PROSPERITY BANCSHARES INC
Form 10-Q
May 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2012

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 001-35388

PROSPERITY BANCSHARES, INC.®

(Exact name of registrant as specified in its charter)

TEXAS	**74-2331986**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

Prosperity Bank Plaza

4295 San Felipe

Houston, Texas 77027

(Address of principal executive offices, including zip code)

(713) 693-9300

(Registrant s telephone number, including area code)

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

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

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

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

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

As of May 1, 2012, there were 47,451,041 outstanding shares of the registrant s Common Stock, par value $1.00 per share.

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PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION

ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS

PROSPERITY BANCSHARES, INC®. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	March 31, 2012	December 31, 2011
	(In thousands, except share data)	
ASSETS		
Cash and due from banks	$ 151,467	$ 212,800
Federal funds sold	445	642
Total cash and cash equivalents	151,912	213,442
Securities available for sale, at fair value (amortized cost of $278,974 and $301,589, respectively)	298,516	322,316
Securities held to maturity, at cost (fair value of $5,494,671 and $4,492,988, respectively)	5,348,013	4,336,620
Loans held for investment	3,874,862	3,765,906
Allowance for credit losses	(51,642)	(51,594)
Loans, net	3,823,220	3,714,312
Accrued interest receivable	30,261	29,405
Goodwill	929,161	924,537
Core deposit intangibles, net of accumulated amortization of $59,583 and $58,158, respectively	19,301	20,996
Bank premises and equipment, net	162,676	159,656
Other real estate owned	7,718	8,328
Bank Owned Life Insurance (BOLI)	52,191	50,029
Federal Home Loan Bank stock	35,032	11,601
Other assets	31,954	31,429
TOTAL ASSETS	$ 10,889,955	$ 9,822,671
LIABILITIES AND SHAREHOLDERS EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	$ 2,088,749	$ 1,972,226
Interest-bearing	6,455,702	6,088,028
Total deposits	8,544,451	8,060,254
Other borrowings	527,536	12,790
Securities sold under repurchase agreements	58,481	54,883
Accrued interest payable	2,573	2,803
Other liabilities	62,326	39,621
Junior subordinated debentures	85,055	85,055
Total liabilities	9,280,422	8,255,406
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS EQUITY:		

Preferred stock, $1 par value; 20,000,000 shares authorized; none issued or outstanding		
Common stock, $1 par value; 200,000,000 shares authorized;47,333,949 and 46,947,415 shares issued at March 31, 2012 and December 31, 2011, respectively; 47,296,861 and 46,910,327 shares outstanding at March 31, 2012 and December 31, 2011, respectively	47,334	46,947
Capital surplus	898,962	883,575
Retained earnings	651,142	623,878
Accumulated other comprehensive income net unrealized gain on available for sale securities, net of tax of $6,840 and $7,254, respectively	12,702	13,472
Less treasury stock, at cost, 37,088 shares	(607)	(607)
Total shareholders equity	1,609,533	1,567,265
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 10,889,955	$ 9,822,671

See notes to interim condensed consolidated financial statements.

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PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
	(Dollars in thousands, except per share data)	
INTEREST INCOME:		
Loans, including fees	$ 53,217	$ 52,200
Securities	38,321	41,204
Federal funds sold	78	5
Total interest income	91,616	93,409
INTEREST EXPENSE:		
Deposits	8,791	11,512
Junior subordinated debentures	663	1,147
Notes payable and other borrowings	316	337
Total interest expense	9,770	12,996
NET INTEREST INCOME	81,846	80,413
PROVISION FOR CREDIT LOSSES	150	1,700
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	81,696	78,713
NONINTEREST INCOME:		
Customer service fees	11,666	12,042
Other	2,279	1,825
Total noninterest income	13,945	13,867
NONINTEREST EXPENSE:		
Salaries and employee benefits	23,252	23,204
Net occupancy	3,557	3,648
Depreciation	2,035	2,021
Debit card, data processing and software amortization	1,532	1,672
Communications	1,748	1,692
Core deposit intangibles amortization	1,695	2,034
Other	6,640	7,424
Total noninterest expense	40,459	41,695
INCOME BEFORE INCOME TAXES	55,182	50,885
PROVISION FOR INCOME TAXES	18,695	17,007
NET INCOME	$ 36,487	$ 33,878
EARNINGS PER SHARE		
Basic	$ 0.77	$ 0.72

Diluted	$	0.77	$	0.72
CASH DIVIDENDS DECLARED				
Cash dividends declared on common stock	$	9,223	$	8,186
Cash dividends declared per common share	$	0.195	$	0.175

See notes to interim consolidated financial statements.

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PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

	Three Months Ended March 31,	
	2012	**2011**
	(Dollars in thousands)	
Net income	$ 36,487	$ 33,878
Other comprehensive loss, before tax:		
Securities available for sale:		
Change in unrealized gain/loss during the period	(1,185)	(919)
Total other comprehensive loss, before tax	(1,185)	(919)
Deferred tax benefit related to other comprehensive income	(415)	(322)
Other comprehensive loss, net of tax	(770)	(597)
Comprehensive income	$ 35,717	$ 33,281

See notes to interim consolidated financial statements.

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PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(UNAUDITED)

	Common Stock Shares	Common Stock Amount	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Shareholders Equity
	(Amounts in thousands, except share and per share data)						
BALANCE AT JANUARY 1, 2011	46,721,114	$ 46,721	$ 876,050	$ 515,871	$ 14,304	$ (607)	$ 1,452,339
Net income				33,878			33,878
Other comprehensive loss					(597)		(597)
Common stock issued in connection with the exercise of stock options and restricted stock awards	97,600	98	2,259				2,357
Stock based compensation expense			707				707
Cash dividends declared, $0.175 per share				(8,186)			(8,186)
BALANCE AT MARCH 31, 2011	46,818,714	$ 46,819	$ 879,016	$ 541,563	$ 13,707	$ (607)	$ 1,480,498
BALANCE AT JANUARY 1, 2012	46,947,415	$ 46,947	$ 883,575	$ 623,878	$ 13,472	$ (607)	$ 1,567,265
Net income				36,487			36,487
Other comprehensive loss					(770)		(770)
Common stock issued in connection with the exercise of stock options and restricted stock awards	71,581	72	1,779				1,851
Common stock issued in connection with the acquisition of Texas Bankers, Inc.	314,953	315	12,393				12,708
Stock based compensation expense			1,215				1,215
Cash dividends declared, $0.195 per share				(9,223)			(9,223)
BALANCE AT MARCH 31, 2012	47,333,949	$ 47,334	$ 898,962	$ 651,142	$ 12,702	$ (607)	$ 1,609,533

See notes to interim consolidated financial statements.

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PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Three Months Ended March 31, 2012	2011
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 36,487	$ 33,878
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,730	4,055
Provision for credit losses	150	1,700
Net premium amortization on investments	9,720	6,980
Stock based compensation expense	1,215	707
Net accretion of discount on loans and deposits		(50)
Gain on sale of assets and other real estate	(411)	(4)
(Increase) decrease in other assets and accrued interest receivable	(24,626)	7,195
Increase in accrued interest payable and other liabilities	23,846	19,295
Net cash provided by operating activities	50,111	73,756
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal paydowns of held to maturity securities	354,183	334,446
Purchase of held to maturity securities	(1,375,431)	(554,369)
Proceeds from maturities and principal paydowns of available for sale securities	22,813	30,497
Net increase in loans	(85,120)	(94,435)
Cash and cash equivalents acquired in the purchase of Texas Bankers, Inc.	44,550	
Purchase of bank premises and equipment	(2,264)	(2,288)
Net proceeds from sale of bank premises, equipment and other real estate	4,817	5,628
Net cash used in investing activities	(1,036,452)	(280,521)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in noninterest-bearing deposits	$ 95,498	$ 57,237
Net increase in interest-bearing deposits	318,341	304,390
Net proceeds from (repayments of) short-term borrowings	515,000	(146,000)
Net repayments of long-term borrowings	(254)	(341)
Net proceeds from (repayments from) securities sold under repurchase agreements	3,598	(8,812)
Redemption of junior subordinated debentures		(7,210)
Proceeds from exercise of stock options	1,851	2,357
Payments of cash dividends	(9,223)	(8,186)
Net cash provided by financing activities	924,811	193,435
NET DECREASE IN CASH AND CASH EQUIVALENTS	$ (61,530)	$ (13,330)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	213,442	159,368
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 151,912	$ 146,038
NONCASH ACTIVITIES:		
Stock issued in connection with the Texas Bankers, Inc. acquisition	12,708	
SUPPLEMENTAL DISCLOSURES:		

Cash paid for interest	$ 10,001	$ 13,492
Cash paid for income taxes	250	2,000
Noncash investing and financing activities-acquisition of real estate through foreclosure of collateral	3,559	5,935

See notes to interim consolidated financial statements.

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PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2012

(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 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, 2011. Operating results for the three-month period ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012 or any other period.

2. INCOME PER COMMON SHARE

Net income per common share for all periods presented has been calculated in accordance with ASC Topic 260. Outstanding stock options issued by the Company represent the only dilutive effect reflected in diluted weighted average shares. The following table illustrates the computation of basic and diluted earnings per share:

	Three Months Ended March 31, 2012	2011
	(In thousands, except per share data)	
Net income available to shareholders	$ 36,487	$ 33,878
Weighted average shares outstanding	47,238	46,733
Potential dilutive shares	173	209
Weighted average shares and equivalents outstanding	47,411	46,942
Basic earnings per share	$ 0.77	$ 0.72
Diluted earnings per share	$ 0.77	$ 0.72

The incremental shares for the assumed exercise of the outstanding options were determined by application of the treasury stock method. There were no stock options exercisable during the quarters ended March 31, 2012 or 2011 that would have had an anti-dilutive effect on the above computation.

3. NEW ACCOUNTING STANDARDS

Accounting Standards Updates

ASU 2011-03, Transfers and Servicing (Topic 860) Reconsideration of Effective Control for Repurchase Agreements. ASU 2011-03 is intended to improve financial reporting of repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. ASU 2011-03 removes from the assessment of effective control (i) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (ii) the collateral maintenance guidance related to that criterion. ASU 2011-03 became effective for the Company on January 1, 2012 and did not have a significant impact on the Company s financial statements.

ASU 2011-04, Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs. ASU 2011-04 amends Topic 820, Fair Value Measurements and Disclosures, to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 became effective for the Company on January 1, 2012 and did not have a significant impact on the Company s financial statements (see Note 5-Fair Value).

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PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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ASU 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income. ASU 2011-05 amends Topic 220, Comprehensive Income, to require that all non-owner changes in stockholders equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders equity was eliminated. ASU 2011-05 became effective for the Company on January 1, 2012; however, certain provisions related to the presentation of reclassification adjustments have been deferred by ASU 2011-12 Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05, as further discussed below. In connection with the application of ASU 2011-05, the Company s financial statements now include a separate statement of comprehensive income.

ASU 2011-08, Intangibles Goodwill and Other (Topic 350) Testing Goodwill for Impairment. ASU 2011-08 amends Topic 350, Intangibles Goodwill and Other, to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. ASU 2011-08 became effective for the Company on January 1, 2012 and did not have a significant impact on the Company s financial statements.

ASU 2011-11, Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities. ASU 2011-11 amends Topic 210, Balance Sheet, to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. ASU 2011-11 is effective for annual and interim periods beginning on January 1, 2013, and is not expected to have a significant impact on the Company s financial statements.

ASU 2011-12 Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. ASU 2011-12 defers changes in ASU 2011-05 that relate to the presentation of reclassification adjustments to allow the FASB time to redeliberate whether to require presentation of such adjustments on the face of the financial statements to show the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. ASU 2011-12 allows entities to continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. All other requirements in ASU 2011-05 are not affected by ASU 2011-12. ASU 2011-12 became effective for the Company on January 1, 2012 and did not have a significant impact on the Company s financial statements.

PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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4. LOANS AND ALLOWANCE FOR CREDIT LOSSES

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

	March 31, 2012	December 31, 2011
	(Dollars in thousands)	
Commercial and industrial	$ 442,559	$ 406,433
Real estate:		
Construction and land development	484,295	482,140
1-4 family residential	1,036,318	1,007,266
Home equity	149,597	146,999
Commercial real estate	1,379,242	1,351,986
Agriculture real estate (farmland)	144,399	136,008
Multi-family residential	94,683	89,240
Agriculture	34,075	34,226
Consumer (net of unearned discount)	76,393	78,187
Other	33,301	33,421
Total	$ 3,874,862	$ 3,765,906

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

(ii) Commercial Real Estate. The Company makes commercial real estate related loans collateralized by owner-occupied and non-owner-occupied real estate to finance the purchase of real estate. The Company s commercial real estate related loans are collateralized by first liens on real estate, typically have variable interest rates (or five year or less fixed rates) and amortize over a 15 to 20 year period. Payments on loans secured by such properties are often dependent on the successful operation or management of the properties. Accordingly, repayment of these loans may be subject to adverse conditions in the real estate market or the economy to a greater extent than other types of loans. The Company seeks to minimize these risks in a variety of ways, including giving careful consideration to the property s operating history, future operating projections, current and projected occupancy, location and physical condition in connection with underwriting these loans. The underwriting analysis also includes credit verification, analysis of global cash flow, appraisals and a review of the financial condition of the borrower. At March 31, 2012, the Company had commercial real estate related loans totaling $1.96 billion which include the categories of construction and land development loans, commercial real estate loans and multi-family residential loans. At March 31, 2012, approximately 35.1% of the outstanding principal balance of the Company s commercial real estate related loans was secured by owner-occupied properties.

PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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(iii) 1-4 Family Residential Loans. The Company originates 1-4 family residential mortgage loans collateralized by owner-occupied residential properties located in the Company s market areas. The Company offers a variety of mortgage loan products which generally are amortized over five to 25 years. Loans collateralized by 1-4 family residential real estate generally have been originated in amounts of no more than 89% of appraised value or have mortgage insurance. The Company requires mortgage title insurance and hazard insurance. The Company has elected to keep all 1-4 family residential loans for its own account rather than selling such loans into the secondary market. By doing so, the Company is able to realize a higher yield on these loans; however, the Company also incurs interest rate risk as well as the risks associated with nonpayments on such loans.

(iv) Construction and Land Development Loans. The Company makes loans to finance the construction of residential and, to a lesser extent, nonresidential properties. Construction loans generally are collateralized by first liens on real estate and have floating interest rates. The Company conducts periodic inspections, either directly or through an agent, prior to approval of periodic draws on these loans. Underwriting guidelines similar to those described above are also used in the Company s construction lending activities. Construction loans involve additional risks attributable to the fact that loan funds are advanced upon the security of a project under construction, and the project is of uncertain value prior to its completion. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If the Company is forced to foreclose on a project prior to completion, there is no assurance that the Company will be able to recover all of the unpaid portion of the loan. In addition, the Company may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. While the Company has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, no assurance can be given that these procedures will prevent losses from the risks described above.

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

(vi) Consumer Loans. Consumer loans made by the Company include direct credit automobile loans, recreational vehicle loans, boat loans, home improvement loans, home equity loans, personal loans (collateralized and uncollateralized) and deposit account collateralized loans. The terms of these loans typically range from 12 to 120 months and vary based upon the nature of collateral and size of loan. Generally, consumer loans entail greater risk than do real estate secured loans, particularly in the case of consumer loans that are unsecured or collateralized by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan balance. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws may limit the amount which can be recovered on such loans.

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

Concentrations of Credit. Most of the Company s lending activity occurs within the State of Texas, including the four largest metropolitan areas of Austin, Dallas/Ft. Worth, Houston and San Antonio, as well as other markets. The majority of the Company s loan portfolio consists of commercial and industrial and commercial real estate loans. As of March 31, 2012 and December 31, 2011, there were no concentrations of loans related to any single industry in excess of 10% of total loans.

PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2012

(UNAUDITED)

Foreign Loans. The Company has U.S. dollar denominated loans and commitments to borrowers in Mexico. The outstanding balance of these loans and the unfunded amounts available under these commitments were not significant at March 31, 2012 or December 31, 2011.

Related Party Loans. As of March 31, 2012 and December 31, 2011, loans outstanding to directors, officers and their affiliates totaled $7.3 million and $9.8 million, respectively. All transactions entered into between the Company and such related parties are done in the ordinary course of business and made on the same terms and conditions as similar transactions with unaffiliated persons.

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

	March 31, 2012	December 31, 2011
	(Dollars in thousands)	
Beginning balance	$ 9,809	$ 12,783
New loans and reclassified related loans	200	4,168
Repayments	(2,728)	(7,142)
Ending balance	$ 7,281	$ 9,809

Nonaccrual and Past Due Loans. The Company has several procedures in place to assist it in maintaining the overall quality of its loan portfolio. The Company has established underwriting guidelines to be followed by its officers and the Company also monitors its delinquency levels for any negative or adverse trends. There can be no assurance, however, that the Company s loan portfolio will not become subject to increasing pressures from deteriorating borrower credit due to general economic conditions.

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

The Company requires appraisals on loans collateralized by real estate. With respect to potential problem loans, an evaluation of the borrower s overall financial condition is made to determine the need, if any, for possible writedowns or appropriate additions to the allowance for credit losses.

As of the dates indicated, nonaccrual loans, segregated by class of loans, were as follows:

	March 31, 2012	December 31, 2011
	(Dollars in thousands)	
Construction and land development	$ 1,210	$ 1,175
Agriculture and agriculture real estate	67	49
1-4 family residential (includes home equity)	937	923
Commercial real estate (includes multi-family residential)	4,266	790
Commercial and industrial	654	633

Consumer and other	8	8
Total	$ 7,142	$ 3,578

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An age analysis of past due loans, segregated by class of loans, as of March 31, 2012 and December 31, 2011 were as follows:

	As of March 31, 2012				
	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Accruing Loans 90 or More Days Past Due
	(Dollars in thousands)				
Construction and land development	$ 3,963	$ 1,210	$ 5,173	$ 479,122	$
Agriculture and agriculture real estate	88	9	97	178,377	
1-4 family (includes home equity)	1,181	563	1,744	1,184,171	
Commercial real estate (includes multi-family residential)	4,947	3,097	8,044	1,465,881	
Commercial and industrial	1,465	364	1,829	440,730	
Consumer and other	242	6	248	109,446	
Total	$ 11,886	$ 5,249	$ 17,135	$ 3,857,727	$

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

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

	March 31, 2012	December 31, 2011
	(Dollars in thousands)	
Nonaccrual loans	$ 7,142	$ 3,578
Total nonperforming loans	7,142	3,578

Repossessed assets	13	146
Other real estate	7,718	8,328
Total nonperforming assets	$ 14,873	$ 12,052
Nonperforming assets to total loans and other real estate	0.38%	0.32%

The Company believes its conservative lending approach has resulted in sound asset quality. The Company had $14.9 million in nonperforming assets at March 31, 2012 compared with $12.1 million at December 31, 2011. If interest on nonaccrual loans had been accrued under the original loan terms, approximately $162,000 would have been recorded as income for the three months ended March 31, 2012.

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

Impaired loans as of March 31, 2012 are set forth in the following table. No interest income was recognized on impaired loans subsequent to their classification as impaired. The average recorded investment is reported on a year-to-date basis.

	March 31, 2012			
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
	(Dollars in thousands)			
With no related allowance recorded:				
Construction and land development	$ 276	$ 277	$	$ 194
Agriculture and agriculture real estate	5	6		5
1-4 family (includes home equity)	340	379		326
Commercial real estate (includes multi-family residential)	1,505	1,527		1,087
Commercial and industrial	4	6		58
Consumer and other				
With an allowance recorded:				
Construction and land development	1,064	1,064	312	1,064
Agriculture and agriculture real estate	42	45	42	42
1-4 family (includes home equity)	601	661	272	639
Commercial real estate (includes multi-family residential)	5,161	5,167	815	2,822
Commercial and industrial	610	2,029	310	566
Consumer and other	7	18	6	7
Total:				
Construction and land development	1,340	1,341	312	1,258
Agriculture and agriculture real estate	47	51	42	47
1-4 family (includes home equity)	941	1,040	272	965
Commercial real estate (includes multi-family residential)	6,666	6,694	815	3,909
Commercial and industrial	614	2,035	310	624
Consumer and other	7	18	6	7

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Impaired loans as of December 31, 2011 are set forth in the following tables. No interest income was recognized on impaired loans subsequent to their classification as impaired. The average recorded investment is reported on a year-to-date basis.

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

Credit Quality Indicators. As part of the ongoing monitoring of the credit quality of the Company s loan portfolio and methodology for calculating the allowance for credit losses, management assigns and tracks loan grades to be used as credit quality indicators. The following is a general description of the loan risk grades used (1-7):

Grade 1 Credits in this category are of the highest standards of credit quality with virtually no risk of loss. These borrowers would represent top rated companies and individuals with unquestionable financial standing with excellent global cash flow coverage, net worth, liquidity and collateral coverage and/or secured by CD/savings accounts.

Grade 2 Credits in this category are not immune from risk but are well-protected by the collateral and paying capacity of the borrower. These loans may exhibit a minor unfavorable credit factor, but the overall credit is sufficiently strong to minimize the possibility of loss.

Grade 3 Credits graded 3 constitute an undue and unwarranted credit risk, however the factors do not rise to a level of substandard. These credits have potential weaknesses and/or declining trends that, if not corrected, could expose the Company to risk at a future date. Credits graded

3 are monitored on the Company s internally generated watch list and evaluated on a quarterly basis.

Grade 4 Credits in this category are deemed substandard loans in accordance with regulatory guidelines. Loans in this category have well-defined weakness that, if not corrected, could make default of principal and interest possible, but it is not yet certain. Loans in this category are still accruing interest and may be dependent upon secondary sources of repayment and/or collateral liquidation.

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Grade 5 Credits in this category are deemed substandard and impaired pursuant to regulatory guidelines. As such, the Company has determined that it is probable that less than 100% of the principal and interest will be collected. Loans graded 5 are individually evaluated for a specific reserve valuation and will typically have the accrual of interest stopped.

Grade 6 Credits in this category include doubtful loans in accordance with regulatory guidance. Such loans are on nonaccrual and factors have indicated a loss is imminent. These loans are also deemed impaired. While a specific reserve may be in place while the loan and collateral is being evaluated these loans are typically charged down to an amount the Company deems collectable.

Grade 7 Credits in this category are deemed a loss in accordance with regulatory guidelines and charged off or charged down. The Company may continue collection efforts and may have partial recovery in the future.

The following table presents risk grades and classified loans by class of loan at March 31, 2012. Classified loans include loans in risk grades 5, 6 and 7.

	Construction and Land Development	Agriculture and Agriculture Real Estate	1-4 Family (Includes Home Equity)	Commercial Real Estate (Includes Multi-Family)	Commercial and Industrial	Consumer and Other	Total
				(Dollars in thousands)			
Grade 1	$	$ 2,866	$	$	$ 44,595	$ 29,250	$ 76,711
Grade 2	467,926	175,256	1,170,383	1,432,728	393,055	80,134	3,719,482
Grade 3	1,716	272	9,823	14,878	3,795		30,484
Grade 4	13,313	33	4,768	19,653	500	303	38,570
Grade 5	1,340	47	922	6,666	565	6	9,546
Grade 6			19		49	1	69
Grade 7							
Total	$ 484,295	$ 178,474	$ 1,185,915	$ 1,473,925	$ 442,559	$ 109,694	$ 3,874,862

The following table presents risk grades and classified loans by class of loan at December 31, 2011. Classified loans include loans in risk grades 5, 6 and 7.

	Construction and Land Development	Agriculture and Agriculture Real Estate	1-4 Family (Includes Home Equity)	Commercial Real Estate (Includes Multi-Family)	Commercial and Industrial	Consumer and Other	Total
				(Dollars in thousands)			
Grade 1	$	$ 3,319	$	$	$ 45,218	$ 31,602	$ 80,139
Grade 2	465,572	166,656	1,140,210	1,399,915	355,862	79,996	3,608,211
Grade 3	1,757	210	9,131	14,335	4,189		29,622
Grade 4	13,636		3,934	25,825	531	2	43,928
Grade 5	1,175	49	970	1,151	532	8	3,885

Grade 6			20		101		121
Grade 7							
Total	$ 482,140	$ 170,234	$ 1,154,265	$ 1,441,226	$ 406,433	$ 111,608	$ 3,765,906

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Charge-offs/recoveries, segregated by class of loans, for the three months ended March 31, 2012 and twelve months ended December 31, 2011 were as follows:

	Three Months Ended March 31, 2012		
	Charge-offs	Recoveries	Net Charge-offs
	(Dollars in thousands)		
Construction and land development	$ (26)	$ 4	$ (22)
1-4 family (includes home equity)	(52)	2	(50)
Commercial real estate and agriculture (includes multi-family)	(23)	5	(18)
Commercial and industrial	(78)	93	15
Consumer and other	(203)	176	(27)
	$ (382)	$ 280	$ (102)

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

Allowance for Credit Losses. The allowance for credit losses is a valuation established through charges to earnings in the form of a provision for credit losses. Management has established an allowance for credit losses which it believes is adequate for estimated losses in the Company s loan portfolio. The amount of the allowance for credit losses is affected by the following: (i) charge-offs of loans that occur when loans are deemed uncollectible and decrease the allowance, (ii) recoveries on loans previously charged off that increase the allowance and (iii) provisions for credit losses charged to earnings that increase the allowance. Based on an evaluation of the loan portfolio and consideration of the factors listed below, management presents a quarterly review of the allowance for credit losses to the Bank s Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance.

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

In setting the specific valuation allowance, the Company follows a loan review program to evaluate the credit risk in the loan portfolio. Through this loan review process, the Company maintains an internal list of impaired loans which, along with the delinquency list of loans, helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for credit losses. All loans that have been identified as impaired are reviewed on a quarterly basis in order to determine whether a specific reserve is required. For each impaired loan, the

Company allocates a specific loan loss reserve primarily based on the value of the collateral securing the impaired loan requiring a reserve in accordance with ASC Topic 310, *Receivables*. The specific reserves are determined on an individual loan basis. Impaired loans are excluded from the general valuation allowance described below.

In determining the amount of the general valuation allowance, management considers factors such as historical loan loss experience, industry diversification of the Company s commercial loan portfolio, concentration risk of specific loan types, the volume, growth and composition of the Company s loan portfolio, current economic conditions that may affect the borrower s ability to pay and the value of collateral, the evaluation of the Company s loan portfolio through its internal loan review process, general economic conditions and other qualitative risk factors both internal and external to the Company and other relevant factors in accordance with

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ASC Topic 450. Based on a review of these factors for each loan type, the Company applies an estimated percentage to the outstanding balance of each loan type, excluding any impaired loan. The Company uses this information to establish the amount of the general valuation allowance.

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

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

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

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

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

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

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

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

At March 31, 2012, the allowance for credit losses totaled $51.6 million or 1.33% of total loans. At December 31, 2011, the allowance aggregated $51.6 million or 1.37% of total loans.

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The following table details the recorded investment in loans and activity in the allowance for credit losses by portfolio segment for the three months ended March 31, 2012. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Construction and Land Development	Agriculture and Agriculture Real Estate	1-4 Family (includes Home Equity)	Commercial Real Estate (includes Multi-Family)	Commercial and Industrial	Consumer and Other	Total
				(Dollars in thousands)			
Allowance for credit losses:							
Beginning balance	$ 12,094	$ 511	$ 12,645	$ 21,460	$ 3,826	$ 1,058	$ 51,594
Provision for credit losses	(732)	109	(72)	468	171	206	150
Charge-offs	(26)		(52)	(23)	(78)	(203)	(382)
Recoveries	4		2	5	93	176	280
Net charge-offs	(22)		(50)	(18)	15	(27)	(102)
Ending balance	$ 11,340	$ 620	$ 12,523	$ 21,910	$ 4,012	$ 1,237	$ 51,642
Ending balance: individually evaluated for impairment	$ 312	$ 42	$ 272	$ 815	$ 310	$ 6	$ 1,757
Ending balance: collectively evaluated for impairment	11,028	578	12,251	21,095	3,702	1,231	49,885
Loans:							
Ending balance: individually evaluated for impairment	1,340	47	941	6,666	614	7	9,615
Ending balance: collectively evaluated for impairment	482,955	178,427	1,184,974	1,467,259	441,945	109,687	3,865,247
Ending balance	$ 484,295	$ 178,474	$ 1,185,915	$ 1,473,925	$ 442,559	$ 109,694	$ 3,874,862

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

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

Troubled Debt Restructurings. The restructuring of a loan is considered a troubled debt restructuring if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. Effective July 1, 2011, the Company adopted the provisions of ASU No. 2011-02, Receivables (Topic 310) A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring. As such, the Company reassessed all loan modifications occurring since January 1, 2011 for identification as troubled debt restructurings.

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The Company had the following troubled debt restructurings outstanding as of the dates indicated:

	As of March 31, 2012			As of December 31, 2011		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in thousands)					
Troubled Debt Restructurings						
Construction and land development		$	$		$	$
Agriculture and agriculture real estate						
1-4 Family (includes home equity)	4	109	76	4	109	84
Commercial real estate (includes multi-family)	1	2,560	2,493	2	5,264	5,171
Commercial and industrial	3	114	93	3	114	93
Consumer and other						
Total	8	$ 2,783	$ 2,662	9	$ 5,487	$ 5,348

As of March 31, 2012, there have been no defaults on any loans that were modified as troubled debt restructurings during the preceding three months. Default is determined at 90 or more days past due. The modifications primarily related to extending the amortization periods of the loans, which includes loans modified during bankruptcy. The Company did not grant principal reductions on any restructured loan. Loans restructured during the three months ended March 31, 2012 on non-accrual status as of March 31, 2012 totaled $169,000. The remaining restructured loans are performing and accruing loans. These modifications did not have a material impact on the Company s determination of the allowance for credit losses.

5. FAIR VALUE

Effective January 1, 2008, the Company adopted FASB ASC Topic 820, *Fair Value Measurement and Disclosures*. ASC Topic 820, which defines fair value, addresses aspects of the expanding application of fair value accounting and establishes a consistent framework for measuring fair value. Fair value represents the estimated price that would be received from selling an asset or paid to transfer a liability, otherwise knows as an exit price.

Fair Value Hierarchy

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

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

Level 2 Other significant observable inputs (including quoted prices in active markets for similar assets or liabilities) or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company s Level 2 assets include U.S. government and agency mortgage-backed debt securities, corporate securities and municipal bonds.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation.

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

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The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of March 31, 2012 and December 31, 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	March 31, 2012			
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Available for sale securities (at fair value):				
States and political subdivisions	$	$ 37,916	$	$ 37,916
Corporate debt securities and other	7,628	1,602		9,230
Collateralized mortgage obligations		727		727
Mortgage-backed securities		250,643		250,643
TOTAL	$ 7,628	$ 290,888	$	$ 298,516

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

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets measured at fair value on a non-recurring basis during the reported periods include certain impaired loans reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data, typically in the case of real estate collateral. For the three months ended March 31, 2012, the Company had additions to impaired loans of $2.1 million of which $2.1 million were outstanding at March 31, 2012.

Financial assets measured at fair value on a non-recurring basis during the reported periods also include other real estate owned and repossessed assets. For the three months ended March 31, 2012, the Company had additions to other real estate owned of $3.5 million, of which $718,000 were outstanding at March 31, 2012. The remaining financial assets and financial liabilities measured at fair value on a non-recurring basis that were recorded in 2012 and remained outstanding at March 31, 2012 were not significant. During the reported periods, all fair value measurements for other real estate owned and repossessed assets utilized Level 2 inputs based on observable market data. There were no transfers between Level 1 and Level 2 assets during the three months ended March 31, 2012.

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

Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. FASB ASC Topic 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

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

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The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

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

Federal Funds Sold The carrying amount is a reasonable estimate of fair value.

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

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

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

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

Other Borrowings Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of existing debt using a discounted cash flows methodology.

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

Off-Balance Sheet Financial Instruments The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and the present creditworthiness of the counterparties.

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

	March 31, 2012	
	Carrying Amount	**Estimated Fair Value**
	(Dollars in thousands)	
Financial assets:		
Cash and due from banks	$ 151,467	$ 151,467
Federal funds sold	445	445
Available for sale securities	298,516	298,516

Held to maturity securities	5,348,013	5,494,671
Loans held for investment and for sale (net of allowance for credit losses)	3,823,220	3,915,517
Total	$ 9,621,661	$ 9,860,616
Financial liabilities:		
Deposits	$ 8,544,451	$ 8,565,167
Other borrowings	527,536	529,424
Securities sold under repurchase agreements	58,481	58,481
Junior subordinated debentures	85,055	71,651
Total	$ 9,215,523	$ 9,224,723

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The Company s off-balance sheet commitments including letters of credit, which totaled $488.0 million at March 31, 2012, are funded at current market rates at the date they are drawn upon. It is management s opinion that the fair value of these commitments would approximate their carrying value, if drawn upon.

The fair value estimates presented herein are based on pertinent information available to management at March 31, 2012. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

6. GOODWILL AND CORE DEPOSIT INTANGIBLES

Changes in the carrying amount of the Company s goodwill and core deposit intangibles (CDI) for three months ended March 31, 2012 were as follows:

	Goodwill	Core Deposit Intangibles
	(Dollars in thousands)	
Balance as of December 31, 2011	$ 924,537	$ 20,996
Amortization		(1,695)
Acquisition of Texas Bankers, Inc.	4,624	
Balance as of March 31, 2012	$ 929,161	$ 19,301

Goodwill is recorded on the acquisition date of each entity. The Company may record subsequent adjustments to goodwill for amounts undeterminable at acquisition date, such as deferred taxes and real estate valuations, and therefore the goodwill amounts reflected in the table above may change accordingly. The Company initially records the total premium paid on acquisitions as goodwill. After finalizing the valuation, core deposit intangibles are identified and reclassified from goodwill to core deposit intangibles on the balance sheet. This reclassification has no effect on total assets, liabilities, shareholders equity, net income or cash flows. Management performs an evaluation annually, and more frequently if a triggering event occurs, of whether any impairment of the goodwill and other intangibles has occurred. If any such impairment is determined, a write-down is recorded. As of March 31, 2012, there were no impairments recorded on goodwill.

Although the Company completed the Texas Bankers acquisition in January 2012, the Company has not yet finalized the allocation of the purchase price.

CDI are amortized on an accelerated basis over their estimated lives, which the Company believes is between 8 and 10 years. Gross core deposit intangibles outstanding were $79.1 million at March 31, 2012 and December 31, 2011. Net core deposit intangibles outstanding were $19.3 million and $21.0 million at the same dates, respectively. Amortization expense related to intangible assets totaled $1.7 million and $2.0 million for the three months ended March 31, 2012 and 2011, respectively. The estimated aggregate future amortization expense for intangible assets remaining as of March 31, 2012 is as follows (dollars in thousands):

Remaining 2012	$ 4,652

2013	4,465
2014	3,314
2015	2,804
2016	2,481
Thereafter	1,585
Total	$ 19,301

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7. STOCK BASED COMPENSATION

At March 31, 2012, the Company had four stock-based employee compensation plans and one stock option plan assumed in connection with an acquisition under which no additional options will be granted. Two of the four plans adopted by the Company have expired and therefore no additional awards may be issued under those plans. The Company accounts for stock-based employee compensation plans using the fair value-based method of accounting in accordance with ASC Topic 718. ASC Topic 718 was effective for companies in 2006; however, the Company has been recognizing compensation expense since January 1, 2003. The Company recognized $1.2 million and $707,000 in stock-based compensation expense for the three months ended March 31, 2012 and 2011, respectively. There was approximately $420,000 and $234,000 of income tax benefit recorded for the stock-based compensation expense for the same periods.

On February 22, 2012, the Company s Board of Directors adopted the Prosperity Bancshares, Inc. 2012 Stock Incentive Plan (the 2012 Plan), subject to approval by the Company s shareholders. The Company s shareholders approved the 2012 Plan at the annual meeting of shareholders on April 17, 2012. The 2012 Plan authorizes the issuance of up to 1,250,000 shares of common stock upon the exercise of options granted under the 2012 Plan or pursuant to the grant or exercise, as the case may be, of other awards granted under the 2012 Plan, including restricted stock, stock appreciation rights, phantom stock awards and performance awards. As of March 31, 2012, no options or other awards have been granted under the 2012 Plan.

During 2004, the Company s Board of Directors adopted the Prosperity Bancshares, Inc. 2004 Stock Incentive Plan (the 2004 Plan) which authorizes the issuance of up to 1,250,000 shares of common stock pursuant to the exercise or grant, as the case may be, of awards under such plan and the shareholders approved the 2004 Plan in 2005. The Company has granted shares with forfeiture restrictions (restricted stock) to certain directors, officers and associates under the 2004 Plan. The awardee is not entitled to the shares until they vest, which is generally over a one to five year period, but the awardee is entitled to receive dividends on and vote the shares prior to vesting. The shares granted do not have a cost to the awardee and the only requirement of vesting is continued service to the Company. Compensation cost related to restricted stock is calculated based on the fair value of the shares at the date of grant. If the awardee leaves the Company before the shares vest, the unvested shares are forfeited. As of March 31, 2012, there were 404,000 shares of restricted stock outstanding with a weighted average grant date fair value of $37.47 per share.

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 also have a contractual term of 10 years from date of original issuance under the original plan. 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 as of the dates indicated:

	March 31,	
	2012	2011
Expected life (in years)	5.27	5.20
Risk free interest rate	3.68%	3.72%
Volatility	20.87%	20.96%
Dividend yield	1.26%	1.25%

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A summary of changes in outstanding options during the three months ended March 31, 2012 is set forth below:

	Number of Options (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Options outstanding, beginning of period	525	$ 28.18		
Options granted				
Options forfeited	(4)	31.19		
Options exercised	(70)	26.43		
Options outstanding, end of period	451	$ 28.42	3.78	$ 7,829
Options vested or expected to vest	437	$ 28.15	3.74	$ 7,713
Options exercisable, end of period	278	$ 27.23	2.93	$ 5,156

No options were granted during the three months ended March 31, 2012 or 2011. The total intrinsic value of the options exercised during the three-month periods ended March 31, 2012 and 2011 was $1.4 million and $1.9 million, respectively. No options vested during the three-month period ended March 31, 2012 and the total fair value of options vested during the three-month period ended March 31, 2011 was approximately $66,000.

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

	Three Months Ended March 31, 2012		2011	
	Number of Options (In thousands)	Weighted Average Grant Date Fair Value	Number of Options (In thousands)	Weighted Average Grant Date Fair Value
Non-vested options outstanding, beginning of period	177	$ 6.96	313	$ 6.89
Options granted				
Non-vested options forfeited	(4)	6.76		
Options vested			(12)	5.62
	173	$ 6.97	301	$ 6.94

Non-vested options outstanding, end of period	

The Company received $1.9 million and $2.4 million in cash from the exercise of stock options during the three-month periods ended March 31, 2012 and 2011, respectively. There was no tax benefit realized from option exercises of the share-based payment arrangements during the three-month periods ended March 31, 2012 and 2011.

As of March 31, 2012, there was $7.9 million of total unrecognized compensation expense related to stock-based compensation arrangements. That cost is expected to be recognized over a weighted average period of 2.0 years.

8. CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ITEMS

Contractual Obligations

The following table summarizes the Company s contractual obligations and other commitments to make future payments as of March 31, 2012 (other than deposit obligations). The payments do not include pre-payment options that may be available to the Company. The Company s future cash payments associated with its contractual obligations pursuant to its junior subordinated debentures, Federal Home Loan Bank (FHLB) advances and long-term notes payable and operating leases as of March 31, 2012 are summarized below. Payments for junior subordinated debentures include interest of $54.0 million that will be paid over future periods. Future interest payments were calculated using the current rate in effect at March 31, 2012. The current principal balance of the junior subordinated debentures at March 31, 2012 was $85.1 million. Payments for FHLB borrowings include interest of $3.3 million that will be paid over the future periods. Payments related to leases are based on actual payments specified in underlying contracts.

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	Payments due in:				
	Remaining Fiscal 2012	Fiscal 2013-2014	Fiscal 2015-2016	Thereafter	Total
	(Dollars in thousands)				
Junior subordinated debentures	$ 1,884	$ 5,024	$ 5,024	$ 127,159	$ 139,091
Federal Home Loan Bank borrowings	516,126	3,258	3,456	8,002	530,842
Operating leases	3,872	7,727	3,125	517	15,241
Total	$ 521,882	$ 16,009	$ 11,605	$ 135,678	$ 685,174

Off-Balance Sheet Items

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

The Company s commitments associated with outstanding standby letters of credit and commitments to extend credit as of March 31, 2012 are summarized below. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Remaining Fiscal 2012	Fiscal 2013-2014	Fiscal 2015-2016	Thereafter	Total
	(Dollars in thousands)				
Standby letters of credit	$ 9,716	$ 5,699	$ 122	$	$ 15,537
Commitments to extend credit	195,980	102,365	8,925	165,168	472,438
Total	$ 205,696	$ 108,064	$ 9,047	$ 165,168	$ 487,975

9. OTHER COMPREHENSIVE INCOME (LOSS)

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

	Before Tax Amount	Tax Expense (Benefit)	Net of Tax Amount
	(Dollars in thousands)		
Three months ended March 31, 2012:			
Securities available for sale:			

Change in net unrealized gain/loss during the period	$ (1,185)	$ (415)	$ (770)
Total other comprehensive income	$ (1,185)	$ (415)	$ (770)
Three months ended March 31, 2011:			
Securities available for sale:			
Change in net unrealized gain/loss during the period	$ (919)	$ (322)	$ (597)
Total other comprehensive income	$ (919)	$ (322)	$ (597)

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Activity in accumulated other comprehensive income, net of tax, was as follows:

	Securities Available For Sale	Accumulated other Comprehensive Income
	(Dollars in thousands)	
Balance January 1, 2012	$ 13,472	$ 13,472
Other comprehensive income (loss)	(770)	(770)
Balance March 31, 2012	$ 12,702	$ 12,702
Balance as of January 1, 2011	$ 14,304	$ 14,304
Other comprehensive income (loss)	(597)	(597)
Balance March 31, 2011	$ 13,707	$ 13,707

10. SUBSEQUENT EVENTS AND RECENT ACQUISITIONS

Acquisition of The Bank Arlington On April 1, 2012, the Company completed the previously announced acquisition of The Bank Arlington. The Bank Arlington operated one banking office in Arlington, Texas, in the Dallas/Fort Worth CMSA. As of March 31, 2012, The Bank Arlington reported total assets of $37.3 million, total loans of $22.8 million and total deposits of $33.2 million.

Under the terms of the agreement, the Company issued 135,347 shares of Company common stock for all outstanding shares of The Bank Arlington capital stock which resulted in a premium of $2.8 million.

Pending Acquisition of American State Financial Corporation On February 27, 2012, the Company announced the signing of a definitive agreement to acquire American State Financial Corporation and its wholly owned subsidiary, American State Bank (ASB), through the merger of American State Financial with and into the Company. ASB operates thirty-seven (37) banking offices in eighteen (18) counties across West Texas. As of March 31, 2012, American State Financial, on a consolidated basis, reported total assets of $3.16 billion, total loans of $1.24 billion and total deposits of $2.51 billion. Under the terms of the definitive agreement, the Company will issue up to 8,525,000 shares of its common stock plus $178.5 million in cash for all outstanding shares of American State Financial capital stock, subject to certain conditions and potential adjustment.

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

Pending Acquisition of East Texas Financial Services, Inc. On December 8, 2011, the Company entered into a definitive agreement to acquire East Texas Financial Services, Inc. (OTC BB: FFBT) and its wholly-owned subsidiary, First Federal Bank Texas (Firstbank). Firstbank operates four banking offices in the Tyler MSA, including three locations in Tyler, Texas and one location in Gilmer, Texas. As of March 31, 2012, East Texas Financial Services, on a consolidated basis, reported total assets of $208.6 million, total loans of $153.5 million and total deposits of $127.6 million.

Under the terms of the definitive agreement, the Company will issue up to 531,000 shares of Company common stock for all outstanding shares of East Texas Financial Services capital stock, subject to certain conditions and potential adjustments. The transaction is subject to customary closing conditions, including the receipt of regulatory approvals and approval of the stockholders of East Texas Financial Services. On May 4, 2012, East Texas Financial Services and each of its directors were named defendants in a suit brought by East Texas Financial Corporation (ETFC), a shareholder of East Texas Financial Services, to block the proposed merger. More specifically, the suit alleges that the stockholders vote approving the merger was invalid and improper. Accordingly, the closing date of the transaction is uncertain at this time.

Acquisition of Texas Bankers, Inc. On January 1, 2012, Prosperity completed the previously announced acquisition of Texas Bankers, Inc. and its wholly-owned subsidiary, Bank of Texas, Austin, Texas.

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The three (3) Bank of Texas banking offices in the Austin, Texas CMSA consisted of a location in Rollingwood, which was consolidated with Prosperity s Westlake location and remains in Bank of Texas Rollingwood banking office; one banking center in downtown Austin, which was consolidated into Prosperity s downtown Austin location; and another banking center in Thorndale. Prosperity now operates thirty-four (34) banking centers in the Central Texas area including Austin and San Antonio.

Texas Bankers, on a consolidated basis, reported total assets of $77.0 million, total loans of $27.6 million and total deposits of $70.4 million as of December 31, 2011.

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

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 the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations resulting in, among other things, a deterioration in credit quality or reduced demand for credit, including the result and effect on the Company s loan portfolio and allowance for credit losses;

- changes in interest rates and market prices, which could reduce the Company s net interest margins, asset valuations and expense expectations;

- changes in the levels of loan prepayments and the resulting effects on the value of the Company s loan portfolio;

- changes in local economic and business conditions which adversely affect the Company s customers and their ability to transact profitable business with the company, including the ability of the Company s borrowers to repay their loans according to their terms or a change in the value of the related collateral;

- increased competition for deposits and loans adversely affecting rates and terms;

the timing, impact and other uncertainties of any future acquisitions, including the Company s ability to identify suitable future acquisition candidates, the success or failure in the integration of their operations, and the ability to enter new markets successfully and capitalize on growth opportunities;

the possible impairment of goodwill associated with an acquisition and possible adverse short-term effects on the results of operations;

increased credit risk in the Company s assets and increased operating risk caused by a material change in commercial, consumer and/or real estate loans as a percentage of the total loan portfolio;

the concentration of the Company s loan portfolio in loans collateralized by real estate;

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

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

a deterioration or downgrade in the credit quality and credit agency ratings of the securities in the Company s securities portfolio;

increased asset levels and changes in the composition of assets and the resulting impact on the Company s capital levels and regulatory capital ratios;

the Company s ability to acquire, operate and maintain cost effective and efficient systems without incurring unexpectedly difficult or expensive but necessary technological changes;

the loss of senior management or operating personnel and the potential inability to hire qualified personnel at reasonable compensation levels;

government intervention in the U.S. financial system;

changes in statutes and government regulations or their interpretations applicable to financial holding companies and the Company s present and future banking and other subsidiaries, including changes in tax requirements and tax rates;

increases in FDIC deposit insurance assessments;

potential risk of environmental liability associated with lending activities;

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

acts of terrorism, an outbreak of hostilities or other international or domestic calamities, weather or other acts of God and other matters beyond the Company s control; and

other risks and uncertainties listed from time to time in the Company s reports and documents filed with the Securities and Exchange Commission.

A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. The Company believes it has chosen these assumptions or bases in good faith and that they are reasonable. However, the Company cautions you that assumptions or bases almost always vary from actual results, and the differences between assumptions or bases and actual results can be material. The Company undertakes no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Management s Discussion and Analysis of Financial Condition and Results of Operations analyzes the major elements of the Company s interim consolidated financial statements and accompanying notes. This section should be read in conjunction with the Company s interim consolidated financial statements and accompanying notes included elsewhere in this report and with the consolidated financial statements and accompanying notes and other detailed information appearing in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

OVERVIEW

The Company, a Texas corporation, 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 and is now known as Prosperity Bank. The Company is a registered financial holding company that derives substantially all of its revenues and income from the operation of its bank subsidiary, Prosperity Bank® (Prosperity Bank® or the Bank). The Bank provides a wide array of financial products and services to small and medium-sized businesses and consumers. As of March 31, 2012, the Bank operated one hundred seventy-six (176) full-service banking locations; with fifty-nine (59) in the Houston area, twenty (20) in the South Texas area including Corpus Christi and Victoria, thirty-four (34) in the Central Texas, ten (10) in the Bryan/College Station area, twenty-one (21) in East Texas and thirty-two (32) in the Dallas/Fort Worth, Texas area. The Company s headquarters are located at Prosperity Bank Plaza, 4295 San Felipe in Houston, Texas and its telephone number is (281) 269-7199. The Company s website address is www.prosperitybanktx.com. Information contained on the Company s website is not incorporated by reference into this quarterly report on Form 10-Q and is not part of this or any other report.

The Company generates the majority of its revenues from interest income on loans, service charges on customer accounts and income from investment in securities. The revenues are partially offset by interest expense paid on deposits and other borrowings and noninterest expenses such as administrative, occupancy and general operating 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 earning assets. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and margin.

Three principal components of the Company s growth strategy are internal growth, stringent cost control practices and acquisitions, including strategic merger transactions and FDIC assisted transactions. The Company focuses on continuous internal growth. Each banking center is operated as a separate profit center, maintaining separate data with respect to its net interest income, efficiency ratio, deposit growth, loan growth and overall profitability. Banking center presidents and managers are accountable for performance in these areas and compensated accordingly. The Company also focuses on maintaining stringent cost control practices and policies. The Company has centralized many of its critical operations, such as data processing and loan processing. Management believes that this centralized infrastructure can accommodate substantial additional growth while enabling the Company to minimize operational costs through certain economies of scale. The Company also intends to continue to seek expansion opportunities. On January 1, 2012, the Company completed the acquisition of Texas Bankers, Inc. which added three retail banking centers of which two were consolidated with nearby existing banking centers. On April 1, 2012, the Company completed the acquisition of The Bank Arlington which added one retail banking center. In addition, the Company has announced the pending acquisitions of East Texas Financial Services, Inc. and American State Financial Corporation.

Total assets were $10.89 billion at March 31, 2012 compared with $9.82 billion at December 31, 2011, an increase of $1.07 billion or 10.9%. Total loans were $3.87 billion at March 31, 2012 compared with $3.77 billion at December 31, 2011, an increase of $109.0 million or 2.9%. Total deposits were $8.54 billion at March 31, 2012 compared with $8.06 billion at December 31, 2011, an increase of $484.2 million or 6.0%. Shareholders equity increased $42.3 million or 2.7%, to $1.61 billion at March 31, 2012 compared with $1.57 billion at December 31, 2011.

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, 2011. The Company believes that of its significant accounting policies, the following may involve a higher degree of judgment and complexity:

Allowance for Credit Losses The allowance for credit losses is established through charges to earnings in the form of a provision for credit losses. Management has established an allowance for credit losses which it believes is adequate for estimated losses in the Company s loan portfolio. Based on an evaluation of the loan portfolio, management presents a monthly review of the allowance for credit losses to the Bank s Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. In making its evaluation, management considers factors such as historical loan loss experience, industry diversification of the Company s commercial loan portfolio, the amount of nonperforming assets and related collateral, the volume, growth and composition of the Company s loan portfolio, current economic conditions that may affect the borrower s ability to pay and the value of collateral, the evaluation of the Company s loan portfolio through its internal loan review process and other relevant factors. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management s judgment, should be charged off. Charge-offs occur when loans are deemed to be uncollectible. The allowance for credit losses includes allowance allocations calculated in accordance with FASB ASC Topic 310, *Receivables*, and allowance allocations determined in accordance with FASB ASC Topic 450, *Contingencies*.

Goodwill and Intangible Assets Goodwill and intangible assets that have indefinite useful lives are subject to an impairment test at least annually, or more often, if events or circumstances indicate that it is more likely than not that the fair value of Prosperity Bank, the Company s only reporting unit with assigned goodwill, is below the carrying value of its equity. Goodwill is tested for impairment using a two-step process that begins with an estimation of the fair value of the Company s reporting unit compared with its carrying value. If the carrying amount exceeds the fair value of the reporting unit, a second test is completed comparing the implied fair value of the reporting unit s goodwill to its carrying value to measure the amount of impairment. The Company estimated the fair value of its reporting unit through several valuation techniques that consider, among other things, the historical and current financial position and results of operations of the Company, general economic and market conditions and exit prices for recent market transactions. The Company had no intangible assets with indefinite useful lives at March 31, 2012. Other identifiable intangible assets that are subject to amortization are amortized on an accelerated basis over the years expected to be benefited, which the Company believes is between eight and ten years. These amortizable intangible assets are reviewed for impairment if circumstances indicate their value may not be recoverable based on a comparison of fair value to carrying value. Based on the Company s annual goodwill impairment test as of September 30, 2011, management does not believe any of its goodwill is impaired as of March 31, 2012 because the fair value of the Company s equity exceeded its carrying value. While the Company believes no impairment existed at March 31, 2012 under accounting standards applicable at that date, different conditions or assumptions, or changes in cash flows or profitability, if significantly negative or unfavorable, could have a material adverse effect on the outcome of the Company s impairment evaluation and financial condition or future results of operations.

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

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

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SUBSEQUENT EVENTS AND RECENT ACQUISITIONS

Acquisition of The Bank Arlington On April 1, 2012, the Company completed the previously announced acquisition of The Bank Arlington. The Bank Arlington operated one banking office in Arlington, Texas, in the Dallas/Fort Worth CMSA. As of March 31, 2012, The Bank Arlington reported total assets of $37.3 million, total loans of $22.8 million and total deposits of $33.2 million.

Under the terms of the agreement, the Company issued 135,347 shares of Company common stock for all outstanding shares of The Bank Arlington capital stock which resulted in a premium of $2.8 million.

Pending Acquisition of American State Financial Corporation On February 27, 2012, the Company announced the signing of a definitive agreement to acquire American State Financial Corporation and its wholly owned subsidiary, American State Bank (ASB), through the merger of American State Financial with and into the Company. ASB operates thirty-seven (37) banking offices in eighteen (18) counties across West Texas. As of March 31, 2012, American State Financial, on a consolidated basis, reported total assets of $3.16 billion, total loans of $1.24 billion and total deposits of $2.51 billion. Under the terms of the definitive agreement, the Company will issue up to 8,525,000 shares of its common stock plus $178.5 million in cash for all outstanding shares of American State Financial capital stock, subject to certain conditions and potential adjustment.

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

Pending Acquisition of East Texas Financial Services, Inc. On December 8, 2011, the Company entered into a definitive agreement to acquire East Texas Financial Services, Inc. (OTC BB: FFBT) and its wholly-owned subsidiary, First Federal Bank Texas (Firstbank). Firstbank operates four banking offices in the Tyler MSA, including three locations in Tyler, Texas and one location in Gilmer, Texas. As of March 31, 2012, East Texas Financial Services, on a consolidated basis, reported total assets of $208.6 million, total loans of $153.5 million and total deposits of $127.6 million.

Under the terms of the definitive agreement, the Company will issue up to 531,000 shares of Company common stock for all outstanding shares of East Texas Financial Services capital stock, subject to certain conditions and potential adjustments. The transaction is subject to customary closing conditions, including the receipt of regulatory approvals and approval of the stockholders of East Texas Financial Services. On May 4, 2012, East Texas Financial Services and each of its directors were named defendants in a suit brought by East Texas Financial Corporation (ETFC), a shareholder of East Texas Financial Services, to block the proposed merger. More specifically, the suit alleges that the stockholders vote approving the merger was invalid and improper. Accordingly, the closing date of the transaction is uncertain at this time.

Acquisition of Texas Bankers, Inc. On January 1, 2012, Prosperity completed the previously announced acquisition of Texas Bankers, Inc. and its wholly-owned subsidiary, Bank of Texas, Austin, Texas.

The three (3) Bank of Texas banking offices in the Austin, Texas CMSA consisted of a location in Rollingwood, which was consolidated with Prosperity s Westlake location and remains in Bank of Texas Rollingwood banking office; one banking center in downtown Austin, which was consolidated into Prosperity s downtown Austin location; and another banking center in Thorndale. Prosperity now operates thirty-four (34) banking centers in the Central Texas area including Austin and San Antonio. As of December 31, 2011, Texas Bankers, on a consolidated basis, reported total assets of $77.0 million, total loans of $27.6 million and total deposits of $70.4 million.

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

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RESULTS OF OPERATIONS

Net income available to shareholders was $36.5 million ($0.77 per common share on a diluted basis) for the quarter ended March 31, 2012 compared with $33.9 million ($0.72 per common share on a diluted basis) for the quarter ended March 31, 2011, an increase of $2.6 million or 7.7%. The Company posted returns on average common equity of 9.15% and 9.22%, returns on average assets of 1.39% and 1.42% and efficiency ratios of 42.23% and 44.30% for the quarters ended March 31, 2012 and 2011, respectively. The efficiency ratio is calculated by dividing total noninterest expense (excluding credit loss provisions) by net interest income plus noninterest income (excluding net gains and losses on the sale of securities and assets). Additionally, taxes are not part of this calculation.

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 was $81.8 million for the quarter ended March 31, 2012 compared with $80.4 million for the quarter ended March 31, 2011, an increase of $1.4 million or 1.8%. The average rate paid on interest-bearing liabilities decreased 26 basis points from 0.83% for the quarter ended March 31, 2011 to 0.57% for the quarter ended March 31, 2012, while the average yield on interest-earning assets decreased 59 basis points from 4.62% for the quarter ended March 31, 2011 compared with 4.03% for the quarter ended March 31, 2012. The average volume of interest-bearing liabilities increased $508.4 million and the average volume of interest-earning assets increased $929.8 million for the same period. The net interest margin on a tax equivalent basis decreased 38 basis points from 4.02% for the quarter ended March 31, 2011 to 3.64% for the quarter ended March 31, 2012.

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The following table sets forth, for each major 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 quarters ended March 31, 2012 and 2011. The table also sets 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 March 31,					
	2012			2011		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate (4)	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate (4)
	(Dollars in thousands)					
Assets						
Interest-earning assets:						
Loans	$ 3,818,991	$ 53,217	5.60%	$ 3,516,524	$ 52,200	6.02%
Securities (1)	5,192,257	38,321	2.95	4,677,900	41,204	3.52
Federal funds sold and other temporary investments	126,154	78	0.25	13,179	5	0.15
Total interest-earning assets	9,137,402	91,616	4.03%	8,207,603	93,409	4.62%
Less allowance for credit losses	(51,601)			(51,697)		
Total interest-earning assets, net of allowance	9,085,801			8,155,906		
Noninterest-earning assets	1,414,340			1,405,708		
Total assets	$ 10,500,141			$ 9,561,614		
Liabilities and shareholders equity						
Interest-bearing liabilities:						
Interest-bearing demand deposits	$ 1,694,240	$ 2,063	0.49%	$ 1,489,160	$ 2,238	0.61%
Savings and money market accounts	2,792,348	2,589	0.37	2,359,077	3,336	0.57
Certificates of deposit	1,971,071	4,139	0.84	2,177,566	5,938	1.11
Junior subordinated debentures	85,055	663	3.14	91,063	1,147	5.11
Federal funds purchased and other borrowings	272,760	279	0.41	191,945	268	0.57
Securities sold under repurchase agreements	53,304	37	0.28	51,609	69	0.54
Total interest-bearing liabilities	6,868,778	9,770	0.57%	6,360,420	12,996	0.83%
Noninterest-bearing liabilities:						
Noninterest-bearing demand deposits	1,970,942			1,672,590		
Other liabilities	65,137			59,556		
Total liabilities	8,904,857			8,092,566		
Shareholders equity	1,595,284			1,469,048		
Total liabilities and shareholders equity	$ 10,500,141			$ 9,561,614		
Net interest rate spread			3.46%			3.79%
Net interest income and margin (2)		$ 81,846	3.60%		$ 80,413	3.97%
Net interest income and margin (tax-equivalent basis) (3)		$ 82,742	3.64%		$ 81,302	4.02%

(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 and based on an actual/366 day basis for the three months ended March 31, 2012 and on an actual/365 day basis for the three months ended March 31, 2011.

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The following table presents 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) attributable to changes in volume and changes in interest rates. For purposes of this table, changes attributable to both rate and volume that cannot be segregated have been allocated to rate.

	Three Months Ended March 31, 2012 vs. 2011		
	Increase (Decrease) Due to		
	Volume	Rate	Total
	(Dollars in thousands)		
Interest-earning assets:			
Loans	$ 4,490	$ (3,473)	$ 1,017
Securities	4,531	(7,414)	(2,883)
Federal funds sold and other temporary investments	43	30	73
Total increase (decrease) in interest income	9,064	(10,857)	(1,793)
Interest-bearing liabilities:			
Interest-bearing demand deposits	312	(487)	(175)
Savings and money market accounts	620	(1,367)	(747)
Certificates of deposit	(569)	(1,230)	(1,799)
Junior subordinated debentures	(77)	(407)	(484)
Federal funds purchased and other borrowings	114	(103)	11
Securities sold under repurchase agreements	2	(34)	(32)
Total increase (decrease) in interest expense	402	(3,628)	(3,226)
Increase (decrease) in net interest income	$ 8,662	$ (7,229)	$ 1,433

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 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 function and other relevant factors.

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

The Company recorded a $150,000 and $1.7 million provision for credit losses for the quarters ended March 31, 2012 and 2011, respectively. For the quarter ended March 31, 2012, net charge-offs were $102,000 compared with net charge-offs of $1.5 million for the quarter ended March 31, 2011.

Noninterest Income

The Company s primary sources of recurring noninterest income are NSF fees, debit and ATM card income and service charges on deposit accounts. Noninterest income does not include loan origination fees which are recognized over the life of the related loan as an adjustment to yield using the interest method. Noninterest income totaled $13.9 million for the three months ended March 31, 2012 compared with $13.9 million for the same period in 2011, an increase of $78,000 or 0.6%. The increase was primarily due to increases in net gain on sale of other real estate and debit card and ATM card income, partially offset by a decrease in NSF fees. The Company expects to be subject to the Durbin Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act beginning in July 2013, which imposes limits on the amount of debit card and ATM card income that can be collected.

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

	Three Months Ended March 31, 2012	2011
	(Dollars in thousands)	
Non-sufficient funds (NSF) fees	$ 5,389	$ 6,107
Debit card and ATM card income	3,836	3,452
Service charges on deposit accounts	2,441	2,483
Banking related service fees	535	500
Bank owned life insurance income (BOLI)	350	335
(Loss) gain on sale of assets, net	(7)	165
Gain (loss) on sale of other real estate, net	418	(160)
Other noninterest income	983	985
Total noninterest income	$ 13,945	$ 13,867

Noninterest Expense

Noninterest expense totaled $40.5 million for the quarter ended March 31, 2012 compared with $41.7 million for the quarter ended March 31, 2011, a decrease of $1.2 million or 3.0%. This decrease was principally due to a decrease in regulatory assessments and FDIC insurance and a decrease in CDI amortization.

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

	Three Months Ended March 31, 2012	2011
	(Dollars in thousands)	
Salaries and employee benefits (1)	$ 23,252	$ 23,204
Non-staff expenses:		
Net occupancy	3,557	3,648
Depreciation	2,035	2,021
Debit card, data processing and software amortization	1,532	1,672
Communications (2)	1,748	1,692
Printing and supplies	461	446
Regulatory assessments and FDIC insurance	1,548	3,001
Ad valorem taxes	1,012	1,005
Core deposit intangibles amortization	1,695	2,034
Professional fees	709	572
Other real estate	691	292
Other	2,219	2,108
Total noninterest expense	$ 40,459	$ 41,695

(1) Includes stock-based compensation expense of $1.2 million and $708,000 for the three months ended March 31, 2012 and 2011, respectively.

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

Income Taxes

Income tax expense increased $1.7 million to $18.7 million for the quarter ended March 31, 2012 compared with $17.0 million for the same period in 2011. The increase was primarily attributable to higher pretax net earnings for the quarter ended March 31, 2012 compared with the same period in 2011. The Company s effective tax rate for the three months ended March 31, 2012 was 33.9% compared with 33.4% for the same period in 2011.

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FINANCIAL CONDITION

Loan Portfolio

Total loans were $3.87 billion at March 31, 2012, an increase of $109.0 million or 2.9% compared with $3.77 billion at December 31, 2011. Outstanding loans at March 31, 2012 comprised 42.4% of average earning assets for the quarter ended March 31, 2012.

The following table summarizes the loan portfolio of the Company by type of loan as of March 31, 2012 and December 31, 2011:

	March 31, 2012		December 31, 2011	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Commercial and industrial	$ 442,559	11.4%	$ 406,433	10.8%
Real estate:				
Construction and land development	484,295	12.5	482,140	12.8
1-4 family residential	1,036,318	26.7	1,007,266	26.7
Home equity	149,597	3.9	146,999	3.9
Commercial real estate	1,379,242	35.6	1,351,986	35.9
Agriculture real estate (farmland)	144,399	3.7	136,008	3.6
Multi-family residential	94,683	2.4	89,240	2.4
Agriculture	34,075	0.9	34,226	0.9
Consumer (net of unearned discount)	76,393	2.0	78,187	2.1
Other	33,301	0.9	33,421	0.9
Total loans	$ 3,874,862	100.0%	$ 3,765,906	100.0%

Nonperforming Assets

The Company had $14.9 million in nonperforming assets at March 31, 2012 and $12.1 million in nonperforming assets at December 31, 2011, an increase of $2.8 million or 23.4%. The ratio of nonperforming assets to loans and other real estate was 0.38% at March 31, 2012 compared with 0.32% at December 31, 2011.

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 loans before attaining nonaccrual status.

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

	March 31, 2012	December 31, 2011
	(Dollars in thousands)	
Nonaccrual loans	$ 7,142	$ 3,578
Total nonperforming loans	7,142	3,578
Repossessed assets	13	146
Other real estate	7,718	8,328
Total nonperforming assets	$ 14,873	$ 12,052
Nonperforming assets to total loans and other real estate	0.38%	0.32%

Nonperforming assets to average earning assets	0.16%	0.15%

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Allowance for Credit Losses

Management actively monitors the Company s asset quality and provides specific loss allowances when necessary. The allowance for credit losses is a reserve established through charges to earnings in the form of a provision for credit losses. 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 March 31, 2012, the allowance for credit losses amounted to $51.6 million or 1.33% of total loans compared with $51.6 million or 1.37% of total loans at December 31, 2011.

Set forth below is an analysis of the allowance for credit losses as of and for the three months ended March 31, 2012 and as of and for the year ended December 31, 2011:

	As of and for the Three Months Ended March 31, 2012	As of and for the Year Ended December 31, 2011
	(Dollars in thousands)	
Average loans outstanding	$ 3,818,991	$ 3,648,701
Gross loans outstanding at end of period	$ 3,874,862	$ 3,765,906
Allowance for credit losses at beginning of period	$ 51,594	$ 51,584
Provision for credit losses	150	5,200
Charge-offs:		
Commercial and industrial	(78)	(1,694)
Real estate and agriculture	(101)	(3,927)
Consumer and other	(203)	(1,229)
Recoveries:		
Commercial and industrial	93	481
Real estate and agriculture	11	472
Consumer and other	176	707
Net charge-offs	(102)	(5,190)
Allowance for credit losses at end of period	$ 51,642	$ 51,594
Ratio of allowance to end of period loans	1.33%	1.37%
Ratio of net charge-offs to average loans (annualized)	0.01%	0.14%
Ratio of allowance to end of period nonperforming loans	723.1%	1,442.0%

Securities

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):

	March 31, 2012	December 31, 2011
	(In thousands)	
U.S. Treasury securities and obligations of U.S. government agencies	$ 8,707	$ 8,696
States and political subdivisions	70,871	74,974

Corporate debt securities	2,992	2,990
Collateralized mortgage obligations	239,636	282,565
Mortgage-backed securities	5,284,593	4,248,796
Qualified School Constructions Bonds (QSCB)	12,900	12,900
Equity securities	7,288	7,288
Total amortized cost	$ 5,626,987	$ 4,638,209
Total fair value	$ 5,793,187	$ 4,815,304

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Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities classified as available for sale or held-to-maturity are evaluated for OTTI under FASB ASC Topic 320, *Investments Debt and Equity Securities*. Certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, that had credit ratings at the time of purchase of below AA are evaluated using the model outlined in ASC Topic 325, Investments Other. The Company currently does not own any securities that are accounted for under ASC Topic 325.

In determining OTTI under ASC Topic 320, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time. If applicable, the second segment of the portfolio uses the OTTI guidance provided by ASC Topic 325 that is specific to purchased beneficial interests that, on the purchase date, were rated below AA. Under the ASC Topic 325 model, an impairment is considered other than temporary if, based on the Company s best estimate of cash flows that a market participant would use in determining the current fair value of the beneficial interest, there has been an adverse change in those estimated cash flows.

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

As of March 31, 2012, the Company does not intend to sell any debt securities and management believes that the Company more likely than not will not be required to sell any debt securities before their anticipated recovery, at which time the Company will receive full value for the securities. Furthermore, as of March 31, 2012, management does not have the intent to sell any of its securities and believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of cost. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of March 31, 2012, management believes any impairment in the Company s securities are temporary and no impairment loss has been realized in the Company s consolidated statements of income.

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The following table presents the amortized cost and fair value of securities classified as available for sale at March 31, 2012:

	0000000000	0000000000	0000000000	0000000000
	March 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
States and political subdivisions	$ 35,845	$ 2,079	$ (8)	$ 37,916
Corporate debt securities and other	8,780	450		9,230
Collateralized mortgage obligations	742		(15)	727
Mortgage-backed securities	233,607	17,098	(62)	250,643
Total	$ 278,974	$ 19,627	$ (85)	$ 298,516
Held to Maturity				
U.S. Treasury securities and obligations of U.S. government agencies	$ 8,707	$ 351	$	$ 9,058
States and political subdivisions (including QSCB)	47,926	3,294	(117)	51,103
Corporate debt securities and other	1,500	102		1,602
Collateralized mortgage obligations	238,894	4,795	(122)	243,567
Mortgage-backed securities	5,050,986	143,368	(5,013)	5,189,341
Total	$ 5,348,013	$ 151,910	$ (5,252)	$ 5,494,671

The amortized cost and fair value of investment securities as of December 31, 2011 are as follows:

	0000000000	0000000000	0000000000	0000000000
	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
States and political subdivisions	$ 37,060	$ 2,022	$ (6)	$ 39,076
Collateralized mortgage obligations	786		(21)	765
Mortgage-backed securities	254,965	18,307	(66)	273,206
Other securities	8,778	491		9,269
Total	$ 301,589	$ 20,820	$ (93)	$ 322,316
Held to Maturity				
U.S. Treasury securities and obligations of U.S. government agencies	$ 8,696	$ 455	$	$ 9,151
States and political subdivisions (including QSCB)	50,814	3,324	(284)	53,854
Corporate debt securities	1,500	114		1,614
Collateralized mortgage obligations	281,778	5,009	(150)	286,637
Mortgage-backed securities	3,993,832	147,991	(91)	4,141,732

Total	$	4,336,620	$	156,893	$	(525)	$	4,492,988

Premises and Equipment

Premises and equipment, net of accumulated depreciation, totaled $162.7 million at March 31, 2012 and $159.7 million at December 31, 2011.

Deposits

Total deposits were $8.54 billion at March 31, 2012 compared with $8.06 billion at December 31, 2011, an increase of $484.2 million or 6.0%. At March 31, 2012, noninterest-bearing deposits accounted for approximately 24.4% of total deposits compared with 24.5% of total deposits at December 31, 2011. Interest-bearing deposits totaled $6.46 billion or 75.6% of total deposits at March 31, 2012 compared with $6.09 billion or 75.5% of total deposits at December 31, 2011.

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

	Three Months Ended March 31, 2012		Year Ended December 31, 2011	
	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)			
Interest-bearing demand	$ 1,694,240	0.49%	$ 1,393,501	0.53%
Regular savings	530,032	0.20	472,983	0.32
Money market savings	2,262,316	0.41	1,948,752	0.53
Time deposits	1,971,071	0.84	2,135,858	1.02
Total average interest-bearing deposits	6,457,659	0.55	5,951,094	0.69
Noninterest-bearing deposits	1,970,942		1,800,102	
Total average deposits	$ 8,428,601	0.42%	$ 7,751,196	0.53%

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 March 31, 2012, the Company had $515.0 million in FHLB advances compared with no FHLB advances at December 31, 2011. The highest outstanding balance of FHLB advances during the first quarter of 2012 was $725.0 million compared with $474.0 million for the year ended December 31, 2011. The average rate paid on FHLB advances for the quarter ended March 31, 2012 was 0.04%. At March 31, 2012, the Company had $12.5 million in FHLB long-term notes payable compared with $12.8 million at December 31, 2011. The weighted average interest rate paid on the FHLB notes payable at March 31, 2012 was 5.3%. The maturity dates on the FHLB notes payable range from the years 2013 to 2028 and have interest rates ranging from 4.1% to 6.1%. FHLB borrowings are available to the Company under a security and pledge agreement. At March 31, 2012, the Company had total funds of $3.84 billion available under this agreement, of which $527.5 million was outstanding.

At March 31, 2012, the Company had $58.5 million in overnight securities sold under repurchase agreements compared with $54.9 million at December 31, 2011, an increase of $3.6 million or 6.6%, with average rates paid of 0.28% and 0.54%, respectively.

The following table presents the Company s borrowings at March 31, 2012 and December 31, 2011:

	March 31, 2012	December 31, 2011
	(Dollars in thousands)	
FHLB advances	$ 515,000	$
FHLB long-term notes payable	12,536	12,790
Total other borrowings	527,536	12,790
Securities sold under repurchase agreements	58,481	54,883
Total	$ 586,017	$ 67,673

Junior Subordinated Debentures

At March 31, 2012 and December 31, 2011, the Company had outstanding $85.1 million in junior subordinated debentures issued to the Company s unconsolidated subsidiary trusts.

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A summary of pertinent information related to the Company s seven issues of junior subordinated debentures outstanding at March 31, 2012 is set forth in the table below:

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

(1) The 3-month LIBOR in effect as of March 31, 2012 was 0.468%.
(2) All debentures are callable five years from issuance date.
(3) Assumed in connection with the SNB acquisition on April 1, 2006.
(4) Assumed in connection with the TXUI acquisition on January 31, 2007.

Liquidity

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

As of March 31, 2012, the Company had outstanding $472.4 million in commitments to extend credit and $15.5 million in commitments associated with outstanding standby letters of credit. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the total outstanding may not necessarily reflect the actual future cash funding requirements.

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

Asset liquidity is provided by cash and assets which are readily marketable or which will mature in the near future. As of March 31, 2012, the Company had cash and cash equivalents of $151.9 million compared with $213.4 million at December 31, 2011, a decrease of $61.5 million. The decrease was primarily due to purchases of securities of $1.38 billion and an increase in loans of $85.1 million, offset by an increase in deposits of $413.8 million, proceeds from the maturities and repayments of securities of $377.0 million, net earnings of $36.5 million, an increase in other assets and accrued interest receivable of $24.6 million and net proceeds from short-term borrowings of $515.0 million.

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Contractual Obligations

The following table summarizes the Company s contractual obligations and other commitments to make future payments as of March 31, 2012 (other than deposit obligations). The payments do not include pre-payment options that may be available to the Company. The Company s future cash payments associated with its contractual obligations pursuant to its junior subordinated debentures, FHLB advances and long-term notes payable and operating leases as of March 31, 2012 are summarized below. Payments for junior subordinated debentures include interest of $54.0 million that will be paid over future periods. Future interest payments were calculated using the current rate in effect at March 31, 2012. The current principal balance of the junior subordinated debentures at March 31, 2012 was $85.1 million. Payments for FHLB borrowings include interest of $3.3 million that will be paid over the future periods. Payments related to leases are based on actual payments specified in underlying contracts.

	Payments due in:				
	Remaining Fiscal 2012	Fiscal 2013-2014	Fiscal 2015-2016	Thereafter	Total
	(Dollars in thousands)				
Junior subordinated debentures	$ 1,884	$ 5,024	$ 5,024	$ 127,159	$ 139,091
Federal Home Loan Bank borrowings	516,126	3,258	3,456	8,002	530,842
Operating leases	3,872	7,727	3,125	517	15,241
Total	$ 521,882	$ 16,009	$ 11,605	$ 135,678	$ 685,174

Off-Balance Sheet Items

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

The Company s commitments associated with outstanding standby letters of credit and commitments to extend credit as of March 31, 2012 are summarized below. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Remaining Fiscal 2012	Fiscal 2013-2014	Fiscal 2015-2016	Thereafter	Total
	(Dollars in thousands)				
Standby letters of credit	$ 9,716	$ 5,699	$ 122	$	$ 15,537
Commitments to extend credit	195,980	102,365	8,925	165,168	472,438
Total	$ 205,696	$ 108,064	$ 9,047	$ 165,168	$ 487,975

Capital Resources

Total shareholders equity was $1.61 billion at March 31, 2012 compared with $1.57 billion at December 31, 2011, an increase of $42.3 million or 2.7%. The increase was due primarily to net earnings of $36.5 million, the issuance of common stock in connection with the exercise of stock options and restricted stock awards of $1.9 million and the issuance of common stock in connection with the acquisition of Texas Bankers of $12.7 million, which was partially offset by dividends paid of $9.2 million for the three months ended March 31, 2012.

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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. The following table sets forth the Company s total risk-based capital, Tier 1 risk-based capital and Tier 1 to average assets (leverage) ratios as of March 31, 2012:

Consolidated Capital Ratios:	
Total capital (to risk weighted assets)	16.80%
Tier 1 capital (to risk weighted assets)	15.70%
Tier 1 capital (to average assets)	7.68%

As of March 31, 2012, the Bank s risk-based capital ratios were above the levels required for the Bank to be designated as well capitalized by the FDIC. To be designated as well capitalized , the minimum ratio requirements for the Bank s total risk-based capital, Tier 1 risk-based capital and Tier 1 to average assets (leverage) capital ratios must be 10.0%, 6.0% and 5.0%, respectively. The following table sets forth the Bank s total risk-based capital, Tier 1 risk-based capital, and Tier 1 to average assets (leverage) capital ratios as of March 31, 2012:

Capital Ratios (Bank Only):	
Total capital (to risk weighted assets)	16.52%
Tier 1 capital (to risk weighted assets)	15.41%
Tier 1 capital (to average assets)	7.53%

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company manages market risk, which for the Company is primarily interest rate volatility, 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 for the year ended December 31, 2011, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations-Interest Rate Sensitivity and Liquidity which was filed with the Securities and Exchange Commission on February 29, 2012 for further discussion.

ITEM 4. CONTROLS AND PROCEDURES

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

Changes in internal control over financial reporting. There were no changes in the Company s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended March 31, 2012 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

There have been no material changes in the Company s risk factors from those disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

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. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS

Exhibit Number	Description of Exhibit
3.1	Amended and Restated Articles of Incorporation of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company s Registration Statement on Form S-1 (Registration No. 333-63267) (the Registration Statement))
3.2	Articles of Amendment to Amended and Restated Articles of Incorporation of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.2 to the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 2006)
3.3	Amended and Restated Bylaws of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company s Current Report on Form 8-K filed on October 19, 2007)
4.1	Form of certificate representing shares of the Company s common stock (incorporated by reference to Exhibit 4 to the Registration Statement)
31.1*	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2*	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1**	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2**	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101*	Interactive Financial Data

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

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SIGNATURES

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

PROSPERITY BANCSHARES, INC.®

(Registrant)

Date: 05/09/12	/s/ David Zalman David Zalman Chief Executive Officer
Date: 05/09/12	/s/ David Hollaway David Hollaway Chief Financial Officer