

Consumer Finance

July operating results mostly solid

Estimate Change

Positive results in July but DQs will keep bear case alive

Earlier, pure-play credit card issuers (COF, DFS, SYF, and BFH) reported July operating metrics and overall, we view the data as generally positive. Loan growth was strong for most issuers, trending in-line or ahead expectations, and credit loss rates were either stable or up within expectations. Still, delinquency rates for all issuers increased m/m which suggests credit losses could be higher in 2H23. This should keep investor concern about credit performance at the forefront as delinquencies are now mostly above 2019 levels, despite the favorable unemployment backdrop. We maintain ratings and POs for all companies but revise our estimates slightly. See inside for details.

COF: Loan balances trending of expectations

Domestic credit card balances at \$138.7B in July suggest 3Q loan balances are trending ahead of BofAe/consensus at \$138.3B/\$138.7B. The m/m growth in balances was well ahead of typical seasonality and loan forecasts will need to be revised upwards (BofAe revised up to \$141.3B). July NCO rate was 4.48% and is trending in-line with 3Q expectations. The 30+ DQ rate increased 21bps m/m, more than typical seasonality and suggests card losses are still biased higher.

DFS: Credit losses improves but DQ trend still unfavorable

The July NCO rate was 3.77%, down from 3.80% in June. The sequential improvement in losses is encouraging as it positions consensus forecasts for 3Q losses of 4.15% as relatively conservative. That said, the DQ rate increased 14bps m/m to 3.00% and are currently 26% above pre-pandemic levels which likely pressures future losses. Loan growth was solid at 18.0% y/y, a slight deceleration from June at 18.7%.

SYF: Loan growth remains strong

July loan balances of \$96.3B was up 14.5% y/y only a slight slowdown from June at 14.6% y/y. Given typical seasonality in August and September, loan balances are trending ahead of our consensus-like \$96.7B estimate. Loss rates were flat m/m at 4.7% and DQ rates increased 20bps m/m to 4.0%. While the increase in DQ rates would suggest higher loss rates moving forward, we note that SYF's 30+ day DQ rate is still below pre-pandemic levels (unlike peers).

BFH: muted loan growth

Loan balances were flat m/m, likely impacted by the pullback in consumer spending and credit tightening that BFH discussed during its 2Q call. Credit metrics were impacted the system transition BFH undertook last year, though this should be the last month of this impact. Card NCO rate did decline to 7.38%, down 31bps m/m. Based on delinquency trends and BFH's guidance (3Q NCO rate of ~7%), net charge-offs should decline further in the immediate term.

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Equity
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Consumer Finance

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COF: Capital One

DFS: Discover Financial

SYF: Synchrony Financial

BFH: Bread Financial

NCO: Net charge-off

DQ: Delinquency

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COF: Strong card loan growth

Card loans trending ahead of expectations

Domestic credit card balances of \$138.7B, up 17.9%, a slight deceleration from June at 18.2% y/y. Loan balances are already ahead of BofAe/cons 3Q forecasts at \$138.3B/\$138.7B. Loan balances grew 200bps m/m compared to the historical 10yr seasonal trend of +69bps. Auto balances at \$75.7B down \$100M m/m likely reflecting continued prudence in the auto market.

Card NCOs at 4.48%

The July card NCO rate was 4.48%, up 10bps from June at 4.38% compared to the 10yr average historical seasonality of losses down 21bps m/m in June which reflects continued credit normalization, in our view. Card losses typically decline in Aug/Sept, but given on going credit normalization and DQ trends, we are comfortable with our/consensus 3Q loss forecasts at ~4.7%.

Delinquencies above pre-pandemic levels

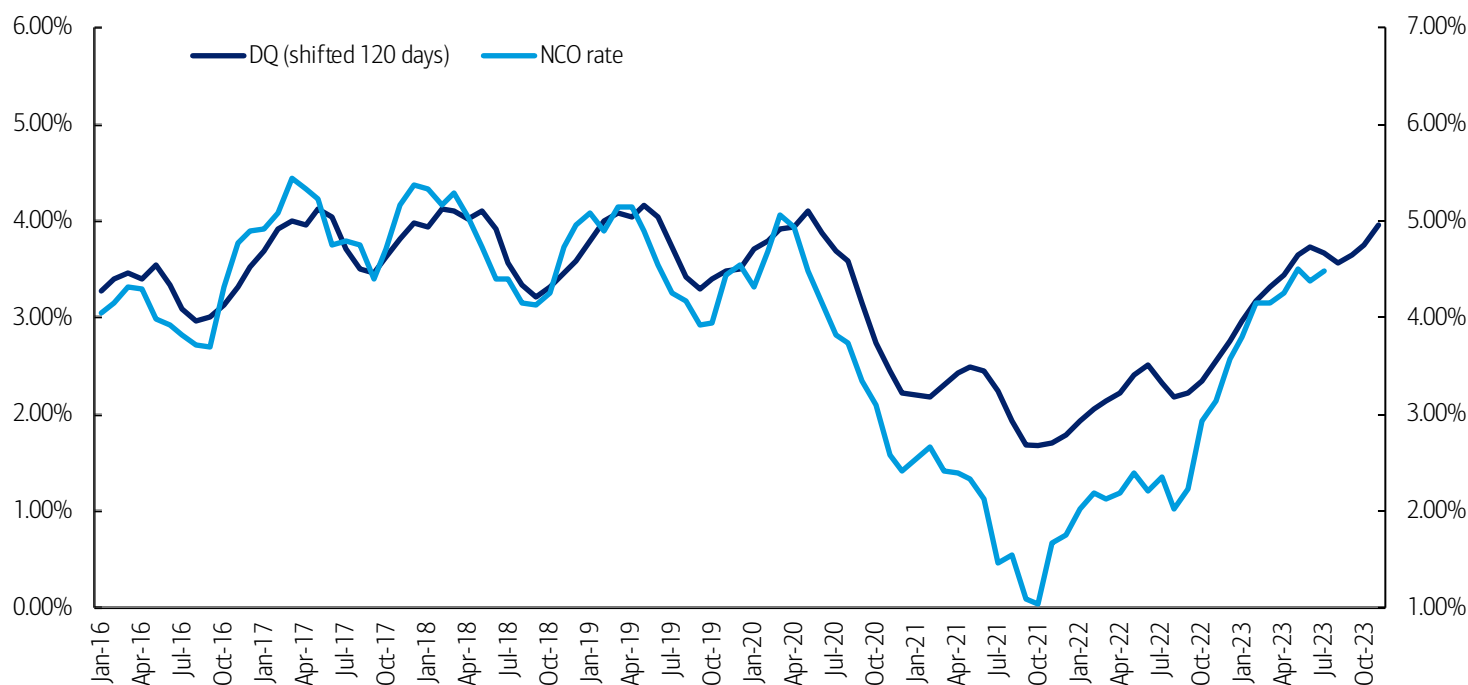
The 30+ day DQ rate for domestic card increased 21bps m/m to 3.95% and DQs are running above pre-pandemic levels. This may also reflect that higher revolve behavior is driving stronger loan growth. Auto loss rates rose 2bps m/m to 1.71% and DQs are up 25bps to 5.63%.

Adjusting estimates

We adjust our card loan estimate higher to reflect better than expected July results. Our 2023/2024 estimates are now \$11.42/\$11.63 from \$11.37/\$13.60 prior. We maintain a \$116 PO based on an unchanged 8.5x multiple to 2024 EPS.

Exhibit 1: DQ rate trend suggests credit losses will continue to rise in 2H23

30+ day DQ rate (lagged 120 days) vs NCO rate



Source: BofA Global Research

BofA GLOBAL RESEARCH

DFS: NCOs improve, loan growth robust

Loan balances up 18.0% y/y in July

May ending loan balances increased to \$95.6B, up 18.0% y/y and 1.70% m/m. Loan growth slowed slightly from June which was up 18.7% y/y. Sequential growth at +1.70% m/m was better than typical seasonality in July (5yr average ex-2020: +1.31%). Loan balance growth is solid and trending ahead of our prior 3Q forecast of \$95.8B. We revise our 3Q forecast to \$97B (consensus \$96.7B).

NCO rates down m/m but DQs still increasing

The July NCO rate was 3.77% and the delinquency rate came in at 3.00%. NCOs decreased 3bps m/m slightly less than historical seasonality would predict (5yr average ex-2020: -10bps). That said, losses at 3.77% are trending better than BofAe/cons at 4.25%/4.15%.

Delinquencies up 14bps m/m

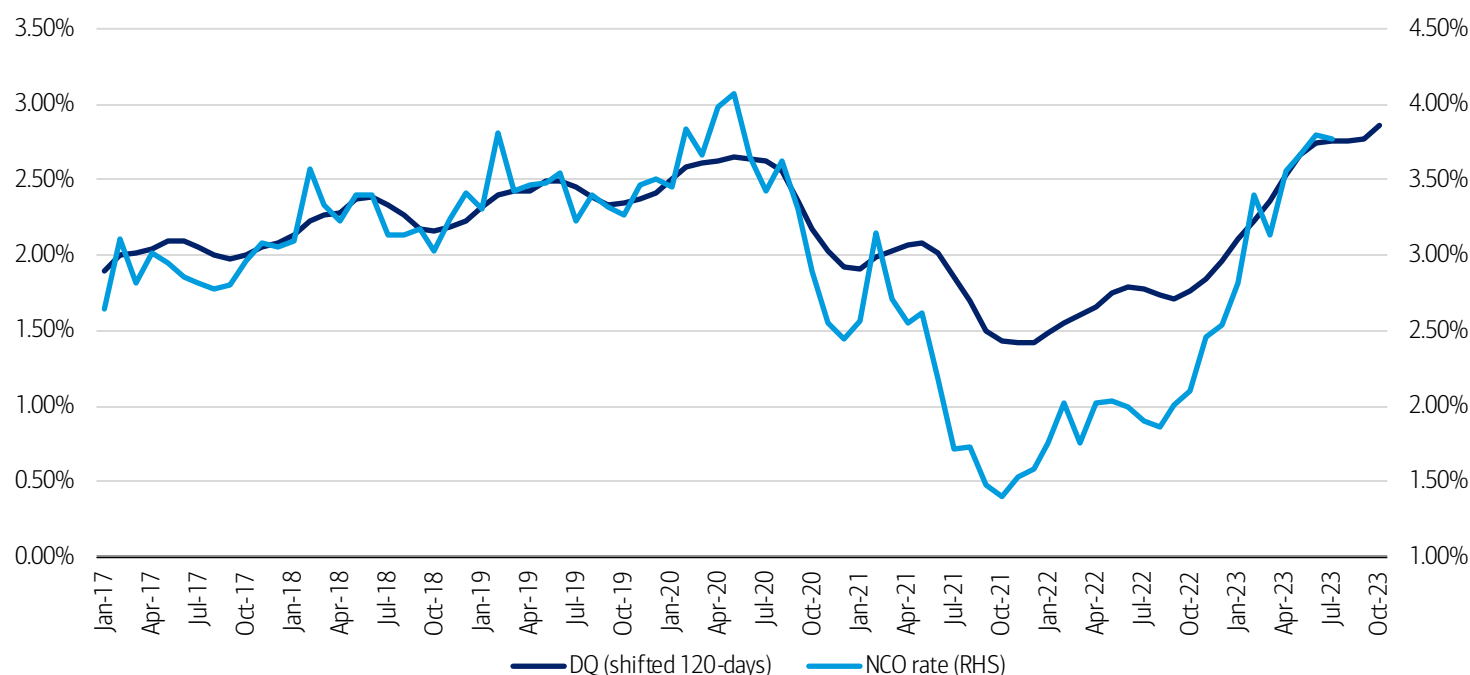
30+ day delinquencies increased 14bps m/m to 3.00% (Exhibit 2). DFS' DQ rates are currently 26% above pre-pandemic levels and suggest credit 'normalization' continues for the immediate future.

Updating estimates

We increase our 2023/2024 estimates to \$12.85/\$13.63 from \$12.74/\$13.60 to account for stronger than expected in-period loan growth and credit results. We maintain a \$116 PO based on an unchanged 8.5x multiple to 2024 EPS.

Exhibit 2: DQ rates suggest some additional loss normalization

30+ day DQ rate (lagged 120 days) vs NCO rate



Source: BofA Global Research

BofA GLOBAL RESEARCH



SYF: Loan growth holds strength

Loan growth up 14.5% y/y

July ending loan balances of \$96.3B were up 14.5% y/y, roughly flat vs June at +14.6% y/y, and up 1.6% m/m. Loan balances are trending slightly ahead of our consensus-like \$96.7B estimate given typical August and September trends. The sequential growth in loans of 1.6% was well above the typical seasonality of +80bps (5-year average excluding 2018's PYPL Credit portfolio acquisition). Average loan balances of \$92.3B are up 10.1% y/y (12.5% y/y in June).

July loss rates at 4.7%, flat m/m

The July NCO rate was 4.7%, flat m/m and up 170bps y/y. July credit losses have declined by an average of 34bps over the past 5 years, so the 2023 result of flat m/m suggests credit normalization. Historically, losses improve further in Aug/Sept so BofAe/consensus 3Q forecast at ~4.9%, could prove conservative. That said, given credit normalization, we are maintaining our forecast for now.

Delinquency rates up 20bps m/m

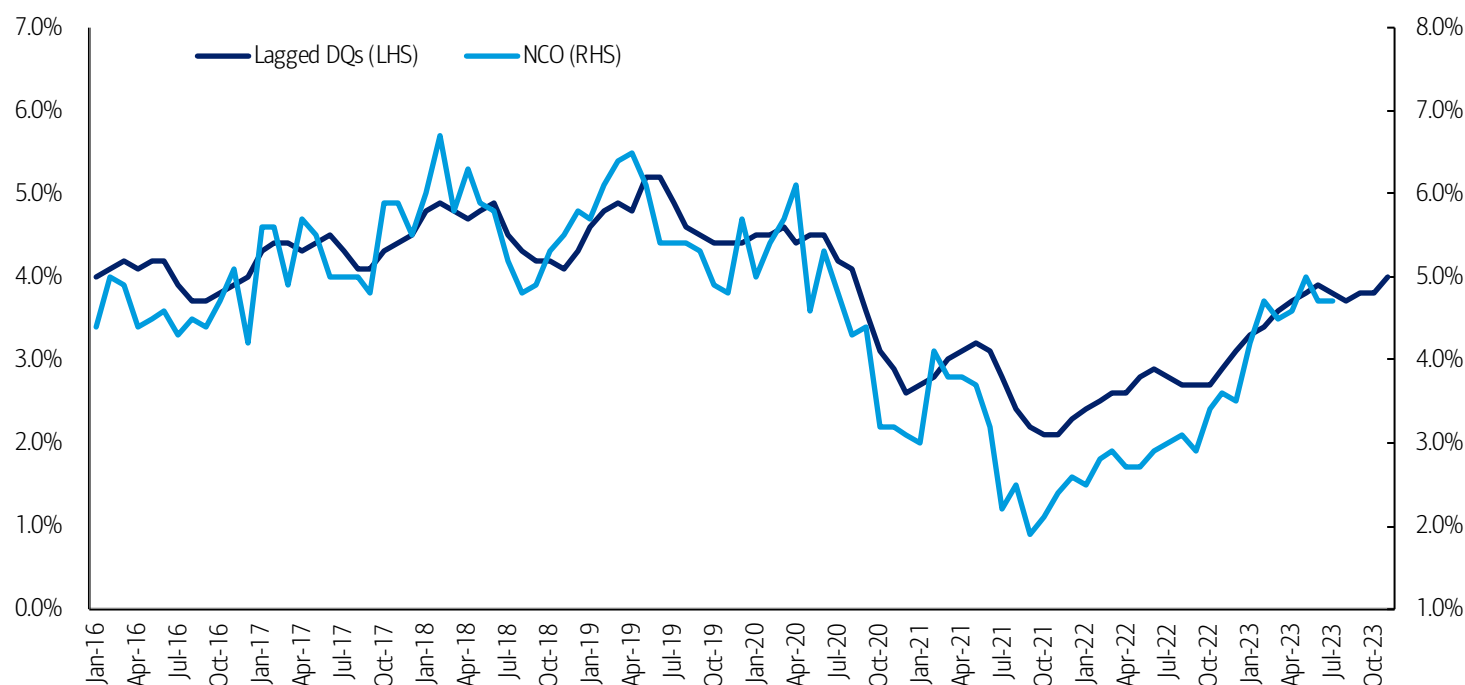
The 30+ day delinquency rate was 4.0%, up 20bps m/m vs typical July seasonality of roughly flat. Positively, SYF's DQ rates are still below pre-pandemic levels which is better than can be said of peers like COF/DFS.

Twueking estimates

We update our 2023/2024 EPS estimates to \$4.95/\$5.40 from \$4.94/\$5.39 prior as we account for July results. We maintain our \$38 PO based on an unchanged 7x multiple to 2024 EPS.

Exhibit 3: DQ rates suggest relative loss stability for the near-term

30+ day DQ rate (lagged 120 days) vs NCO rate



Source: BofA Global Research

BofA GLOBAL RESEARCH

BFH: muted m/m loan growth

July loan balances flat m/m

July end of period receivables of \$18.0B, up 0.4% y/y, a slowdown from 2.4% y/y in June. Loan balances were up only +1bp sequentially. The m/m growth was worse than historical seasonality of +60 bps m/m (5yr average ex-2020), likely due to reduced spending which BFH has noted was due to both credit actions it is taking and consumers pulling back. Average receivables at \$17.6B are up 0.5% y/y and flat m/m.

Card losses at 7.38%, another processing transition month

BFH reported an NCO rate of 7.38% in July compared to 7.69% in June. While the sequential step down in losses is encouraging and July reflects the last month of the card processing transition noise, a 7.38% loss rate is still well above 3Q estimates and guidance at ~7%.

Delinquency rates up 19bps m/m

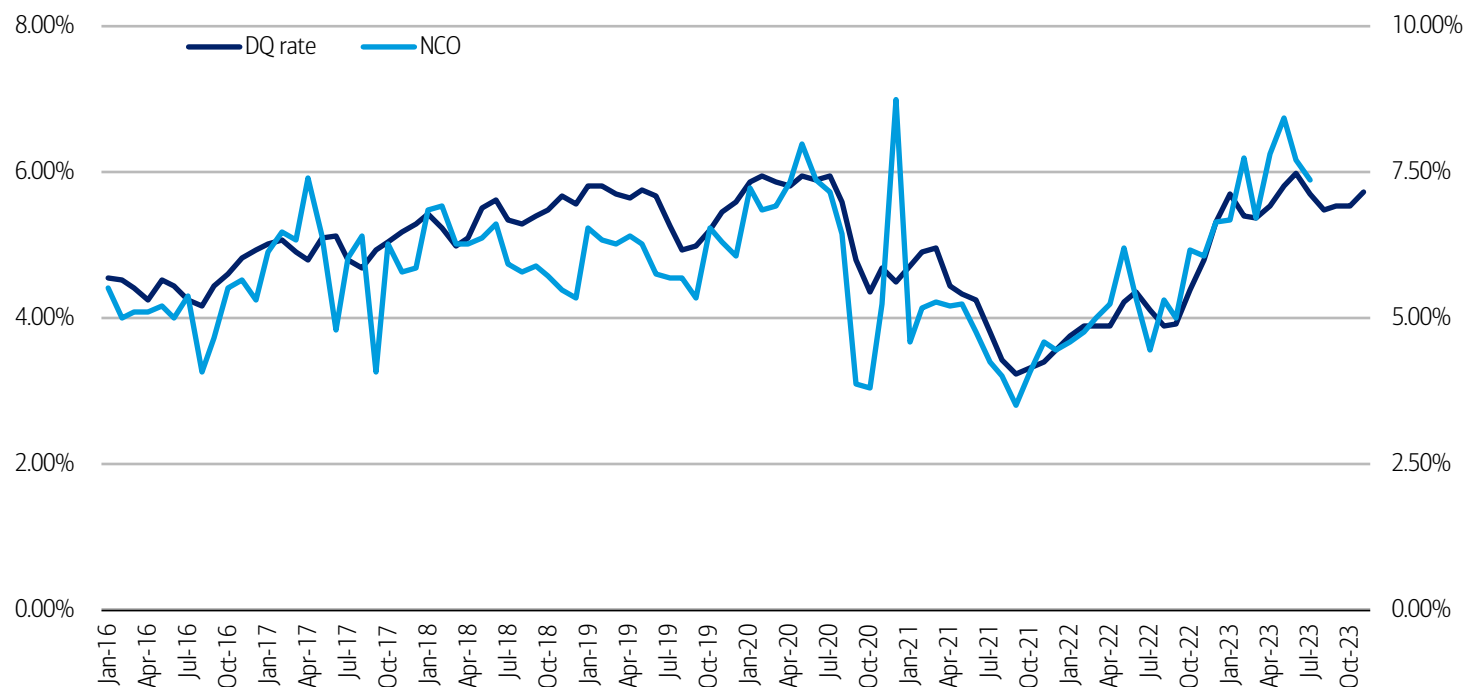
Delinquency rates were 5.73% in July (up 19bps m/m). Delinquency rates are running about 25-30bps above 2019 levels currently. We note, that BFH has guided to credit improvements resulting in lower losses than pre-pandemic levels so DQ levels should settle at below pre-pandemic levels longer-term. Positively, DQ trends suggest loss rates should decline in the near-term (Exhibit 4).

Adjusting estimates

We adjust our 2023/2024 EPS estimates to \$11.96/\$10.98 from \$11.95/\$11.01 as we account for July results and 10-Q data. We maintain a \$44 PO based on an unchanged 4x multiple to our 2024 EPS estimate.

Exhibit 4: DQ rates suggest NCO rates should decline in the near-term

30+ day DQ rate (lagged 120 days) vs NCO rate



Source: BofA Global Research

BofA GLOBAL RESEARCH



Stocks mentioned

Prices and ratings for stocks mentioned in this report

| BofA Ticker | Bloomberg ticker | Company name | Price | Rating |
|--------------------|-------------------------|---------------------|--------------|---------------|
| BFH | BFH US | Bread Financial | US\$ 39.34 | C-1-7 |
| COF | COF US | Capital One | US\$ 109.16 | B-2-7 |
| DFS | DFS US | Discover Finl | US\$ 102.65 | B-2-7 |
| SYF | SYF US | Synchrony Financial | US\$ 34.23 | B-2-7 |

Source: BofA Global Research

Price objective basis & risk**Bread Financial Holdings Inc (BFH)**

Our \$44 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 \$116 PO is based on a 8.5x PE multiple to our 2024 EPS forecast. A 8.5x PE multiple is in the middle of the historical range (7-12x) which we think is appropriate given the relatively uncertain macro backdrop and rising credit costs, partially offset by strong loan growth.

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.

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.

Discover Financial (DFS)

We calculate a \$116 PO based on an 8.5x PE multiple to our 2024 EPS forecast. A 8.5x multiple is in the middle of DFS's recent historical range (7-12x) and reflects concerns on rising unemployment and credit losses, offset by robust loan growth.

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.

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.

Synchrony Financial (SYF)

Our \$38 PO is based on a 7x P/E multiple on 2024E EPS. Our multiple is on the low end of the typical trading range for SYF (7-12x), 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

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| | Accenture Plc | ACN | ACN US | Jason Kupferberg |
| | American Express Company | AXP | AXP US | Mihir Bhatia |
| | Ares Capital Corporation | ARCC | ARCC US | Derek Hewett |
| | Ares Commercial Real Estate Corporation | ACRE | ACRE US | Derek Hewett |
| | Barings BDC Inc | BBDC | BBDC US | Derek Hewett |
| | Blackrock TCP Capital Corp | TCPC | TCPC US | Derek Hewett |
| | Blackstone Mortgage Trust Inc | BXMT | BXMT US | Derek Hewett |
| | Block Inc | SQ | SQ US | Jason Kupferberg |
| | Blue Owl Capital Corporation | OBDC | OBDC US | Derek Hewett |
| | Bread Financial Holdings Inc | BFH | BFH US | Mihir Bhatia |
| | Carlyle Secured Lending Inc | CGBD | CGBD US | Derek Hewett |
| | CI&T | CINT | CINT US | Jason Kupferberg |
| | Compass Diversified Holdings | CODI | CODI US | Derek Hewett |
| | Crescent Capital BDC | CCAP | CCAP US | Derek Hewett |
| | EngageSmart | ESMT | ESMT US | Jason Kupferberg |
| | 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 |
| | Mastercard Inc | MA | MA US | Jason Kupferberg |
| | MGIC Investment Corp. | MTG | MTG US | Mihir Bhatia |
| | New Mountain Finance Corporation | NMFC | NMFC US | Derek Hewett |
| | Nuvei | NVEI | NVEI US | Jason Kupferberg |
| | Nuvei | YNVEI | NVEI CN | Jason Kupferberg |
| | OneMain Holdings, Inc. | OMF | OMF US | Mihir Bhatia |
| | PayPal Holdings Inc | PYPL | PYPL US | Jason Kupferberg |
| | Safehold, Inc | SAFE | SAFE US | Derek Hewett |
| | Shift4 Payments, Inc | FOUR | FOUR US | Jason Kupferberg |
| | Sixth Street Specialty Lending, Inc | TSIX | TSIX US | Derek Hewett |
| | Starwood Property Trust | STWD | STWD US | Derek Hewett |
| | Telus International | TIXT | TIXT US | Cassie Chan |
| | Telus International | YTIXT | TIXT CN | Cassie Chan |
| | Toast | TOST | TOST US | Jason Kupferberg |
| | Visa Inc. | V | V US | Jason Kupferberg |
| | WEX Inc. | WEX | WEX US | Mihir Bhatia |
| NEUTRAL | | | | |
| | Affirm Holdings | AFRM | AFRM US | Jason Kupferberg |
| | AGNC Investment Corp | AGNC | AGNC US | Derek Hewett |
| | Annaly Capital Management | NLY | NLY US | Derek Hewett |
| | Apollo Commercial Real Estate Finance | ARI | ARI US | Derek Hewett |
| | Bain Capital Specialty Finance, Inc. | BCSF | BCSF US | Derek Hewett |
| | Blackstone Secured Lending Fund | BXSL | BXSL US | Derek Hewett |
| | BrightSpire Capital Inc. | BRSP | BRSP US | Derek Hewett |
| | Capital One Financial | COF | COF US | Mihir Bhatia |
| | Discover Financial | DFS | DFS US | Mihir Bhatia |
| | DLocal | DLO | DLO US | Jason Kupferberg |
| | Ellington Financial | EFC | EFC US | Derek Hewett |
| | Enact Holdings | ACT | ACT US | Mihir Bhatia |
| | Goldman Sachs BDC, Inc. | GSBD | GSBD US | Derek Hewett |
| | Golub Capital BDC, Inc. | GBDC | GBDC US | Derek Hewett |
| | Jack Henry & Associates | JKHY | JKHY US | Jason Kupferberg |
| | Ladder Capital Corp | LADR | LADR US | Derek Hewett |
| | Marqeta | MQ | MQ US | Jason Kupferberg |
| | Paymentus | PAY | PAY US | Jason Kupferberg |
| | PennyMac Mortgage Investment Trust | PMT | PMT US | Derek Hewett |
| | SoFi Technologies Inc | SOFI | SOFI US | Mihir Bhatia |
| | Synchrony Financial | SYF | SYF US | Mihir Bhatia |
| | Thoughtworks | TWKS | TWKS US | Jason Kupferberg |
| | TPG RE Finance Trust, Inc. | TRTX | TRTX US | Derek Hewett |
| | TTEC Holdings | TTEC | TTEC US | Cassie Chan |

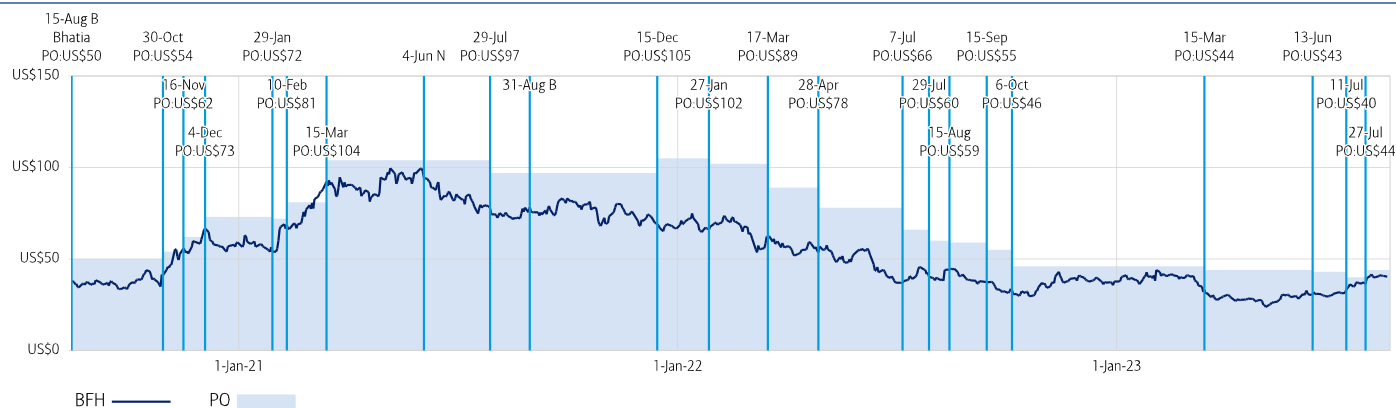
US - Payments, Processors, Specialty Finance and IT services Coverage Cluster

| Investment rating | Company | BofA Ticker | Bloomberg symbol | Analyst |
|-------------------|--------------------------------|-------------|------------------|------------------|
| UNDERPERFORM | ADP | ADP | ADP US | Jason Kupferberg |
| | Angel Oak Mortgage Inc. | AOMR | AOMR US | Derek Hewett |
| | 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 |
| | Guild Holdings Company | GHLD | GHLD US | Derek Hewett |
| | Invesco Mortgage Capital, Inc. | IVR | IVR US | Derek Hewett |
| | loanDepot Inc | LDI | LDI US | Derek Hewett |
| | MidCap Financial Investment Co | MFIC | MFIC US | Derek Hewett |
| | New York Mortgage Trust | NYMT | NYMT US | Derek Hewett |
| | 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 |
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Disclosures

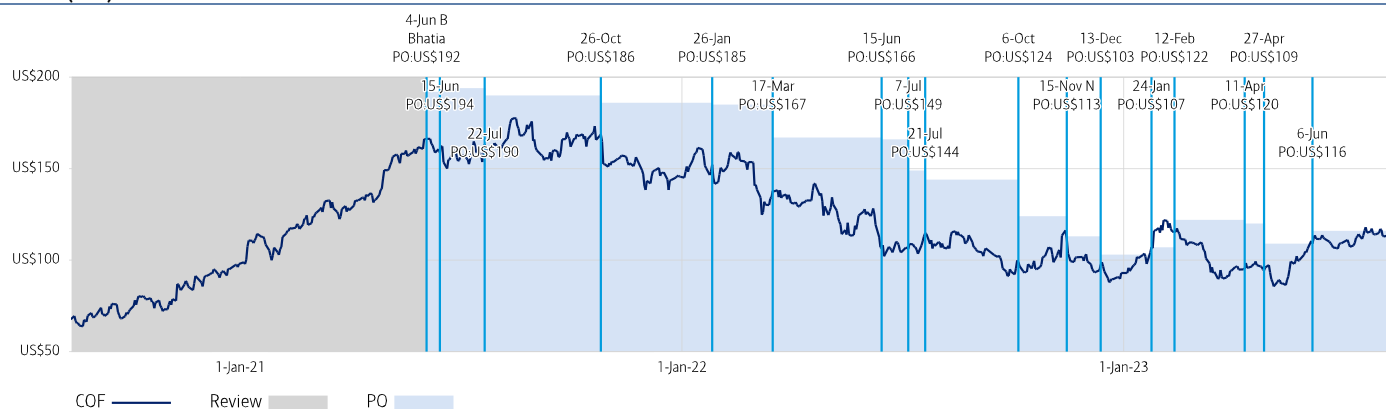
Important Disclosures

Bread Financial (BFH) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Capital One (COF) Price Chart

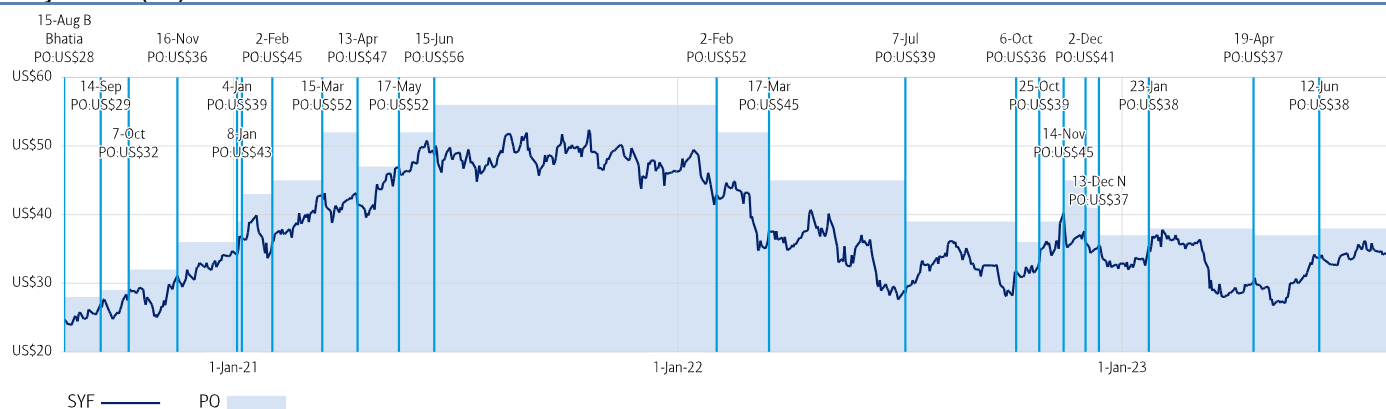
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Discover Finl (DFS) Price Chart

B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Synchrony Financial (SYF) Price Chart

B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Equity Investment Rating Distribution: Financial Services Group (as of 30 Jun 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 145 | 50.52% | Buy | 91 | 62.76% |
| Hold | 78 | 27.18% | Hold | 47 | 60.26% |
| Sell | 64 | 22.30% | Sell | 38 | 59.38% |

Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 1877 | 53.28% | Buy | 1040 | 55.41% |
| Hold | 815 | 23.13% | Hold | 464 | 56.93% |
| Sell | 831 | 23.59% | Sell | 385 | 46.33% |

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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|-------------------|---|--|
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| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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