

PROSPERITY BANCSHARES INC  
Form 10-Q  
August 09, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006

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: 000-25051

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**PROSPERITY BANCSHARES, INC.<sup>®</sup>**

(Exact name of registrant as specified in its charter)

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**TEXAS**  
(State or other jurisdiction of  
incorporation or organization)

Prosperity Bank Plaza  
4295 San Felipe

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

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Houston, Texas 77027

(Address of principal executive offices, including zip code)

(713) 693-9300

(Registrant's telephone number, including area code)

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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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

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

As of August 1, 2006, there were 32,768,281 shares of the registrant's Common Stock, par value \$1.00 per share, outstanding.

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PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

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**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(UNAUDITED)**

	June 30,	December 31,
	2006	2005
	(Dollars in thousands, except share data)	
<b>ASSETS</b>		
Cash and due from banks	\$ 102,921	\$ 91,518
Federal funds sold	20,322	5,846
Total cash and cash equivalents	123,243	97,364
Interest bearing deposits in financial institutions	297	297
Available for sale securities, at fair value (amortized cost of \$397,141 and \$416,425, respectively)	389,293	410,361
Held to maturity securities, at cost (fair value of \$1,204,581, and \$1,135,694, respectively)	1,254,119	1,162,241
Loans held for investment	2,204,792	1,542,125
Less allowance for credit losses	(24,280)	(17,203)
Loans, net	2,180,512	1,524,922
Accrued interest receivable	19,877	16,105
Goodwill	423,534	261,964
Core deposit intangibles, net of accumulated amortization of \$9,129 and \$6,704, respectively	25,476	22,461
Bank premises and equipment, net	64,242	49,244
Other real estate owned	77	239
Bank Owned Life Insurance (BOLI), net	13,926	13,676
Leased assets	4,087	4,464
Other assets	33,268	22,644
<b>TOTAL ASSETS</b>	<b>\$ 4,531,951</b>	<b>\$ 3,585,982</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>LIABILITIES:</b>		
Deposits:		
Noninterest-bearing	\$ 839,317	\$ 674,407
Interest-bearing	2,800,683	2,245,911
Total deposits	3,640,000	2,920,318
Other borrowings	77,711	55,404
Securities sold under repurchase agreements	47,494	46,985
Accrued interest payable	8,175	6,546
Other liabilities	22,679	16,237
Junior subordinated debentures	100,519	75,775
Total liabilities	3,896,578	3,121,265
<b>SHAREHOLDERS EQUITY:</b>		

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Preferred stock, \$1 par value; 20,000,000 shares authorized; none issued or outstanding		
Common stock, \$1 par value; 200,000,000 shares authorized; 32,801,241 and 27,857,887 shares issued at June 30, 2006 and December 31, 2005, respectively; 32,764,153 and 27,820,799 shares outstanding at June 30, 2006 and December 31, 2005, respectively	32,801	27,858
Capital surplus	424,699	280,525
Retained earnings	183,581	160,883
Accumulated other comprehensive loss net unrealized loss on available for sale securities, net of tax benefit of \$2,747 and \$2,122, respectively	(5,101)	(3,942)
Less treasury stock, at cost, 37,088 shares	(607)	(607)
Total shareholders equity	635,373	464,717
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 4,531,951	\$ 3,585,982

See notes to interim consolidated financial statements.

**Table of Contents****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****(UNAUDITED)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<b>(Dollars in thousands, except per share data)</b>				
<b>INTEREST INCOME:</b>				
Loans, including fees	\$ 41,578	\$ 25,716	\$ 70,060	\$ 45,386
<b>Securities:</b>				
Taxable	18,510	14,749	35,065	28,196
Nontaxable	524	319	824	665
70% nontaxable preferred dividends	266	128	407	256
Federal funds sold	131	192	334	633
Deposits in financial institutions	3	2	6	3
<b>Total interest income</b>	<b>61,012</b>	<b>41,106</b>	<b>106,696</b>	<b>75,139</b>
<b>INTEREST EXPENSE:</b>				
Deposits	20,875	10,691	34,968	18,962
Junior subordinated debentures	1,994	1,273	3,391	2,162
Securities sold under repurchase agreements	434	146	795	244
Note payable and federal funds sold	1,127	517	1,770	815
<b>Total interest expense</b>	<b>24,430</b>	<b>12,627</b>	<b>40,924</b>	<b>22,183</b>
<b>NET INTEREST INCOME</b>	<b>36,582</b>	<b>28,479</b>	<b>65,772</b>	<b>52,956</b>
<b>PROVISION FOR CREDIT LOSSES</b>	<b>120</b>	<b>120</b>	<b>240</b>	<b>240</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES</b>	<b>36,462</b>	<b>28,359</b>	<b>65,532</b>	<b>52,716</b>
<b>NONINTEREST INCOME:</b>				
Customer service fees	7,206	6,478	13,531	11,886
Other	1,950	1,403	3,292	2,528
<b>Total noninterest income</b>	<b>9,156</b>	<b>7,881</b>	<b>16,823</b>	<b>14,414</b>
<b>NONINTEREST EXPENSE:</b>				
Salaries and employee benefits	11,732	9,520	20,927	18,051
Net occupancy expense	1,967	1,691	3,648	3,062
Depreciation expense	1,327	1,158	2,502	2,129
Data processing	989	701	1,800	1,297
Core deposit intangible amortization	1,358	1,098	2,425	1,821
Other	4,026	3,644	7,346	7,286
<b>Total noninterest expense</b>	<b>21,399</b>	<b>17,812</b>	<b>38,648</b>	<b>33,646</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>24,219</b>	<b>18,428</b>	<b>43,707</b>	<b>33,484</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>8,324</b>	<b>6,220</b>	<b>14,948</b>	<b>10,722</b>

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NET INCOME	\$ 15,895	\$ 12,208	\$ 28,759	\$ 22,762
EARNINGS PER SHARE				
Basic	\$ 0.49	\$ 0.44	\$ 0.95	\$ 0.88
Diluted	\$ 0.48	\$ 0.44	\$ 0.94	\$ 0.87

See notes to interim consolidated financial statements.

**Table of Contents****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY****(UNAUDITED)**

	Common Stock		Capital	Retained	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders Equity
	Shares	Amount	Surplus	Earnings	(Dollars in thousands, except share data)		
BALANCE AT JANUARY 1, 2005	22,418,128	\$ 22,418	\$ 134,288	\$ 122,647	\$ (3,099)	\$ (607)	\$ 275,647
Comprehensive Income:							
Net income				47,860			47,860
Net change in unrealized loss on available for sale securities					(894)		(894)
Add: Reclassification adjustment for net losses included in net income, net of tax benefit of \$ 28					51		51
Total comprehensive income							47,017
Issuance of common stock in connection with the exercise of stock options	123,098	123	962				1,085
Common stock issued in connection with restricted stock awards	4,917	5	127				132
Common stock issued in connection with the First Capital acquisition	5,078,856	5,079	137,439				142,518
Common stock issued in connection with the Grapeland acquisition	232,888	233	6,894				7,127
Stock based compensation expense			619				619
Cash dividends declared, \$ 0.35 per share				(9,624)			(9,624)
Other			196				196
BALANCE AT DECEMBER 31, 2005	27,857,887	\$ 27,858	\$ 280,525	\$ 160,883	\$ (3,942)	\$ (607)	\$ 464,717
Comprehensive income:							
Net income				28,759			28,759
Net change in unrealized loss on available for sale securities					(1,159)		(1,159)
Total comprehensive income							27,600
Issuance of common stock in connection with the exercise of stock options and restricted stock	495,129	495	6,878				7,373
Common stock issued in connection with the SNB acquisition	4,448,225	4,448	136,914				141,362
Stock based compensation expense			382				382
Cash dividends declared, \$0.20 per share				(6,061)			(6,061)
BALANCE AT JUNE 30, 2006	32,801,241	\$ 32,801	\$ 424,699	\$ 183,581	\$ (5,101)	\$ (607)	\$ 635,373

See notes to interim consolidated financial statements.





**Table of Contents****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(Dollars in thousands)</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 28,759	\$ 22,762
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,927	3,950
Stock-based compensation expense	382	303
Provision for credit losses	240	240
Net amortization of discount on investments	32	1,633
Net gain on sale of other real estate	(9)	(31)
Net gain on held for sale loans		(121)
Net gain on sale of premises and equipment	(436)	(20)
Net (increase) decrease in other assets and accrued interest receivable	(1,918)	8,598
Net increase (decrease) in accrued interest payable and other liabilities	7,277	(7,011)
<b>Net cash provided by operating activities</b>	<b>39,254</b>	<b>30,303</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from maturities and principal paydowns of held to maturity securities	173,566	122,306
Purchase of held to maturity securities	(54,166)	(128,989)
Proceeds from maturities, sales and principal paydowns of available for sale securities	33,172	34,251
Purchase of available for sale securities		(65,000)
Net increase in loans	(64,273)	(18,668)
Purchase of bank premises and equipment	(1,661)	(774)
Net proceeds acquired from sale of bank premises, equipment, and other real estate	2,484	1,212
Purchase of SNB Bancshares, Inc.	(93,832)	
Cash and cash equivalents acquired from SNB Bancshares, Inc.	18,020	
Purchase of Grapeland Bancshares, Inc.	(74)	
Purchase of First Capital Bankers, Inc		(2,267)
Cash and cash equivalents acquired from First Capital Bankers, Inc.		58,972
<b>Net cash provided by investing activities</b>	<b>13,236</b>	<b>1,043</b>

Table continued on next page.

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	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(Dollars in thousands)</b>	
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net increase in noninterest-bearing deposits	35,093	1,973
Net decrease in interest-bearing deposits	(59,332)	(88,430)
Net proceeds (repayments) from lines of credit	1,807	(540)
Redemption of Paradigm Capital Trust II, net	(6,000)	
Net increase in securities sold under repurchase agreements	509	9,569
Proceeds from exercise of stock options	7,373	505
Payments of cash dividends	(6,061)	(4,569)
<b>Net cash used in financing activities</b>	<b>(26,611)</b>	<b>(81,492)</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>\$ 25,879</b>	<b>\$ (50,146)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>97,364</b>	<b>137,910</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 123,243</b>	<b>\$ 87,764</b>
<b>NON-CASH ACTIVITIES:</b>		
Issuance of common stock for the acquisition of SNB Bancshares	\$ 141,362	\$
Issuance of common stock for the acquisition of First Capital Bankers, Inc.		142,518

See notes to interim consolidated financial statements.

**Table of Contents****PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES****NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2006****(UNAUDITED)****1. BASIS OF PRESENTATION**

The interim consolidated financial statements include the accounts of Prosperity Bancshares, Inc.® (the Company) and its wholly-owned subsidiaries, Prosperity Bank® (the Bank) and Prosperity Holdings of Delaware, LLC. All significant inter-company transactions and balances have been eliminated.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the statements reflect all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows of the Company on a consolidated basis, and all such adjustments are of a normal recurring nature. These financial statements and the notes thereto should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2005. Operating results for the six-month period ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

**2. INCOME PER COMMON SHARE**

The following table illustrates the computation of basic and diluted earnings per share:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands, except per share amounts)</b>			
Net income available to common shareholders	\$ 15,895	\$ 12,208	\$ 28,759	\$ 22,762
Weighted average common shares outstanding	32,483	27,504	30,179	25,801
Potential dilutive common shares	480	293	389	290
Weighted average common shares and equivalents outstanding	32,963	27,797	30,568	26,091
Basic earnings per common share	\$ 0.49	\$ 0.44	\$ 0.95	\$ 0.88
Diluted earnings per common share	\$ 0.48	\$ 0.44	\$ 0.94	\$ 0.87

**3. NEW ACCOUNTING STANDARDS**

*FSP FIN 46(R)-6, Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)*. FSP FIN 46(R)-6 introduces the by-design approach to determine the variability to consider when applying Interpretation 46(R). As a general rule, assets and operations of an entity create its variability, while its liabilities and equity interest absorb the variability. The by-design approach is used for determining which risk or risks are important in evaluating whether an interest is a variable interest under Interpretation 46(R). The analysis should focus on the role of a contract or arrangement in the design of the entity, rather than its legal form or accounting classification. FSP FIN 46(R)-6 was effective for all entities with which an enterprise first becomes involved, and for all entities previously required to be analyzed under Interpretation 46(R) when a reconsideration event has occurred beginning the first day of the first reporting period beginning after June 15, 2006. The Company adopted FSP FIN 46(R) on July 1, 2006 and its adoption did not have a material impact on the Company's financial statements.



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SFAS No. 123(R), *Share-Based Payment (Revised 2004)*. SFAS 123(R) establishes standards for the accounting for transactions in which an entity (i) exchanges its equity instruments for goods or services, or (ii) incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of the equity instruments. SFAS 123(R) eliminates the ability to account for stock-based compensation using Accounting Pronouncements Board (APB) 25 and requires that such transactions be recognized as compensation cost in the income statement based on their fair values on the date of the grant. SFAS 123(R) applies to new awards, modified awards and to awards cancelled after January 1, 2006. SFAS 123(R) was effective on January 1, 2006 and its adoption did not have a material impact on the Company's financial statements. The Company had previously adopted SFAS No. 123 on January 1, 2003. The Company recorded \$382,000 in stock based compensation expense for the six months ended June 30, 2006. There was no income tax benefit recorded for the stock based compensation expense.

On March 29, 2005, the SEC issued Staff Accounting Bulletin (SAB) 107 to provide public companies additional guidance in applying the provisions of SFAS 123(R). Among other things, SAB 107 describes the SEC staff's expectations in determining the assumptions that underlie the fair value estimates and discusses the interaction of SFAS 123(R) with certain existing SEC guidance. The guidance is also beneficial to users of financial statements in analyzing the information provided under SFAS 123(R). SAB 107 was applied upon the adoption of SFAS 123(R).

**4. GOODWILL AND CORE DEPOSIT INTANGIBLES**

Changes in the carrying amount of the Company's goodwill and core deposit intangibles (CDI) for the six months ended June 30, 2006 were as follows:

	<b>Goodwill</b>	<b>Core Deposit Intangibles</b>
		<b>( In thousands)</b>
Balance as of December 31, 2005	\$ 261,964	\$ 22,461
Amortization		(2,425)
Acquisition of SNB Bancshares, Inc.	160,119	5,734
Acquisition of Grapeland Bancshares, Inc.	664	(294)
Acquisition of First Capital Bankers, Inc	371	
Acquisitions prior to December 31, 2004 (deferred taxes)	416	
Balance as of June 30, 2006	\$ 423,534	\$ 25,476

Gross core deposit intangibles outstanding were \$34.6 million at June 30, 2006 and \$29.2 million at December 31, 2005. 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 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 a third party valuation, core deposit intangibles are identified and reclassified from goodwill to core deposit intangibles on the balance sheet. This reclassification had no effect on total assets, liabilities, shareholders' equity, net income or cash flows. Management performs an annual evaluation 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 June 30, 2006, there were no impairments recorded on goodwill.

**5. STOCK BASED COMPENSATION**

At June 30, 2006, the Company had two stock-based employee compensation plans and four stock option plans assumed in connection with acquisitions under which no additional options will be granted. Prior to 2003, the Company accounted for those plans under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. The Company adopted

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SFAS 123(R) on January 1, 2006. The Company recognized \$382,000 and \$303,000 in stock-based compensation expense for the six months ended June 30, 2006 and 2005 and \$210,000 and \$173,000 in stock-based compensation expense for the three months ended June 30, 2006 and 2005, respectively. There was no income tax benefit recorded for the stock-based compensation expense for the same periods.

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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 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:

	June 30,	
	2006	2005
Expected life	4.61	4.60
Risk free interest rate	4.16%	4.24%
Volatility	21.34%	21.48%
Dividend yield	1.27%	1.32%

A summary of changes in outstanding vested and unvested options during the six months ended June 30, 2006 is set forth below:

	Number of Options (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In thousands)
Options outstanding, beginning of period	1,169	\$ 21.58		
Options granted(1)	468	15.10		
Options forfeited	(20)	26.43		
Options exercised	(490)	15.04		
Options outstanding, end of period	1,127	\$ 21.19	7.89	\$ 13,186
Options exercisable, end of period	366	\$ 14.87	7.88	\$ 6,590

(1) Consists of options to acquire 467,578 shares of Common Stock assumed in connection with the SNB acquisition. The weighted-average grant-date fair value of the options assumed in connection with the SNB acquisition in April 2006 was \$14.93. The total intrinsic value of the options exercised during the six month periods ended June 30, 2006 and 2005 was \$8.7 million and \$1.7 million, respectively. The total fair value of shares vested during the six month period ended June 30, 2006 was \$176,000.

A summary of changes in non-vested options is set forth below:

Number of Options (In thousands)	Six Months Ended June 30,		Number of Options (In thousands)	Weighted Average Grant Date Fair Value
	2006	Weighted Average Grant Date Fair Value		



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Non-vested options outstanding, beginning of period	849	\$	5.52	833	\$	4.95
Options granted				134		5.55
Non-vested options forfeited	(20)		5.44	(11)		5.60
Options vested	(68)		2.56	(107)		1.85
Non-vested options outstanding, end of period	761	\$	5.80	849	\$	5.44

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The Company received \$7.4 million and \$373,000 in cash from the exercise of stock options during the six month periods ended June 30, 2006 and 2005, respectively. The increase in cash received for the exercise of stock options was primarily due to the exercise of options assumed in connection with the SNB acquisition. The Company assumed 467,578 options with a weighted average exercise price of \$15.10, of which 383,202 were exercised during the second quarter of 2006. There was no tax benefit realized from option exercises of the stock-based compensation arrangements during the six month periods ended June 30, 2006 and 2005.

As of June 30, 2006, there was \$2.1 million of total unrecognized compensation expense related to non-vested stock-based compensation arrangements. That cost is expected to be recognized over a weighted average period of 2.60 years.

**6. RECENT ACQUISITION**

On April 1, 2006, the Company completed its acquisition of SNB Bancshares, Inc., Sugar Land, Texas ( SNB ). Under the terms of the merger agreement, SNB was merged into the Company and subsequently, SNB's wholly owned subsidiary, Southern National Bank of Texas, was merged into the Bank. The Company issued approximately 4.448 million shares of its common stock and approximately \$93.8 million in cash for all of the issued and outstanding capital stock of SNB. In addition, options to acquire 762,950 shares of SNB common stock were converted into options to acquire 467,578 shares of Company common stock. All remaining options to acquire SNB common stock were cancelled and redeemed for cash prior to the merger. In connection with the merger, the Company assumed \$30.9 million in junior subordinated debentures issued to three subsidiary trusts. SNB was publicly traded and operated five (5) banking offices in Fort Bend County, Houston and Katy, Texas and two (2) stand alone motor banks in Houston, Texas. At the time of acquisition, SNB had an additional banking office under construction in Katy, Texas, which became a full-service banking center of the Company upon completion in July 2006. As of December 31, 2005, SNB had, on a consolidated basis, total assets of \$1.025 billion, loans (including loans held for sale) of \$652.8 million, deposits of \$892.0 million and shareholders' equity of \$82.5 million.

The table below summarizes select pro forma data for the two combined companies for the periods indicated:

	<b>For the six months ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In thousands, except per share amounts)</b>	
Net interest income	\$ 73,836	69,451
Net income	30,904	27,023
Earnings per share (diluted)	\$ 0.95	0.94

**7. PENDING ACQUISITION**

On July 19, 2006, the Company announced its proposed acquisition of Texas United Bancshares, Inc., La Grange, Texas ( TXUI ). Under the terms of the merger agreement, TXUI will merge into the Company and subsequently, TXUI's wholly owned subsidiary banks, State Bank, GNB Financial, n.a., Gateway National Bank and Northwest Bank, will merge into the Bank. The Company expects to issue approximately 10.875 million shares of its common stock for all of the issued and outstanding capital stock of TXUI, subject to adjustment as provided in the merger agreement. TXUI is publicly traded and operates forty-three (43) banking offices in Texas. As of June 30, 2006, TXUI had, on a consolidated basis, total assets of \$1.818 billion, loans of \$1.255 billion, deposits of \$1.323 billion and shareholders' equity of \$169.3 million.

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

**Special Cautionary Notice Regarding Forward-Looking Statements**

Statements and financial discussion and analysis contained in this quarterly report on Form 10-Q that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on assumptions and involve a number of risks and uncertainties, many of which are beyond the Company's control. Many possible events or factors could affect the future financial results and performance of the Company and could cause such results or performance to differ materially from those expressed in the forward-looking statements. These possible events or factors include, without limitation:

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;

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 failure of assumptions underlying the establishment of and provisions made to the allowance for credit losses;

changes in the availability of funds resulting in increased costs or reduced liquidity;

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;

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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;

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. 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, unless the securities laws require the Company to do so.

**Table of Contents****RECENT ACQUISITION**

On April 1, 2006, the Company completed its acquisition of SNB Bancshares, Inc., Sugar Land, Texas ( SNB ). Under the terms of the merger agreement, SNB was merged into the Company and subsequently, SNB's wholly owned subsidiary, Southern National Bank of Texas, was merged into the Bank. The Company issued approximately 4.448 million shares of its common stock and approximately \$93.8 million in cash for all of the issued and outstanding capital stock of SNB. In addition, options to acquire 762,950 shares of SNB common stock were converted into options to acquire 467,578 shares of Company common stock. All remaining options to acquire SNB common stock were cancelled and redeemed for cash prior to the merger. In connection with the merger, the Company assumed \$30.9 million in junior subordinated debentures issued to three subsidiary trusts. SNB was publicly traded and operated five (5) banking offices in Fort Bend County, Houston and Katy, Texas and two (2) stand alone motor banks in Houston, Texas. At the time of acquisition, SNB had an additional banking office under construction in Katy, Texas, which became a full-service banking center of the Company upon completion in July 2006. As of December 31, 2005, SNB had, on a consolidated basis, total assets of \$1.025 billion, loans (including loans held for sale) of \$652.8 million, deposits of \$892.0 million and shareholders' equity of \$82.5 million.

**PENDING ACQUISITION**

On July 19, 2006, the Company announced its proposed acquisition of Texas United Bancshares, Inc., La Grange, Texas ( TXUI ). Under the terms of the merger agreement, TXUI will merge into the Company and subsequently, TXUI's wholly owned subsidiary banks, State Bank, GNB Financial, n.a., Gateway National Bank and Northwest Bank, will merge into the Bank. The Company expects to issue approximately 10.875 million shares of its common stock for all of the issued and outstanding capital stock of TXUI, subject to adjustment as provided in the merger agreement. TXUI is publicly traded and operates forty-three (43) banking offices in Texas. As of June 30, 2006, TXUI had, on a consolidated basis, total assets of \$1.818 billion, loans of \$1.255 billion, deposits of \$1.323 billion and shareholders' equity of \$169.3 million.

**OVERVIEW**

The Company was formed in 1983 as a vehicle to acquire the former Allied First Bank in Edna, Texas which was chartered in 1949 as The First National Bank of Edna. 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 wide array of financial products and services to small and medium-sized businesses and consumers. The Bank operates eighty-eight (88) full-service banking locations; with thirty-eight (38) in the Greater Houston Consolidated Metropolitan Statistical Area ( CMSA ), seventeen (17) in fifteen contiguous counties situated south and southwest of Houston and extending into South Texas, five (5) in the Austin, Texas area, fifteen (15) in the Corpus Christi, Texas area, two (2) in East Texas and eleven (11) in the Dallas/Fort Worth, Texas area. The Greater Houston CMSA includes Austin, Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery, San Jacinto and Waller counties. The Company's headquarters are located at Prosperity Bank Plaza, 4295 San Felipe in Houston, Texas and its telephone number is (713) 693-9300. The Company's website address is [www.prosperitybanktx.com](http://www.prosperitybanktx.com). Information contained on the Company's website is not incorporated by reference into this quarterly report on Form 10-Q and is not part of this or any other report.

The Company generates the majority of its revenues from interest income on loans, service charges on customer accounts and income from investment in securities. The revenues are partially offset by interest expense paid on deposits and other borrowings and non-interest 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. 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 to the yield earned on interest-earning assets increasing at a greater rate than the increase in rates paid on interest bearing liabilities and 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 strategic merger transactions. The Company focuses on continual internal growth. Each banking center is operated as a separate profit center, maintaining separate data with respect to its net interest income, efficiency ratio, deposit growth, loan growth and overall profitability. Banking center presidents and managers are accountable for performance in these areas and compensated accordingly. The Company also focuses on maintaining stringent cost control practices and policies. The Company has invested significantly in the infrastructure required to centralize many of its critical operations, such as data

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processing and loan application 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 Company also intends to continue to seek expansion opportunities. On March 1, 2005, the Company acquired First Capital Bankers, Inc. (the First Capital acquisition ) which added an additional twenty seven (27) banking centers, and on December 1, 2005, the Company acquired Grapeland Bancshares, Inc. (the Grapeland acquisition ) which added two additional banking centers. On April 1, 2006, the Company acquired SNB which added five banking centers.

Total assets were \$4.53 billion at June 30, 2006 compared with \$3.59 billion at December 31, 2005, an increase of \$946.0 million or 26.4%. Total loans were \$2.205 billion at June 30, 2006 compared with \$1.54 billion at December 31, 2005, an increase of \$662.7 million or 43.0%. Total deposits were \$3.640 billion at June 30, 2006 compared with \$2.92 billion December 31, 2005, an increase of \$719.7 million or 24.6%. Shareholders' equity increased \$170.7 million or 36.7%, to \$635.4 million at June 30, 2006 compared with \$464.7 million at December 31, 2005. These increases were primarily the result of the SNB acquisition.

**CRITICAL ACCOUNTING POLICIES**

The Company's accounting policies are integral to understanding the financial results reported. Accounting policies are described in detail in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. The Company believes that of its significant accounting policies, the following may involve a higher degree of judgment and complexity:

*Allowance for Credit Losses* The allowance for credit losses is a reserve 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 quarterly review of the allowance for credit losses to the Bank's Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. In making its evaluation, management considers factors such as historical loan loss experience, 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 changes 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 Statement of Financial Accounting Standards (SFAS) No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended by SFAS 118, and allowance allocations determined in accordance with SFAS No. 5, *Accounting for Contingencies*.

*Goodwill* Goodwill and intangible assets that have indefinite useful lives are subject to at least an annual impairment test and more frequently if circumstances indicate their value may not be recoverable. Goodwill is tested for impairment using a two-step process that begins with an estimation of the fair value of each of the Company's reporting units compared with its carrying value. If the carrying amount exceeds the fair value of a reporting unit, a second step test is completed comparing the implied fair value of the reporting unit's goodwill to its carrying value to measure the amount of impairment. Intangible assets that are not amortized will be tested for impairment at least annually by comparing the fair values of those assets to their carrying values. 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 eight 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, 2005, management does not believe any of its goodwill is impaired as of June 30, 2006. While the Company believes no impairment existed at June 30, 2006 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 adopted the provisions of SFAS No. 123R *Share-Based Payment (Revised 2004)*, on January 1, 2006 and its adoption did not have a material impact on the Company's financial statements. The Company had previously adopted SFAS No. 123 on January 1, 2003. Among other things, SFAS No. 123R eliminates the ability to account for stock-based compensation using the intrinsic value based method of accounting and requires that such transactions be recognized as compensation expense in the income statement based on their fair values on the date of the grant. SFAS No. 123R 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 highly subjective assumptions.

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**Table of Contents****RESULTS OF OPERATIONS**

Net income available to common shareholders was \$15.9 million (\$0.48 per common share on a diluted basis) for the quarter ended June 30, 2006 compared with \$12.2 million (\$0.44 per common share on a diluted basis) for the quarter ended June 30, 2005, an increase in net income of \$3.7 million, or 30.2%. The Company posted returns on average common equity of 10.15% and 11.31%, returns on average assets of 1.40% and 1.41% and efficiency ratios of 47.24% and 49.06% for the quarters ended June 30, 2006 and 2005, respectively. The efficiency ratio is calculated by dividing total noninterest expense (excluding credit loss provisions) by net interest income plus noninterest income (excluding securities gains and losses and net gain on sale of assets). Additionally, taxes are not part of this calculation.

For the six months ended June 30, 2006, net income available to common shareholders was \$28.8 million (\$0.94 per common share on a diluted basis) compared with \$22.8 million (\$0.87 per common share on a diluted basis) for the same period in 2005, an increase in net income of \$6.0 million or 26.3%. The Company posted returns on average common equity of 10.43% and 11.99%, returns on average assets of 1.41% and 1.41% and efficiency ratios of 47.05% and 49.98% for the six months ended June 30, 2006 and 2005, respectively.

*Net Interest Income*

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

Net interest income before the provision for credit losses and on a tax equivalent basis was \$37.1 million for the quarter ended June 30, 2006 compared with \$28.8 million for the quarter ended June 30, 2005, an increase of \$8.3 million, or 28.7%. Net interest income increased as a result of an increase in average interest-earning assets to \$3.89 billion for the quarter ended June 30, 2006 compared with \$3.03 billion for the quarter ended June 30, 2005, an increase of \$867.2 million, or 28.7%. The increase in average earning assets was primarily attributable to increases in average loans and securities from the quarter ended June 30, 2005 compared with the quarter ended June 30, 2006 resulting primarily from the SNB acquisition on April 1, 2006.

The net interest margin on a tax equivalent basis remained constant at 3.82% for the quarters ended June 30, 2006 and 2005. The rate paid on interest-bearing liabilities increased 109 basis points from 2.11% for the quarter ended June 30, 2005 to 3.20% for the quarter ended June 30, 2006. The yield on earning assets increased 84 basis points from 5.45% for the quarter ended June 30, 2005 to 6.29% for the quarter ended June 30, 2006. The volume of interest-bearing liabilities increased \$652.5 million and the volume of interest-earning assets increased \$867.2 million for the same periods.

Net interest income before the provision for credit losses and on a tax equivalent basis increased \$13.0 million, or 24.1%, to \$66.6 million for the six months ended June 30, 2006 compared with \$53.6 million for the same period in 2005. This increase is mainly attributable to higher average interest-earning assets resulting from an increase in average loans. The net interest margin on a tax equivalent basis increased to 3.82% compared with 3.81% for the same periods principally due to a 77 basis point increase in the yield on earning assets from 5.34% for the six months ended June 30, 2005 to 6.11% for the six months ended June 30, 2006, partially offset by a 102 basis point increase in the rate paid on interest-bearing liabilities from 1.99% for the six months ended June 30, 2005 to 3.01% for the six months ended June 30, 2006.

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The following tables set forth, for each category of interest-earning assets and interest-bearing liabilities, the average amounts outstanding, the interest earned or paid on such amounts, and the average rate earned or paid for the three and the six month periods ended June 30, 2006 and 2005. The tables also set forth the average rate paid on total interest-bearing liabilities, and the net interest margin on average total interest-earning assets for the same periods. Except as indicated in the footnotes, no tax-equivalent adjustments were made and all average balances are daily average balances. Any nonaccruing loans have been included in the table as loans carrying a zero yield.

	Three Months Ended June 30,					
	Average Outstanding Balance	2006 Interest Earned/ Paid	Average Yield/ Rate (4)	Average Outstanding Balance	2005 Interest Earned/ Paid	Average Yield/ Rate (4)
(Dollars in thousands)						
<b>Assets</b>						
Interest-earning assets:						
Loans	\$ 2,174,278	\$ 41,578	7.67%	\$ 1,514,629	\$ 25,716	6.81%
Securities(1)	1,707,314	19,300	4.52	1,484,400	15,196	4.09
Federal funds sold and other temporary investments	11,064	134	4.86	26,475	194	2.94
Total interest-earning assets	3,892,656	61,012	6.29%	3,025,504	41,106	5.45%
Less allowance for credit losses	(24,300)			(16,889)		
Total interest-earning assets, net of allowance	3,868,356			3,008,615		
Noninterest-earning assets	678,864			447,746		
Total assets	\$ 4,547,220			\$ 3,456,361		
<b>Liabilities and shareholders equity</b>						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 665,882	\$ 3,324	2.00%	\$ 488,312	\$ 1,156	0.95%
Savings and money market accounts	917,424	5,696	2.49	704,181	2,461	1.40
Certificates of deposit	1,236,668	11,855	3.85	1,066,039	7,074	2.66
Junior subordinated debentures	100,519	1,994	7.96	75,775	1,273	6.74
Federal funds purchased and other borrowings	90,164	1,127	5.01	44,273	517	4.68
Securities sold under repurchase agreements	47,076	434	3.70	26,659	146	2.20
Total interest-bearing liabilities	3,057,733	24,430	3.20%	2,405,239	12,627	2.11%
Noninterest-bearing liabilities:						
Noninterest-bearing demand deposits	829,653			605,014		
Other liabilities	33,198			14,419		
Total liabilities	3,920,584			3,024,672		
Shareholders equity	626,636			431,689		
Total liabilities and shareholders equity	\$ 4,547,220			\$ 3,456,361		
Net interest rate spread			3.09%			3.34%
Net interest income and margin(2)		\$ 36,582	3.77%		\$ 28,479	3.78%
Net interest income and margin (tax-equivalent basis)(3)		\$ 37,077	3.82%		\$ 28,817	3.82%



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- (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%.
  - (4) Annualized.

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	Six Months Ended June 30,					
	Average Outstanding Balance	2006 Interest Earned/ Paid	Average Yield/ Rate (4)	Average Outstanding Balance	2005 Interest Earned/ Paid	Average Yield/ Rate (4)
(Dollars in thousands)						
<b>Assets</b>						
Interest-earning assets:						
Loans	\$ 1,864,558	\$ 70,060	7.58%	\$ 1,357,830	\$ 45,386	6.74%
Securities(1)	1,640,160	36,296	4.43	1,427,941	29,117	4.08
Federal funds sold and other temporary investments	14,522	340	4.72	50,720	636	2.53
Total interest-earning assets	3,519,240	106,696	6.11%	2,836,491	75,139	5.34%
Less allowance for credit losses	(20,793)			(15,661)		
Total interest-earning assets, net of allowance	3,498,447			2,820,830		
Noninterest-earning assets	574,131			396,794		
Total assets	\$ 4,072,578			\$ 3,217,624		
<b>Liabilities and shareholders equity</b>						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 572,589	\$ 4,698	1.65%	\$ 499,580	\$ 2,459	0.99%
Savings and money market accounts	828,111	9,559	2.33	650,736	4,186	1.30
Certificates of deposit	1,139,978	20,711	3.66	975,418	12,317	2.55
Junior subordinated debentures	84,023	3,391	8.14	63,962	2,162	6.82
Federal funds purchased and other borrowings	72,002	1,770	4.96	33,989	815	4.84
Securities sold under repurchase agreements	44,920	795	3.57	25,633	244	1.92
Total interest-bearing liabilities	2,741,623	40,924	3.01%	2,249,318	22,183	1.99%
Noninterest-bearing liabilities:						
Noninterest-bearing demand deposits	750,806			570,679		
Other liabilities	28,470			17,815		
Total liabilities	3,520,899			2,837,812		
Shareholders equity	551,679			379,812		
Total liabilities and shareholders equity	\$ 4,072,578			\$ 3,217,624		
Net interest rate spread			3.10%			3.35%
Net interest income and margin(2)		\$ 65,772	3.77%		\$ 52,956	3.76%
Net interest income and margin (tax-equivalent basis)(3)		\$ 66,601	3.82%		\$ 53,647	3.81%

(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%.

(4) Annualized.



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The following tables present the dollar amount of changes in interest income and interest expense for the major components of interest-earning assets and interest-bearing liabilities and distinguishes between the increase (decrease) related to changes in outstanding balances and the volatility of interest rates. For purposes of this table, changes attributable to both rate and volume which cannot be segregated have been allocated to rate.

	<b>Three Months Ended June 30,</b>		
	<b>2006 vs. 2005</b>		
	<b>Increase</b>		
	<b>(Decrease)</b>		
	<b>Due to</b>		
	<b>Volume</b>	<b>Rate</b>	<b>Total</b>
	<b>(Dollars in thousands)</b>		
<b>Interest-earning assets:</b>			
Loans	\$ 11,200	\$ 4,662	\$ 15,862
Securities	2,282	1,822	4,104
Federal funds sold and other temporary investments	(113)	53	(60)
<b>Total increase in interest income</b>	<b>13,369</b>	<b>6,537</b>	<b>19,906</b>
<b>Interest-bearing liabilities:</b>			
Interest-bearing demand deposits	420	1,748	2,168
Savings and money market accounts	745	2,490	3,235
Certificates of deposit	1,132	3,649	4,781
Junior subordinated debentures	416	305	721
Federal funds purchased and other borrowings	536	74	610
Securities sold under repurchase agreements	112	176	288
<b>Total increase in interest expense</b>	<b>3,361</b>	<b>8,442</b>	<b>11,803</b>
<b>Increase (decrease) in net interest income</b>	<b>\$ 10,008</b>	<b>\$ (1,905)</b>	<b>\$ 8,103</b>

	<b>Six Months Ended June 30,</b>		
	<b>2006 vs. 2005</b>		
	<b>Increase</b>		
	<b>(Decrease)</b>		
	<b>Due to</b>		
	<b>Volume</b>	<b>Rate</b>	<b>Total</b>
	<b>(Dollars in thousands)</b>		
<b>Interest-earning assets:</b>			
Loans	\$ 16,938	\$ 7,736	24,674
Securities	4,327	2,852	7,179
Federal funds sold and other temporary investments	(454)	158	(296)
<b>Total increase in interest income</b>	<b>20,811</b>	<b>10,746</b>	<b>31,557</b>
<b>Interest-bearing liabilities:</b>			
Interest-bearing demand deposits	359	1,880	2,239

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Savings and money market accounts	1,141	4,232	5,373
Certificates of deposit	2,078	6,316	8,394
Junior subordinated debentures	678	551	1,229
Federal funds purchased and other borrowings	911	44	955
Securities sold under repurchase agreements	184	367	551
<b>Total increase in interest expense</b>	<b>5,351</b>	<b>13,390</b>	<b>18,741</b>
Increase (decrease) in net interest income	\$ 15,460	\$ (2,644)	\$ 12,816

**Table of Contents***Provision for Credit Losses*

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

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

The Company made a \$120,000 provision for credit losses for the quarter ended June 30, 2006 and 2005. For the quarter ended June 30, 2006, net charge-offs were \$206,000 compared with net charge-offs of \$115,000 for the quarter ended June 30, 2005.

*Noninterest Income*

The Company's primary sources of noninterest income are service charges on deposit accounts and other banking service related fees. 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. Banking related service fees include check cashing fees, official check fees, safe deposit box rent and currency handling fees. Noninterest income totaled \$9.2 million for the three months ended June 30, 2006 compared with \$7.9 million for the same period in 2005, an increase of \$1.3 million, or 16.2%. Noninterest income increased \$2.4 million, or 16.7%, to \$16.8 million for the six months ended June 30, 2006 compared with \$14.4 million for the same period in 2005. The changes during both periods were primarily due to an increase in net gain on sale of assets and an increase in insufficient funds charges and customer service charges which resulted from the increase in the number of accounts due to the SNB acquisition on April 1, 2006. At June 30, 2006, the acquisition added approximately 12,500 deposit accounts and over 3,500 debit cards.

The net gain on sale of assets increased \$386,000 to \$436,000 for the three months ended June 30, 2006 compared with \$50,000 for the three months ended June 30, 2005. The net gain on sale of assets increased \$394,000 for the six months ended June 30, 2006 to \$445,000 compared with \$51,000 for the same period in 2005. Both increases were principally due to the sale of two properties during the second quarter of 2006.

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

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
	(Dollars in thousands)			
Service charges on deposit accounts	\$ 7,206	\$ 6,478	\$ 13,531	\$ 11,886
Banking related service fees	342	288	645	555
Brokered mortgage income	245	193	428	318
Trust and investment income	43	87	113	156
Net gain on sale of assets	436	50	445	51
Net gain on sale of securities				
Net gain on held for sale loans		69		121
Other noninterest income	884	716	1,661	1,327
<b>Total noninterest income</b>	<b>\$ 9,156</b>	<b>\$ 7,881</b>	<b>\$ 16,823</b>	<b>\$ 14,414</b>

**Table of Contents***Noninterest Expense*

Noninterest expense totaled \$21.4 million for the quarter ended June 30, 2006 compared with \$17.8 million for the quarter ended June 30, 2005, an increase of \$3.6 million, or 20.1%. This increase occurred primarily in salaries and employee benefits, core deposit intangibles amortization and depreciation expense. Noninterest expense totaled \$38.6 million for the six months ended June 30, 2006 compared with \$33.6 million for the six months ended June 30, 2005, an increase of \$5.0 million, or 14.9%. The increases during both periods were primarily due to the SNB acquisition. The following table presents, for the periods indicated, the major categories of noninterest expense:

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
	(Dollars in thousands)			
Salaries and employee benefits(1)	\$ 11,732	\$ 9,520	\$ 20,927	\$ 18,051
Non-staff expenses:				
Net occupancy expense	1,967	1,691	3,648	3,062
Depreciation	1,327	1,158	2,502	2,129
Data processing	989	701	1,800	1,297
Communications expense	1,106	954	2,161	1,774
Professional fees	398	289	699	540
Regulatory assessments and FDIC insurance	161	121	330	249
Ad valorem and franchise taxes	583	430	1,071	774
Core deposit intangibles amortization	1,358	1,098	2,425	1,821
Other	1,778	1,850	3,085	3,949
Total non-staff expenses	9,667	8,292	17,721	15,595
Total noninterest expense	\$ 21,399	\$ 17,812	\$ 38,648	\$ 33,646

(1) Includes stock based compensation expense of \$210,000 and \$173,000 for the three months ended June 30, 2006 and 2005, respectively, and \$382,000 and \$303,000 for the six months ended June 30, 2006 and 2005, respectively.

Salaries and employee benefit expenses were \$11.7 million for the quarter ended June 30, 2006 compared with \$9.5 million for the quarter ended June 30, 2005, an increase of \$2.2 million, or 23.2%. For the six months ended June 30, 2006, salaries and employee benefit expenses were \$20.9 million, an increase of \$2.9 million or 15.9% compared with \$18.1 million for the six months ended June 30, 2005. The increases during both periods were principally due to additional staff associated with the SNB acquisition in April 2006. The number of full-time equivalent (FTE) associates employed by the Company increased from 902 at June 30, 2005 to 931 at June 30, 2006.

Non-staff expenses increased \$1.4 million, or 16.6%, to \$9.7 million for the quarter ended June 30, 2006 compared with \$8.3 million during the same period in 2005. Non-staff expenses increased \$2.1 million, or 13.6%, to \$17.7 million for the six months ended June 30, 2006 compared to \$15.6 million during the same period in 2005. The increases during both periods were principally due to additional expenses associated with the SNB acquisition, increases in core deposit intangibles amortization related to the 2005 and 2006 acquisitions and increases in depreciation expense due to the addition of the SNB banking centers.

*Income Taxes*

Income tax expense increased \$2.1 million to \$8.3 million for the quarter ended June 30, 2006 compared with \$6.2 million for the same period in 2005. For the six months ended June 30, 2006, income tax expense totaled \$14.9 million, an increase of \$4.2 million or 39.4% compared with \$10.7 million for the same period in 2005. Both increases were primarily attributable to higher pretax net earnings for the quarter and six months ended June 30, 2006 compared with the same respective periods in 2005.





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## FINANCIAL CONDITION

*Loan Portfolio*

Total loans were \$2.205 billion at June 30, 2006, an increase of \$662.7 million, or 43.0% from \$1.542 billion at December 31, 2005. The increase was primarily due to the SNB acquisition and internal growth. At June 30, 2006, \$585.5 million of total loans was attributed to SNB. Period end loans comprised 56.6% of average earning assets for the quarter ended June 30, 2006 compared with 49.9% of average earning assets for the quarter ended December 31, 2005.

The following table summarizes the loan portfolio of the Company by type of loan as of June 30, 2006 and December 31, 2005:

	June 30,		December 31,	
	2006 Amount	Percent (Dollars in thousands)	2005 Amount	Percent
Commercial and industrial	\$ 297,230	13.5%	\$ 222,773	14.4%
Real estate:				
Construction and land development	396,246	18.0	206,653	13.4
1-4 family residential	373,783	17.0	313,184	20.3
Home equity	64,540	2.9	58,729	3.8
Commercial mortgages	839,769	38.1	566,356	36.7
Farmland	32,756	1.5	30,920	2.0
Multifamily residential	73,004	3.3	32,039	2.1
Agriculture	34,251	1.6	25,429	1.6
Other	21,781	1.0	20,859	1.4
Consumer (net of unearned discount)	71,432	3.1	65,183	4.3
Total loans	\$ 2,204,792	100.0%	\$ 1,542,125	100.0%

*Nonperforming Assets*

The Company had \$1.2 million in nonperforming assets at June 30, 2006 and \$1.4 million in nonperforming assets at December 31, 2005, a decrease of \$237,000 or 16.8%.

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 generally charges off all loans before attaining nonaccrual status.

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

	June 30, 2006	December 31, 2005
	(Dollars in thousands)	
Nonaccrual loans	\$ 350	\$ 355
Restructured loans		
Accruing loans 90 or more days past due	744	788
Total nonperforming loans	1,094	1,143
Repossession assets		26
Other real estate	77	239

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Total nonperforming assets	\$ 1,171	\$ 1,408
Nonperforming assets to total loans and other real estate	0.05%	0.09%

**Table of Contents***Allowance for Credit Losses*

Management actively monitors the Company's asset quality and provides specific loss allowances when necessary. Loans are charged-off against the allowance for credit losses when appropriate. Although management believes it uses the best information available to make determinations with respect to the allowance for credit losses, future adjustments may be necessary if economic conditions differ from the assumptions used in making the initial determinations. As of June 30, 2006, the allowance for credit losses amounted to \$24.3 million, or 1.10% of total loans compared with \$17.2 million, or 1.12% of total loans at December 31, 2005.

Set forth below is an analysis of the allowance for credit losses for the six months ended June 30, 2006 and the year ended December 31, 2005:

	<b>As of and for the Six Months Ended June 30, 2006</b>	<b>As of and for the Year Ended December 31, 2005</b>
	<b>(Dollars in thousands)</b>	
Average loans outstanding	\$ 1,864,558	\$ 1,435,376
Gross loans outstanding at end of period	\$ 2,204,792	\$ 1,542,125
Allowance for credit losses at beginning of period	\$ 17,203	\$ 13,105
Balance acquired with the SNB acquisition in 2006 and the First Capital and Grapeland acquisitions in 2005, respectively	7,054	4,028
Provision for credit losses	240	480
Charge-offs:		
Commercial and industrial	(138)	(410)
Real estate and agriculture	(21)	(242)
Consumer	(156)	(240)
Recoveries:		
Commercial and industrial	19	188
Real estate and agriculture	33	184
Consumer	46	110
Net charge-offs	(217)	(410)
Allowance for credit losses at end of period	\$ 24,280	\$ 17,203
Ratio of allowance to end of period loans	1.10%	1.12%
Ratio of net charge-offs to average loans	0.01%	0.03%
Ratio of allowance to end of period nonperforming loans	2,219.4%	1,505.1%

*Securities*

Carrying cost of securities totaled \$1.64 billion at June 30, 2006 compared with \$1.57 billion at December 31, 2005, an increase of \$70.8 million or 4.5%. The increase was principally due to the SNB acquisition. At June 30, 2006, securities represented 36.3% of total assets compared with 43.9% of total assets at December 31, 2005.

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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):

	June 30, 2006	December 31, 2005
	(Dollars in thousands)	
U.S. Treasury securities and obligations of U.S. government agencies	\$ 319,022	\$ 296,349
70% non-taxable preferred stock	24,000	24,000
States and political subdivisions	48,634	31,250
Corporate debt securities	7,234	8,550
Collateralized mortgage obligations	308,219	222,615
Mortgage-backed securities	932,133	987,088
Qualified Zone Academy Bond (QZAB)	8,000	8,000
Other	4,018	814
<b>Total amortized cost</b>	<b>\$ 1,651,260</b>	<b>\$ 1,578,666</b>
<b>Total fair value</b>	<b>\$ 1,593,874</b>	<b>\$ 1,546,055</b>

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things, (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, and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Management has the ability and intent to hold the securities classified as held to maturity until they mature, at which time the Company will receive full value for the securities. Furthermore, management also has the ability and intent to hold the securities classified as available for sale for a period of time sufficient for 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 bonds 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 June 30, 2006, 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.

*Premises and Equipment*

Premises and equipment, net of accumulated depreciation, totaled \$64.2 million and \$49.2 million at June 30, 2006 and December 31, 2005, respectively, an increase of \$15.0 million or 30.5%. The increase was primarily due to the SNB acquisition which added (5) five banking centers in April 2006 and an additional banking center under construction that opened in July 2006.

*Deposits*

Total deposits were \$3.640 billion at June 30, 2006 compared with \$2.920 billion at December 31, 2005, an increase of \$719.7 million or 24.6%. The increase was primarily due to the SNB acquisition in April 2006. At June 30, 2006 and December 31, 2005, noninterest-bearing deposits accounted for approximately 23.1% of total deposits. Interest-bearing demand deposits totaled \$2.801 billion, or 76.9%, of total deposits at June 30, 2006 compared with \$2.246 billion, or 76.9%, of total deposits at December 31, 2005.

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

For the Six Months Ended June 30, 2006		For the Year Ended December 31, 2005	
Amount	Rate	Amount	Rate
(Dollars in thousands)			

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Interest-bearing checking	\$ 572,589	1.65%	\$ 477,199	0.98%
Regular savings	164,685	1.09	150,577	0.83
Money market savings	663,426	2.63	545,660	1.73
Time deposits	1,139,978	3.66	1,009,147	2.80
<b>Total interest-bearing deposits</b>	<b>2,540,678</b>	<b>2.78</b>	<b>2,182,583</b>	<b>2.00</b>
Noninterest-bearing deposits	754,309		609,230	
<b>Total deposits</b>	<b>\$ 3,294,987</b>	<b>2.14%</b>	<b>\$ 2,791,813</b>	<b>1.56%</b>

**Table of Contents***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. At June 30, 2006, the Company had \$77.7 million in FHLB borrowings of which \$40.0 million consisted of FHLB advances and \$37.7 million consisted of long-term FHLB notes payable compared with \$55.4 million in FHLB borrowings at December 31, 2005, which consisted of \$38.4 million in long-term FHLB notes payable and \$17.0 million in FHLB advances. The maturity dates on the FHLB notes payable range from the years 2006 to 2028 and have interest rates ranging from 2.79% to 6.48%. The highest outstanding balance of FHLB advances during the six months ended June 30, 2006 was \$116.0 million compared with \$39.0 million during the year ended December 31, 2005. The Company had no federal funds purchased at June 30, 2006 or December 31, 2005.

At June 30, 2006, the Company had \$47.5 million in securities sold under repurchase agreements compared with \$47.0 million at December 31, 2005.

*Junior Subordinated Debentures*

At June 30, 2006 and December 31, 2005, the Company had outstanding \$100.5 million and \$75.8 million, respectively, in junior subordinated debentures issued to the Company's subsidiary trusts. The increase of \$24.7 million was due to the Company's assumption of \$30.9 million in junior subordinated debentures issued by SNB to its three subsidiary trusts, partially offset by the redemption of \$6.2 million junior subordinated debentures held by Paradigm Capital Trust II on February 28, 2006.

A summary of pertinent information related to the Company's eight issues of junior subordinated debentures outstanding at June 30, 2006 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	\$ 15,464,000	July 31, 2031
			+ 3.58%, not to exceed 12.50%		
Prosperity Statutory Trust III	Aug. 15, 2003	12,500,000	6.50%(3)	12,887,000	Sept. 17, 2033
Prosperity Statutory Trust IV	Dec. 30, 2003	12,500,000	6.50%(4)	12,887,000	Dec. 30, 2033
First Capital Statutory Trust I(5)	Mar. 26, 2002	20,000,000	3-month LIBOR	20,619,000	Mar. 26, 2032
			+3.60%		
First Capital Statutory Trust II(5)	Sept. 26, 2002	7,500,000	3-month LIBOR	7,732,000	Sept. 26, 2032
			+3.40%		
SNB Statutory Trust II(6)	Mar. 26, 2003	10,000,000	3-month LIBOR	10,310,000	Mar. 26, 2033
			+3.15%		
SNB Capital Trust III(6)	Mar. 27, 2003	10,000,000	3-month LIBOR	10,310,000	Mar. 27, 2033
			+3.15%		
SNB Capital Trust IV(6)	Sept. 25, 2003	10,000,000	3-month LIBOR	10,310,000	Sept. 25, 2033
			+3.00%		

(1) The 3-month LIBOR in effect as of June 30, 2006 was 5.48%.







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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.

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*Capital Resources*

Total shareholders' equity was \$635.4 million at June 30, 2006 compared with \$464.7 million at December 31, 2005, an increase of \$170.7 million, or 36.7%. The increase was due primarily to net earnings of \$28.8 million, common stock issued in connection with the SNB acquisition of \$141.4 million and common stock issued in connection with the exercise of stock options of \$7.3 million, partially offset by dividends paid of \$6.1 million for the six months ended June 30, 2006.

Both the Board of Governors of the Federal Reserve System, with respect to the Company, and the Federal Deposit Insurance Corporation (FDIC), with respect to the Bank, have established certain minimum risk-based capital standards that apply to bank holding companies and federally insured banks. As of June 30, 2006, the Company's Tier 1 risk-based capital, total risk-based capital and leverage capital ratios were 12.47%, 13.53% and 6.98%, respectively. As of June 30, 2006, the Bank's risk-based capital ratios were above the levels required for the Bank to be designated as well capitalized by the FDIC, with Tier-1 risk-based capital, total risk-based capital and leverage capital ratios of 12.16%, 13.22% and 6.73%, respectively.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

The Company uses simulation analysis to examine the potential effects of market changes on net interest income and market value. The Company considers macroeconomic variables, Company strategy, liquidity and other factors as it quantifies market risk. See the Company's Annual Report on Form 10-K, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations-Interest Rate Sensitivity and Liquidity which was filed on March 15, 2006 for further discussion.

ITEM 4. CONTROLS AND PROCEDURES

*Evaluation of disclosure controls and procedures.* As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) are effective.

*Changes in internal control over financial reporting.* During the quarter ended June 30, 2006, 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 have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not Applicable

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### ITEM 1A. RISK FACTORS

The Company's Annual Report on Form 10-K for the year ended December 31, 2005 includes a detailed description of the Company's risk factors. The information presented below updates and should be read in conjunction with the risk factors disclosed in the Form 10-K.

#### **Risks Related to the Company's Pending Acquisition of Texas United Bancshares, Inc.**

*There may be undiscovered risks or losses associated with the Texas United acquisition.*

As a result of the pending acquisition of Texas United, the Company will acquire all of the assets and liabilities of Texas United, including, without limitation, its loan portfolio. The Company has not previously owned or operated Texas United and it does not have any detailed working experience related to its business and operations. There may be instances when the Company, under its normal operating procedures, may find after the acquisition, that there may be additional losses or undisclosed liabilities with respect to the assets and liabilities of Texas United, and, with respect to its loan portfolio, that the ability of a borrower to repay a loan may have become impaired, the quality of the value of the collateral securing a loan may fall below the Company's standards or the allowance for credit losses may not be adequate. One or more of these factors might cause the Company to have additional losses or liabilities, additional loan charge-offs or increases in allowance for credit losses, which could have a negative impact upon the Company's future income.

*The Company may not be able to successfully consummate the acquisition of Texas United. Even if the acquisition is consummated, the Company may not be able to integrate Texas United's operations with its business efficiently.*

While the Company has entered into a definitive agreement to acquire all of the capital stock of Texas United, there are a number of conditions to completing the acquisition, including regulatory approval and the approval of the shareholders of Texas United and the Company, and there can be no assurance that those conditions will be satisfied. Even if the acquisition is consummated, it will create risks associated with the integration of Texas United's operations with the Company's operations, including, without limitation, the loss of key employees and customers, the disruption of ongoing businesses and possible inconsistencies in standards, controls and procedures.

The Company may not realize the benefits from the Texas United acquisition that it anticipates, or it may not be able to integrate Texas United's operations successfully. If the Company fails to integrate the operations of Texas United efficiently, it could have a material adverse effect on the Company's business, financial condition, results of operation and future prospects.

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

a. Not applicable

b. Not applicable

c. Not applicable

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On April 18, 2006, the Company held its Annual Meeting of Shareholders to consider and act upon the items listed below:

1. James A. Bouligny, Charles J. Howard, M.D., S. Reed Morian, Robert Steelhammer and H.E. Timanus, Jr. were elected as Class II directors to serve on the Board of Directors of the Company until the Company's 2009 Annual Meeting of

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Shareholders and until their successors are duly elected and qualified. A total of 23,287,341 shares were voted in favor of the election of James. A. Boulogny and 1,090,926 shares were withheld from voting. A total of 23,335,464 shares were voted in favor of the election of Charles J. Howard, M.D. and 1,042,803 shares were withheld from voting. A total of 22,787,953 shares were voted in favor of the election of S. Reed Morian and 1,590,314 shares were withheld from voting. A total of 22,661,576 shares were voted in favor of the election of Robert Steelhammer and 1,716,691 shares were withheld from voting. A total of 23,269,295 shares were voted in favor of the election of H.E. Timanus, Jr. and 1,108,972 shares were withheld from voting.

The following Class I and Class III directors continued in office after the Annual Meeting: Charles A. Davis, Jr., William H. Fagan, M.D., Ned S. Holmes, D. Michael Hunter, Perry Mueller, Jr., D.D.S., Tracy T. Rudolph, Harrison Stafford II and David Zalman.

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2. The shareholders approved an amendment to the Company's Articles of Incorporation to increase the number of authorized shares of Common Stock from 50,000,000 to 200,000,000 shares. A total of 16,161,083 shares were voted in favor of the amendment, 8,169,338 shares were voted against the amendment and 47,846 shares abstained from voting.
  
3. The shareholders ratified the appointment of Deloitte & Touche LLP as the Company's independent registered public accounting firm for the year ending December 31, 2006. A total of 23,637,557 shares were voted in favor of the appointment, 716,607 shares were voted against the appointment and 24,103 shares abstained from voting.

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS

- a. Exhibits:

The following exhibits are furnished with this Quarterly Report on Form 10-Q:

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
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.

SIGNATURES

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

PROSPERITY BANCSHARES, INC.<sup>SM</sup>  
(Registrant)

Date: 08/09/06

/s/ David Zalman  
David Zalman  
Chief Executive Officer

Date: 08/09/06

/s/ David Hollaway  
David Hollaway  
Chief Financial Officer