

## Capital One Financial

# OpEx drive EPS miss, but credit trends are favorable; Reiterate Buy.

Reiterate Rating: BUY | PO: 146.00 USD | Price: 132.55 USD

## 4Q misses, but credit outlook should be view positively

Capital One (COF) reported 4Q results that missed consensus expectations primarily due to higher expenses. Despite the headline EPS miss, we thought call commentary on credit, growth opportunities, and expenses struck a positive tone. Capital One gave rare near-term guidance on net charge-off rates which should be well received. Additionally, COF expects to deliver flat to modest operating leverage in 2024, inclusive of potential adverse impacts of the CFPB late fee rule (in 4Q). The company also increased marketing spend by 12% y/y (29% q/q) and sees an attractive opportunity to lean-in on account growth. We think COF's positive credit commentary should be well received and strikes a contrast to others still grappling with normalization. Reiterate Buy.

## "Charge-offs should move with seasonality"

COF noted that it is through credit normalization and NCOs should move with seasonality over the near-term. It expects NCOs to run about 15% above 2019 levels in the near-term. We were particularly struck by COF's confidence and tone, given the company does not typically provide specific forward guidance. COF's confidence in its outlook comes from 30+ DQs performing in-line with historical seasonality and gross charge-offs at 2018-19 levels (6.16% in 4Q23 vs. 6.08% in 2018-19). Recoveries should increase prospectively, and we would expect NCO rate to decline in 2H24, though are likely to increase in 1H24 on typical seasonality.

## Efficiency ratio flat to modestly lower in '24

The company was adamant on improving the efficiency ratio while driving revenue growth rather than cutting costs. It plans to continue its investments in technology, as well as invest to improve cardholder experiences. It also sees an opportunity to attract new customers which is driving marketing expense higher. For 2024, including these investments, management expects a flat-to-modestly lower efficiency ratio. The guide includes a theoretical revenue hit from the CFPB late fee rule (4Q implementation).

## Adjusting estimates and PO

We tweak our 2024/2025 EPS estimates to \$13.90/\$16.12 from \$14.20/\$16.30 previously as we account for 4Q results and company commentary. Our 2024 estimate is lower due to higher marketing and OpEx spend, which should drive long-term growth. As a result, we slightly lower our price objective to \$146 (\$149 prior) based on an unchanged 10.5x P/E multiple. **See inside for 4Q key metrics and variance table.**

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026
EPS	17.71	12.52	13.90	16.12	NA
GAAP EPS	17.91	11.98	13.90	16.12	NA
EPS Change (YoY)	-34.7%	-29.3%	11.0%	16.0%	NA
Consensus EPS (Bloomberg)			13.91	16.51	NA
DPS	2.40	2.40	2.60	2.80	NA
Valuation (Dec)					
P/E	7.5x	10.6x	9.5x	8.2x	NA
GAAP P/E	7.4x	11.1x	9.5x	8.2x	NA
Dividend Yield	1.8%	1.8%	2.0%	2.1%	NA

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Timestamp: 25 January 2024 07:16PM EST

25 January 2024

### Equity

#### Key Changes

(US\$)	Previous	Current
Price Obj.	149.00	146.00
2024E DPS	2.80	2.60

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### Stock Data

Price	132.55 USD
Price Objective	146.00 USD
Date Established	25-Jan-2024
Investment Opinion	B-1-7
52-Week Range	83.93 USD -134.26 USD
Mkt Val / Shares Out (mn)	50,502 USD / 381.0
Free Float	95.3%
Average Daily Value	365.33 USD
BofA Ticker / Exchange	COF / NYSE
Bloomberg / Reuters	COF US / COF.N
ROE (2024E)	0%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

CFPB: Consumer Financial Protection Bureau

DQ: Delinquency

NCO: Net charge-off

# iQprofile<sup>SM</sup> Capital One Financial

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026
Net Interest Income	27,114	29,241	31,045	32,173	NA
% change	12.2%	7.8%	6.2%	3.6%	NA
Net Fee Income	7,136	7,546	7,742	8,131	NA
Securities Gains / (Losses)	NA	NA	NA	NA	NA
Total Operating Income	34,250	36,787	38,788	40,304	NA
Operating Expenses	(19,163)	(20,316)	(21,023)	(21,805)	NA
% change	15.6%	6.0%	3.5%	3.7%	NA
Provisions Expense	(5,847)	(10,426)	(10,759)	(10,614)	NA
% change	NA	78.3%	3.2%	-1.4%	NA
Operating Pre-Tax Income	9,240	6,045	7,005	7,885	NA
Operating Net Income to Comm S/Hold.	7,044	4,582	5,266	5,961	NA
GAAP Net Income	7,360	4,887	5,534	6,229	NA

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026
Total Assets	455,249	478,464	483,452	500,678	NA
Average Interest Earning Assets	NA	NA	NA	NA	NA
Total Gross Customer Loans	NA	NA	NA	NA	NA
% change	NA	NA	NA	NA	NA
Total Customer Deposits	332,992	348,413	352,458	359,507	NA
% change	7.1%	4.6%	1.2%	2.0%	NA
Tangible Equity	NA	NA	NA	NA	NA
Common Shareholders' Equity	52,582	58,089	59,795	61,385	NA

## Key Metrics (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026
Net Interest Margin	NA	NA	NA	NA	NA
Effective Tax Rate	20.3%	19.2%	21.0%	21.0%	NA
Loan / Deposit Ratio	0%	0%	0%	0%	NA
Tangible Common Equity / Assets	0%	0%	0%	0%	NA
ROA	NA	NA	NA	NA	NA
ROE	NA	NA	NA	NA	NA
RoTE	NA	NA	NA	NA	NA
Dividend Payout Ratio	13.3%	20.0%	18.7%	17.4%	NA
Efficiency Ratio (Cost / Income Ratio)	56.0%	55.2%	54.2%	54.1%	NA
Billings Growth	NA	NA	NA	NA	NA
Share / Issue Repurchase	NA	NA	NA	NA	NA
Cost of Dividends Paid	(947)	(915)	(987)	(1,039)	NA
Change in Debt	NA	NA	NA	NA	NA

## Quality of Earnings (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026
Total Non-Interest Inc / Operating Inc	20.8%	20.5%	20.0%	20.2%	NA
Loan Loss Reserves / Total Loans	NA	NA	NA	NA	NA

## Company Sector

Financial Services-Consumer/Commercial

## Company Description

Headquartered in McLean, Virginia, Capital One Financial Corporation (COF) is a bank holding company that is primarily in the business of issuing credit cards and auto loans. In 2022, COF was the second-largest credit card issuer (by cards outstanding) and had the second-largest auto loan portfolio in the U.S. In addition to offering credit cards and auto loans to US consumers, COF provides debit cards, business cards, and commercial banking services

## Investment Rationale

We rate COF Buy. In our view, early indicators suggest COF's delinquency and net charge-offs are becoming more constructive. The more optimistic macro outlook and resilient consumer balance sheet should support credit metrics if unemployment does tick higher. Also COF's strategy to lean-in on marketing OpEx is helping to grow cards in-force and loan growth.

## Stock Data

Average Daily Volume 2,756,143

## Quarterly Earnings Estimates

	2023	2024
Q1	2.31A	4.12E
Q2	3.52A	3.18E
Q3	4.45A	3.64E
Q4	2.24A	2.95E

## Key metrics

Capital One's 4Q adjusted EPS of \$2.24 came in below BofAe/cons at \$2.32/\$2.60. Relative to our forecast, the miss was driven by higher OpEx (-\$0.43/share) partially offset by lower provision expense (+\$0.40). We note that OpEx, including the FDIC special assessment fee, led to a (-\$1.00) impact to GAAP EPS vs. our estimate.

**PPNR (-):** of \$3,789M was well below BofAe/cons at \$4,265M/\$4,255M driven primarily by higher OpEx which included a \$289M FDIC special assessment fee charge.

**Loan balances (-):** at \$320B were below BofAe/cons at \$324B/\$322B. Credit card balances of \$155B were in-line with expectations and auto balances at \$74B were a touch below. NIM came in at 6.73% below BofAe at 6.81% but slightly below cons at 6.75%.

**Credit / reserves (+/-):** The company-wide NCO rate was 3.18% slightly above BofAe/cons at 3.12%/3.03%. Card NCO at 5.33% compares to BofAe/cons at 5.19%/5.10%. That said, COF built \$326M in reserves, below BofAe/cons at \$545M/\$490M, which resulted in a company wide reserve ratio of 4.77% (up 2bps q/q). We note that domestic card reserve ratio declined 16bps q/q driven by higher transaction balances. The lower reserve ratio is a positive and indicates COF's confidence in charge-offs approaching a cyclical peak, in our view.

**OpEx (-):** at \$5,717M vs BofAe/cons at \$5,213M/\$5,243M which drove an efficiency ratio of 60%, up 8pp q/q. Excluding the FDIC special assessment fee, OpEx would have been \$5,428M, still above expectations due to higher marketing spend. COF noted that it sees opportunities across the board and it is leaning in especially in the card business. COF believes its technology investments have enabled it to leverage more data and created more opportunities to invest and create better and customized solutions for customers. COF also continues to invest in building out its capabilities to attract heavy spending transactors (Venture X portfolio) through best-in-class digital experiences, airport lounges, event access etc. It also continues to lean in on brand marketing for its national bank platform.

### Exhibit 1: Higher OpEx drove the EPS and PPNR miss

Variance table

(\$ in millions)	Actual	Estimate	Variance	Var per share	Consensus
	Dec-23-A	Dec-23-E	(Act - Est)	(net of tax)	
<b>Income Statement</b>					
Interest Income	\$11,145	\$11,201	(\$56)	(\$0.11)	\$11,296
y/y growth	21.7%	22.3%			23.4%
Interest Expense	\$3,626	\$3,700	(\$74)	\$0.15	\$3,696
y/y growth	84.9%	88.7%			88.5%
Net interest income	\$7,519	\$7,501	\$18	\$0.04	\$7,561
y/y growth	4.5%	4.2%			5.1%
Provision for credit losses	\$2,857	\$3,060	(\$203)	\$0.40	\$2,901
y/y growth	18.3%	26.7%			20.1%
Net interest income after provisions	\$4,662	\$4,441	\$221	\$0.44	\$4,660
y/y growth	-2.5%	-7.1%			
Total non-interest income	\$1,987	\$1,978	\$9	\$0.02	\$1,950
y/y growth	7.8%	7.3%			5.8%
Total non-interest expense	\$5,717	\$5,213	\$504	(\$1.00)	\$5,243
y/y growth	12.5%	2.6%			3.2%
As a % of revenue (Efficiency ratio)	60.1%	55.0%			55.1%
Income before taxes	\$932	\$1,205	(\$273)	(\$0.54)	\$1,354
Pre-tax margin	9.8%	12.7%			14.2%
Income tax provision	\$226	\$234	(\$8)	\$0.02	\$270
Net income	\$706	\$971	(\$265)	(\$0.69)	\$1,069
After-tax margin	7.4%	10.2%			11.2%
Undistributed earnings and dividends	(\$67)	(\$85)	\$18	\$0.05	(\$77)
Net income available to common shareholders	\$639	\$886	(\$247)	(\$0.65)	\$991
y/y growth	-45.0%	-23.7%			-14.7%
<b>PER SHARE STATISTICS</b>					



**Exhibit 1: Higher OpEx drove the EPS and PPNR miss**

Variance table

(\$ in millions)	Actual	Estimate	Variance	Var per share	Consensus
Diluted EPS	\$1.67	\$2.32	(\$0.65)		\$2.60
y/y growth	-44.7%	-23.2%			-14.2%
Adjusted EPS	\$2.24	\$2.32	(\$0.09)		\$2.60
y/y growth	-20.6%	-17.5%			-14.2%
Weighted average common shares outstanding (diluted)	382	381	1		382
<b>Key Metrics</b>					
Pre-provision net revenue	\$3,789	\$4,265			\$4,255
y/y growth	-4.3%	7.7%			7.4%
Effective tax rate	24.2%	19.4%			19.9%
ROE	4.54%	6.52%			7.91%
Purchase volume	\$162,055	\$164,971			\$164,552
y/y growth	4.1%	6.0%			5.7%
Total loans receivable	\$320,472	\$323,911			\$322,176
Total loan growth (company)	2.6%	3.7%			3.2%
Credit card loan receivable	\$154,547	\$155,450			\$154,268
Credit card loan growth	12.2%	12.9%			12.0%
Auto loan receivable	\$74,075	\$74,454			\$74,782
Auto loan growth	-5.5%	-5.0%			-4.6%
Net interest margin	6.73%	6.81%			6.75%
Net charge-off rate (Company)	3.18%	3.12%			3.03%
Net charge-off rate (Card)	5.33%	5.19%			5.10%
Reserve ratio (Company)	4.77%	4.79%			4.79%
Reserve build / release	\$326	\$545			\$490

**Source:** BofA Global Research estimates, Visible Alpha

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## Price objective basis & risk

### Capital One Financial (COF)

Our \$146 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.

## 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
<b>BUY</b>				
	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
<b>NEUTRAL</b>				
	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
<b>UNDERPERFORM</b>				
	CGI Inc.	GIB	GIB US	Jason Kupferberg
	CGI Inc.	YGIBA	GIB/A CN	Jason Kupferberg



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

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	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
<b>RSTR</b>	EngageSmart	ESMT	ESMT US	Jason Kupferberg

**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Numerator**

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Denominator**

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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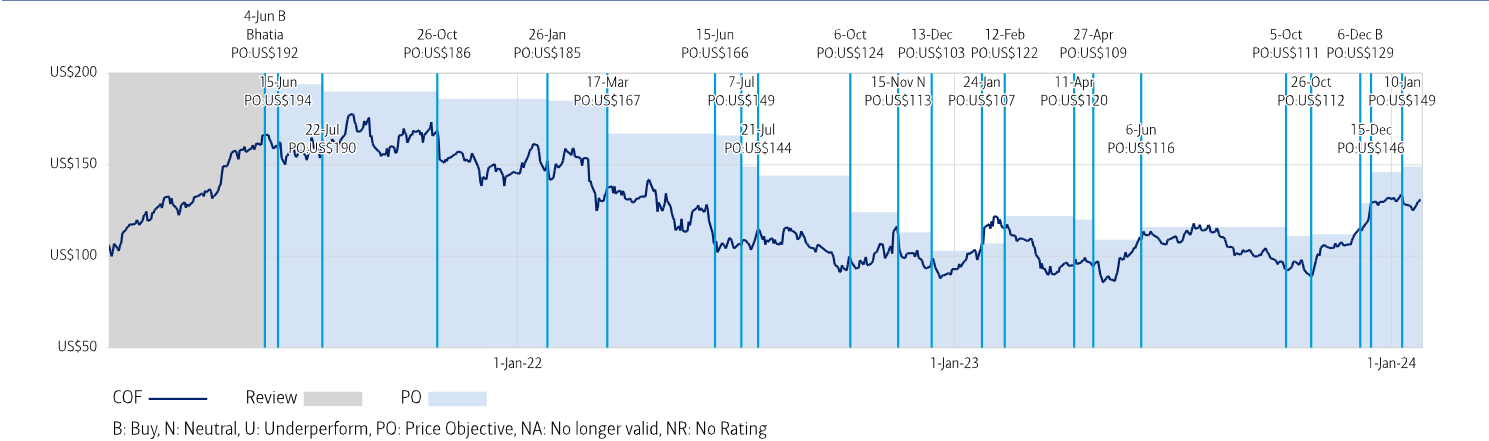
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# Disclosures

## Important Disclosures

Capital One (COF) Price Chart



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.

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

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	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 <sup>R1</sup>	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%

<sup>R1</sup> 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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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> 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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