Consumer Finance

Discover 4Q read thru: Weak loan and credit outlook likely isolated

Industry Overview

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Credit and loan growth issues appear contained to DFS

On Wednesday, January 17th, Discover Financial (DFS) reported 4Q earnings along with 2024 guidance that negatively surprised the Street. DFS guided for relatively flat loan balances, below expectations of +5.7% growth, and a sharp slowdown in new card acquisitions. Shares sold off with the news, trading down 9% the following day. In our view, these results are specific to DFS and will not spillover to other card issuers (COF, SYF, BFH). We note that commentary by other large card issuers including JP Morgan Chase, Wells Fargo, Citi, and US Bancorp on their 4Q23 earnings calls, was more positive on 2024 card loan growth. As such, we believe this is a DFS specific issue.

Other large issuers anticipate card balance growth

On their most recent earnings calls, JPM, WFC, C, and USB all expressed that they anticipated card loans to be a source of growth in 2024 (Exhibit 2). JPM called out that growth would be slower than 2023 (+14% y/y) but would still be strong. Citi management noted they are still seeing activity in originating new card loans, particularly considering their recent acquisitions. WFC announced plans to launch additional credit cards, including a new travel card, as part of its' 2024 initiatives. Given collective comments on positive growth, the DFS "relatively flat" guide is likely specific to the underwriting actions the company is taking and we think also reflects some conservativism on the part of management.

Loan growth guidance likely reflects credit tightening

DFS' guidance assumes flat spending, a persistently elevated payment rate, and lower new account generation from tighter underwriting. Tighter underwriting is likely driven by the performance of the 2022 vintage, early seasoning of the 2023 vintages, and the macro backdrop which is getting incrementally more difficult relative to the prior two years. 4Q23 loss rates were 28.5% above 2019 levels, above COF, SYF, and BFH averaging +18.0% from 2019 levels in November. This could suggest DFS was more aggressive in driving growth post-pandemic and now needs to tighten. We note that SYF and BFH also tightened underwriting in 2023 to keep credit results in-check.

Maintaining our outlook for AXP, COF, SYF, BFH

We believe our current 4Q and 2024 forecasts for the other pure-play card issuers are reasonable given that the large banks have maintained an upbeat tone on card growth prospects. All our 2024 forecasts reflect slower growth than 2023, except for BFH which had acquisition / divesture noise impacting 2023 growth (Exhibit 1). We do assume slower growth at SYF and BFH as both have also been tightening credit, though we don't think either was as aggressive in driving growth as DFS over the past two years. Maintain ratings on covered companies.

See inside for loan growth and credit / consumer health commentary from the large banks (Exhibits 2-3)

AXP: American Express

BFH: Bread Financial

C: Citi

COF: Capital One

JPM: JP Morgan Chase

SYF: Synchrony Financial

WFC: Wells Fargo

Exhibit 1: Card loan growth y/y

Deceleration in DFS expected to be more drastic than peers

	2023	2024E
AXP	15.8% (E)	10.5%
DFS	13.5% (A)	2.0%
COF	12.9% (E)	7.0%
SYF	12.0% (E)	6.1%
BFH	-9.7% (E)	2.4%

Source: BofA Global Research, Company reports
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What the large banks are saying

Exhibit 2: Large banks see credit card as a source of growth in 2024
Large bank 4Q earnings commentary

JPM	"We expect strong loan growth in Card to continue, but not at the same pace as 2023" (2023 +14% y/y)
WFC	This expectation is anchored on the forward rate curve and a series of business assumptions, including...modest growth in commercial and credit card loans in the second half of the year after a slow start to the year."
C	"Expect continued momentum in cards, albeit more in line with mid-single-digit loan growth"
USB	"Feel like (commercial loans) along with credit cards will be good sources of growth for us as we think about loan growth going forward"

Source: Bloomberg

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Exhibit 3: Large banks see consumer health as solid
Large bank 4Q earnings commentary

JPM	"The way we see it, the consumer is fine. All of the relevant metrics are now effectively normalized."
WFC	"The financial health of our consumers remains strong. While average deposit balances per customer continued to decline from their peak, they remained above pre-pandemic levels as wage growth has more than offset increased spending."
USB	"We focus on prime, super prime sort of customers. And even through this cycle, I think it's going to perform very well."

Source: Bloomberg

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Exhibit 4: Stock Mentioned
Stock prices and ratings mentioned in this report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
AXP	AXP US	American Express	US$ 179.79	B-1-7
BFH	BFH US	Bread Financial	US$ 29.44	C-2-7
COF	COF US	Capital One	US$ 124.92	B-1-7
DFS	DFS US	Discover Finl	US$ 97	B-1-7
SYF	SYF US	Synchrony Financial	US$ 35.77	B-2-7

Source: BofA Global Research

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Price objective basis & risk

American Express Company (AXP)

Our $206 price objective is based on a 16x multiple to our 2024 EPS forecast. An 16x PE multiple is on the higher end of the historical range (12-18x) for AXP, which we think is appropriate given the faster growth outlook and strong operating momentum it is experiencing.

Downside risks to our PO are weaker-than-expected macroeconomic conditions, softer consumer and business spending, weaker loan growth, increasing competition, weaker

US consumer credit performance, disruptions in capital markets, or an increasing regulatory burden.

Bread Financial Holdings Inc (BFH)
Our $34 PO is based on a 4x PE multiple to '24e EPS. A 4x PE multiple is below peers currently trading at 7x and the typical range for card issuers (7-12x), reflecting the hostile macro backdrop and BFH's outsized exposure to the subprime consumer relative to peers.

Downside risks to our price objective are: an economic downturn, which could lead to elevated loan loss rates, increased defaults, higher credit costs and slower loan growth. Deteriorating economic conditions would likely hurt investor sentiment and drive valuations lower. Loss of retail partners also poses a risk to growth and the earnings outlook.

Capital One Financial (COF)
Our $149 PO is based on a 10.5x PE multiple to our 2024 EPS forecast. A 10.5x PE multiple is in the middle of the historical range (7-12x) which we think is appropriate given the more optimistic macro outlook and strong loan growth, partially offset by rising credit costs.

Downside risks are: slower than expected revolving credit growth, faltering economic recovery and rising loan losses, which could drive earnings below our estimates, and result in valuation compression. Cybersecurity and regulations are also risks.

Discover Financial (DFS)
We calculate a $118 PO based on an 10.5x PE multiple to our 2024 EPS forecast. A 10.5x multiple is in the middle of DFS's recent historical range (7-12x) and reflects the more optimistic macro outlook, resilient consumer balance sheets, and strong business fundamentals.

Downside risks to our price objective are: if the economy falls into a recession, credit costs could rise rapidly and compress margins more than our current forecast. Deteriorating economic conditions would likely hurt sentiment and drive DFS's valuation lower.

Synchrony Financial (SYF)
Our $40 PO is based on a 6.5x P/E multiple on 2025E EPS. Our multiple is on the low end of the typical trading range for SYF (6-12x), which we think is appropriate given the relatively uncertain macro backdrop and rising credit costs, somewhat balanced by the potential for high capital returns.

Downside risks to our price objective are an economic downturn, which could lead to elevated loan loss rates, increased defaults, higher credit costs and slower loan growth. Deteriorating economic conditions would likely hurt investor sentiment and drive valuations lower. Loss of retail partners also poses a risk to growth and earnings outlook.

Upside risks are: Consumer balance sheets continue to hold strength and credit metrics remain strong. Increased visibility in peak loss rates shifts investor sentiment. Federal reserve achieves a soft landing. Outsized capital return.

Analyst Certification

I, Mihir Bhatia, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

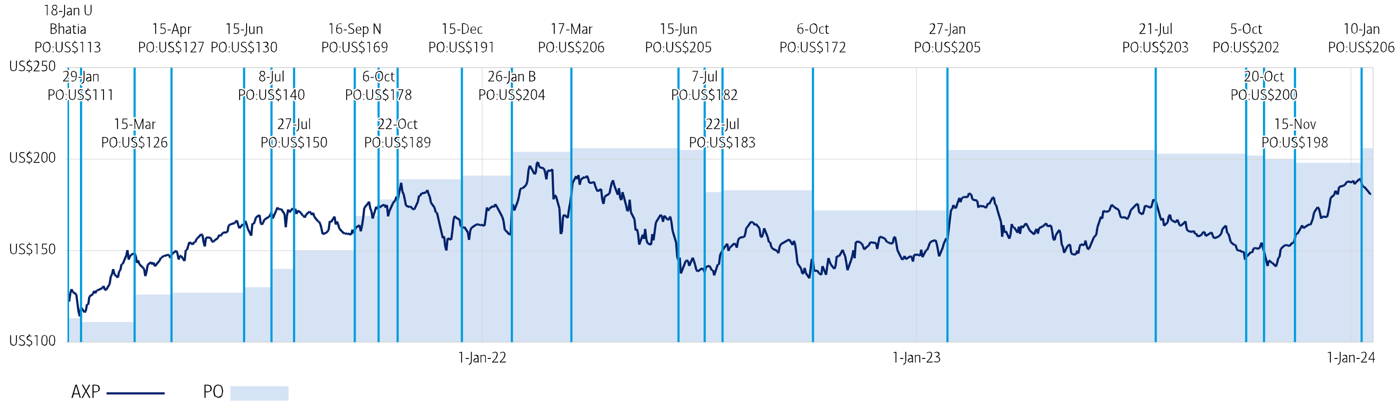
US - Payments, Processors, Specialty Finance and IT services Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Accenture Plc	ACN	ACN US	Jason Kupferberg
	American Express Company	AXP	AXP US	Mihir Bhatia
	Block Inc	SQ	SQ US	Jason Kupferberg
	Capital One Financial	COF	COF US	Mihir Bhatia
	Discover Financial	DFS	DFS US	Mihir Bhatia
	Enact Holdings	ACT	ACT US	Mihir Bhatia
	Essent Group	ESNT	ESNT US	Mihir Bhatia
	Fidelity National Information Services	FIS	FIS US	Jason Kupferberg
	Fiserv Inc	FI	FI US	Jason Kupferberg
	FleetCor Technologies Inc.	FLT	FLT US	Mihir Bhatia
	Flywire	FLYW	FLYW US	Jason Kupferberg
	Global Payments Inc	GPN	GPN US	Jason Kupferberg
	Jack Henry & Associates	JKHY	JKHY US	Jason Kupferberg
	Mastercard Inc	MA	MA US	Jason Kupferberg
	MGIC Investment Corp.	MTG	MTG US	Mihir Bhatia
	NMI Holdings	NMIH	NMIH US	Mihir Bhatia
	Nuvei	NVEI	NVEI US	Jason Kupferberg
	Nuvei	YNVEI	NVEI CN	Jason Kupferberg
	OneMain Holdings, Inc.	OMF	OMF US	Mihir Bhatia
	Shift4 Payments, Inc	FOUR	FOUR US	Jason Kupferberg
	Telus International	TIXT	TIXT US	Cassie Chan
	Telus International	YTIXT	TIXT CN	Cassie Chan
	Visa Inc.	V	V US	Jason Kupferberg
	WEX Inc.	WEX	WEX US	Mihir Bhatia
NEUTRAL				
	ADP	ADP	ADP US	Jason Kupferberg
	Affirm Holdings	AFRM	AFRM US	Jason Kupferberg
	Bread Financial Holdings Inc	BFH	BFH US	Mihir Bhatia
	DLocal	DLO	DLO US	Jason Kupferberg
	Globant SA	GLOB	GLOB US	Jason Kupferberg
	Marqeta	MQ	MQ US	Jason Kupferberg
	PayPal Holdings Inc	PYPL	PYPL US	Jason Kupferberg
	SoFi Technologies Inc	SOFI	SOFI US	Mihir Bhatia
	Synchrony Financial	SYF	SYF US	Mihir Bhatia
	Thoughtworks	TWKS	TWKS US	Jason Kupferberg
	Toast	TOST	TOST US	Jason Kupferberg
	TTEC Holdings	TTEC	TTEC US	Cassie Chan
UNDERPERFORM				
	CGI Inc.	GIB	GIB US	Jason Kupferberg
	CGI Inc.	YGIBA	GIB/A CN	Jason Kupferberg
	Cognizant Technology Solutions	CTSH	CTSH US	Jason Kupferberg
	Coinbase	COIN	COIN US	Jason Kupferberg
	DXC Technology	DXC	DXC US	Jason Kupferberg
	EPAM Systems	EPAM	EPAM US	Jason Kupferberg
	Paychex	PAYX	PAYX US	Jason Kupferberg
	Radian Group Inc	RDN	RDN US	Mihir Bhatia
	Rocket Companies, Inc.	RKT	RKT US	Mihir Bhatia
	TaskUs	TASK	TASK US	Cassie Chan
	Western Union	WU	WU US	Jason Kupferberg
RSTR				
	EngageSmart	ESMT	ESMT US	Jason Kupferberg

Disclosures

Important Disclosures

American Express (AXP) Price Chart



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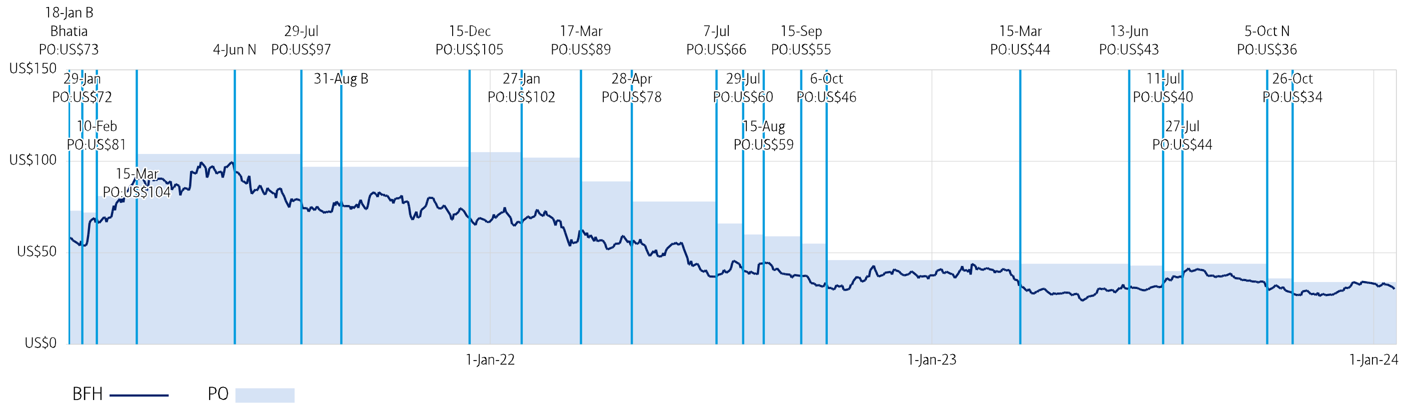
Bread Financial (BFH) Price Chart



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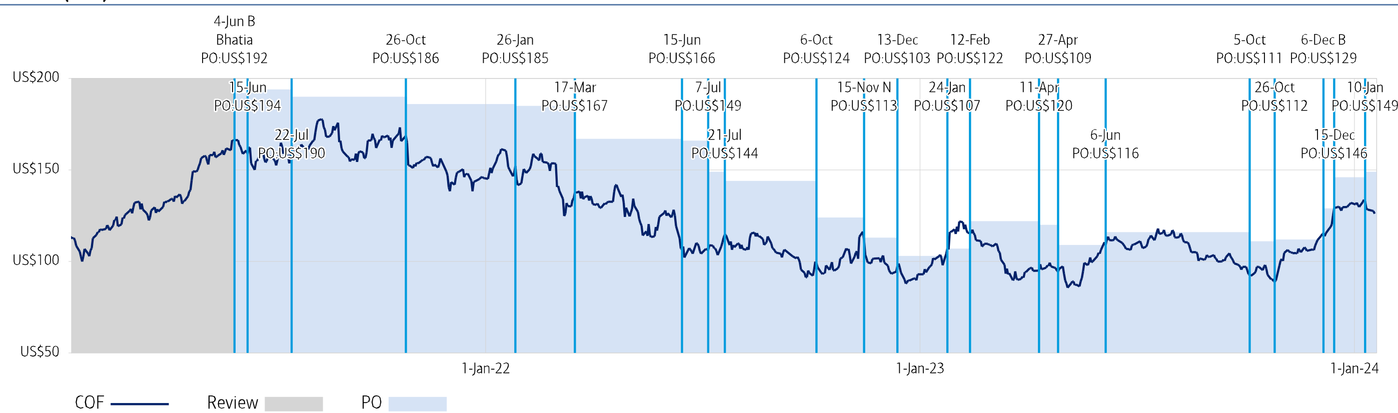
Capital One (COF) Price Chart



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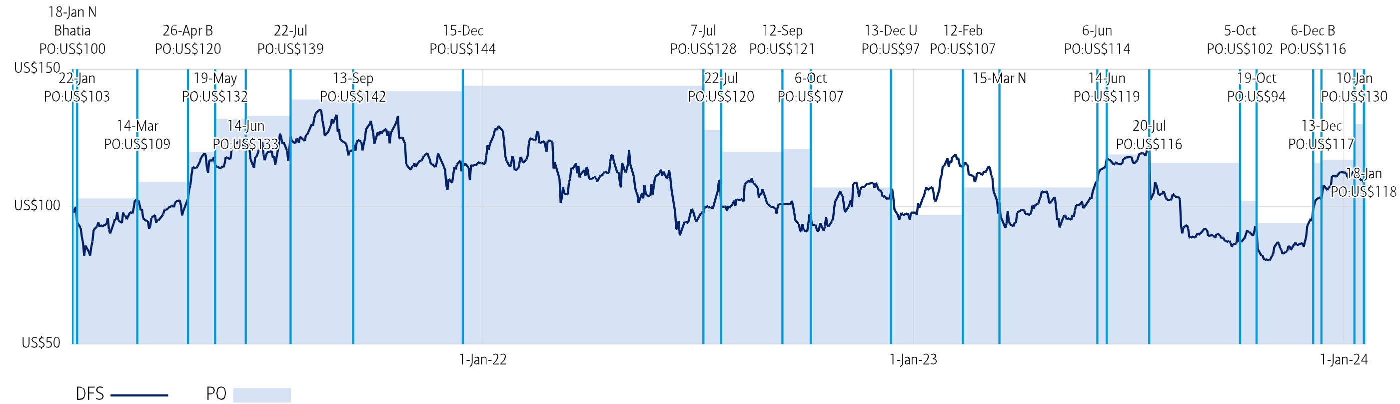
Discover Finl (DFS) Price Chart



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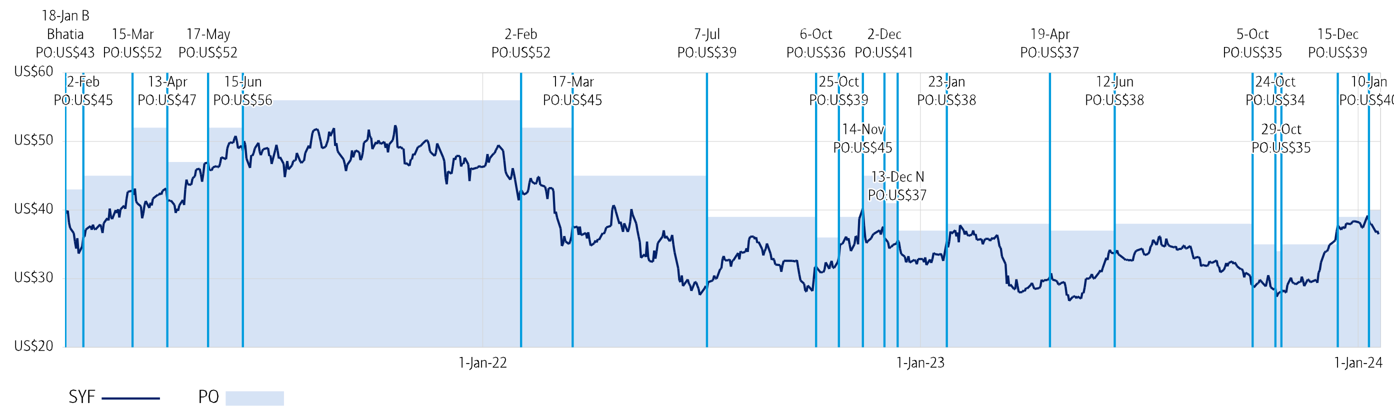
Synchrony Financial (SYF) Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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