

MGT 6090 Assignment 9

Hilltop Holdings Inc. Report

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Executive Summary

Hilltop Holdings is a bank holding company offering services in commercial banking, residential mortgage origination, and investment banking, through its three subsidiaries. This report analyzes market opinion, financial performance metrics, risk profile, and off-balance sheet activities to evaluate future profitability and financial stability of Hilltop Holdings.

Despite a down year in 2018, the market believes in Hilltop Holdings previous growth and ability to bounce back. Returns have recently performed well and both volatility measurements have been decreasing. Credit ratings are good, and analyst opinions are cautiously bullish, with mostly “Buy” or “Overweight” ratings.

Earnings (2018 excluded), net interest margin, and non-interest income, weighted by firm total assets, were consistently within the top percentiles compared to peer group firms (consolidated assets of at least \$10 billion), highlighted by an extremely strong non-interest income that consistently ranked above the 97th percentile. Having strong non-interest income sources helps provide diversification and financial stability. Despite a larger than average real estate loan asset composition, Hilltop Holdings has managed to maintain diversified liquidity and funding through relatively stronger presences in other areas such as “Time Deposits of \$250K or More” and “Federal Funds Purchased and Repos”. Capitalization ratios showcase a strong resilience to negative financial stress with a constant over 90th percentile Tier 1 leverage ratio and Tier 1 common capital ratio, as well as 70th percentile equity capital ratios. Since 2018, Hilltop Holdings has reported robust growth rates in noncore funding, net loans, and assets. Interest sensitivity analysis demonstrates a net interest income that is resilient to interest rate changes with a firm chance of strong profitability.

There are few significant risk factors for Hilltop Holdings that would make it stand out from its peers. Many of the risks are standard financial institution risks. The one increased risk is due to geographic concentration; as a significant portion of Hilltop Holdings business operations are conducted in Texas, the impacts of localized adverse effects could be magnified. With its two primary off-balance sheet activities, extending credit and standby letters of credit, Hilltop Holdings has slightly larger credit risk.

This report finds that Hilltop Holdings has a steady base for financial stability with solid future growth potential. Hilltop Holdings has a history of robust performance and has rebounded well from its 2018 dip.

1 Introduction

Hilltop Holdings Inc. is a financial holding company based out of Texas, and as of March 31 2020, the 104th largest holding company in the United States with reported total assets of about \$15.7 billion.¹ It's traded on the New York Stock Exchange under the ticker HTH and is currently also a component of the Russell 2000 index. Through its three subsidiaries PlainsCapital Bank, PrimeLending, and Hilltop Securities, Hilltop Holdings offers a variety of financial services. These consist of standard commercial and consumer banking, residential mortgage origination, and municipal investment banking, which is further split into public finance municipal advisory, wealth management, fixed income capital markets, and structured finance/debt capital markets.²

2 Ownership

As seen in Table 1, about 24% of all shares are held by insiders and 63% by institutions. Nearly 80% of floating stock is held by institutions as well. Table 2 and Table 4 show the top institutional and insider holders of HTH, respectively. Quite a few high profile investment companies and asset managers hold large amounts of Hilltop Holdings stock. This high amount of insider and institutional ownership could indicate strong optimism for future growth of HTH stock. Alternatively, as Hilltop Holdings is not a prevalent firm in modern popular culture, it is not surprising that it's non-institutional and non-insider ownership is a much lower 13.03%. Insider HTH stock purchases in the last 6 months have largely outweighed insider HTH stock sales in the last 6 months (shown in Table 3). With fourteen times more buying transactions than selling transactions and overall twice as many shares purchased than sold, it seems insiders are also bullish on HTH stock.

3 Market Opinion

Looking at compounded Hilltop Holdings returns versus market returns over the last 10 years in Figure 1, HTH has performed at around market level except in 2018 where there was a brief but sustained period of loss. Since 2018, HTH has rebounded with a strong stock performance. The monthly trailing 12 month beta for HTH in Figure 2 shows several periods of large turbulence and volatility in the last 10 years, though since late 2019, this has leveled off quite a bit. The monthly trailing 12 month annualized volatility in Figure 3 shows some

periods of high volatility that have since dropped off as well. Table 5 presents bi-monthly short interest and short ratio information; in the last year, short interest peaked in June and July. This peak could have come from investor sentiments around the Q2 2020 earnings which were reported on July 30. Fitch ratings for Hilltop Holdings shown in Table 6 give a long term credit rating of **BBB** and short term credit rating of **F2**. The default risk for HTH is low, with an intermediate vulnerability to adverse business or economic circumstances, and has good chance for timely payments for immediate financial commitments. Analyst opinion on Hilltop Holdings, displayed in Table 7, are carefully optimistic; HTH has a several overweight and buy ratings.

4 Performance and Financial Position

A variety of financial metrics portray Hilltop Holdings to be in a strong position to succeed. Figure 4 shows earnings for Hilltop Holdings as a percent of average assets for each fiscal year. Compared to its industry peer group, firms with consolidated assets of at least \$10 billion each year, Hilltop Holdings has almost frequently been in the top percentiles for earnings as a percent of average assets. There was a notable down year in 2018, but it responded strongly in 2019, reporting strong earnings in the 90th percentile, significantly outperforming many peers. Net interest margin as a percent of average assets for Hilltop Holdings and its peers is reported in Figure 5. Once again, Hilltop Holdings has consistently been an above average performer. Even the 2018 down year shows an above average net interest margin compared to peers. Hilltop Holdings' non-interest income, shown in Figure 6, is a strong part of its portfolio, consistently reported above 7.5% of average assets and above the 97th percentile in the last five years compared to its peers. This diversity can help protect HTH profit margins against possible future adverse economic conditions. In Figure 7, HTH revenue as a percent of average assets is shown. This asset turnover ratio of over 12% each year is a very strong value for a bank holding company.

The Hilltop Holdings' loan mix is shown in Figure 8. Around 70% each year over the last five years is real estate loans. Two of the three HTH subsidiaries, PlainsCapital Bank and PrimeLending, both offer real estate loans, with the latter specifically specializing in home lending as a nationwide mortgage originator. While this is a much higher real estate loan percentage than most peers, more loan diversity is introduced in the "Other loans and leases" category, where Hilltop Holdings has a larger stake than its peers.³ Hilltop Holdings has done

well with managing loan and lease loss as well. This is indicated in Figures 9, 10, and 11, showing information about Hilltop Holdings' loan losses and allowances. Aside from fiscal year 2016, HTH has managed to have a less-than-average net loan and lease loss to average loan and lease ratio. This is in line with the HTH allowance for loan and lease losses; given their previous data with loan and lease loss, Hilltop Holdings has had small allowances for loan and lease loss every year.

Figure 12 exhibits Hilltop Holdings' liquidity and funding avenues as percents of total assets. While the majority is still comprised of loans and leases and core deposits, these percents are smaller than those of its peer group. And as previously discussed, of these loans, real estate loans play a large part in overall bank performance. Another notable difference seen in the bank report from peers is a relatively small amounts of investment securities, ranging from the 10th to 15th percentile the last five years. These differences are offset by "Time Deposits of \$250K or more" and "Federal Funds Purchased and Repos", both of which HTH has had around 5% of total assets, and around the 80th percentile compared to peers.³ Hilltop Holdings has a very diverse set of funding and liquidity through its various business interests.

Capitalization ratios and growth rates presented in Figures 13 and 14 also show positive indicators for Hilltop Holdings future. Its Tier 1 leverage ratio is consistently high, having been in the 90th percentile compared to peers for each of the last 5 years. The HTH "Common Equity Tier 1 Capital / Total Risk-Weighted Assets" or Tier 1 common capital ratio also ranks very high, though most recently coming in at the 91st percentile, a few short of its Tier 1 leverage ratio. Given these, Hilltop Holdings is well-capitalized firm that is in a very strong position to withstand any financial stress and sudden negative effects to its balance sheet. Its other overall equity capital ratios are around 15% of total assets, which is about the 70th percentile in fiscal year 2019, so HTH is able effectively fund all asset requirements without taking on too much debt. Its low net loans and leases to equity capital ratio means there is not a lot of risk of defaults in the future. Hilltop Holdings is still expanding its growth and operations, so a lower dividend payout ratio is to be expected as well. The aforementioned 2018 dip is very notable in its growth rates, with all four measurements bottoming out. However, Hilltop Holdings has responded well, posting incredibly high percentile growth compared to peers in all categories except equity capital which it still underwent average growth.

Next, Figures 15 and 16 display Hilltop Holdings asset and liability composition. As pre-

viously discussed, Hilltop Holdings large real estate loan holdings in its asset composition being higher than most other firms is expected, given two out of its three subsidiaries are heavily involved in the field. Commercial and industrial loans and loans to individuals are on the lower side, the former ranging from 8-9% and the latter around 0.25%. Other unspecified assets (“All Other Assets” in figure) make up a large part of HTH assets as well, making up about 20% of all assets. Although a significant portion is in real estate loans, Hilltop Holdings still has a well diversified asset composition. Looking at liabilities, demand deposits and “MMDA and Other Savings Accounts” were the two largest liabilities until 2017, when the former drastically decreased and the latter drastically increased. Aside from this recent change, Hilltop Holdings has a fairly standard liability composition.

In Table 8 and Table 9, Hilltop Holdings maturity gap and interest sensitivity analysis are displayed. Loans make up a large majority of the interest sensitive assets, and largely outweigh securities aside from assets maturing in over five years. Liabilities are largely comprised of interest bearing checking and time deposits. Notes payable and other borrowing are also prominent for liabilities due in 3 months or less. Maturity gap increases for the time and interest sensitive assets as the time to maturity increases. Interest sensitivity analysis shows that the net interest income is very resilient and profitable. An interest increase of 100 basis points would increase net income by 4.2% while, a decrease of 100 basis points would only decrease net income by 0.49%. Economic value of equity is a more susceptible to decrease in interest rates.

5 Risk Profile

There are several risk factors in the Hilltop Holdings business model. Given how much of the asset composition is comprised of loans, credit risk is always an issue; if allowance for loan and lease losses is insufficient in upcoming years, future earnings will be negatively impacted. In addition, loans and fixed income securities can be affected by potential changes in interest rates or exchange rates, bringing about two types of risk. Interest rate risk can affect maturity transformation and maturity gap as well as introduce market risk, if assets or liabilities prices are affected by the changing interest rate. Similarly, given that a large part of HTH assets are real estate loans, changes in the real estate industry could drastically affect future earnings. Operational risk also exist. Cybersecurity is incredibly important; breaches in operational systems could lead to confidential information being stolen, which

has a multitude of consequences ranging from damage to reputation and regulatory penalties. Since a large portion of business is done in Texas, geographic concentration heightens any risk from natural disasters. With letters of credit and commitments to extend credit, some off-balance sheet risk exists as well, although these risks are fairly similar to general credit risk. Finally, as a bank holding company with three other financial subsidiaries taking part in many financial services, there is always some element of regulatory risk at play.⁴

6 Off-Balance Sheet

Hilltop Holdings has two major off-balance sheet arrangements: commitments to extend credit and standby letters of credit. These are provided to help customers with financing. As of December 31, 2019, there were “outstanding unused commitments to extend credit of \$2.1 billion ... and outstanding financial and performance standby letters of credit of \$90.9 million.”⁴ Derivative financial instruments are primarily comprised of interest rate swaps to limit exposure to interest rate risk. There are some other minor derivative instruments used on a smaller level to hedge certain assets and liabilities. Securitization occurs in some mortgage origination activities. Additionally, Level 1, Level 2, and Level 3 assets in the last two years are shown in Table 9. As previously mentioned, derivatives are a very small part and primarily used to help in other aspects.⁴

References

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- ⁶ MarketBeat. Hilltop Short Interest Ratio and Short Volume. <https://www.marketbeat.com/stocks/NYSE/HTH/short-interest>, September 2020.
- ⁷ Fitch Ratings. Fitch Affirms Hilltop Holdings' Long-Term IDR at 'BBB'; Outlook Stable Despite Coronavirus Impact. <https://www.fitchratings.com/research/banks/fitch-affirms-hilltop-holdings-long-term-idr-at-bbb-outlook-stable-despite-coronavirus-impact-04-05-2020>, May 2020.
- ⁸ MarketBeat. Hilltop Price Target, Predictions & Analyst Ratings. <https://www.marketbeat.com/stocks/NYSE/HTH/price-target>, August 2020.
- ⁹ Wharton Research Data Services. CRSP Monthly Stock. https://wrds-web.wharton.upenn.edu/wrds/ds/crsp/stock_a/msf.cfm?navId=128, January 2020.

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Ownership	Breakdown
% of Shares Held by All Insider	23.91
% of Shares Held by Institutions	63.06
% of Shares Held by Other	13.03
% of Float Held by Institutions	82.88
Number of Institutions Holding Shares	279.0

Table 1: HTH ownership structure. Data taken from Yahoo Finance.⁵ Table generated in Python.

Holder	Shares	% Out	Value
Vanguard Group, Inc. (The)	6908804	7.66	127467433
Dimensional Fund Advisors LP	5479123	6.07	101089819
Blackrock Inc.	4978234	5.52	91848417
Wellington Management Company, LLP	3946010	4.37	72803884
State Street Corporation	1837915	2.04	33909531
American Century Companies, Inc.	1685264	1.87	31093120
Westwood Holdings Group Inc.	1479345	1.64	27293915
Northern Trust Corporation	1256725	1.39	23186576
Norges Bank Investment Management	1130635	1.25	28186730
Geode Capital Management, LLC	1120243	1.24	20668483

Table 2: Top institutional holders. Data taken from Yahoo Finance website.⁵ Table generated in Python.

Last 6 Months	Shares	Transactions
Purchases	79163	28
Sales	32500	2
Net Shares Purchased (Sold)	46663	30
Total Insider Shares Held	21.58M	N/A
% Net Shares Purchased (Sold)	0.2	N/A

Table 3: Summary of insider transactions over the last 6 months. Data taken from Yahoo Finance website.⁵ Table generated in Python.

Date	Shares Sold Short	Dollar Volume Sold Short	Days to Cover
2020-09-30	1060000	\$22.77 million	2.3
2020-09-15	1300000	\$26.52 million	3.0
2020-08-31	1240000	\$24.12 million	3.1
2020-08-14	1240000	\$25.42 million	2.9
2020-07-31	1700000	\$34.70 million	3.6
2020-07-15	2060000	\$40.11 million	4.2
2020-06-30	2140000	\$39.57 million	4.2
2020-06-15	1690000	\$30.34 million	3.2
2020-05-29	1870000	\$32.65 million	2.9
2020-05-15	1960000	\$36.63 million	2.9
2020-04-30	1970000	\$37.41 million	3.1
2020-04-15	1900000	\$29.74 million	3.0
2020-03-31	1750000	\$28.75 million	2.9
2020-03-13	1938600	\$33.58 million	4.0
2020-02-28	970700	\$13.57 million	2.0
2020-02-14	855700	\$17.45 million	2.1
2020-01-31	787000	\$16.66 million	1.9
2020-01-15	812900	\$18.35 million	2.0
2019-12-31	713600	\$17.17 million	1.8
2019-08-15	1456900	\$33.55 million	3.3

Table 4: Bi-monthly short interest and short ratio. Data taken from MarketBeat website.⁶ Table generated in Python.

Rated Entity / Debt	Rating Type	Rating	Date
Hilltop Holdings, Inc.	Long Term Issuer Default Rating	BBB Rating Outlook Stable	2020-05-04
Hilltop Holdings, Inc.	Short Term Issuer Default Rating	F2	2020-05-04
Hilltop Holdings, Inc.	Support Rating	5	2020-05-04
Hilltop Holdings, Inc.	Support Rating Floor	NF	2020-05-04
Hilltop Holdings, Inc.	Viability Rating	bbb	2020-05-04

Table 5: Hilltop Holdings Fitch ratings. Data taken from Fitch Ratings website.⁷ Table generated in Python.

Date	Brokerage	Action	Rating	Price Target
2020-08-14	Stephens	Upgrade	Equal Weight → Overweight	24
2020-05-19	SunTrust Banks	Boost Price Target	Buy	19.00→20.00
2019-08-29	Raymond James	Upgrade	Market Perform → Outperform	26
2019-03-28	Piper Jaffray Companies	Upgrade	Neutral → Overweight	21
2019-01-28	Compass Point	Reiterated Rating	Buy → Buy	25.00→21.50

Table 6: Hilltop Holdings analyst ratings. Data taken from MarketBeat website.⁸ Table generated in Python.

	December 31, 2019					Total
	3 Months or Less	> 3 Months to 1 Year	> 1 Year to 3 Years	> 3 Years to 5 Years	> 5 Years	
<u>Interest sensitive assets:</u>						
Loans	\$ 5,263,406	\$ 1,216,672	\$ 1,569,875	\$ 473,252	\$ 124,009	\$ 8,647,214
Securities	164,723	120,447	330,098	296,842	386,314	1,298,424
Federal funds sold and securities purchased under agreements to resell	394	—	—	—	—	394
Other interest sensitive assets	263,663	—	—	—	29,282	292,945
Total interest sensitive assets	5,692,186	1,337,119	1,899,973	770,094	539,605	10,238,977
<u>Interest sensitive liabilities:</u>						
Interest bearing checking	\$ 4,300,208	\$ —	\$ —	\$ —	\$ —	\$ 4,300,208
Savings	199,076	—	—	—	—	199,076
Time deposits	559,324	624,567	292,048	59,914	—	1,535,853
Notes payable and other borrowings	707,670	3,375	3,733	3,830	22,834	741,442
Total interest sensitive liabilities	5,766,278	627,942	295,781	63,744	22,834	6,776,579
Interest sensitivity gap	\$ (74,092)	\$ 709,177	\$ 1,604,192	\$ 706,350	\$ 516,771	\$ 3,462,398
Cumulative interest sensitivity gap	\$ (74,092)	\$ 635,085	\$ 2,239,277	\$ 2,945,627	\$ 3,462,398	
Percentage of cumulative gap to total interest sensitive assets	(0.72)%	6.20 %	21.87 %	28.77 %	33.82 %	

Table 7: Hilltop Holdings interest sensitivity gap. Data and table adapted from Hilltop Holdings 10-K.⁴

Change in Interest Rates (basis points)	Changes in Net Interest Income		Changes in Economic Value of Equity	
	Amount	Percent	Amount	Percent
+200	\$ 30,261	8.60 %	\$ 274,752	15.43 %
+100	\$ 14,776	4.20 %	\$ 161,765	9.08 %
-50	\$ (1,466)	(0.42)%	\$ (119,377)	(6.70)%
-100	\$ (1,730)	(0.49)%	\$ (295,657)	(16.60)%

Table 8: Hilltop Holdings interest sensitivity analysis. Data and table adapted from Hilltop Holdings 10-K.⁴

December 31, 2019	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	\$ —	\$ 689,576	\$ —	\$ 689,576
Available for sale securities	—	998,392	—	998,392
Equity securities	20,007	—	—	20,007
Loans held for sale	—	1,868,518	67,195	1,935,713
Derivative assets	—	33,129	—	33,129
MSR asset	—	—	55,504	55,504
Securities sold, not yet purchased	29,080	14,737	—	43,817
Derivative liabilities	—	17,140	—	17,140
December 31, 2018	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading securities	\$ 7,947	\$ 737,519	\$ —	\$ 745,466
Available for sale securities	—	875,658	—	875,658
Equity securities	19,679	—	—	19,679
Loans held for sale	—	1,207,311	50,464	1,257,775
Derivative assets	—	35,010	—	35,010
MSR asset	—	—	66,102	66,102
Securities sold, not yet purchased	33,000	48,667	—	81,667
Derivative liabilities	—	26,355	—	26,355

Table 9: Hilltop Holdings Level 1, Level 2, and Level 3 assets. Values are in thousands. Data and table adapted from Hilltop Holdings 10-K.⁴

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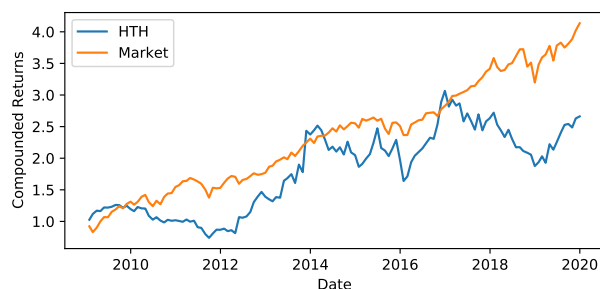


Figure 1: Compounded HTH and market returns over the last 10 years. Data adapted from CRSP monthly data.⁹ Figure generated in Python.

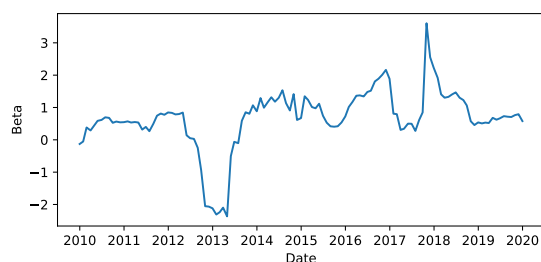


Figure 2: Monthly trailing 12 month beta over the last 10 years. Data adapted from CRSP monthly data.⁹ Figure generated in Python.

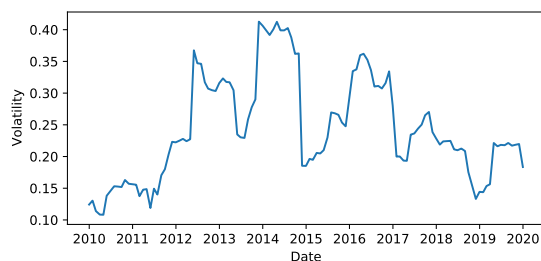


Figure 3: Monthly trailing 12 month annualized log return volatility over the last 10 years. Data adapted from CRSP monthly data.⁹ Figure generated in Python.

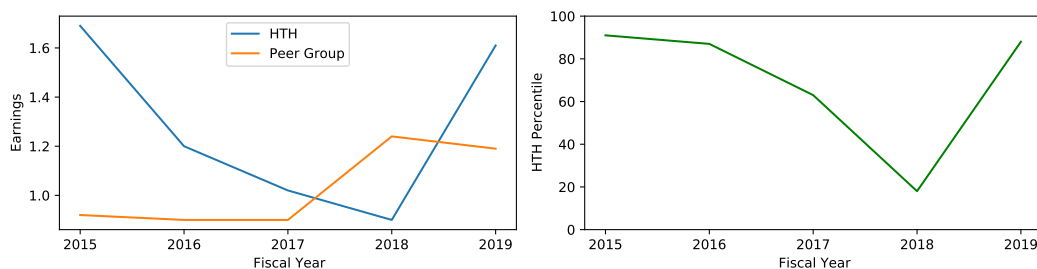


Figure 4: Earnings as a percent of average assets for Hilltop Holdings and its peer group average, as well as Hilltop Holdings earnings percentile. Peer group is firms with consolidated assets equal to or greater than \$10 billion. Data taken from FFIEC BHCPR.³ Figure generated in Python.

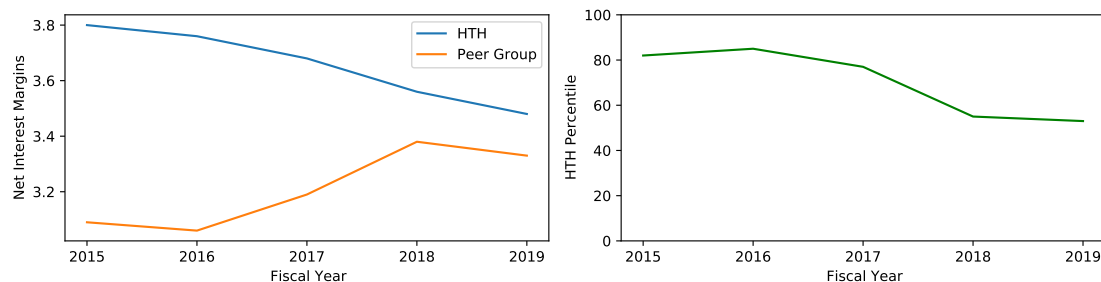


Figure 5: Net interest margins for Hilltop Holdings and its peer group average, as well as Hilltop Holdings net interest margin percentile. Peer group is firms with consolidated assets equal to or greater than \$10 billion. Data taken from FFIEC BHCPR.³ Figure generated in Python.

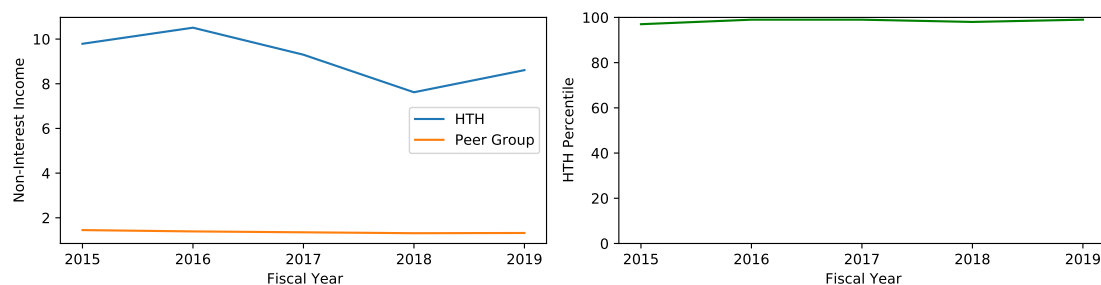


Figure 6: Non-interest income as a percent of average assets for Hilltop Holdings and its peer group average, as well as Hilltop Holdings non-interest income percentile. Peer group is firms with consolidated assets equal to or greater than \$10 billion. Data taken from FFIEC BHCPR.³ Figure generated in Python.

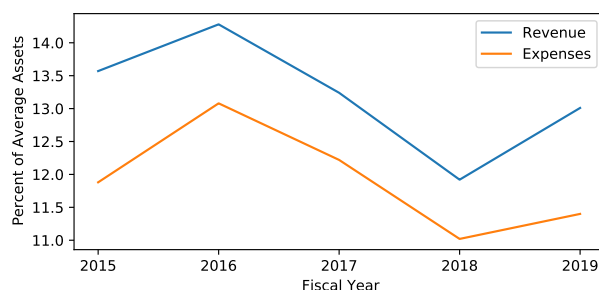


Figure 7: Revenue and expenses as percent of average assets for Hilltop Holdings. Data taken from FFIEC BHCPR.³ Figure generated in Python.

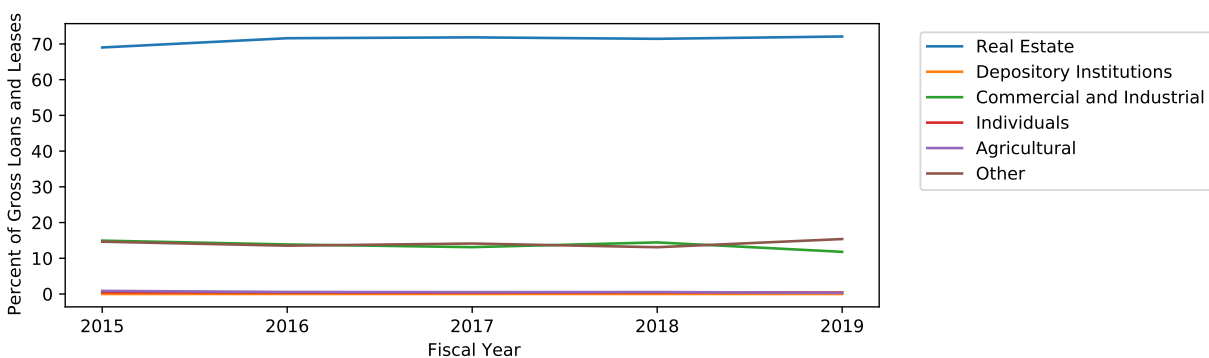


Figure 8: Loan mix for Hilltop Holdings. Each loan is reported as percent of gross loans and leases. Data taken from FFIEC BHCPR.³ Figure generated in Python.

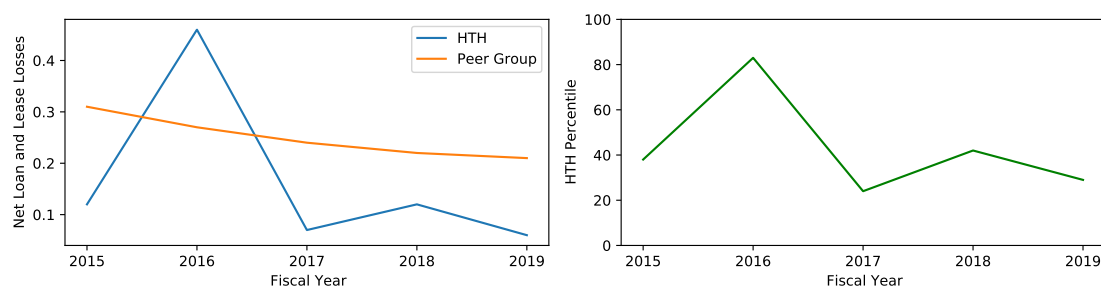


Figure 9: Net loan and lease losses over average loans and leases for Hilltop Holdings and its peer group average, as well as Hilltop Holdings net loan and lease losses percentile. Peer group is firms with consolidated assets equal to or greater than \$10 billion. Data taken from FFIEC BHCPR.³ Figure generated in Python.

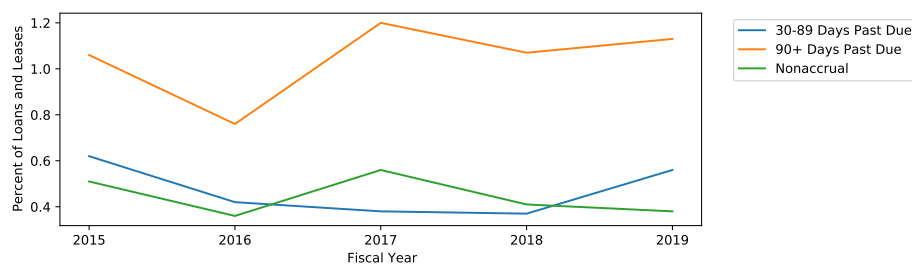


Figure 10: Past due loans and leases as percent of total loans and leases for Hilltop Holdings. Data taken from FFIEC BHCPR.³ Figure generated in Python.

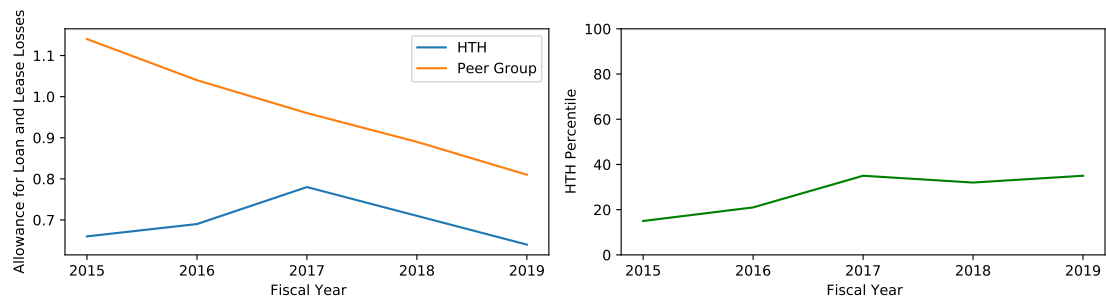


Figure 11: Allowance for loan and lease losses over total loans and leases for Hilltop Holdings and its peer group average, as well as Hilltop Holdings allowance for loan and lease losses percentile. Peer group is firms with consolidated assets equal to or greater than \$10 billion. Data taken from FFIEC BHCPR.³ Figure generated in Python.

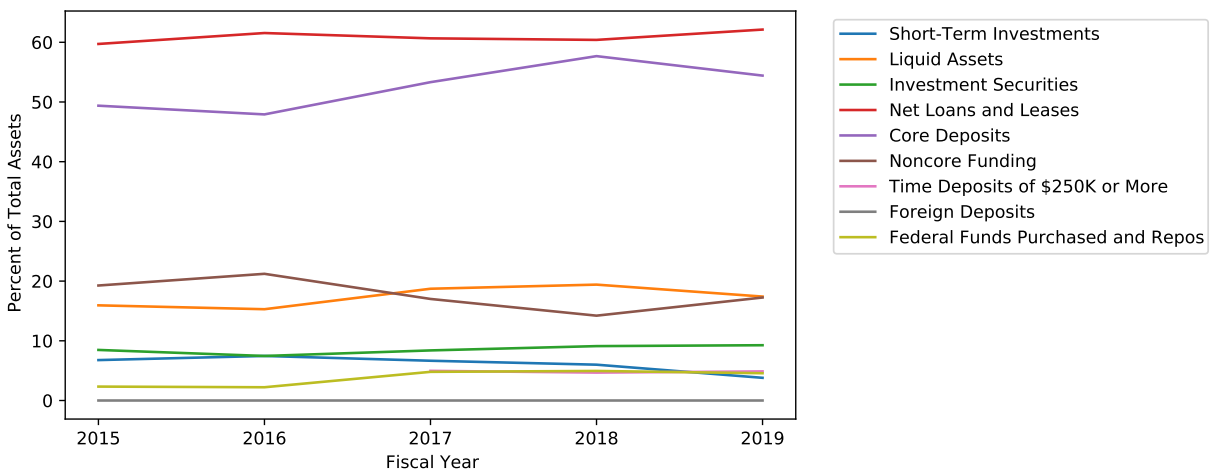


Figure 12: Liquidity and funding as percent of total assets for Hilltop Holdings. Data taken from FFIEC BHCPR.³ Figure generated in Python.

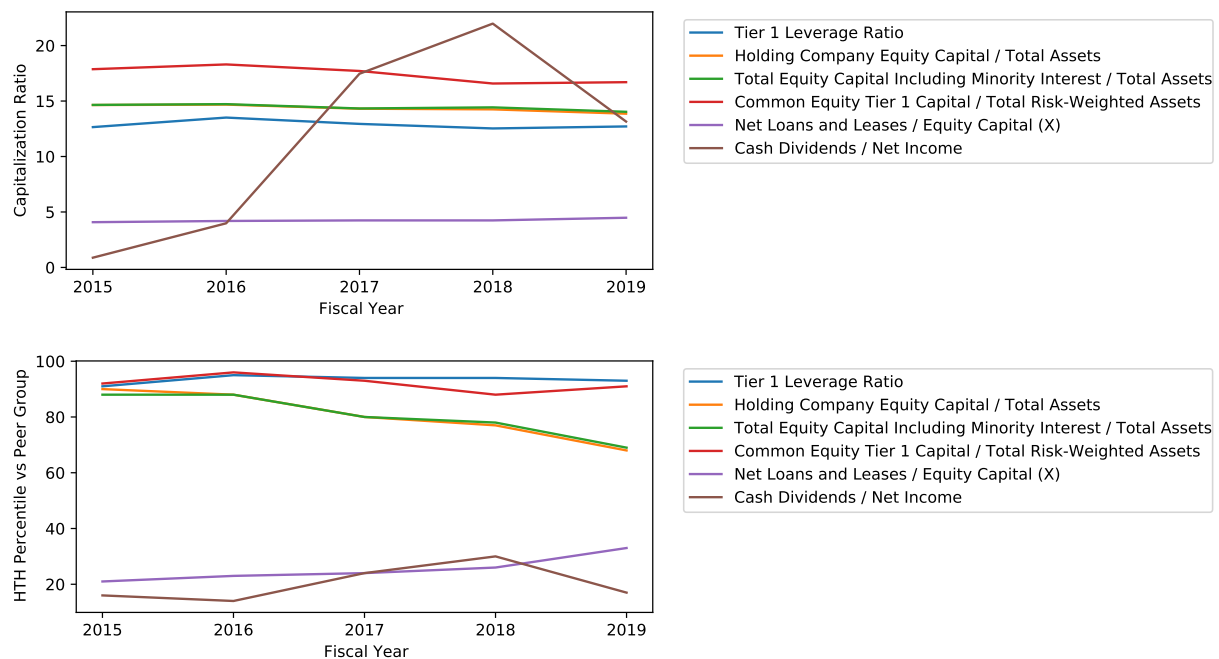


Figure 13: Capitalization ratios for Hilltop Holdings and percentiles relative to peer group. Peer group is firms with consolidated assets equal to or greater than \$10 billion. Data taken from FFIEC BHCPR.³ Figure generated in Python.

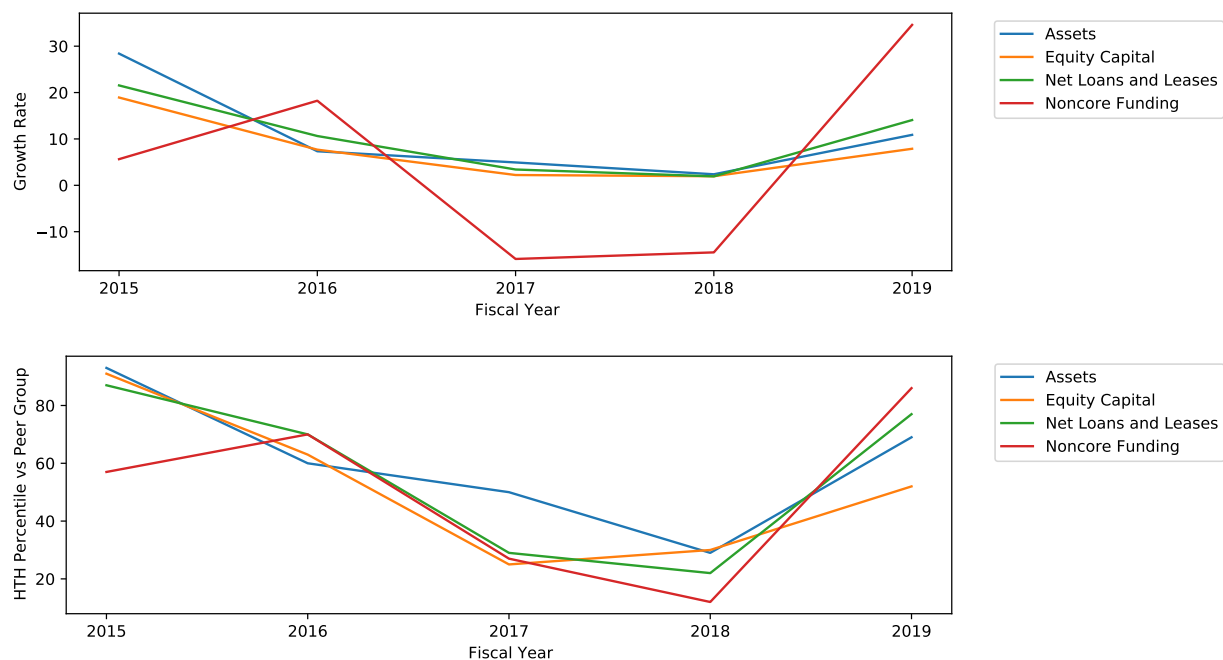


Figure 14: Growth rates for Hilltop Holdings and percentiles relative to peer group. Peer group is firms with consolidated assets equal to or greater than \$10 billion. Data taken from FFIEC BHCPR.³ Figure generated in Python.

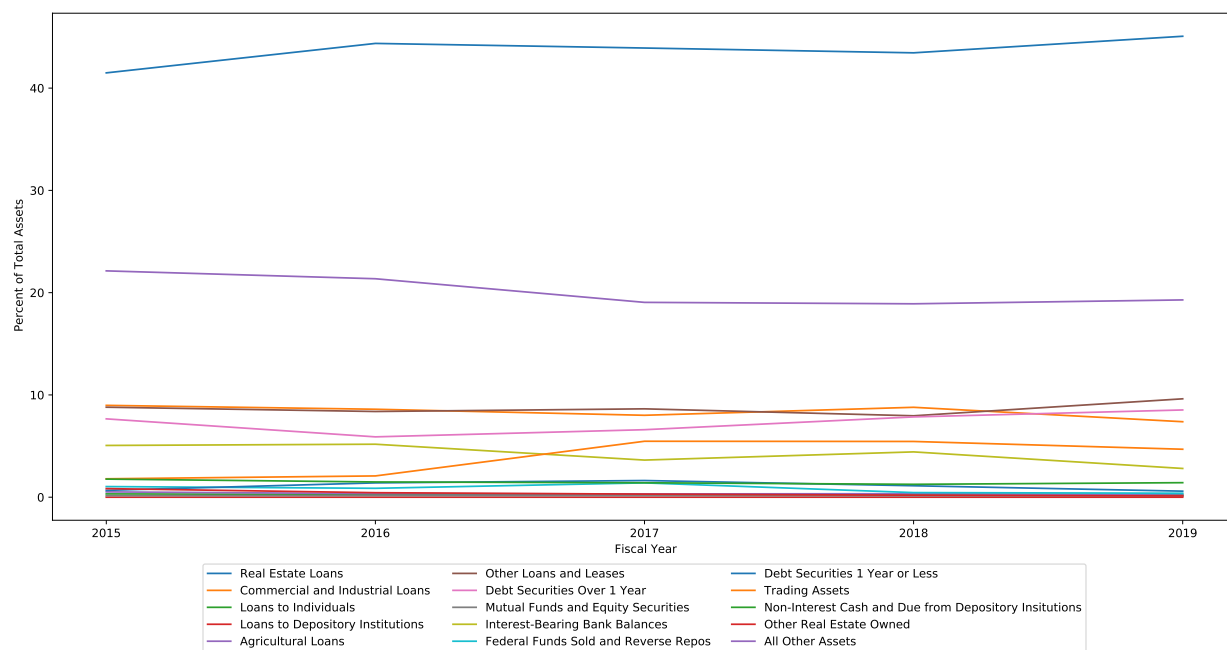


Figure 15: Hilltop Holdings asset composition. Each asset is given as percent of total assets. Data taken from FFIEC BHCPR.³ Figure generated in Python.

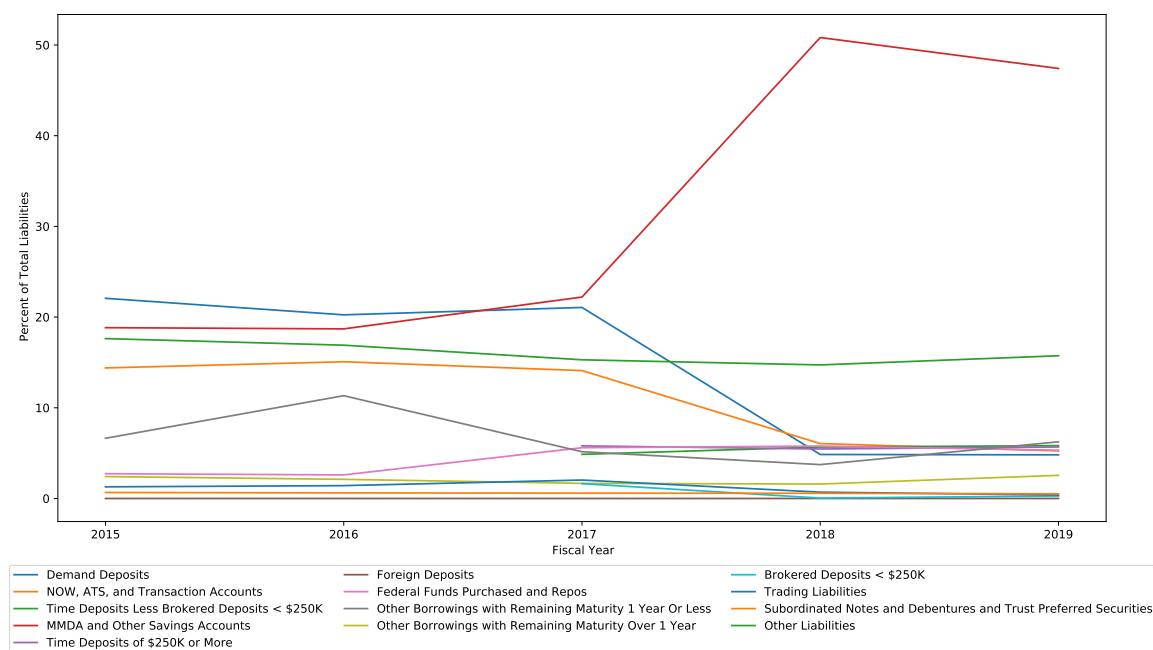


Figure 16: Hilltop Holdings liability composition. Each liability is given as percent of total liabilities. Data taken from FFIEC BHCPR.³ Figure generated in Python.