life because borrowers have the right to prepay their obligations at any time. Mortgage-backed securities monthly pay downs cause the average lives of the securities to be much different than their stated lives. The weighted average life of the Company's complete portfolio is 2.6 years with an effective duration of 2.5 years at December 31, 2011.

At December 31, 2011 and 2010, 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.

The average yield of the securities portfolio was 3.41% in 2011 compared with 3.87% in 2010 and 4.69% in 2009. Both decreases in yields were primarily due to the Company reinvesting funds at lower rates in 2011 and 2010 compared to 2010 and 2009, respectively. The overall growth in the average securities portfolio over the comparable periods was primarily funded by deposit growth.

The following table summarizes the carrying value by classification of securities as of the dates shown:

	2011	2010	December 31, 2009	2008	2007
(Dollars in thousands)					
Available-for-sale	\$ 322,316	\$ 428,553	\$ 599,503	\$ 817,244	\$ 260,444
Held-to-maturity	4,336,620	4,188,563	3,518,787	3,343,157	1,597,162

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Total	\$ 4,658,936	\$ 4,617,116	\$ 4,118,290	\$ 4,160,401	\$ 1,857,606
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Table of Contents

Index to Financial Statements

The following tables present the amortized cost and fair value of securities classified as available-for-sale at December 31, 2011, 2010 and 2009:

	Amortized Cost	December 31, 2011 Gross Unrealized Gains (Dollars in thousands)	December 31, 2011 Gross Unrealized Losses (Dollars in thousands)	Fair Value	Amortized Cost	December 31, 2010 Gross Unrealized Gains (Dollars in thousands)	December 31, 2010 Gross Unrealized Losses (Dollars in thousands)	Fair Value
U.S. Treasury securities and obligations of U.S. government agencies	\$	\$	\$	\$	\$	\$	\$	\$
States and political subdivisions	37,060	2,022	(6)	39,076	39,637	1,155	(278)	40,514
Collateralized mortgage obligations	786		(21)	765	967		(24)	943
Mortgage-backed securities	254,965	18,307	(66)	273,206	349,170	20,466	(91)	369,545
Qualified Zone Academy Bond (QZAB)					8,000	326		8,326
Other	8,778	491		9,269	8,772	453		9,225
Total	\$ 301,589	\$ 20,820	\$ (93)	\$ 322,316	\$ 406,546	\$ 22,400	\$ (393)	\$ 428,553

	Amortized Cost	December 31, 2009 Gross Unrealized Gains (Dollars in thousands)	December 31, 2009 Gross Unrealized Losses (Dollars in thousands)	Fair Value
U.S. Treasury securities and obligations of U.S. government agencies	\$ 1,014	\$ 26	\$	\$ 1,040
States and political subdivisions	49,280	1,398	(356)	50,322
Collateralized mortgage obligations	1,169		(31)	1,138
Mortgage-backed securities	505,170	24,306	(106)	529,370
Qualified Zone Academy Bond (QZAB)	8,000	582		8,582
Other	9,015	36		9,051
Total	\$ 573,648	\$ 26,348	\$ (493)	\$ 599,503

Table of Contents

Index to Financial Statements

The following tables present the amortized cost and fair value of securities classified as held-to-maturity at December 31, 2011, 2010 and 2009:

	Amortized Cost	December 31, 2011 Gross Unrealized Gains (Dollars in thousands)	Gross Unrealized Losses (Dollars in thousands)	Fair Value	Amortized Cost	December 31, 2010 Gross Unrealized Gains (Dollars in thousands)	Gross Unrealized Losses (Dollars in thousands)	Fair Value
U.S. Treasury securities and obligations of U.S. government agencies	\$ 8,696	\$ 455	\$	\$ 9,151	\$ 10,996	\$ 789	\$	\$ 11,785
States and political subdivisions	37,914	1,282	(283)	38,912	36,394	639	(1,155)	35,878
Corporate debt securities	1,500	114		1,614	1,500	176		1,676
Collateralized mortgage obligations	281,778	5,009	(149)	286,637	443,859	7,272	(429)	450,702
Mortgage-backed securities	3,993,832	147,991	(91)	4,141,732	3,682,914	118,886	(4,259)	3,797,541
Qualified School Construction Bonds (QSCB)	12,900	2,042		14,942	12,900	325		13,225
Total	\$ 4,336,620	\$ 156,893	\$ (523)	\$ 4,492,988	\$ 4,188,563	\$ 128,087	\$ (5,843)	\$ 4,310,807

	Amortized Cost	December 31, 2009 Gross Unrealized Gains (Dollars in thousands)	Gross Unrealized Losses (Dollars in thousands)	Fair Value
U.S. Treasury securities and obligations of U.S. government agencies	\$ 40,701	\$ 1,621	\$	\$ 42,322
States and political subdivisions	32,895	809	(1,050)	32,654
Corporate debt securities	1,500	10		1,510
Collateralized mortgage obligations	295,754	3,652	(1,156)	298,250
Mortgage-backed securities	3,135,037	111,045	(22)	3,246,060
Qualified School Construction Bonds (QSCB)	12,900	57		12,957
Total	\$ 3,518,787	\$ 117,194	\$ (2,228)	\$ 3,633,753

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 model. Investment securities classified as available for sale or held-to-maturity are generally evaluated for OTTI under ASC Topic 320, *Investments Debt and Equity Securities*. If the Company were to purchase certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, that had credit ratings at the time of purchase of below AA, they would be evaluated using the model outlined in ASC Topic 325, *Investments-Other*. The Company currently does not own any securities that are accounted for under ASC Topic 325.

In determining OTTI under ASC Topic 320, management considers many factors, including: (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term

Table of Contents

Index to Financial Statements

prospects of the issuer, (iii) whether the market decline was affected by macroeconomic conditions and (iv) 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. If applicable, the second segment of the portfolio uses the OTTI guidance provided by ASC Topic 325 that is specific to purchased beneficial interests that, on the purchase date, were rated below AA. Under the ASC Topic 325 model, an impairment is considered other than temporary if, based on the Company's best estimate of cash flows that a market participant would use in determining the current fair value of the beneficial interest, there has been an adverse change in those estimated cash flows.

When OTTI occurs under either model, the amount of the other-than-temporary impairment 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 loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors shall be 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.

Management does not intend to sell any debt securities or more likely than not will not be required to sell any debt securities before their anticipated recovery, at which time the Company will receive full value for the securities. Furthermore, as of December 31, 2011, 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 December 31, 2011, management believes any impairment in the Company's securities are temporary and no impairment loss has been realized in the Company's consolidated income statement. The Company recorded no other-than-temporary impairment charges in 2009, 2010 or 2011.

Mortgage-backed securities are securities that have been developed by pooling a number of real estate mortgages and which are principally issued by federal agencies such as Government National Mortgage Association (Ginnie Mae), Fannie Mae and Freddie Mac. These securities are deemed to have high credit ratings, and minimum regular monthly cash flows of principal and interest are guaranteed by the issuing agencies.

Unlike U.S. Treasury and U.S. government agency securities, which have a lump sum payment at maturity, mortgage-backed securities provide cash flows from regular principal and interest payments and principal prepayments throughout the lives of the securities. Mortgage-backed securities which are purchased at a premium will generally suffer decreasing net yields as interest rates drop because home owners tend to refinance their mortgages. Thus, the premium paid must be amortized over a shorter period. Therefore, these securities purchased at a discount will obtain higher net yields in a decreasing interest rate environment. As interest rates rise, the opposite will generally be true. During a period of increasing interest rates, fixed rate mortgage-backed securities do not tend to experience heavy prepayments of principal and consequently, the average life of this security will be lengthened. If interest rates begin to fall, prepayments will increase, thereby shortening the estimated life of this security. At December 31, 2011, 39.2% of the mortgage-backed securities held by the Company had contractual final maturities of more than ten years with a weighted average life of 3.0 years.

Table of Contents**Index to Financial Statements**

Collateralized mortgage obligations (CMOs) are bonds that are backed by pools of mortgages. The pools can be Ginnie Mae, Fannie Mae or Freddie Mac pools or they can be private-label pools. CMOs are designed so that the mortgage collateral will generate a cash flow sufficient to provide for the timely repayment of the bonds. The mortgage collateral pool can be structured to accommodate various desired bond repayment schedules, provided that the collateral cash flow is adequate to meet scheduled bond payments. This is accomplished by dividing the bonds into classes to which payments on the underlying mortgage pools are allocated in different order. The bond's cash flow, for example, can be dedicated to one class of bondholders at a time, thereby increasing call protection to bondholders. In private-label CMOs, losses on underlying mortgages are directed to the most junior of all classes and then to the classes above in order of increasing seniority, which means that the senior classes have enough credit protection to be given the highest credit rating by the rating agencies.

Deposits

The Company's lending and investing activities are primarily funded by deposits. The Company offers a variety of deposit accounts having a wide range of interest rates and terms including demand, savings, money market and time accounts. The Company relies primarily on competitive pricing policies and customer service to attract and retain these deposits. The Company does not have or accept any brokered deposits.

Total deposits at December 31, 2011 were \$8.060 billion, an increase of \$605.3 million or 8.1% compared with \$7.455 billion at December 31, 2010. Total deposits at December 31, 2010 were \$7.455 billion, an increase of \$196.4 million or 2.7% compared with \$7.259 billion at December 31, 2009. The increase is primarily attributed to the deposits assumed in the U.S. Bank and First Bank acquisitions. At December 31, 2010, deposits assumed from these two acquisitions totaled \$638.5 million. Noninterest-bearing deposits at December 31, 2011 were \$1.972 billion compared with \$1.673 billion at December 31, 2010, an increase of \$299.0 million or 17.9%. Noninterest-bearing deposits were \$1.673 billion at December 31, 2010, an increase of \$180.6 million or 12.1% compared with \$1.493 billion at December 31, 2009. Interest-bearing deposits at December 31, 2011 were \$6.088 billion, up \$306.3 million or 5.3% compared with \$5.782 billion at December 31, 2010. Interest-bearing deposits at December 31, 2010 of \$5.782 billion represented a \$15.8 million increase compared with \$5.766 billion at December 31, 2009. There were no major concentrations of deposits at December 31, 2011, 2010 or 2009.

The daily average balances and weighted average rates paid on deposits for each of the years ended December 31, 2011, 2010 and 2009 are presented below:

	2011		Years Ended December 31, 2010		2009	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)					
Interest-bearing checking	\$ 1,393,501	0.53%	\$ 1,336,400	0.67%	\$ 1,082,332	0.79%
Regular savings	472,983	0.32	377,456	0.46	320,530	0.56
Money market savings	1,948,752	0.53	1,812,239	0.74	1,590,191	1.11
Time deposits	2,135,858	1.02	2,438,968	1.53	2,730,263	2.48
Total interest-bearing deposits	5,951,094	0.69	5,965,063	1.03	5,723,316	1.67
Noninterest-bearing deposits	1,800,102		1,567,676		1,488,699	
Total deposits	\$ 7,751,196	0.53%	\$ 7,532,739	0.82%	\$ 7,212,015	1.33%

The Company's ratio of average noninterest-bearing deposits to average total deposits for the years ended December 31, 2011, 2010, and 2009 was 23.2%, 20.8%, and 20.6%, respectively.

Table of Contents

Index to Financial Statements

The following table sets forth the amount of the Company's certificates of deposit that are \$100,000 or greater by time remaining until maturity:

	December 31, 2011 (Dollars in thousands)
Three months or less	\$ 276,934
Over three through six months.	266,874
Over six through 12 months	314,149
Over 12 months	171,419
Total	\$ 1,029,376

Other Borrowings

The Company utilizes borrowings to supplement deposits to fund its lending and investment activities. Borrowings consist of funds from the Federal Home Loan Bank (FHLB) and correspondent banks. FHLB advances are considered short-term, overnight borrowings and used to control liquidity as needed. At December 31, 2011 the Company had outstanding \$12.8 million in FHLB borrowings of which all consisted of long-term FHLB notes payable compared to \$374.4 million in FHLB borrowings, of which \$14.4 million consisted of long-term FHLB notes payable and \$360.0 million consisted of short-term overnight borrowings at December 31, 2010. FHLB advances are available to the Company under a security and pledge agreement. At December 31, 2011, the Company had total funds of \$3.13 billion available under this agreement of which \$12.8 million was outstanding. The weighted average interest rate paid on the FHLB notes payable at December 31, 2011 was 4.4%. The maturity dates on the FHLB notes payable range from the years 2013 to 2028 and have interest rates ranging from 4.08% to 6.10%. The highest outstanding balance of FHLB advances during 2011 was \$474.0 million compared with \$465.0 million during 2010. The average rate paid on FHLB advances for the year ended December 31, 2011 was 0.22%.

At December 31, 2011, the Company had \$54.9 million in overnight securities sold under repurchase agreements compared with \$60.7 million at December 31, 2010, a decrease of \$5.8 million or 9.5% with average rates paid of 0.54% and 0.73%, respectively.

The following table presents the Company's borrowings at December 31, 2011 and 2010:

	December 31, 2011 (Dollars in thousands)	December 31, 2010 (Dollars in thousands)
FHLB advances	\$ 12,790	\$ 360,000
FHLB long-term notes payable	12,790	14,433
Total other borrowings	12,790	374,433
Securities sold under repurchase agreements	54,883	60,659
Total	\$ 67,673	\$ 435,092

At December 31, 2011 and 2010, the Company had outstanding \$85.1 million and \$92.3 million in junior subordinated debentures issued to the Company's unconsolidated subsidiary trusts, respectively. On March 7, 2011, the Company redeemed \$7.2 million in junior subordinated debentures held by TXUI Statutory Trust I that bore a fixed interest rate of 10.60%. A penalty of \$383,000 was incurred in connection with the payoff and recorded as interest expense.

Table of Contents**Index to Financial Statements**

A summary of pertinent information related to the Company's seven issues of junior subordinated debentures outstanding at December 31, 2011 is set forth in the table below:

Description	Issuance Date	Trust Preferred Securities Outstanding	Interest Rate ⁽¹⁾	Junior Subordinated Debt Owed to Trusts	Maturity Date ⁽²⁾
Prosperity Statutory Trust II	July 31, 2001	\$ 15,000,000	3 month LIBOR + 3.58%, not to exceed 12.50%	\$ 15,464,000	July 31, 2031
Prosperity Statutory Trust III	Aug. 15, 2003	12,500,000	3 month LIBOR + 3.00%	12,887,000	Sept. 17, 2033
Prosperity Statutory Trust IV	Dec. 30, 2003	12,500,000	3 month LIBOR + 2.85%	12,887,000	Dec. 30, 2033
SNB Capital Trust IV ⁽³⁾	Sept. 25, 2003	10,000,000	3 month LIBOR + 3.00%	10,310,000	Sept. 25, 2033
TXUI Statutory Trust II ⁽⁴⁾	Dec. 19, 2003	5,000,000	3 month LIBOR + 2.85%	5,155,000	Dec. 19, 2033
TXUI Statutory Trust III ⁽⁴⁾	Nov. 30, 2005	15,500,000	3 month LIBOR + 1.39%	15,980,000	Dec. 15, 2035
TXUI Statutory Trust IV ⁽⁴⁾	Mar. 31, 2006	12,000,000	3 month LIBOR + 1.39%	12,372,000	June 30, 2036
				\$ 85,055,000	

(1) The 3-month LIBOR in effect as of December 31, 2011 was 0.581%.

(2) All debentures are callable five years from issuance date.

(3) Assumed in connection with the SNB acquisition on April 1, 2006.

(4) Assumed in connection with the TXUI acquisition on January 31, 2007.

Each of the trusts is a capital or statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds in the Company's junior subordinated debentures. The preferred trust securities of each trust represent preferred beneficial interests in the assets of the respective trusts and are subject to mandatory redemption upon payment of the junior subordinated debentures held by the trust. The common securities of each trust are wholly owned by the Company. Each trust's ability to pay amounts due on the trust preferred securities is solely dependent upon the Company making payment on the related junior subordinated debentures. The debentures, which are the only assets of each trust, are subordinate and junior in right of payment to all of the Company's present and future senior indebtedness. The Company has fully and unconditionally guaranteed each trust's obligations under the trust securities issued by such trust to the extent not paid or made by each trust, provided such trust has funds available for such obligations.

Under the provisions of each issue of the debentures, the Company has the right to defer payment of interest on the debentures at any time, or from time to time, for periods not exceeding five years. If interest payments on either issue of the debentures are deferred, the distributions on the applicable trust preferred securities and common securities will also be deferred.

Interest Rate Sensitivity and Market Risk

The Company's asset liability and funds management policy provides management with the guidelines for effective funds management, and the Company has established a measurement system for monitoring its net interest rate sensitivity position. The Company manages its sensitivity position within established guidelines.

Table of Contents

Index to Financial Statements

As a financial institution, the Company's primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of the Company's assets and liabilities, and the market value of all interest-earning assets and interest-bearing liabilities, other than those which have a short term to maturity. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income.

The Company manages its exposure to interest rates by structuring its balance sheet in the ordinary course of business. The Company does not enter into instruments such as leveraged derivatives, interest rate swaps, financial options, financial future contracts or forward delivery contracts for the purpose of reducing interest rate risk. Based upon the nature of the Company's operations, the Company is not subject to foreign exchange or commodity price risk. The Company does not own any trading assets.

The Company's exposure to interest rate risk is managed by the Asset Liability Committee (ALCO), which is composed of senior officers of the Company, in accordance with policies approved by the Company's Board of Directors. The ALCO formulates strategies based on appropriate levels of interest rate risk. In determining the appropriate level of interest rate risk, the ALCO considers the impact on earnings and capital of the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The ALCO meets regularly to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and market values of assets and liabilities, unrealized gains and losses, purchase and sale activities, commitments to originate loans and the maturities of investments and borrowings. Additionally, the ALCO reviews liquidity, cash flow flexibility, maturities of deposits and consumer and commercial deposit activity. Management uses two methodologies to manage interest rate risk: (i) an analysis of relationships between interest-earning assets and interest-bearing liabilities; and (ii) an interest rate shock simulation model. The Company has traditionally managed its business to reduce its overall exposure to changes in interest rates.

An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. The management of interest rate risk is performed by analyzing the maturity and repricing relationships between interest-earning assets and interest-bearing liabilities at specific points in time (GAP) and by analyzing the effects of interest rate changes on net interest income over specific periods of time by projecting the performance of the mix of assets and liabilities in varied interest rate environments. Interest rate sensitivity reflects the potential effect on net interest income of a movement in interest rates. A company is considered to be asset sensitive, or having a positive GAP, when the amount of its interest-earning assets maturing or repricing within a given period exceeds the amount of its interest-bearing liabilities also maturing or repricing within that time period. Conversely, a company is considered to be liability sensitive, or having a negative GAP, when the amount of its interest-bearing liabilities maturing or repricing within a given period exceeds the amount of its interest-earning assets also maturing or repricing within that time period. During a period of rising interest rates, a negative GAP would tend to affect net interest income adversely, while a positive GAP would tend to result in an increase in net interest income. During a period of falling interest rates, a negative GAP would tend to result in an increase in net interest income, while a positive GAP would tend to affect net interest income adversely.

Table of Contents**Index to Financial Statements**

The following table sets forth the Company's interest rate sensitivity analysis at December 31, 2011:

	0-30 days	31-180 days	Volumes Subject to Repricing Within		
			181-365 days	Greater than one year	Total
(Dollars in thousands)					
Interest-earning assets:					
Securities (excluding unrealized gain of \$20.7 million)	\$ 155,223	\$ 691,796	\$ 703,771	\$ 3,087,419	\$ 4,638,209
Loans	788,435	291,222	354,354	2,331,895	3,765,906
Federal funds sold and other temporary investments	642				642
Total interest-earning assets	\$ 944,300	\$ 983,018	\$ 1,058,125	\$ 5,419,314	\$ 8,404,757
Interest-bearing liabilities:					
Demand, money market and savings deposits	\$ 4,089,723	\$	\$	\$	4,089,723
Certificates of deposit and other time deposits.	189,068	845,083	623,375	340,779	1,998,305
Junior subordinated debentures	85,055				85,055
Securities sold under repurchase agreements	54,883				54,883
Other borrowings	84	427	667	11,612	12,790
Total interest-bearing liabilities	\$ 4,418,813	\$ 845,510	\$ 624,042	\$ 352,391	\$ 6,240,756
Period GAP	\$ (3,474,513)	\$ 137,508	\$ 434,083	\$ 5,066,923	\$ 2,164,001
Cumulative GAP	\$ (3,474,513)	\$ (3,337,005)	\$ (2,902,922)	\$ 2,164,001	
Period GAP to total assets	(35.37)%	1.40%	4.42%	51.58%	
Cumulative GAP to total assets	(35.37)%	(33.97)%	(29.55)%	22.03%	

While the GAP position is a useful tool in measuring interest rate risk and contributes toward effective asset and liability management, it is difficult to predict the effect of changing interest rates solely on that measure, without accounting for alterations in the maturity or repricing characteristics of the balance sheet that occur during changes in market interest rates. For example, the GAP position reflects only the prepayment assumptions pertaining to the current rate environment. Assets tend to prepay more rapidly during periods of declining interest rates than during periods of rising interest rates. Because of this and other risk factors not contemplated by the GAP position, an institution could have a matched GAP position in the current rate environment and still have its net interest income exposed to increased rate risk. Additionally, the Company had \$1.97 billion in noninterest-bearing deposits at December 31, 2011 that are not reflected in the table above and are not directly impacted by interest rate changes.

The assumptions used are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model's simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various management strategies.

In addition to GAP analysis, the Company uses an interest rate risk simulation model and shock analysis to test the interest rate sensitivity of net interest income and the balance sheet, respectively. Contractual maturities and repricing opportunities of loans are incorporated in the model as are prepayment assumptions, maturity data and call options within the investment portfolio. Assumptions based on past experience are incorporated into the model for nonmaturity deposit accounts. The assumptions used are inherently uncertain and, as a result, the

Table of Contents**Index to Financial Statements**

model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model's simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various management strategies.

The Company utilizes static balance sheet rate shocks to estimate the potential impact on net interest income of changes in interest rates under various rate scenarios. This analysis estimates a percentage of change in the metric from the stable rate base scenario versus alternative scenarios of rising and falling market interest rates by instantaneously shocking a static balance sheet. The following table summarizes the simulated change in net interest income over a 12-month horizon as of December 31, 2011:

Change in Interest	
Rates (Basis Points)	Percent Change in Net Interest Income
+200	0.0%
+100	2.1%
Base	
-100	(3.7)%

The results are primarily due to behavior of demand, money market and savings deposits during such rate fluctuations. The Company has found that historically, interest rates on these deposits change more slowly than changes in the discount and federal funds rates. This assumption is incorporated into the simulation model and is generally not fully reflected in a GAP analysis. The assumptions incorporated into the model are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model's simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various strategies.

Liquidity

Liquidity involves the Company's ability to raise funds to support asset growth and acquisitions 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 and manage unexpected events. During the two years ended December 31, 2011, the Company's liquidity needs have primarily been met by growth in core deposits, security and loan maturities and amortizing investment and loan portfolios. Although access to purchased funds from correspondent banks and overnight advances from the Federal Home Loan Bank-Dallas are available and have been utilized on occasion to take advantage of investment opportunities, the Company does not generally rely on these external funding sources.

Table of Contents**Index to Financial Statements**

The following table illustrates, during the years presented, the mix of the Company's funding sources and the average assets in which those funds are invested as a percentage of the Company's average total assets for the period indicated. Average assets totaled \$9.629 billion in 2011 compared to \$9.278 billion in 2010.

	2011	2010
Source of Funds:		
Deposits:		
Noninterest-bearing	18.69%	16.90%
Interest-bearing	61.80	64.29
Junior subordinated debentures	0.90	0.99
Securities sold under repurchase agreements	0.71	0.88
Other borrowings	1.59	1.18
Other noninterest-bearing liabilities	0.59	0.61
Shareholders' equity	15.72	15.15
Total	100.00%	100.00%
Uses of Funds:		
Loans	37.89%	36.59%
Securities	48.04	48.60
Federal funds sold and other interest-earning assets	0.28	0.53
Other noninterest-earning assets	13.79	14.28
Total	100.00%	100.00%
Average noninterest-bearing deposits to total average deposits	23.22%	20.81%
Average loans to average deposits	47.07%	45.06%

The Company's largest source of funds is deposits and its largest uses of funds are securities and loans. The Company does not expect a change in the source or use of its funds in the foreseeable future. The Company's average loans increased 7.5% for the year ended December 31, 2011 compared with the year ended December 31, 2010. The Company predominantly invests excess deposits in government backed securities until the funds are needed to fund loan growth. The Company's securities portfolio has a weighted average life of 2.6 years and an effective duration of 2.5 years at December 31, 2011.

As of December 31, 2011, the Company had outstanding \$449.0 million in commitments to extend credit and \$14.6 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.

As of December 31, 2011, the Company had no exposure to future cash requirements associated with known uncertainties or capital expenditures of a material nature.

As of December 31, 2011, the Company had cash and cash equivalents of \$213.4 million compared with \$159.4 million at December 31, 2010. The increase was primarily due to a increase in cash and due from banks of \$53.8 million.

Contractual Obligations

The following table summarizes the Company's contractual obligations and other commitments to make future payments as of December 31, 2011 (other than deposit obligations and securities sold repurchase agreements). The Company's future cash payments associated with its contractual obligations pursuant to its junior subordinated debentures, FHLB notes payable and operating leases as of December 31, 2011 are summarized below. Payments for junior subordinated debentures include interest of \$54.6 million that will be

Table of Contents

Index to Financial Statements

paid over the future periods. The future interest payments were calculated using the current rate in effect at December 31, 2011. The current principal balance of the junior subordinated debentures at December 31, 2011 was \$85.1 million. Payments for FHLB notes payable include interest of \$3.5 million 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	Payments due in: 3 years or more but less than 5 years (Dollars in thousands)	5 years or more	Total
Junior subordinated debentures	\$ 2,506	\$ 5,012	\$ 5,012	\$ 127,149	\$ 139,679
Federal Home Loan Bank notes payable	1,548	3,258	3,456	8,002	16,264
Operating leases	5,219	7,727	3,125	517	16,588
Total.	\$ 9,273	\$ 15,997	\$ 11,593	\$ 135,668	\$ 172,531

Off-Balance Sheet Items

In the normal course of business, the Company enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, 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 period as of December 31, 2011 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 (Dollars in thousands)	5 years or more	Total
Standby letters of credit	\$ 10,573	\$ 4,020	\$ 55	\$	\$ 14,648
Commitments to extend credit	286,574	32,754	11,513	118,128	448,969
Total	\$ 297,147	\$ 36,774	\$ 11,568	\$ 118,128	\$ 463,617

Standby Letters of Credit. Standby letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Company would be entitled to seek recovery from the customer. The Company's policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

Commitments to Extend Credit. The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Company's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for credit losses.

Table of Contents

Index to Financial Statements

Capital Resources

Capital management consists of providing equity to support the Company's current and future operations. The Company is subject to capital adequacy requirements imposed by the Federal Reserve Board and the Bank is subject to capital adequacy requirements imposed by the FDIC. Both the Federal Reserve Board and the FDIC have adopted risk-based capital requirements for assessing bank holding company and bank capital adequacy. These standards define capital and establish minimum capital requirements in relation to assets and off-balance sheet exposure, adjusted for credit risk. The risk-based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profiles among bank holding companies and banks, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Assets and off-balance sheet items are assigned to broad risk categories, each with appropriate relative risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

The risk-based capital standards issued by the Federal Reserve Board require all bank holding companies to have Tier 1 capital of at least 4.0% and total risk-based capital (Tier 1 and Tier 2) of at least 8.0% of total risk-weighted assets. Tier 1 capital generally includes common shareholders' equity and qualifying perpetual preferred stock together with related surpluses and retained earnings, less deductions for goodwill and various other intangibles. Tier 2 capital may consist of a limited amount of intermediate-term preferred stock, a limited amount of term subordinated debt, certain hybrid capital instruments and other debt securities, perpetual preferred stock not qualifying as Tier 1 capital, and a limited amount of the general valuation allowance for loan losses. The sum of Tier 1 capital and Tier 2 capital is total risk-based capital.

The Federal Reserve Board has also adopted guidelines which supplement the risk-based capital guidelines with a minimum ratio of Tier 1 capital to average total consolidated tangible assets, or leverage ratio, of 3.0% for institutions with well diversified risk, including no undue interest rate exposure; excellent asset quality; high liquidity; good earnings; and that are generally considered to be strong banking organizations, rated composite 1 under applicable federal guidelines, and that are not experiencing or anticipating significant growth. Other banking organizations are required to maintain a leverage ratio of at least 4.0%. These rules further provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain capital positions substantially above the minimum supervisory levels and comparable to peer group averages, without significant reliance on intangible assets.

Pursuant to FDICIA, each federal banking agency revised its risk-based capital standards to ensure that those standards take adequate account of interest rate risk, concentration of credit risk and the risks of nontraditional activities, as well as reflect the actual performance and expected risk of loss on multifamily mortgages. The Bank is subject to capital adequacy guidelines of the FDIC that are substantially similar to the Federal Reserve Board's guidelines. Also pursuant to FDICIA, the FDIC has promulgated regulations setting the levels at which an insured institution such as the Bank would be considered well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Under the FDIC's regulations, the Bank is classified well-capitalized for purposes of prompt corrective action.

Total shareholders' equity increased to \$1.57 billion at December 31, 2011 compared with \$1.45 billion at December 31, 2010, an increase of \$114.9 million or 7.9%. This increase was primarily the result of net income of \$141.7 million, common stock issued in connection with the exercise of stock options and restricted stock awards of \$4.2 million and stock based compensation expense of \$3.6 million, partially offset by dividends paid on the common stock of \$33.7 million. Total shareholders' equity increased to \$1.452 billion at December 31, 2010 compared with \$1.351 billion at December 31, 2009, an increase of \$101.1 million or 7.5%. This increase was primarily the result of net income of \$127.7 million, common stock issued in connection with the exercise of stock options and restricted stock awards of \$2.7 million and stock based compensation expense of \$3.0 million, partially offset by dividends paid on the common stock of \$29.8 million and a decrease in the change in unrealized gains on available for sale securities of \$2.5 million.

Table of Contents**Index to Financial Statements**

The following table provides a comparison of the Company's and the Bank's leverage and risk-weighted capital ratios as of December 31, 2011 to the minimum and well-capitalized regulatory standards:

	Minimum Required for Capital Adequacy Purposes	To Be Categorized as Well-Capitalized Under Prompt Corrective Action Provisions	Actual Ratio at December 31, 2011
The Company			
Leverage ratio	3.00% ⁽¹⁾	N/A	7.89%
Tier 1 risk-based capital ratio	4.00	N/A	15.90
Total risk-based capital ratio	8.00	N/A	17.09
The Bank			
Leverage ratio	3.00% ⁽²⁾	5.00%	7.75%
Tier 1 risk-based capital ratio	4.00	6.00	15.62
Total risk-based capital ratio	8.00	10.00	16.81

(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.

As of December 31, 2011, all trust preferred securities were counted as Tier 1 capital. Under the Dodd-Frank Act, the Company must deduct all trust preferred securities issued on or after May 19, 2010 from the Company's Tier 1 capital; however, bank holding companies with less than \$15.0 billion in total consolidated assets as of December 31, 2009, such as the Company, are not required to deduct existing trust preferred securities issued prior to May 19, 2010 from Tier 1 capital.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For information regarding the market risk of the Company's financial instruments, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation—Financial Condition—Interest Rate Sensitivity and Market Risk. The Company's principal market risk exposure is to changes in interest rates.

Table of Contents**Index to Financial Statements****ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The financial statements, the report thereon, the notes thereto and supplementary data commence at page 77 of this Annual Report on Form 10-K.

The following table presents certain unaudited consolidated quarterly financial information concerning the Company's results of operations for each of the two years indicated below. The information should be read in conjunction with the historical consolidated financial statements of the Company and the notes thereto appearing elsewhere in this Annual Report on Form 10-K.

CONSOLIDATED QUARTERLY FINANCIAL DATA OF THE COMPANY

	Quarter Ended 2011			
	December 31	September 30	June 30	March 31
	(Dollars in thousands, except per share data)			
	(unaudited)			
Interest income	\$ 89,658	\$ 93,189	\$ 95,652	\$ 93,409
Interest expense	9,571	10,651	12,022	12,996
Net interest income	80,087	82,538	83,630	80,413
Provision for credit losses	1,150	950	1,400	1,700
Net interest income after provision	78,937	81,588	82,230	78,713
Noninterest income	14,065	14,581	13,530	13,867
Noninterest expense	38,385	41,151	42,514	41,695
Income before income taxes	54,617	55,018	53,246	50,885
Provision for income taxes	18,211	18,645	18,154	17,007
Net income	\$ 36,406	\$ 36,373	\$ 35,092	\$ 33,878
Earnings per share ⁽¹⁾ :				
Basic	\$ 0.78	\$ 0.78	\$ 0.75	\$ 0.72
Diluted	\$ 0.77	\$ 0.77	\$ 0.75	\$ 0.72

	Quarter Ended 2010			
	December 31	September 30	June 30	March 31
	(Dollars in thousands, except per share data)			
	(unaudited)			
Interest income	\$ 92,436	\$ 96,247	\$ 99,358	\$ 96,496
Interest expense	12,927	15,980	18,758	18,724
Net interest income	79,509	80,267	80,600	77,772
Provision for credit losses	2,900	3,000	3,275	4,410
Net interest income after provision	76,609	77,267	77,325	73,362
Noninterest income	13,905	13,654	13,296	12,978
Noninterest expense	41,227	42,593	43,049	39,725
Income before income taxes	49,287	48,328	47,572	46,615

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Provision for income taxes	16,489	16,162	15,826	15,617
Net income	\$ 32,798	\$ 32,166	\$ 31,746	\$ 30,998
Earnings per share ⁽¹⁾ :				
Basic	\$ 0.70	\$ 0.69	\$ 0.68	\$ 0.67
Diluted	\$ 0.70	\$ 0.69	\$ 0.68	\$ 0.66

- (1) Earnings per share are computed independently for each of the quarters presented and therefore may not total earnings per share for the year.

Table of Contents

Index to Financial Statements

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. 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 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 defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended December 31, 2011, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

Index to Financial Statements

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed under the supervision of the Company's Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with generally accepted accounting principles.

As of December 31, 2011, management assessed the effectiveness of the Company's internal control over financial reporting based on the criteria for effective internal control over financial reporting established in Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. This assessment included controls over the preparation of the schedules equivalent to the basic financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C) to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act. Based on the assessment, management determined that the Company maintained effective internal control over financial reporting as of December 31, 2011.

Deloitte & Touche LLP the independent registered public accounting firm that audited the consolidated financial statements of the Company included in this Annual Report on Form 10-K, has issued an attestation report on the Company's internal control over financial reporting as of December 31, 2011. The report is included in this Item under the heading Report of Independent Registered Public Accounting Firm.

Compliance with Designated Laws and Regulations

Management is also responsible for ensuring compliance with the federal laws and regulations concerning loans to insiders and the federal and state laws and regulations concerning dividend restrictions, both of which are designated by the FDIC as safety and soundness laws and regulations.

Management assessed its compliance with the designated safety and soundness laws and regulations and has maintained records of its determinations and assessments as required by the FDIC. Based on this assessment, management believes that the Company has complied with the designated safety and soundness laws and regulations for the year ended December 31, 2011.

Table of Contents

Index to Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

Prosperity Bancshares, Inc.

Houston, Texas

We have audited the internal control over financial reporting of Prosperity Bancshares, Inc. and subsidiaries (the Company) as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management's assessment and our audit of the Company's internal control over financial reporting included controls over the preparation of the schedules equivalent to the basic financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have not examined and, accordingly, we do not express an opinion or any other form of assurance on management's statement referring to compliance with laws and regulations.

Table of Contents

Index to Financial Statements

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2011 of the Company and our report dated February 29, 2012 expressed an unqualified opinion on those financial statements.

/s/ Deloitte & Touche LLP

Houston, Texas

February 29, 2012

ITEM 9B. OTHER INFORMATION

None.

PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated herein by reference to the information under the captions Election of Directors, Continuing Directors and Executive Officers, Section 16(a) Beneficial Ownership Reporting Compliance, Corporate Governance Committees of the Board Audit Committee, Corporate Governance Director Nomination Process and Corporate Governance Code of Ethics in the Company's definitive Proxy Statement for its 2012 Annual Meeting of Shareholders (the 2012 Proxy Statement) to be filed with the Commission pursuant to Regulation 14A under the Exchange Act within 120 days of the Company's fiscal year end.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated herein by reference to the information under the captions Executive Compensation and Other Matters and Director Compensation in the 2012 Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

Certain information required by this Item 12 is included under Securities Authorized for Issuance under Equity Compensation Plans in Part II, Item 5 of this Annual Report on Form 10-K. The other information required by this Item is incorporated herein by reference to the information under the caption Beneficial Ownership of Common Stock by Management of the Company and Principal Shareholders in the 2012 Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated herein by reference to the information under the captions Corporate Governance Director Independence and Certain Relationships and Related Transactions in the 2012 Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated herein by reference to the information under the caption Fees and Services of Independent Registered Public Accounting Firm in the 2012 Proxy Statement.

Table of Contents

Index to Financial Statements

PART IV.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this Annual Report on Form 10-K:

1. Consolidated Financial Statements. Reference is made to the Consolidated Financial Statements, the report thereon and the notes thereto commencing at page 77 of this Annual Report on Form 10-K. Set forth below is a list of such Consolidated Financial Statements:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2011 and 2010

Consolidated Statements of Income for the Years Ended December 31, 2011, 2010, and 2009

Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2011, 2010 and 2009

Consolidated Statements of Cash Flows for the Years Ended December 31, 2011, 2010 and 2009

Notes to Consolidated Financial Statements

2. Financial Statement Schedules. All supplemental schedules are omitted as inapplicable or because the required information is included in the Consolidated Financial Statements or notes thereto.

3. The exhibits to this Annual Report on Form 10-K listed below have been included only with the copy of this report filed with the Securities and Exchange Commission. The Company will furnish a copy of any exhibit to shareholders upon written request to the Company and payment of a reasonable fee not to exceed the Company's reasonable expense.

Each exhibit marked with an asterisk is filed or furnished with this Annual Report on Form 10-K as noted below.

Exhibit

Number⁽¹⁾	Description
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))
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 October 19, 2007)
4.1	Form of certificate representing shares of Prosperity Bancshares, Inc. common stock (incorporated herein by reference to Exhibit 4 to the Company's Registration Statement on Form S-1 (Registration No. 333-63267))
4.2	Indenture dated as of July 31, 2001 by and between Prosperity Bancshares, Inc., as Issuer, and State Street Bank and Trust Company of Connecticut, National Association, as Trustee, with respect to the Floating Rate Junior Subordinated Deferrable Interest Debentures of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001)
4.3	Amended and Restated Declaration of Trust of Prosperity Statutory Trust II dated as of July 31, 2001 (incorporated herein by reference to Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001)

Table of Contents

Index to Financial Statements

Exhibit

Number⁽¹⁾	Description
4.4	Guarantee Agreement dated as of July 31, 2001 by and between Prosperity Bancshares, Inc. and State Street Bank and Trust Company of Connecticut, National Association (incorporated herein by reference to Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001)
10.1	Prosperity Bancshares, Inc. 1995 Stock Option Plan (incorporated herein by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-1 (Registration No. 333-63267))
10.2	Prosperity Bancshares, Inc. 1998 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.2 to the Company's Registration Statement on Form S-1 (Registration No. 333-63267))
10.3	Prosperity Bancshares, Inc. 2004 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.3 to the Company's Registration Statement on Form S-4 (Registration No. 333-121767))
10.4	Second Amended and Restated Employment Agreement effective January 1, 2009 by and among Prosperity Bancshares, Inc., Prosperity Bank and David Zalman (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed January 7, 2009)
10.5	First Amendment to the Second Amended and Restated Employment Agreement effective February 22, 2012 by and among Prosperity Bancshares, Inc., Prosperity Bank and H. E. Timanus, Jr. (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed February 24, 2012)
10.6	Second Amended and Restated Employment Agreement effective January 1, 2009 by and among Prosperity Bancshares, Inc., Prosperity Bank and H. E. Timanus, Jr. (incorporated herein by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed January 7, 2009)
10.7	Amended and Restated Employment Agreement effective January 1, 2009 by and among Prosperity Bancshares, Inc., Prosperity Bank and James D. Rollins III (incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on January 7, 2009)
10.8	Amended and Restated Employment Agreement effective January 1, 2009 by and among Prosperity Bancshares, Inc., Prosperity Bank and David Hollaway (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on January 7, 2009)
10.9	SNB Bancshares, Inc. 2002 Stock Option Plan, as amended and restated (incorporated herein by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 (Registration No. 333-133214))
21.1*	Subsidiaries of Prosperity Bancshares, Inc.
23.1*	Consent of Deloitte & Touche LLP
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.

Table of Contents

Index to Financial Statements

Exhibit

Number⁽¹⁾	Description
101**	Interactive financial data

Management contract or compensatory plan or arrangement.

* Filed with this Annual Report on Form 10-K.

** Furnished with this Annual Report on Form 10-K.

(1) The Company has other long-term debt agreements that meet the exclusion set forth in Section 601(b)(4)(iii)(A) of Regulation S-K. The Company hereby agrees to furnish a copy of such agreements to the Commission upon request.

(b) Exhibits. See the exhibit list included in Item 15(a)3 of this Annual Report on Form 10-K.

(c) Financial Statement Schedules. See Item 15(a)2 of this Annual Report on Form 10-K.

Table of Contents**Index to Financial Statements****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant, has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: February 29, 2012

PROSPERITY BANCSHARES, INC.[®]
(Registrant)

By: **/s/ DAVID ZALMAN**
David Zalman

Chairman of the Board and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Positions	Date
/s/ DAVID ZALMAN David Zalman	Chairman of the Board and Chief Executive Officer (principal executive officer); Director	February 29, 2012
/s/ DAVID HOLLOWAY David Holloway	Chief Financial Officer (principal financial officer and principal accounting officer)	February 29, 2012
/s/ JAMES A. BOULIGNY James A. Bouligny	Director	February 29, 2012
/s/ WILLIAM H. FAGAN, M.D. William Fagan, M.D.	Director	February 29, 2012
/s/ LEAH HENDERSON Leah Henderson	Director	February 29, 2012
/s/ NED S. HOLMES Ned S. Holmes	Director	February 29, 2012
/s/ PERRY MUELLER, JR., D.D.S. Perry Mueller, Jr., D.D.S.	Director	February 29, 2012
/s/ JAMES D. ROLLINS III	Director	February 29, 2012

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James D. Rollins III

/s/ HARRISON STAFFORD II

Director

February 29, 2012

Harrison Stafford II

/s/ ROBERT STEELHAMMER

Director

February 29, 2012

Robert Steelhammer

Table of Contents

Index to Financial Statements

Signature	Positions	Date
/s/ H.E. TIMANUS, JR. H.E. Timanus, Jr.	Director	February 29, 2012
/s/ ERVAN ZOUZALIK Ervan Zouzalik	Director	February 29, 2012

Table of Contents

Index to Financial Statements

TABLE OF CONTENTS TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
Prosperity Bancshares, Inc.®	
<u>Report of Independent Registered Public Accounting Firm</u>	78
<u>Consolidated Balance Sheets as of December 31, 2011 and 2010</u>	79
<u>Consolidated Statements of Income for the Years Ended December 31, 2011, 2010 and 2009</u>	80
<u>Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2011, 2010 and 2009</u>	81
<u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2011, 2010 and 2009</u>	82
<u>Notes to Consolidated Financial Statements</u>	83

Table of Contents

Index to Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

Prosperity Bancshares, Inc.

Houston, Texas

We have audited the accompanying consolidated balance sheets of Prosperity Bancshares, Inc. and subsidiaries (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Prosperity Bancshares, Inc. and subsidiaries at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 29, 2012 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

Houston, Texas

February 29, 2012

Table of Contents**Index to Financial Statements****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2011	2010
	(Dollars in thousands)	
ASSETS		
Cash and due from banks	\$ 212,800	\$ 158,975
Federal funds sold	642	393
Total cash and cash equivalents	213,442	159,368
Available for sale securities, at fair value	322,316	428,553
Held to maturity securities, at cost (fair value of \$4,492,988 and \$4,310,807, respectively)	4,336,620	4,188,563
Loans held for investment	3,765,906	3,485,023
Less allowance for credit losses	(51,594)	(51,584)
Loans, net	3,714,312	3,433,439
Accrued interest receivable	29,405	29,935
Goodwill	924,537	924,258
Core deposit intangibles, net of accumulated amortization of \$58,158 and \$50,378, respectively	20,996	28,776
Bank premises and equipment, net	159,656	159,053
Other real estate owned	8,328	11,053
Bank Owned Life Insurance (BOLI), net	50,029	48,697
Federal Home Loan Bank of Dallas stock	11,601	24,982
Other assets	31,429	39,895
TOTAL ASSETS	\$ 9,822,671	\$ 9,476,572
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$ 1,972,226	\$ 1,673,190
Interest-bearing	6,088,028	5,781,730
Total deposits	8,060,254	7,454,920
Other borrowings	12,790	374,433
Securities sold under repurchase agreements	54,883	60,659
Accrued interest payable	2,803	4,014
Other liabilities	39,621	37,942
Junior subordinated debentures	85,055	92,265
Total liabilities	8,255,406	8,024,233
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		
Preferred stock, \$1 par value; 20,000,000 shares authorized; none issued or outstanding		
Common stock, \$1 par value; 200,000,000 shares authorized; 46,947,415 and 46,721,114 shares issued at December 31, 2011 and 2010, respectively; 46,910,327 and 46,684,026 shares outstanding at December 31, 2011 and 2010, respectively	46,947	46,721
Capital surplus	883,575	876,050
Retained earnings	623,878	515,871

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Accumulated other comprehensive income net unrealized gain on available for sale securities, net of tax of \$7,254 and \$7,702, respectively	13,472	14,304
Less treasury stock, at cost, 37,088 shares	(607)	(607)
Total shareholders equity	1,567,265	1,452,339
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 9,822,671	\$ 9,476,572

See notes to consolidated financial statements.

Table of Contents**Index to Financial Statements****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

	For the Years Ended December 31,		
	2011	2010	2009
	(Dollars in thousands, except		
	per share data)		
INTEREST INCOME:			
Loans, including fees	\$ 214,273	\$ 209,711	\$ 219,320
Securities	157,580	174,707	190,106
Federal funds sold	55	119	188
Total interest income	371,908	384,537	409,614
INTEREST EXPENSE:			
Deposits	40,975	61,509	95,834
Junior subordinated debentures	2,984	3,250	3,760
Securities sold under repurchase agreements	369	595	1,166
Other borrowings	912	1,035	1,753
Total interest expense	45,240	66,389	102,513
NET INTEREST INCOME	326,668	318,148	307,101
PROVISION FOR CREDIT LOSSES	5,200	13,585	28,775
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	321,468	304,563	278,326
NONINTEREST INCOME:			
Non-sufficient Funds (NSF) fees	24,442	27,580	31,094
Debit card and ATM card income	15,391	12,581	10,975
Service charges on deposit accounts	9,981	10,089	9,853
Other	6,229	3,583	8,355
Total noninterest income	56,043	53,833	60,097
NONINTEREST EXPENSE:			
Salaries and employee benefits	92,057	86,980	84,396
Net occupancy	14,634	15,153	14,910
Debit card, data processing and software amortization	6,823	6,222	6,449
Regulatory assessments and FDIC insurance	8,901	11,039	13,662
Core deposit intangibles amortization	7,780	9,016	10,076
Depreciation	8,150	8,313	8,226
Other	25,400	29,871	31,981
Total noninterest expense	163,745	166,594	169,700
INCOME BEFORE INCOME TAXES	213,766	191,802	168,723
PROVISION FOR INCOME TAXES	72,017	64,094	56,844

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NET INCOME	\$ 141,749	\$ 127,708	\$ 111,879
EARNINGS PER SHARE:			
Basic	\$ 3.03	\$ 2.74	\$ 2.42
Diluted	\$ 3.01	\$ 2.73	\$ 2.41

See notes to consolidated financial statements.

Table of Contents**Index to Financial Statements****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

	Common Stock			Accumulated Other Comprehensive Income		Treasury Stock	Total Shareholders Equity
	Shares	Amount	Capital Surplus (In thousands, except share and per share data)	Retained Earnings			
BALANCE AT DECEMBER 31, 2008	46,116,801	46,117	867,380	332,363	9,853	(607)	1,255,106
Comprehensive income:							
Net income				111,879			111,879
Net change in unrealized gain on available for sale securities (net of tax of \$3.7 million)					6,953		6,953
Total comprehensive income							118,832
Common stock issued in connection with the exercise of stock options and restricted stock awards	461,167	461	1,565				2,026
Stock based compensation expense			1,515				1,515
Cash dividends declared, \$0.568 per share				(26,234)			(26,234)
BALANCE AT DECEMBER 31, 2009	46,577,968	46,578	870,460	418,008	16,806	(607)	1,351,245
Comprehensive income:							
Net income				127,708			127,708
Net change in unrealized gain on available for sale securities (net of tax benefit of \$1.3 million)					(2,502)		(2,502)
Total comprehensive income							125,206
Common stock issued in connection with the exercise of stock options and restricted stock awards	143,146	143	2,553				2,696
Stock based compensation expense			3,037				3,037
Cash dividends declared, \$0.64 per share				(29,845)			(29,845)
BALANCE AT DECEMBER 31, 2010	46,721,114	\$ 46,721	\$ 876,050	\$ 515,871	\$ 14,304	\$ (607)	\$ 1,452,339
Comprehensive income:							
Net income				141,749			141,749
Net change in unrealized gain on available for sale securities (net of tax benefit of \$448 thousand)					(832)		(832)
Total comprehensive income							140,917
Common stock issued in connection with the exercise of stock options and restricted stock awards	226,301	226	3,949				4,175
Stock based compensation expense			3,576				3,576
Cash dividends declared, \$0.72 per share				(33,742)			(33,742)
BALANCE AT DECEMBER 31, 2011	46,947,415	\$ 46,947	\$ 883,575	\$ 623,878	\$ 13,472	\$ (607)	\$ 1,567,265

See notes to consolidated financial statements.

Table of Contents**Index to Financial Statements****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	For the Years Ended December 31,		
	2011	2010	2009
	(Dollars in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 141,749	\$ 127,708	\$ 111,879
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and CDI amortization	15,930	17,329	18,302
Provision for credit losses	5,200	13,585	28,775
Net accretion of discount on investments	28,675	22,181	930
Loss (gain) on sale or write down of premises, equipment and other real estate	528	3,860	(623)
Loss on sale of securities	581		
Net amortization of premium on loans and deposits	(33)	(1,354)	(6,917)
Proceeds from sale of loans held for sale			99
Stock based compensation expense	3,576	3,037	1,515
Decrease (increase) in accrued interest receivable and other assets	20,967	(674)	(31,290)
Increase (decrease) in accrued interest payable and other liabilities	696	(7,976)	(49,042)
Net cash provided by operating activities	217,869	177,696	73,628
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from maturities and principal paydowns of held to maturity securities	1,301,230	1,246,820	898,293
Purchase of held to maturity securities	(1,478,721)	(1,940,137)	(1,076,085)
Proceeds from maturities, sales and principal paydowns of available for sale securities	1,255,715	1,168,459	829,639
Purchase of available for sale securities	(1,150,000)	(999,998)	(599,999)
Net (increase) decrease in loans held for investment	(298,246)	(29,160)	148,533
Purchase of bank premises and equipment	(9,480)	(13,866)	(34,974)
Proceeds from sale of bank premises, equipment and other real estate	14,202	35,353	27,697
Cash and cash equivalents acquired in the purchase of U.S. Bank branches		344,722	
Premium paid for U.S. Bank branches		(13,136)	
Cash and cash equivalents acquired in the purchase of First Bank branches		379,771	
Premium paid for First Bank branches		(26,876)	
Purchase of Banco Popular branches			(50)
Purchase of 1 st Choice Bancorp, Inc.			(17)
Purchase of assets of Franklin Bank			(865)
Net decrease in interest-bearing deposits in financial institutions			106
Net cash (used in) provided by investing activities	(365,300)	151,952	192,278
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase (decrease) in noninterest-bearing deposits	299,036	52,066	(33,187)
Net increase (decrease) in interest-bearing deposits	306,665	(723,063)	(15,151)
(Repayments of) proceeds from other short-term borrowings	(360,000)	360,000	(200,000)
Repayments of other long-term borrowings	(1,643)	(11,707)	(3,255)
Net decrease in securities sold under repurchase agreements	(5,776)	(15,744)	(23,421)
Redemption of junior subordinated debentures	(7,210)		
Proceeds from stock option exercises	4,175	2,696	2,026
Payments of cash dividends	(33,742)	(29,845)	(26,234)
Net cash provided by (used in) financing activities	201,505	(365,597)	(299,222)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	54,074	(35,949)	(33,316)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	159,368	195,317	228,633

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CASH AND CASH EQUIVALENTS, END OF PERIOD	\$	213,442	\$	159,368	\$	195,317
SUPPLEMENTAL INFORMATION:						
Income taxes paid		70,324		64,477		61,100
Interest paid	\$	46,451	\$	69,718	\$	109,795
Noncash investing and financing activities acquisition of real estate through foreclosure of collateral	\$	14,051	\$	44,751	\$	33,605

See notes to consolidated financial statements.

Table of Contents

Index to Financial Statements

PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

Nature of Operations Prosperity Bancshares, Inc. (Bancshares) and its subsidiaries, Prosperity Holdings of Delaware, LLC (Holdings) and Prosperity Bank® (the Bank , and together with Bancshares and Holdings, collectively referred to as the Company) provide retail and commercial banking services. The Company operates its business as one domestic segment.

The Bank operated one hundred seventy-five (175) full-service banking locations; with sixty (60) in the Houston area, twenty (20) in the South Texas area including Corpus Christi and Victoria, thirty-three (33) in the Central Texas, ten (10) in the Bryan/College Station area, twenty-one (21) in East Texas and thirty-one (31) in the Dallas/Fort Worth, Texas area.

Accounting Standards Codification The Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) became effective on July 1, 2009. At that date, the ASC became FASB's officially recognized source of authoritative U.S. generally accepted accounting principles applicable to all public and non-public non-governmental entities, superseding existing FASB, American Institute of Certified Public Accountants Emerging Issues Task Force and related literature. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered non-authoritative. The switch to the ASC affects the way companies refer to U.S. GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure.

Principles of Consolidation The consolidated financial statements include the accounts of Bancshares and its wholly owned subsidiaries. All intercompany transactions have been eliminated in consolidation. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (GAAP) and the prevailing practices within the banking industry. A summary of significant accounting and reporting policies is as follows:

Use of Estimates The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates include, but are not limited to, the calculation of stock-based compensation and the allowance for credit losses as well as the valuation of goodwill and available for sale securities. Actual results could differ from these estimates.

Securities Securities held to maturity are carried at cost, adjusted for the amortization of premiums and the accretion of discounts. Management has the positive intent and the Company has the ability to hold these assets as long-term securities until their estimated maturities.

Securities available for sale are carried at fair value. Unrealized gains and losses are excluded from earnings and reported, net of tax, as a separate component of shareholders' equity until realized. Securities within the available for sale portfolio may be used as part of the Company's asset/liability strategy and may be sold in response to changes in interest risk, prepayment risk or other similar economic factors.

When other-than-temporary impairment (OTTI) occurs, the amount of the other-than-temporary impairment 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

Table of Contents

Index to Financial Statements

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.

Premiums and discounts are amortized and accreted to operations using the level-yield method of accounting, adjusted for prepayments as applicable. The specific identification method of accounting is used to compute gains or losses on the sales of these assets. Interest earned on these assets is included in interest income.

Loans Held for Investment Loans are stated at the principal amount outstanding, net of unearned discount and fees. Unearned discount relates principally to consumer installment loans. The related interest income for multipayment loans is recognized principally by the simple interest method; for single payment loans, such income is recognized using the straight-line method.

Nonrefundable Fees and Costs Associated with Lending Activities Loan origination fees in excess of the associated costs are recognized over the life of the related loan as an adjustment to yield using the interest method.

Loan commitment fees and loan origination costs are deferred and recognized as an adjustment of yield by the interest method over the related loan life or, if the commitment expires unexercised, recognized in income upon expiration of the commitment.

Nonperforming and Past Due Loans Included in the nonperforming loan category are loans which have been categorized by management as nonaccrual because collection of interest is doubtful and loans which have been restructured to provide a reduction in the interest rate or a deferral of interest or principal payments. When the payment of principal or interest on a loan is delinquent for 90 days, or earlier in some cases, the loan is placed on nonaccrual status unless the loan is in the process of collection and the underlying collateral fully supports the carrying value of the loan. If the decision is made to continue accruing interest on the loan, periodic reviews are made to confirm the accruing status of the loan. When a loan is placed on nonaccrual status, interest accrued during the current year prior to the judgment of uncollectibility is charged to operations. Interest accrued during prior periods is charged to the allowance for credit losses. Any payments received on nonaccrual loans are applied first to outstanding loan amounts and next to the recovery of charged-off loan amounts. Any excess is treated as recovery of lost interest.

Restructured loans are those loans on which concessions in terms have been granted because of a borrower's financial difficulty. Interest is generally accrued on such loans in accordance with the new terms.

Allowance for Credit Losses The allowance for credit losses is a valuation allowance available for losses incurred on loans. All losses are charged to the allowance when the loss actually occurs or when a determination is made that such a loss is probable. Recoveries are credited to the allowance at the time of recovery.

Throughout the year, management estimates the probable level of losses to determine whether the allowance for credit losses is adequate to absorb losses inherent in the loan portfolio. Based on these estimates, an amount is charged to the provision for credit losses and credited to the allowance for credit losses in order to adjust the allowance to a level determined to be adequate to absorb losses.

Table of Contents

Index to Financial Statements

In making its evaluation of the adequacy of the allowance for credit losses, management considers factors such as historical loan loss experience, industry diversification of the Company's commercial loan portfolio, the amount of nonperforming assets and related collateral, 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 and other relevant factors.

Estimates of credit losses involve an exercise of judgment. While it is possible that in the short term the Company may sustain losses which are substantial in relation to the allowance for credit losses, it is the judgment of management that the allowance for credit losses reflected in the consolidated balance sheets is adequate to absorb probable losses that exist in the current loan portfolio.

The Company's allowance for credit losses consists of two elements: (i) specific valuation allowances determined in accordance with ASC Topic 310, *Receivables* based on probable losses on specific loans; and (ii) 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 accordance with ASC Topic 450, *Contingencies*. A loan is defined as impaired by ASC Topic 310 if, based on current information and events, it is probable that a creditor will be unable to collect all amounts due, both interest and principal, according to the contractual terms of the loan agreement. Specifically, ASC Topic 310 requires that the allowance for credit losses related to impaired loans be determined based on the difference of carrying value of loans and the present value of expected cash flows discounted at the loan's effective interest rate or, as a practical expedient, the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. At December 31, 2011, the Company had \$3.6 million in nonaccrual loans and no 90 days or more past due loans. At December 31, 2010, the Company had \$4.4 million in nonaccrual loans and \$189,000 in 90 days or more past due loans. The Company had \$5.3 million and \$2.6 million in troubled debt restructurings at December 31, 2011 and 2010, respectively. The recorded investment in impaired loans was \$4.0 million and \$4.3 million at December 31, 2011 and 2010, respectively. Such impaired loans required an allowance for credit losses of \$1.2 million and \$993,000 at December 31, 2011 and 2010, respectively. Interest revenue received on impaired loans is either applied against principal or realized as interest revenue, according to management's judgment as to the collectibility of principal. If interest on nonaccrual loans had been accrued under the original loan terms, approximately \$253,000, \$701,000 and \$434,000 would have been recorded as income for the years ended December 31, 2011, 2010 and 2009, respectively.

Premises and Equipment Premises and equipment are carried at cost less accumulated depreciation. Depreciation expense is computed principally using the straight-line method over the estimated useful lives of the assets which range from three to 30 years. Leasehold improvements are amortized using the straight-line method over the periods of the leases or the estimated useful lives, whichever is shorter.

Goodwill Goodwill is annually assessed for impairment or when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. The Company bases its evaluation on such impairment factors as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present.

Amortization of Core Deposit Intangibles Core deposit intangibles are amortized using an accelerated amortization method over an 8 to 10 year period.

Income Taxes Bancshares files a consolidated federal income tax return.

Deferred tax assets and liabilities are recognized for the estimated tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Table of Contents**Index to Financial Statements**

Effective January 1, 2008, the Company adopted the provisions of FASB Codification Topic 740, *Income Taxes*, which discusses the accounting for uncertainty in income taxes recognized in an entity's financial statements. GAAP prescribes a specified recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

Stock-Based Compensation The Company accounts for stock-based employee compensation plans using the fair value-based method of accounting in accordance with FASB ASC Topic 718, *Stock Compensation*. ASC Topic 718 was effective for companies in 2006, however, the Company has been recognizing stock-based compensation expense since January 1, 2003. The Company's results of operations reflect compensation expense for all employee stock-based compensation, including the unvested portion of stock options granted prior to 2003. ASC Topic 718 requires that management make assumptions including stock price volatility and employee turnover that are utilized to measure compensation expense. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of subjective assumptions.

Cash and Cash Equivalents For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks as well as federal funds sold that mature in three days or less.

Earnings Per Share On January 1, 2009, the Company adopted new authoritative accounting guidance under ASC Topic 260, *Earnings Per Share*, which provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method.

ASC Topic 260 requires presentation of basic and diluted earnings per share. Under the two-class method, basic earnings per common share is computed by dividing net earnings allocated to common stock by the weighted-average number of common shares outstanding during the applicable period, excluding outstanding participating securities. Diluted earnings per common share is computed using the weighted-average number of shares determined for the basic earnings per common share computation plus the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock using the treasury stock method.

Net income per common share for all periods presented has been calculated in accordance with ASC Topic 260. 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:

	2011		December 31, 2010		2009	
	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
	(In thousands, except per share data)					
Net income	\$ 141,749		\$ 127,708		\$ 111,879	
Basic:						
Weighted average shares outstanding	46,846	\$ 3.03	46,621	\$ 2.74	46,177	\$ 2.42
Diluted:						
Weighted average shares outstanding	46,846		46,621		46,177	
Effect of dilutive securities options	171		211		177	
Total	47,017	\$ 3.01	46,832	\$ 2.73	46,354	\$ 2.41

Table of Contents

Index to Financial Statements

The incremental shares for the assumed exercise of the outstanding options were determined by application of the treasury stock method. There were no stock options exercisable at December 31, 2011, 2010 and 2009 that would have had an anti-dilutive effect on the above computation.

New Accounting Standards

Accounting Standards Updates (ASU)

ASU No. 2010-20, *Receivables (Topic 310) Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU 2010-20 requires entities to provide disclosures designed to facilitate financial statement users' evaluation of (i) the nature of credit risk inherent in the entity's portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (iii) the changes and reasons for those changes in the allowance for credit losses. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for credit losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a rollforward of the allowance for credit losses as well as information about modified, impaired, non-accrual and past due loans and credit quality indicators. ASU 2010-20 became effective for the Company's financial statements as of December 31, 2010, as it relates to disclosures required as of the end of a reporting period. Disclosures that relate to activity during a reporting period became effective for the Company's financial statements beginning on January 1, 2011. ASU 2011-01, *Receivables (Topic 310) - Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings* in Update No. 2010-20, temporarily deferred the effective date for disclosures related to troubled debt restructurings to coincide with the effective date of the then proposed ASU 2011-02, *Receivables (Topic 310) A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*, which is further discussed below.

ASU No. 2010-28, *Intangibles - Goodwill and Other (Topic 350) When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*. ASU 2010-28 modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist such as if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. ASU 2010-28 became effective for the Company on January 1, 2011 and did not have a significant impact on the Company's financial statements.

ASU No. 2011-02, *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*. ASU 2011-02 provides additional guidance or clarification to help determine whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. ASU 2011-02 was adopted by the Company on July 1, 2011, and applied retrospectively to restructurings occurring on or after January 1, 2011. The adoption of ASU 2011-02 did not have a significant impact on the Company's financial statements.

ASU 2011-04, *Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs*. ASU 2011-04 amends Topic 820, *Fair Value Measurements and Disclosures*, to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 is effective for annual periods beginning after December 15, 2011, and is not expected to have a significant impact on the Company's financial statements.

Table of Contents

Index to Financial Statements

ASU 2011-05, *Comprehensive Income (Topic 220) Presentation of Comprehensive Income*. ASU 2011-05 amends Topic 220, Comprehensive Income, to require that all nonowner changes in shareholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in shareholders' equity was eliminated. ASU 2011-05 is effective for annual periods beginning after December 15, 2011, and will require that the Company change its presentation of comprehensive income.

ASU 2011-08, *Intangibles - Goodwill and Other (Topic 350) - Testing Goodwill for Impairment*. ASU 2011-08 amends Topic 350, Intangibles - Goodwill and Other, to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. ASU 2011-08 is effective for annual and interim impairment tests beginning after December 15, 2011, and is not expected to have a significant impact on the Company's financial statements.

ASU 2011-12, *Comprehensive Income (Topic 220) - Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. ASU 2011-12 defers changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments to allow the FASB time to redeliberate whether to require presentation of such adjustments on the face of the financial statements to show the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. ASU 2011-12 allows entities to continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU No. 2011-05. All other requirements in ASU No. 2011-05 are not affected by ASU No. 2011-12. ASU 2011-12 is effective for annual and interim periods beginning after December 15, 2011 and is not expected to have a significant impact on the Company's financial statements.

2. ACQUISITIONS

Acquisitions are an integral part of the Company's growth strategy. All acquisitions were accounted for using the purchase method of accounting. Accordingly, the assets and liabilities of the acquired entities were recorded at their fair values at the acquisition date. The excess of the purchase price over the estimated fair value of the net assets for tax free acquisitions was recorded as goodwill, none of which is deductible for tax purposes. The excess of the purchase price over the estimated fair value of the net assets for taxable acquisitions was also recorded as goodwill, and is deductible for tax purposes. The identified core deposit intangibles for each acquisition are being amortized using an accelerated amortization method over an 8 to 10 year life. The results of operations for each acquisition have been included in the Company's consolidated financial results beginning on the respective acquisition date. The following acquisitions were completed on the dates indicated:

The Company completed no acquisitions in 2011.

On March 29, 2010, the Company completed its acquisition of three (3) Texas banking centers from U.S. Bank. In connection with the acquisition, the Company assumed approximately \$375.0 million in deposits. The Company paid a premium of \$13.1 million to assume the deposits of the three U.S. Bank branches.

Table of Contents**Index to Financial Statements**

In connection with the purchase, the Company recorded a premium of \$13.3 million, of which \$369 thousand was identified as core deposit intangibles. The remaining \$12.9 million of the premium was recorded as goodwill.

On April 30, 2010, the Company completed its acquisition of nineteen (19) Texas banking centers from First Bank. In connection with the acquisition, the Company assumed approximately \$500.0 million in deposits. Four banking centers were subsequently closed and consolidated with nearby Company banking centers. The Company paid a premium of \$26.9 million to assume the deposits of the nineteen First Bank branches.

In connection with the purchase, the Company recorded a premium of \$36.4 million, of which \$2.0 million was identified as core deposit intangibles. The remaining \$34.3 million of the premium was recorded as goodwill.

The Company completed no acquisitions in 2009.

3. GOODWILL AND CORE DEPOSIT INTANGIBLES

Changes in the carrying amount of the Company's goodwill and core deposit intangibles for fiscal 2011 and 2010 were as follows:

	Goodwill	Core Deposit
	(Dollars in thousands)	Intangibles
Balance as of December 31, 2009	876,987	35,385
Less:		
Amortization		(9,016)
Add:		
Acquisition of U.S. Bank branches.	12,928	369
Acquisition of First Bank branches	34,343	2,038
Balance as of December 31, 2010	924,258	28,776
Less:		
Amortization		(7,780)
Add:		
Acquisition of First Bank branches	279	
Balance as of December 31, 2011	\$ 924,537	\$ 20,996

Purchase accounting adjustments to prior year acquisitions were made to adjust deferred tax asset and liability balances. 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 reflected in the table above 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 or liabilities. Management performs an evaluation annually, and more frequently if a triggering event occurs, of whether any impairment of the goodwill and other intangibles has occurred. If any such impairment is determined, a write down is recorded. As of December 31, 2011, there was no impairment recorded on goodwill.

Core deposit intangibles (CDI) are amortized on an accelerated basis over their estimated lives, which the Company believes is between 8 and 10 years. Gross core deposit intangibles outstanding were \$79.2 million at December 31, 2011 and December 31, 2010. Net core deposit intangibles outstanding were \$21.0 million and \$28.8 million at the same dates, respectively. The decrease was due to amortization. Amortization expense related to intangible assets totaled \$7.8 million and \$9.0 million for the years ended December 31, 2011 and 2010, respectively. The decrease was primarily attributed to certain CDI that fully amortized in 2011.

Table of Contents**Index to Financial Statements**

The estimated aggregate future amortization expense for CDI remaining as of December 31, 2011 is as follows (dollars in thousands):

2012	\$ 6,347
2013	4,465
2014	3,314
2015	2,804
2016	2,481
Thereafter	1,585
Total	\$ 20,996

4. CASH AND DUE FROM BANKS

The Bank is required by the Federal Reserve Bank of Dallas to maintain average reserve balances. Cash and due from banks in the consolidated balance sheets includes amounts so restricted of \$46.2 million and \$42.6 million at December 31, 2011 and 2010, respectively.

5. SECURITIES

The amortized cost and fair value of investment securities as of December 31, 2011 are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale				
States and political subdivisions	\$ 37,060	\$ 2,022	\$ (6)	\$ 39,076
Collateralized mortgage obligations	786		(21)	765
Mortgage-backed securities	254,965	18,307	(66)	273,206
Other securities	8,778	491		9,269
Total	\$ 301,589	\$ 20,820	\$ (93)	\$ 322,316
Held to Maturity				
U.S. Treasury securities and obligations of U.S. government agencies	\$ 8,696	\$ 455	\$	\$ 9,151
States and political subdivisions	37,914	1,282	(283)	38,912
Corporate debt securities	1,500	114		1,614
Collateralized mortgage obligations	281,778	5,009	(149)	286,637
Mortgage-backed securities	3,993,832	147,991	(91)	4,141,732
Qualified School Construction Bonds (QSCB)	12,900	2,042		14,942
Total	\$ 4,336,620	\$ 156,893	\$ (523)	\$ 4,492,988

Table of Contents**Index to Financial Statements**

The amortized cost and fair value of investment securities as of December 31, 2010 are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale				
States and political subdivisions	\$ 39,637	\$ 1,155	\$ (278)	\$ 40,514
Collateralized mortgage obligations	967		(24)	943
Mortgage-backed securities	349,170	20,466	(91)	369,545
Qualified Zone Academy Bond	8,000	326		8,326
Other securities	8,772	453		9,225
Total	\$ 406,546	\$ 22,400	\$ (393)	\$ 428,553

Held to Maturity

U.S. Treasury securities and obligations of U.S. government agencies	\$ 10,996	\$ 789	\$	\$ 11,785
States and political subdivisions	36,394	639	(1,155)	35,878
Corporate debt securities	1,500	176		1,676
Collateralized mortgage obligations	443,859	7,272	(429)	450,702
Mortgage-backed securities	3,682,914	118,886	(4,259)	3,797,541
Qualified School Construction Bonds (QSCB)	12,900	325		13,225
Total	\$ 4,188,563	\$ 128,087	\$ (5,843)	\$ 4,310,807

Management evaluates securities for other-than-temporary impairment 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 model. Investment securities classified as available for sale or held-to-maturity are evaluated for OTTI under FASB ASC Topic 320, *Investments Debt and Equity Securities*. Certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, that had credit ratings at the time of purchase of below AA are evaluated using the model outlined in ASC Topic 325, *Investments Other*. The Company currently does not own any securities that are accounted for under ASC Topic 325.

In determining OTTI under ASC Topic 320, 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. If applicable, the second segment of the portfolio uses the OTTI guidance provided by ASC Topic 325 that is specific to purchased beneficial interests that, on the purchase date, were rated below AA. Under the ASC Topic 325 model, an impairment is considered other than temporary if, based on the Company's best estimate of cash flows that a market participant would use in determining the current fair value of the beneficial interest, there has been an adverse change in those estimated cash flows.

When OTTI occurs under either model, the amount of the other-than-temporary impairment 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

Table of Contents**Index to Financial Statements**

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 December 31, 2011, the Company does not intend to sell any debt securities and management believes that the Company more likely than not will not be required to sell any debt securities before their anticipated recovery, at which time the Company will receive full value for the securities. Furthermore, as of December 31, 2011, management does not have the intent to sell any of its 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 December 31, 2011, management believes any impairment in the Company's securities are temporary and no impairment loss has been realized in the Company's consolidated statements of income.

Securities with unrealized losses segregated by length of time such securities have been in a continuous loss position at December 31, 2011 were as follows:

	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
(Dollars in thousands)						
Available for Sale						
States and political subdivisions	\$ 375	\$	\$ 510	\$ (6)	\$ 885	\$ (6)
Collateralized mortgage obligations			765	(21)	765	(21)
Mortgage-backed securities	297	(1)	7,423	(65)	7,720	(66)
Total	\$ 672	\$ (1)	\$ 8,698	\$ (92)	\$ 9,370	\$ (93)
Held to Maturity						
States and political subdivisions	\$ 3,169	\$ (186)	\$ 2,803	\$ (97)	\$ 5,972	\$ (283)
Collateralized mortgage obligations	353	(27)	1,693	(122)	2,046	(149)
Mortgage-backed securities	281,796	(88)	305	(3)	282,101	(91)
Total	\$ 285,318	\$ (301)	\$ 4,801	\$ (222)	\$ 290,119	\$ (523)

At December 31, 2011, there were approximately 360 securities in an unrealized loss position for more than 12 months.

Table of Contents

Index to Financial Statements

Securities with unrealized losses segregated by length of time such securities have been in a continuous loss position at December 31, 2010 were as follows:

	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
(Dollars in thousands)						
Available for Sale						
States and political subdivisions	\$ 7,707	\$ (228)	\$ 842	\$ (50)	\$ 8,549	\$ (278)
Collateralized mortgage obligations			933	(24)	933	(24)
Mortgage-backed securities	2,794	(15)	6,449	(76)	9,243	(91)
Total	\$ 10,501	\$ (243)	\$ 8,224	\$ (150)	\$ 18,725	\$ (393)

Held to Maturity

U.S. Treasury securities and obligations of U.S. government agencies	\$ 1,000	\$	\$	\$	\$ 1,000	\$
States and political subdivisions	14,769	(790)	4,057	(365)	18,826	(1,155)
Collateralized mortgage obligations	3		6,201	(429)	6,204	(429)
Mortgage-backed securities	579,431	(4,256)	320	(3)	579,751	(4,259)
Total	\$ 595,203	\$ (5,046)	\$ 10,578	\$ (797)	\$ 605,781	\$ (5,843)

The amortized cost and fair value of investment securities at December 31, 2011, 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.

	December 31, 2011			
	Held to Maturity		Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(Dollars in thousands)				
Due in one year or less	\$ 6,696	\$ 6,888	\$ 7,659	\$ 8,026
Due after one year through five years	13,961	14,720	2,097	2,251
Due after five years through ten years	11,215	11,590	22,775	24,126
Due after ten years	29,138	31,421	13,307	13,942
Subtotal	61,010	64,619	45,838	48,345
Mortgage-backed securities and collateralized mortgage obligations	4,275,610	4,428,369	255,751	273,971
Total	\$ 4,336,620	\$ 4,492,988	\$ 301,589	\$ 322,316

The Company recorded a loss on sale of securities of \$581,000 for the twelve months ended December 31, 2011 compared with no loss on sale of securities for the twelve months ended December 31, 2010. The Company sold two non-agency collateralized mortgage obligations (CMOs) with a total book value of \$3.2 million due to a downgrade of the CMOs to less than investment grade in the second quarter of 2011. At December 31, 2011, the Company had eight investment grade non-agency CMOs remaining with a book value of \$3.4 million and a fair value of \$3.3 million.

At December 31, 2011 and 2010, 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.

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Securities with an amortized cost of \$2.48 billion and \$2.46 billion and a fair value of \$2.57 billion and \$2.55 billion at December 31, 2011 and 2010, respectively, were pledged to collateralize public deposits and for other purposes required or permitted by law.

Table of Contents**Index to Financial Statements****6. LOANS AND ALLOWANCE FOR CREDIT LOSSES**

The loan portfolio consists of various types of loans made principally to borrowers located in South and Southeast Texas, Houston, Central Texas, Bryan/College Station, East Texas, Corpus Christi and Dallas/Fort Worth and is classified by major type as follows:

	December 31,	
	2011	2010
	(Dollars in thousands)	
Commercial and industrial	\$ 406,433	\$ 409,426
Real estate:		
Construction and land development	482,140	502,327
1-4 family residential	1,007,266	824,057
Home equity	146,999	118,781
Commercial real estate	1,351,986	1,288,023
Farmland	136,008	98,871
Multi-family residential	89,240	82,626
Agriculture	34,226	41,881
Consumer (net of unearned discount)	78,187	87,977
Other	33,421	31,054
Total	\$ 3,765,906	\$ 3,485,023

Loan Origination/Risk Management. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions. All loans over \$500,000 and below \$2.5 million are evaluated and acted upon on a daily basis by two of the six company-wide loan concurrence officers. All loans above \$2.5 million are evaluated and acted upon by an officers' loan committee which meets weekly. In addition to the officers' loan committee evaluation, loans from \$15.0 million to \$25.0 million are evaluated and acted upon by the directors' loan committee which consists of three directors of the Bank and meets as necessary. Total loan relationships over \$25.0 million are evaluated and acted upon by the Bank's board of directors either at a regularly scheduled monthly board meeting or by teleconference or written consent.

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.

(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. The increased risk also derives from 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.

(ii) Commercial Real Estate. The Company makes commercial real estate loans collateralized by owner-occupied and non-owner-occupied real estate to finance the purchase of real estate. The Company's commercial

Table of Contents

Index to Financial Statements

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 such 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 December 31, 2011, approximately 35.4% of the outstanding principal balance of the Company's commercial real estate loans were secured by owner-occupied properties. At December 31, 2011, the Company had total commercial real estate loans totaling \$1.92 billion which include the categories of construction and land development loans, commercial real estate loans and multi-family residential loans.

(iii) 1-4 Family Residential Loans. The Company's lending activities also includes the origination of 1-4 family residential mortgage loans collateralized by owner-occupied residential properties located in the Company's market areas. The Company offers a variety of mortgage loan 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. Other than with respect to mortgage banking activities acquired in the TXUI acquisition, the Company has elected to keep all 1-4 family residential loans for its own account rather than selling such loans into the secondary market. By doing so, the Company is able to realize a higher yield on these loans; however, the Company also incurs interest rate risk as well as the risks associated with nonpayments on such loans.

(iv) Construction and Land Development 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, there is no assurance that the Company will 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. While the Company has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, no assurance can be given that these procedures will prevent losses from the risks described above.

(v) Agriculture Loans. The Company provides agriculture loans for short-term 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, home equity loans, personal loans (collateralized and uncollateralized) and deposit account collateralized loans. The terms of these loans typically

Table of Contents**Index to Financial Statements**

range from 12 to 120 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 contractual maturity ranges of the 1-4 family residential, home equity, commercial and industrial, commercial mortgage, construction and land development and agriculture portfolios and the amount of such loans with predetermined interest rates and floating rates in each maturity range as of December 31, 2011 are summarized in the following table:

	December 31, 2011			
	One Year or Less	After One Through Five Years	After Five Years	Total
	(Dollars in thousands)			
1-4 family residential and home equity	\$ 9,490	\$ 43,819	\$ 1,100,956	\$ 1,154,265
Commercial and industrial	154,649	144,070	107,714	406,433
Commercial real estate	30,714	97,811	1,223,461	1,351,986
Construction and land development	93,174	55,445	333,521	482,140
Agriculture	22,946	10,992	288	34,226
Total	\$ 310,973	\$ 352,137	\$ 2,765,940	\$ 3,429,050
Loans with a predetermined interest rate	\$ 92,662	\$ 199,524	\$ 1,189,365	\$ 1,481,551
Loans with a floating interest rate	218,311	152,613	1,576,575	1,947,499
Total	\$ 310,973	\$ 352,137	\$ 2,765,940	\$ 3,429,050

Concentrations of Credit. Most of the Company's lending activity occurs within the State of Texas, including the four largest metropolitan areas of Austin, Dallas/Ft. Worth, Houston and San Antonio, as well as other markets. The majority of the Company's loan portfolio consists of commercial and industrial and commercial real estate loans. As of December 31, 2011 and 2010, 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 was not significant at December 31, 2011 or 2010.

Related Party Loans. As of December 31, 2011 and 2010, loans outstanding to directors, officers and their affiliates totaled \$9.8 million and \$12.8 million, respectively. All transactions entered into between the Company and such related parties are done in the ordinary course of business, 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:

	Year Ended December 31,	
	2011	2010
	(Dollars in thousands)	
Beginning balance	\$ 12,783	\$ 15,540
New loans and reclassified related loans	4,168	910
Repayments	(7,142)	(3,667)

Ending balance	\$ 9,809	\$ 12,783
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Table of Contents

Index to Financial Statements

Non-Accrual 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 and the Company also monitors its delinquency levels for any negative or adverse trends. There can be no assurance, however, that the Company's loan portfolio will not 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.

The Company requires appraisals on loans collateralized by real estate. 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.

Year-end non-accrual loans, segregated by class of loans, were as follows:

	December 31, 2011	December 31, 2010
	(Dollars in thousands)	
Construction and land development	\$ 1,175	\$ 1,417
Agriculture and agriculture real estate (includes farmland)	49	11
1-4 family (includes home equity)	923	1,559
Commercial real estate (includes multi-family residential)	790	235
Commercial and industrial	633	1,179
Consumer and other	8	38
Total	\$ 3,578	\$ 4,439

If interest on nonaccrual loans had been accrued under the original loan terms, approximately \$253,000, \$701,000 and \$434,000 would have been recorded as income for the years ended December 31, 2011, 2010 and 2009, respectively.

An aging analysis of past due loans, segregated by class of loans, was as follows:

Year Ended December 31, 2011					
	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Accruing Loans 90 or More Days Past Due
	(Dollars in thousands)				
Construction and land development	\$ 1,281	\$ 111	\$ 1,392	\$ 480,748	\$
Agriculture and agriculture real estate (includes farmland)	365	9	374	169,860	
1-4 family (includes home equity)	1,527	314	1,841	1,152,424	
Commercial real estate (includes multi-family residential)	5,630	390	6,020	1,435,206	
Commercial and industrial	1,544	394	1,938	404,495	
Consumer and other	89		89	111,519	
Total	\$ 10,436	\$ 1,218	\$ 11,654	\$ 3,754,252	\$

Table of Contents

Index to Financial Statements

	Years Ended December 31, 2010				
	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Accruing Loans 90 or More Days Past Due
	(Dollars in thousands)				
Construction and land development	\$ 6,395	\$ 1,465	\$ 7,860	\$ 494,467	\$ 48
Agriculture and agriculture real estate (includes farmland)	251	11	262	140,490	
1-4 family (includes home equity)	6,217	1,701	7,918	934,920	141
Commercial real estate (includes multi-family residential)	6,243	235	6,478	1,364,171	
Commercial and industrial	2,047	1,179	3,226	406,200	
Consumer and other	241	37	278	118,753	
Total	\$ 21,394	\$ 4,628	\$ 26,022	\$ 3,459,001	\$ 189

The following table presents information regarding past due loans and nonperforming assets at the dates indicated:

	2011	2010	December 31, 2009	2008	2007
	(Dollars in thousands)				
Nonaccrual loans	\$ 3,578	\$ 4,439	\$ 6,079	\$ 2,142	\$ 1,035
Accruing loans 90 or more days past due		189	2,332	7,594	4,092
Total nonperforming loans	3,578	4,628	8,411	9,736	5,127
Repossession assets	146	161	116	182	56
Other real estate	8,328	11,053	7,829	4,450	10,207
Total nonperforming assets	\$ 12,052	\$ 15,842	\$ 16,356	\$ 14,368	\$ 15,390
Nonperforming assets to total loans and other real estate	0.32%	0.45%	0.48%	0.40%	0.49%
Nonperforming assets to average earning assets	0.15%	0.20%	0.22%	0.25%	0.31%

The Company's conservative lending approach has resulted in sound asset quality. The Company had \$12.1 million in nonperforming assets at December 31, 2011 compared with \$15.8 million at December 31, 2010 and \$16.4 million at December 31, 2009. The nonperforming assets at December 31, 2011 consisted of ninety-nine separate credits or ORE properties.

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 collectibility 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.

Table of Contents**Index to Financial Statements**

Year-end impaired loans are set forth in the following tables. No interest income was recognized on impaired loans subsequent to their classification as impaired.

	Recorded Investment	Unpaid Principal Balance	December 31, 2011 Related Allowance (Dollars in thousands)	Average Recorded Investment
With no related allowance recorded:				
Construction and land development	\$ 111	\$ 111	\$	\$ 58
Agriculture and agriculture real estate (includes farmland)	6	6		5
1-4 family (includes home equity)	313	344		291
Commercial real estate (includes multi-family residential)	668	705		637
Commercial and industrial	112	1,513		253
Consumer and other				3
With an allowance recorded:				
Construction and land development	1,064	1,064	312	584
Agriculture and agriculture real estate (includes farmland)	43	46	39	21
1-4 family (includes home equity)	677	731	362	663
Commercial real estate (includes multi-family residential)	483	485	165	309
Commercial and industrial	521	535	300	642
Consumer and other	8	20	8	18
Total:				
Construction and land development	1,175	1,175	312	642
Agriculture and agriculture real estate (includes farmland)	49	52	39	26
1-4 family (includes home equity)	990	1,075	362	954
Commercial real estate (includes multi-family residential)	1,151	1,190	165	946
Commercial and industrial	633	2,048	300	895
Consumer and other	8	20	8	21

Table of Contents**Index to Financial Statements**

	December 31, 2010			Average
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment ⁽¹⁾
	(Dollars in thousands)			
With no related allowance recorded:				
Construction and land development	\$ 126	\$ 126	\$	N/A
Agriculture and agriculture real estate (includes farmland)				N/A
1-4 family (includes home equity)	229	244		N/A
Commercial real estate (includes multi-family residential)	221	221		N/A
Commercial and industrial	354	1,354		N/A
Consumer and other				N/A
With an allowance recorded:				
Construction and land development	1,329	1,329	284	N/A
Agriculture and agriculture real estate (includes farmland)	11	11	5	N/A
1-4 family (includes home equity)	1,266	1,274	293	N/A
Commercial real estate (includes multi-family residential)				N/A
Commercial and industrial	726	745	388	N/A
Consumer and other	30	40	23	N/A
Total:				
Construction and land development	1,455	1,455	284	N/A
Agriculture and agriculture real estate (includes farmland)	11	11	5	N/A
1-4 family (includes home equity)	1,495	1,518	293	N/A
Commercial real estate (includes multi-family residential)	221	221		N/A
Commercial and industrial	1,080	2,099	388	N/A
Consumer and other	30	40	23	N/A

(1) Information not available at December 31, 2010.

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 are of the highest standards of credit quality with virtually no risk of loss. These borrowers would represent top rated companies and individuals with unquestionable financial standing with excellent global cash flow coverage, net worth, liquidity and collateral coverage and/or secured by deposit accounts.

Grade 2 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 3 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 4 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

Table of Contents

Index to Financial Statements

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 5 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 valuation and will typically have the accrual of interest stopped.

Grade 6 Credits in this category include doubtful loans in accordance with regulatory guidance. Such loans are no longer accruing interest and factors indicated 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 7 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 classified loans by class of loan at December 31, 2011. Classified loans include loans in risk grades 5, 6 and 7.

	Construction and Land Development	Agriculture and Real Estate (Includes Farmland)	1-4 Family (Includes Home Equity)	Commercial Real Estate (Includes Multi- Family)	Commercial and Industrial	Consumer and Other	Total
	(Dollars in thousands)						
Grade 1	\$	\$ 3,319	\$	\$	\$ 45,218	\$ 31,602	\$ 80,139
Grade 2	465,572	166,656	1,140,210	1,399,915	355,862	79,996	3,608,211
Grade 3	1,757	210	9,131	14,335	4,189		29,622
Grade 4	13,636		3,934	25,825	531	2	43,928
Grade 5	1,175	49	970	1,151	532	8	3,885
Grade 6			20		101		121
Grade 7							
Total	\$ 482,140	\$ 170,234	\$ 1,154,265	\$ 1,441,226	\$ 406,433	\$ 111,608	\$ 3,765,906

The following table presents risk grades and classified loans by class of loan at December 31, 2010. Classified loans include loans in risk grades 5, 6 and 7.

	Construction and Land Development	Agriculture and Real Estate (Includes Farmland)	1-4 Family (Includes Home Equity)	Commercial Real Estate (Includes Multi- Family)	Commercial and Industrial	Consumer and Other	Total
	(Dollars in thousands)						
Grade 1	\$	\$ 4,057	\$	\$	\$ 41,455	\$ 35,188	\$ 80,700
Grade 2	479,443	136,607	930,110	1,335,222	364,150	83,797	3,329,329
Grade 3	4,492		6,571	13,165	858	1	25,087
Grade 4	16,937	77	4,663	22,041	1,883	15	45,616
Grade 5	1,455	11	1,425	221	286	30	3,428
Grade 6			69		794		863
Grade 7							

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Total	\$ 502,327	\$	140,752	\$	942,838	\$	1,370,649	\$	409,426	\$	119,031	\$ 3,485,023
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Table of Contents**Index to Financial Statements**

Charge-offs/recoveries, segregated by class of loans, were as follows:

	Year Ended December 31, 2011		
	Charge-offs	Recoveries	Net Charge-offs
	(Dollars in thousands)		
Construction and land development	\$ (1,509)	\$ 400	\$ (1,109)
1-4 family (includes home equity)	(1,392)	32	(1,360)
Commercial real estate and agriculture (includes multi-family)	(1,027)	41	(986)
Commercial and industrial	(1,694)	526	(1,168)
Consumer and other	(1,228)	661	(567)
	\$ (6,850)	\$ 1,660	\$ (5,190)

	Year Ended December 31, 2010		
	Charge-offs	Recoveries	Net Charge-offs
	(Dollars in thousands)		
Construction and land development	\$ (5,337)	\$ 277	\$ (5,060)
1-4 family (includes home equity)	(1,919)	66	(1,853)
Commercial real estate and agriculture (includes multi-family)	(3,293)	101	(3,192)
Commercial and industrial	(2,863)	346	(2,517)
Consumer and other	(2,071)	829	(1,242)
	\$ (15,483)	\$ 1,619	\$ (13,864)

Net charge-offs for the years ended December 31, 2011 and 2010 were \$5.2 million and \$13.9 million, respectively. Net charge-offs for the year ended December 31, 2009 were \$13.9 million.

Allowance for Possible Loan Credit Losses. The allowance for credit losses is 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: (i) charge-offs of loans that occur when loans are deemed uncollectible and decrease the allowance, (ii) recoveries on loans previously charged off that increase the allowance and (iii) 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.

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 loan portfolio. 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 each impaired loan, 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. 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.

Table of Contents

Index to Financial Statements

In determining the amount of the general valuation allowance, management considers factors such as historical loan loss experience, industry diversification of the Company's commercial loan portfolio, 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. 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 connection with its 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;

for commercial mortgage 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 and land development 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 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 December 31, 2011, the allowance for credit losses totaled \$51.6 million, or 1.37% of total loans. At December 31, 2010, the allowance aggregated \$51.6 million or 1.48% of total loans and at December 31, 2009, the allowance was \$51.9 million or 1.54% of total loans.

Table of Contents

Index to Financial Statements

An analysis of activity in the allowance for credit losses is as follows:

	Year Ended December 31,		
	2011	2010	2009
	(Dollars in thousands)		
Balance at beginning of year	\$ 51,584	\$ 51,863	\$ 36,970
Addition provision charged to operations	5,200	13,585	28,775
Charge-offs and recoveries:			
Loans charged off	(6,850)	(15,483)	(15,399)
Loan recoveries	1,660	1,619	1,517
Net charge-offs	(5,190)	(13,864)	(13,882)
Balance at end of year.	\$ 51,594	\$ 51,584	\$ 51,863

The following table details the recorded investment in loans and activity in the allowance for credit losses by portfolio segment for the year ended December 31, 2011. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Construction and Land Development	Agriculture and Agriculture Real Estate (includes farmland)	1-4 Family (Includes Home Equity)	Commercial Real Estate (Commercial Mortgage and Multi-Family)	Commercial and Industrial	Consumer and Other	Total
	(Dollars in thousands)						
Allowance for credit losses:							
Beginning balance	\$ 12,994	\$ 271	\$ 12,837	\$ 20,436	\$ 3,891	\$ 1,155	\$ 51,584
Provision for credit losses	209	239	1,168	2,011	1,103	470	5,200
Charge-offs	(1,509)		(1,392)	(1,027)	(1,694)	(1,228)	(6,850)
Recoveries	400	1	32	40	526	661	1,660
Net charge-offs	(1,109)	1	(1,360)	(987)	(1,168)	(567)	(5,190)
Ending balance	12,094	511	12,645	21,460	3,826	1,058	51,594
Ending balance: individually evaluated for impairment	312	39	362	165	300	8	1,186
Ending balance: collectively evaluated for impairment	\$ 11,782	\$ 472	\$ 12,283	\$ 21,295	\$ 3,526	\$ 1,050	\$ 50,408
Loans:							
Ending balance: individually evaluated for impairment	1,175	49	990	1,151	633	8	4,006
Ending balance: collectively evaluated for impairment	480,965	170,185	1,153,275	1,440,075	405,800	111,600	3,761,900
Ending balance	\$ 482,140	\$ 170,234	\$ 1,154,265	\$ 1,441,226	\$ 406,433	\$ 111,608	\$ 3,765,906

Table of Contents

Index to Financial Statements

The Company's allowance for credit losses and recorded investment in loans as of December 31, 2010 related to each balance in the allowance for possible loan losses by portfolio segment and disaggregated on the basis of the Company's impairment methodology was as follows:

	Construction and Land Development	Agriculture and Agriculture Real Estate (Includes Farmland)	1-4 Family (Includes Home Equity)	Commercial Real Estate (Includes Multi-Family)	Commercial and Industrial	Consumer and Other	Total
(Dollars in thousands)							
Allowance for credit losses:							
Ending balance.	\$ 12,994	\$ 271	\$ 12,837	\$ 20,436	\$ 3,891	\$ 1,155	\$ 51,584
Ending balance: individually evaluated for impairment	284	5	293		388	23	993
Ending balance: collectively evaluated for impairment	12,710	266	12,544	20,436	3,503	1,132	50,591
Loans:							
Ending balance.	502,327	140,752	942,838	1,370,649	409,426	119,031	3,485,023
Ending balance: individually evaluated for impairment	1,455	11	1,494	221	1,080	30	4,291
Ending balance: collectively evaluated for impairment	500,872	140,741	941,344	1,370,428	408,346	119,001	3,480,732

The 2010 table above has been corrected to present only loan grades 5 through 7 in the *individually evaluated for impairment* loan balances to be in compliance with ASC Topic 310. Previously Management disclosed loan grades 3 through 7 in the *individually evaluated for impairment* loan balances. As a result of this correction the *collectively evaluated for impairment* loan balances changed by a corresponding amount. These changes had no effect on the ending loan balance as previously presented.

Troubled Debt Restructurings. The restructuring of a loan is considered a troubled debt restructuring if both (i) the borrower is experiencing financial difficulties and (ii) 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. Effective July 1, 2011, the Company adopted the provisions of ASU No. 2011-02, Receivables (Topic 310) A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. As such, the Company reassessed all loan modifications occurring since January 1, 2011 for identification as troubled debt restructurings. The Company had the following troubled debt restructurings outstanding as of the dates indicated:

	As of December 31,					
	2011	2011	2010	2010	2010	2010
	Number of Contracts	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment	Number of Contracts	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
(Dollars in thousands)						
Troubled Debt Restructurings						
Construction and land development		\$	\$		\$	\$
Agriculture and agriculture real estate						
1-4 Family (includes home equity)	4	109	84			
Commercial real estate (commercial mortgage and multi-family)	2	5,264	5,171	1	2,560	2,538
Commercial and industrial	3	114	93	1	90	80
Consumer and other				1	15	14
Total	9	\$ 5,487	\$ 5,348	3	\$ 2,665	\$ 2,632

Table of Contents**Index to Financial Statements**

As of December 31, 2011, 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. The modifications primarily 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 loan. For the year ended December 31, 2011, the Company added \$3.5 million in new troubled debt restructurings of which \$2.8 million were still outstanding on December 31, 2011. The new troubled debt restructurings included an associated specific reserve of \$10,000. Loans restructured during the year ended December 31, 2011 on non-accrual status as of December 31, 2011 totaled \$177,000. The remaining restructured loans are performing and accruing loans. These modifications did not have a material impact on the Company's determination of the allowance for credit losses.

7. FAIR VALUE

Effective January 1, 2008, the Company adopted FASB ASC Topic 820, which defines fair value, addresses aspects of the expanding application of fair value accounting and establishes a consistent framework for measuring fair value. 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.

Fair Value Hierarchy

ASC Topic 820 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. In accordance with ASC Topic 820, these inputs are summarized in the three broad levels listed below:

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets include U.S. Treasury securities that are highly liquid and are actively traded in over-the-counter markets.

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. The Company's Level 2 assets include U.S. government and agency mortgage-backed debt securities, corporate securities, municipal bonds and CRA funds.

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. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation.

In determining the appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to ASC Topic 820.

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

	Level 1	As of December 31, 2011		Total
		Level 2	Level 3	
		(Dollars in thousands)		
Available for sale securities:				
States and political subdivisions	\$	\$ 39,076	\$	\$ 39,076
Corporate debt securities and other	7,656	1,613		9,269
Collateralized mortgage obligations		765		765
Mortgage-backed securities		273,206		273,206
Total	\$ 7,656	\$ 314,660	\$	\$ 322,316

Table of Contents**Index to Financial Statements**

	Level 1	As of December 31, 2010 Level 2 (Dollars in thousands)	Level 3	Total
Available for sale securities:				
States and political subdivisions (including QZAB)	\$	\$ 48,840	\$	\$ 48,840
Corporate debt securities and other		9,225		9,225
Collateralized mortgage obligations		943		943
Mortgage-backed securities		369,545		369,545
Total	\$	\$ 428,553	\$	\$ 428,553

Certain assets and liabilities are measured at fair value on a non-recurring 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 and impaired loans per ASC Topic 310. For the year ended December 31, 2011, the Company had additions to other real estate owned of \$11.6 million, of which \$4.6 million were outstanding as of December 31, 2011. For the year ended December 31, 2011, the Company had additions to impaired loans of \$7.5 million, of which \$3.5 million were outstanding as of December 31, 2011. The remaining financial assets and financial liabilities measured at fair value on a non-recurring basis that were recorded in 2011 and remained outstanding at December 31, 2011 were not significant. During the reported periods, all fair value measurements for assets measured at fair value on a non-recurring basis utilized Level 2 inputs.

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. ASC Topic 820 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 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 future expected loss experience, 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 methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and due from banks For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Federal funds sold For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Securities For securities held as investments, fair value equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Table of Contents**Index to Financial Statements**

Loans held for investment For certain homogeneous fixed-rate categories of loans (such as some residential mortgages and other consumer loans), fair value is estimated by discounting the future cash flows using the risk-free Treasury rate for the applicable maturity, adjusted for servicing and credit risk. The carrying value of variable rate loans approximates fair value because the loans reprice frequently to current market rates.

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.

Junior subordinated debentures The fair value of the junior subordinated debentures was calculated using the quoted market prices, if available. If quoted market prices are not available, fair value is estimated using quoted market prices for similar subordinated debentures.

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.

Securities sold under repurchase agreements The fair value of securities sold under repurchase agreements is the amount payable on demand at the reporting date.

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.

FASB ASC Topic 825, *Financial Instruments*, requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The carrying amount and estimated fair values of the Company's financial instruments are as follows:

	December 31,			
	2011		2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(Dollars in thousands)			
Financial assets:				
Cash and due from banks	\$ 212,800	\$ 212,800	\$ 158,975	\$ 158,975
Federal funds sold	642	642	393	393
Held to maturity securities	4,336,620	4,492,988	4,188,563	4,310,807
Available for sale securities	322,316	322,316	428,553	428,553
Loans held for investment, net of allowance for credit losses	3,714,312	3,814,858	3,433,439	3,421,488
Total	\$ 8,586,690	\$ 8,843,604	\$ 8,209,923	\$ 8,320,216
Financial liabilities:				
Deposits	\$ 8,060,254	\$ 8,074,093	\$ 7,454,920	\$ 7,467,523
Junior subordinated debentures	85,055	71,001	92,265	92,284
Other borrowings	12,790	14,974	374,433	375,882
Securities sold under repurchase agreements	54,883	54,883	60,659	60,659
Total	\$ 8,212,982	\$ 8,214,951	\$ 7,982,277	\$ 7,996,348

The Company's off-balance sheet commitments are funded at current market rates at the date they are drawn upon. It is management's opinion that the fair value of these commitments would approximate their carrying value, if drawn upon.

Table of Contents**Index to Financial Statements**

The fair value estimates presented herein are based on pertinent information available to management as of the dates indicated. 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.

8. PREMISES AND EQUIPMENT

Premises and equipment are summarized as follows:

	Year Ended December 31,	
	2011	2010
	(Dollars in thousands)	
Land	\$ 55,819	\$ 55,776
Buildings	122,116	117,063
Furniture, fixtures and equipment	28,109	25,097
Construction in progress	854	949
Total	206,898	198,885
Less accumulated depreciation	(47,242)	(39,832)
Premises and equipment, net	\$ 159,656	\$ 159,053

Depreciation expense was \$8.2 million, \$8.3 million and \$8.2 million for the years ended December 31, 2011, 2010 and 2009, respectively.

9. DEPOSITS

Included in interest-bearing deposits are certificates of deposit in amounts of \$100,000 or more. These certificates and their remaining maturities at December 31, 2011 were as follows:

	December 31, 2011
	(Dollars in thousands)
Three months or less	\$ 276,934
Over three through six months.	266,874
Over six through 12 months	314,149
Over 12 months	171,419
Total	\$ 1,029,376

Interest expense for certificates of deposit in excess of \$100,000 was \$11.6 million, \$19.5 million and \$36.3 million, for the years ended December 31, 2011, 2010 and 2009, respectively.

The Company has no brokered deposits and there are no major concentrations of deposits with any one depositor.

10. OTHER BORROWINGS AND SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

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The Company utilizes borrowings to supplement deposits to fund its lending and investment activities. Borrowings consist of funds from the Federal Home Loan Bank (FHLB) and correspondent banks. FHLB advances are considered short-term, overnight borrowings and used to manage liquidity as needed. At December 31, 2011 the Company had outstanding \$12.8 million in FHLB borrowings of which all consisted of long-term FHLB notes payable compared to \$374.4 million in FHLB borrowings, of which \$14.4 million consisted of long-term FHLB notes payable and \$360.0 million consisted of short-term overnight borrowings at

Table of Contents**Index to Financial Statements**

December 31, 2010. FHLB advances are available to the Company under a security and pledge agreement. At December 31, 2011, the Company had total funds of \$3.13 billion available under this agreement of which \$12.8 million was outstanding. The weighted average interest rate paid on the FHLB notes payable at December 31, 2011 was 4.4%. The maturity dates on the FHLB notes payable range from the years 2013 to 2028 and have interest rates ranging from 4.08% to 6.10%. The highest outstanding balance of FHLB advances during 2011 was \$474.0 million compared with \$465.0 million during 2010. The average rate paid on FHLB advances for the year ended December 31, 2011 was 0.22%.

At December 31, 2011, the Company had \$54.9 million in overnight securities sold under repurchase agreements compared with \$60.7 million at December 31, 2010 with average rates paid of 0.54% and 0.73% for years ended December 31, 2011 and 2010, respectively.

The following table presents the Company's borrowings at December 31, 2011 and 2010:

	December 31, 2011	December 31, 2010
	(Dollars in thousands)	
FHLB advances	\$	\$ 360,000
FHLB long-term notes payable	12,790	14,433
Total other borrowings	12,790	374,433
Securities sold under repurchase agreements	54,883	60,659
Total	\$ 67,673	\$ 435,092

11. INCOME TAXES

The components of the provision for federal income taxes are as follows:

	Year Ended December 31,		
	2011	2010	2009
	(Dollars in thousands)		
Current	\$ 70,011	\$ 63,555	\$ 61,794
Deferred	2,006	539	(4,950)
Total	\$ 72,017	\$ 64,094	\$ 56,844

The provision for federal income taxes differs from the amount computed by applying the federal income tax statutory rate on income as follows:

	Year Ended December 31,		
	2011	2010	2009
	(Dollars in thousands)		
Taxes calculated at statutory rate	\$ 74,818	\$ 67,131	\$ 59,053
Increase (decrease) resulting from:			
Tax-exempt interest	(2,364)	(1,951)	(1,825)
Qualified Zone Academy Bond credit	(373)	(373)	(373)
Qualified School Construction Bond credit	(504)	(501)	(29)
BOLI income	(484)	(580)	(470)

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Qualified stock options	55	99	148
Other, net	869	269	340
Total	\$ 72,017	\$ 64,094	\$ 56,844

Table of Contents**Index to Financial Statements**

Deferred tax assets and liabilities are as follows:

	December 31,	
	2011	2010
	(Dollars in thousands)	
Deferred tax assets:		
Allowance for credit losses	\$ 17,886	\$ 17,811
Accrued liabilities	3,474	3,777
Certificates of deposit	11	34
Deferred compensation	282	310
ORE write-downs	525	465
Securities	512	680
Restricted stock	2,309	1,206
Self insurance reserve	378	
Other	26	26
Total deferred tax assets	25,403	24,309
Deferred tax liabilities:		
Loans	\$ (38)	\$ (155)
Goodwill and core deposit intangibles	(15,168)	(13,723)
Unrealized gain on available for sale securities	(7,254)	(7,702)
Bank premises and equipment	(6,980)	(5,814)
Deferred loan fees and costs	(606)	(479)
Investments in partnerships	(9,233)	(8,785)
Prepaid expenses	(713)	(719)
Total deferred tax liabilities.	(39,992)	(37,377)
Net deferred tax liabilities	\$ (14,589)	\$ (13,068)

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and estimates of future taxable income over the periods for which the deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these deductible differences at December 31, 2011.

ASC Topic 740 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. The Company had no tax positions at December 31, 2011 or December 31, 2010 that did not meet the more-likely-than-not recognition threshold. ASC Topic 740 also provides guidance on the accounting for and disclosure of unrecognized tax benefits, interest and penalties. The Company's policy for recording interest and penalties associated with audits is to record such items as a component of income before taxes. Penalties are recorded in other (gains) losses and interest paid or received is recorded in interest expense or interest income, respectively, in the consolidated statement of income. As of December 31, 2011 and December 31, 2010, the Company has not accrued any interest and penalties related to unrecognized tax benefits. The Company has identified its federal tax return and its state tax return in Texas as major tax jurisdictions, as defined. The only periods subject to examination for the Company's federal return are the 2008 through 2010 tax years.

Table of Contents

Index to Financial Statements

12. STOCK INCENTIVE PROGRAMS

At December 31, 2011, the Company had three stock-based employee compensation plans and one stock option plan assumed in connection with acquisitions under which no additional options will be granted. Two of the three plans adopted by the Company have expired and therefore no additional awards may be issued under those plans. The Company accounts for stock-based employee compensation plans using the fair value-based method of accounting in accordance with ASC Topic 718. ASC Topic 718 was effective for companies in 2006; however, the Company has been recognizing compensation expense since January 1, 2003. The Company recognized stock-based compensation expense of \$3.6 million, \$3.0 million and \$1.5 million for the years ended December 31, 2011, 2010 and 2009, respectively. There was approximately \$1.2 million, \$964,000 and \$383,000 of income tax benefit recorded for the stock-based compensation expense for the same periods, respectively.

During 1995, the Company's Board of Directors approved a stock option plan (the 1995 Plan) for executive officers and key associates to purchase common stock of Bancshares. The maximum number of shares reserved for issuance pursuant to options granted under the 1995 Plan was 680,000 (after two-for-one and four-for-one stock splits) and a total of 675,000 options were granted under the 1995 Plan. Options to purchase a total of 3,750 shares of common stock of Bancshares granted under the 1995 Plan were outstanding and exercisable at December 31, 2011. The 1995 Plan has expired and therefore no additional options may be issued from the 1995 Plan.

During 1998, the Company's Board of Directors and shareholders approved the Prosperity Bancshares, Inc. 1998 Stock Incentive Plan (the 1998 Plan) which authorized the issuance of up to 920,000 (after two-for-one stock split) shares of the common stock of Bancshares under both non-qualified and incentive stock options to employees and non-qualified stock options to directors who are not employees. The 1998 Plan also provided for the granting of restricted stock awards, stock appreciation rights, phantom stock awards and performance awards on substantially similar terms. A total of 819,500 options were granted under the 1998 Plan. Options to purchase a total of 330,064 shares of common stock of Bancshares granted under the 1998 Plan were outstanding at December 31, 2011, of which 254,264 options were exercisable. The 1998 Plan has expired and therefore no additional options may be issued from the 1998 Plan.

In December 2004, the Company's Board of Directors established the Prosperity Bancshares, Inc. 2004 Stock Incentive Plan (the 2004 Plan), which was approved by the Company's shareholders on February 23, 2005. The 2004 Plan authorizes 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 provides 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 provides for the granting of shares of restricted stock, stock appreciation rights, phantom stock awards and performance awards on substantially similar terms. A total of 199,500 options and 505,709 shares of restricted stock have been granted under the 2004 Plan as of December 31, 2011. Options to purchase a total of 179,500 shares of common stock of Bancshares granted under the 2004 Plan were outstanding at December 31, 2011, of which 78,000 were exercisable. At December 31, 2011, 402,533 shares of restricted stock were outstanding and subject to forfeiture restrictions. Remaining shares available for grant under the 2004 Plan totaled 544,791 at December 31, 2011.

On April 1, 2006, the Company acquired SNB Bancshares, Inc. The options to purchase shares of SNB Bancshares, Inc. common stock outstanding at the effective time of the transaction were converted into options to purchase a total of 467,578 shares of Bancshares common stock at exercise prices ranging from \$8.15 to \$17.63 per share. The converted options are governed by the original plan under which they were issued. Options to purchase a total of 11,698 shares of common stock of Bancshares granted under the 2004 Plan were outstanding and exercisable at December 31, 2011.

Stock options are issued at the current market price on the date of the grant, subject to a pre-determined vesting period with a contractual term of 10 years. Options assumed in connection with acquisitions have

Table of Contents**Index to Financial Statements**

contractual terms as established in the original option grant agreements entered into prior to acquisition. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

The fair value of options was estimated using an option-pricing model with the following weighted average assumptions:

	2011	December 31, 2010	2009
Expected life in years	5.30	5.19	5.12
Risk free interest rate	3.67%	3.82%	3.94%
Volatility ⁽¹⁾	20.98%	21.12%	21.25%
Dividend yield	1.25%	1.23%	1.25%

(1) Volatility is a measure of fluctuations in the Company's share price.

A summary of changes in outstanding vested and unvested options during the three year period ended December 31, 2011 is set forth below:

	Number of Options (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (In thousands)
Options outstanding, January 1, 2009	917	\$ 24.58		
Options granted	72	30.64		
Options forfeited	(20)	28.40		
Options exercised	(113)	17.86		
Options outstanding, December 31, 2009	856	\$ 25.88	4.97	\$ 12,481
Options granted				
Options forfeited	(19)	25.68		
Options exercised	(141)	19.16		
Options outstanding, December 31, 2010	696	\$ 27.24	4.48	\$ 8,374
Options granted				
Options forfeited				
Options exercised	(171)	24.48		
Options outstanding, December 31, 2011	525	\$ 28.18	3.88	\$ 6,391
Options vested or expected to vest, December 31, 2011	509	\$ 27.90	3.84	\$ 6,342
Options vested, December 31, 2011	348	\$ 27.07	3.10	\$ 4,617

The total intrinsic value of the options exercised during the year ended December 31, 2011 and 2010 was \$2.7 million and \$2.8 million, respectively. The total fair value of shares vested during the year ended December 31, 2011 was \$903,000. There were no forfeitures for the year ended December 31, 2011.

Table of Contents

Index to Financial Statements

A summary of changes in unvested options during the three year period ended December 31, 2011 is set forth below:

	Number of Options (In thousands)	Weighted Average Grant Date Fair Value
Unvested options outstanding, January 1, 2009	529	\$ 6.83
Options granted	72	6.31
Unvested options forfeited	(15)	6.98
Options vested	(210)	6.63
Unvested options outstanding, December 31, 2009	376	\$ 6.78
Options granted		
Unvested options forfeited	(17)	6.75
Options vested	(46)	5.98
Unvested options outstanding, December 31, 2010	313	\$ 6.89
Options granted		
Unvested options forfeited		
Options vested	(136)	6.67
Unvested options outstanding, December 31, 2011	177	\$ 6.96

The Company received \$4.2 million, \$2.7 million and \$2.0 million in cash from the exercise of stock options during the years ended December 31, 2011, 2010 and 2009, respectively. There was no tax benefit realized from exercises of the stock-based compensation arrangements during the years ended December 31, 2011 and 2010.

As of December 31, 2011, there was \$9.1 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 1.9 years.

The following table presents information relating to the Company's stock options outstanding at December 31, 2011:

Range of Exercise Prices	Number Outstanding	Options Outstanding Weighted Average Exercise Price	Weighted Average Remaining Life (years)	Options Exercisable Number Outstanding	Weighted Average Exercise Price
\$ 0.00 - \$ 5.00		\$			\$
\$ 5.01 - \$10.00	1,534	8.15	0.92	1,534	8.15
\$10.01 - \$15.00					
\$15.01 - \$20.00	10,164	17.63	2.65	10,164	17.63
\$20.01 - \$25.00	27,500	23.75	3.16	23,750	23.64
\$25.01 - \$30.00	363,814	27.42	3.03	275,514	27.46
\$30.01 - \$35.00	122,000	32.26	6.25	36,750	32.63
	525,012	\$ 28.18	3.88	347,712	\$ 27.07

Table of Contents**Index to Financial Statements****13. OTHER NONINTEREST INCOME AND EXPENSE**

Other noninterest income and expense totals are presented in the following tables. Components of these totals exceeding 1% of the aggregate of total net interest income and total noninterest income for any of the years presented and other amounts the Company elected to present are stated separately.

	Years Ended December 31,		
	2011	2010	2009
	(Dollars in thousands)		
Other noninterest income			
Banking related service fees	\$ 2,184	\$ 2,166	\$ 2,009
Brokered mortgage	211	205	305
Income from leased assets	51	294	318
BOLI	1,382	1,658	1,344
Net (losses) gains on sales of assets	(1,108)	(3,860)	839
Rental	1,424	1,285	1,154
Other	2,085	1,835	2,386
Total	\$ 6,229	\$ 3,583	\$ 8,355
Other noninterest expense			
Communications	\$ 6,946	\$ 7,781	\$ 8,466
Ad valorem and franchise taxes	3,823	3,947	3,561
Printing and supplies	1,807	1,951	2,250
Travel and development	1,539	1,691	1,749
Professional fees	2,598	3,099	4,419
Other real estate	1,501	3,483	3,205
Other	7,186	7,919	8,331
Total	\$ 25,400	\$ 29,871	\$ 31,981

14. PROFIT SHARING PLAN

The Company has adopted a profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code whereby the participants may contribute a percentage of their compensation as permitted under the Code. Matching contributions are made at the discretion of the Company. Presently, the Company matches 50% of an employee's contributions, up to 15% of such employee's compensation, not to exceed the maximum allowable pursuant to the Internal Revenue Code and excluding catch-up contributions. Such matching contributions were approximately \$1.8 million, \$2.0 million and \$1.9 million for the years ended December 31, 2011, 2010 and 2009, respectively.

Table of Contents**Index to Financial Statements****15. OFF-BALANCE SHEET ARRANGEMENTS, COMMITMENTS AND CONTINGENCIES**

The following table summarizes the Company's contractual obligations and other commitments to make future payments as of December 31, 2011 (other than deposit obligations and securities sold repurchase agreements). The Company's future cash payments associated with its contractual obligations pursuant to its junior subordinated debentures, FHLB notes payable and operating leases as of December 31, 2011 are summarized below. Payments for junior subordinated debentures include interest of \$54.6 million that will be paid over the future periods. The future interest payments were calculated using the current rate in effect at December 31, 2011. The current principal balance of the junior subordinated debentures at December 31, 2011 was \$85.1 million. Payments for FHLB notes payable include interest of \$3.5 million 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	Payments due in: 3 years or more but less than 5 years (Dollars in thousands)	5 years or more	Total
Junior subordinated debentures	\$ 2,506	\$ 5,012	\$ 5,012	\$ 127,149	\$ 139,679
Federal Home Loan Bank notes payable	1,548	3,258	3,456	8,002	16,264
Operating leases	5,219	7,727	3,125	517	16,588
Total.	\$ 9,273	\$ 15,997	\$ 11,593	135,668	\$ 172,531

Off-Balance Sheet Items

In the normal course of business, the Company enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, 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 period as of December 31, 2011 are summarized below.

	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years (Dollars in thousands)	5 years or more	Total
Standby letters of credit	\$ 10,573	\$ 4,020	\$ 55	\$	\$ 14,648
Commitments to extend credit	286,574	32,754	11,513	118,128	448,969
Total	\$ 297,147	\$ 36,774	\$ 11,568	\$ 118,128	\$ 463,617

Standby Letters of Credit. Standby letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Company would be entitled to seek recovery from the customer. The Company's policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

Commitments to Extend Credit. The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Company's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit

Table of Contents**Index to Financial Statements**

risk associated with certain commitments to extend credit in determining the level of the allowance for credit losses. Since many of the commitments are expected to expire without being fully drawn upon, the total commitment amounts disclosed above do not necessarily represent future cash funding requirements. At December 31, 2011, \$80.0 million of commitments to extend credit have fixed rates ranging from 1.60% to 18.00%.

The Company evaluates customer creditworthiness on a case-by-case basis. The amount of collateral obtained, if considered necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer.

Leases The following table presents a summary of non-cancelable future operating lease commitments as of December 31, 2011 (dollars in thousands):

2012	\$ 5,219
2013	4,374
2014	3,353
2015	2,046
2016	1,079
Thereafter	517
Total	\$ 16,588

It is expected that in the normal course of business, expiring leases will be renewed or replaced by leases on other property or equipment.

Rent expense under all noncancelable operating lease obligations aggregated approximately \$5.2 million for the year ended December 31, 2011, \$5.3 million for the year ended December 31, 2010 and \$5.1 million for the year ended December 31, 2009.

Litigation The Company has been named as a defendant in various legal actions arising in the normal course of business. In the opinion of management, after reviewing such claims with outside counsel, resolution of such matters will not have a materially adverse impact on the consolidated financial statements.

16. REGULATORY MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Any institution that fails to meet its minimum capital requirements is subject to actions by regulators that could have a direct material effect on the Company's financial statements. Under the capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines based on the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and the Bank's classification under the regulatory framework for prompt corrective action are also subject to qualitative judgments by the regulators about the components, risk weightings and other factors.

To meet the capital adequacy requirements, the Company and the Bank must maintain minimum capital amounts and ratios as defined in the regulations. As of December 31, 2011, the Company and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2011, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the table. There have been no conditions or events since that notification which management believes have changed the Bank's category.

Table of Contents**Index to Financial Statements**

The following is a summary of the Company's and the Bank's capital ratios at December 31, 2011 and 2010:

	Actual Amount	Ratio	For Capital Adequacy Purposes Amount (Dollars in thousands)	Ratio	To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions Amount	Ratio
CONSOLIDATED:						
As of December 31, 2011						
Total Capital (to Risk Weighted Assets)	\$ 744,910	17.09%	\$ 348,567	8.00%	N/A	N/A
Tier I Capital (to Risk Weighted Assets)	693,315	15.90	174,284	4.00	N/A	N/A
Tier I Capital (to Average Tangible Assets)	693,315	7.89	263,518	3.00	N/A	N/A
As of December 31, 2010						
Total Capital (to Risk Weighted Assets)	\$ 626,087	14.87%	\$ 336,901	8.00%	N/A	N/A
Tier I Capital (to Risk Weighted Assets)	574,503	13.64	168,451	4.00	N/A	N/A
Tier I Capital (to Average Tangible Assets)	574,503	6.87	251,044	3.00	N/A	N/A
PROSPERITY BANK® ONLY:						
As of December 31, 2011						
Total Capital (to Risk Weighted Assets)	\$ 731,732	16.81%	\$ 348,096	8.00%	\$ 435,120	10.00%
Tier I Capital (to Risk Weighted Assets)	680,138	15.62	174,048	4.00	261,072	6.00
Tier I Capital (to Average Tangible Assets)	680,138	7.75	263,342	3.00	438,904	5.00
As of December 31, 2010						
Total Capital (to Risk Weighted Assets)	\$ 613,796	14.60%	\$ 336,418	8.00%	\$ 405,208	10.00%
Tier I Capital (to Risk Weighted Assets)	562,212	13.37	168,209	4.00	243,125	6.00
Tier I Capital (to Average Tangible Assets)	562,212	6.72	250,863	3.00	394,991	5.00

Dividends paid by Bancshares and the Bank are subject to restrictions by certain regulatory agencies. Dividends paid by Bancshares during the years ended December 31, 2011, 2010 and 2009 were \$33.7 million, \$29.8 million and \$26.2 million, respectively. Dividends paid by the Bank to Bancshares during the years ended December 31, 2011, 2010 and 2009 were \$35.8 million, \$27.4 million and \$24.5 million, respectively.

17. JUNIOR SUBORDINATED DEBENTURES

At December 31, 2011 and 2010, the Company had outstanding \$85.1 million and \$92.3 million in junior subordinated debentures issued to the Company's unconsolidated subsidiary trusts, respectively. On March 7, 2011, the Company redeemed \$7.2 million in junior subordinated debentures held by TXUI Statutory Trust I that bore a fixed interest rate of 10.60%. A penalty of \$383,000 was incurred in connection with the payoff and recorded as interest expense.

Table of Contents**Index to Financial Statements**

A summary of pertinent information related to the Company's seven issues of junior subordinated debentures outstanding at December 31, 2011 is set forth in the table below:

Description	Issuance Date	Trust Preferred Securities Outstanding	Interest Rate ⁽¹⁾	Junior Subordinated Debt Owed to Trusts	Maturity Date ⁽²⁾
Prosperity Statutory Trust II	July 31, 2001	\$ 15,000,000	3 month LIBOR + 3.58%, not to exceed 12.50%	\$ 15,464,000	July 31, 2031
Prosperity Statutory Trust III	Aug. 15, 2003	12,500,000	3 month LIBOR + 3.00%	12,887,000	Sept. 17, 2033
Prosperity Statutory Trust IV	Dec. 30, 2003	12,500,000	3 month LIBOR + 2.85%	12,887,000	Dec. 30, 2033
SNB Capital Trust IV ⁽³⁾	Sept. 25, 2003	10,000,000	3 month LIBOR + 3.00%	10,310,000	Sept. 25, 2033
TXUI Statutory Trust II ⁽⁴⁾	Dec. 19, 2003	5,000,000	3 month LIBOR + 2.85%	5,155,000	Dec. 19, 2033
TXUI Statutory Trust III ⁽⁴⁾	Nov. 30, 2005	15,500,000	3 month LIBOR + 1.39%	15,980,000	Dec. 15, 2035
TXUI Statutory Trust IV ⁽⁴⁾	Mar. 31, 2006	12,000,000	3 month LIBOR + 1.39%	12,372,000	June 30, 2036

\$ 85,055,000

(1) The 3-month LIBOR in effect as of December 31, 2011 was 0.581%.

(2) All debentures are callable five years from issuance date.

(3) Assumed in connection with the SNB acquisition on April 1, 2006.

(4) Assumed in connection with the TXUI acquisition on January 31, 2007.

Each of the trusts is a capital or statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds in the Company's junior subordinated debentures. The preferred trust securities of each trust represent preferred beneficial interests in the assets of the respective trusts and are subject to mandatory redemption upon payment of the junior subordinated debentures held by the trust. The common securities of each trust are wholly owned by the Company. Each trust's ability to pay amounts due on the trust preferred securities is solely dependent upon the Company making payment on the related junior subordinated debentures. The debentures, which are the only assets of each trust, are subordinate and junior in right of payment to all of the Company's present and future senior indebtedness. The Company has fully and unconditionally guaranteed each trust's obligations under the trust securities issued by such trust to the extent not paid or made by each trust, provided such trust has funds available for such obligations.

Under the provisions of each issue of the debentures, the Company has the right to defer payment of interest on the debentures at any time, or from time to time, for periods not exceeding five years. If interest payments on either issue of the debentures are deferred, the distributions on the applicable trust preferred securities and common securities will also be deferred.

Table of Contents**Index to Financial Statements****18. PARENT COMPANY ONLY FINANCIAL STATEMENTS****PROSPERITY BANCSHARES, INC.****(Parent Company Only)****CONDENSED BALANCE SHEETS**

	December 31,	
	2011	2010
	(Dollars in thousands)	
ASSETS		
Cash	\$ 1,209	\$ 1,158
Investment in subsidiary	1,635,199	1,525,610
Investment in capital and statutory trusts	2,555	2,765
Goodwill	3,982	3,982
Other assets	9,954	11,891
TOTAL	\$ 1,652,899	\$ 1,545,406
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Accrued interest payable and other liabilities	\$ 579	\$ 802
Junior subordinated debentures	85,055	92,265
Total liabilities	85,634	93,067
SHAREHOLDERS' EQUITY:		
Common stock	46,947	46,721
Capital surplus	883,575	876,050
Retained earnings	623,878	515,871
Unrealized gain on available for sale securities, net of tax benefit	13,472	14,304
Less treasury stock, at cost, 37,088 shares	(607)	(607)
Total shareholders' equity	1,567,265	1,452,339
TOTAL	\$ 1,652,899	\$ 1,545,406

Table of Contents**Index to Financial Statements****PROSPERITY BANCSHARES, INC.****(Parent Company Only)****CONDENSED STATEMENTS OF INCOME**

	For the Years Ended December 31,		
	2011	2010	2009
	(Dollars in thousands)		
OPERATING INCOME:			
Dividends from subsidiaries	\$ 35,800	\$ 27,400	\$ 24,500
Other income	142	150	164
Total income	35,942	27,550	24,664
OPERATING EXPENSE:			
Junior subordinated debentures interest expense	2,984	3,250	3,760
Stock-based compensation expense (includes restricted stock)	3,576	3,037	1,515
Other expenses	404	358	380
Total operating expense	6,964	6,645	5,655
INCOME BEFORE INCOME TAX BENEFIT AND EQUITY IN UNDISTRIBUTED EARNINGS OF SUBSIDIARIES			
	28,978	20,905	19,009
FEDERAL INCOME TAX BENEFIT	2,350	2,191	1,792
INCOME BEFORE EQUITY IN UNDISTRIBUTED EARNINGS OF SUBSIDIARIES			
	31,328	23,096	20,801
EQUITY IN UNDISTRIBUTED EARNINGS OF SUBSIDIARIES	110,421	104,612	91,078
NET INCOME	\$ 141,749	\$ 127,708	\$ 111,879

Table of Contents**Index to Financial Statements****PROSPERITY BANCSHARES, INC.****(Parent Company Only)****CONDENSED STATEMENTS OF CASH FLOWS**

	For the Years Ended December 31,		
	2011	2010	2009
	(Dollars in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 141,749	\$ 127,708	\$ 111,879
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiaries	(110,421)	(104,612)	(91,078)
Stock based compensation expense (includes restricted stock)	3,576	3,037	1,515
Decrease (increase) in other assets	2,147	1,620	(3,751)
Decrease in accrued interest payable and other liabilities	(223)	(8)	(140)
Net cash provided by operating activities	36,828	27,745	18,425
CASH FLOWS FROM INVESTING ACTIVITIES:			
Cash paid for acquisitions			
Cash acquired from acquisitions			
Net cash used in investing activities			
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from stock option exercises	4,175	2,696	2,026
Redemption of junior subordinated debentures (net)	(7,210)		
Payments of cash dividends	(33,742)	(29,845)	(26,234)
Net cash used in financing activities	(36,777)	(27,149)	(24,208)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	51	596	(5,783)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	1,158	562	6,345
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 1,209	\$ 1,158	\$ 562

19. SUBSEQUENT EVENTS AND RECENT ACQUISITIONS

Pending Acquisition of American State Financial Corporation On February 27, 2012, the Company announced the signing of a definitive agreement to acquire American State Financial Corporation and its wholly owned subsidiary, American State Bank (ASB), through the merger of American State Financial with and into the Company. ASB operates thirty-seven (37) banking offices in eighteen (18) counties across West Texas. As of December 31, 2011, American State Financial, on a consolidated basis, reported total assets of \$3.08 billion, total loans of \$1.21 billion and total deposits of \$2.46 billion. Under the terms of the definitive agreement, the Company will issue up to 8,525,000 shares of its common stock plus \$178.5 million in cash for all outstanding shares of American State Financial capital stock, subject to certain conditions and potential adjustment.

The merger has been approved by the Boards of Directors of both companies and is expected to close during the third quarter of 2012, although delays may occur. The transaction is subject to certain conditions, including the approval by American State Financial's shareholders and customary regulatory approvals. Operational integration is anticipated to begin during the third quarter of 2012.

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Pending Acquisition of The Bank Arlington On January 19, 2012, the Company entered into a definitive agreement to acquire The Bank Arlington. The Bank Arlington operates one banking office in Arlington, Texas, in the Dallas/Fort Worth CMSA. As of December 31, 2011, The Bank Arlington reported total assets of \$37.3 million, total loans of \$21.2 million and total deposits of \$32.8 million.

Table of Contents

Index to Financial Statements

Under the terms of the definitive agreement, the Company will issue up to 138,600 shares of Company common stock for all outstanding shares of The Bank Arlington capital stock, subject to certain conditions and potential adjustments. The transaction is subject to customary closing conditions, including the receipt of regulatory approvals and approval of the shareholders of The Bank Arlington. The transaction is expected to close during the second quarter of 2012, although delays could occur.

Pending Acquisition of East Texas Financial Services, Inc. On December 8, 2011, the Company entered into a definitive agreement to acquire East Texas Financial Services, Inc. (OTC BB: FFBT) and its wholly-owned subsidiary, First Federal Bank Texas (Firstbank). First Bank operates four banking offices in the Tyler MSA, including three locations in Tyler, Texas and one location in Gilmer, Texas. As of December 31, 2011, East Texas Financial Services reported total assets of \$210.5 million, total loans of \$163.1 million and total deposits of \$126.7 million.

Under the terms of the definitive agreement, the Company will issue up to 531,000 shares of Company common stock for all outstanding shares of East Texas Financial Services capital stock, subject to certain conditions and potential adjustments. The transaction is subject to customary closing conditions, including the receipt of regulatory approvals and approval of the stockholders of East Texas Financial Services. The transaction is expected to close during the second quarter of 2012, although delays could occur.

Acquisition of Texas Bankers, Inc. On January 1, 2012, the Company completed the previously announced acquisition of Texas Bankers, Inc. and its wholly-owned subsidiary, Bank of Texas, Austin, Texas. The transaction continues the Company's strategic growth and expansion of the franchise in Central Texas.

The three Bank of Texas banking offices in the Austin, Texas CMSA consist of a location in Rollingwood, which upon operational integration will be consolidated with the Company's Westlake location and remain in Bank of Texas Rollingwood banking office; one banking center in downtown Austin, which upon operational integration will be consolidated into the Company's downtown Austin location; and another banking center in Thorndale. Following the acquisition, the Company operates thirty-four banking centers in the Central Texas area including Austin and San Antonio.

Texas Bankers, Inc. reported total assets of \$77.0 million, total loans of \$27.6 million and total deposits of \$70.4 million as of December 31, 2011. Under the terms of the agreement, the Company issued 314,953 shares of Company common stock for all outstanding shares of Texas Bankers capital stock which resulted in a premium of \$5.2 million.