

Bread Financial Holdings Inc

Outlook murky, but valuation compelling

Reiterate Rating: BUY | PO: 44.00 USD | Price: 27.41 USD

1Q beat driven by BJ's portfolio sale

Bread Financial (BFH) reported 1Q EPS of \$9.08 ahead of BofAe/consensus at \$8.55/\$7.36. Excluding the sale of the BJ's portfolio, we estimate core EPS at \$5.81. Relative to our forecast the beat was driven by higher net interest income (+\$0.60/shr), a higher purchase price for the portfolio (\$0.84/shr), partially offset by higher provision for credit losses (-\$0.79/shr). While guidance was reiterated, the volatility in the net loss rate outlook and a cautious tone on consumer behavior is likely leading to the muted stock reaction. That said, valuation at current levels is compelling and, in our view, incorporates a meaningful amount of downside risk. Maintain Buy.

FY23 guidance reiterated

BFH mostly reiterated its full-year outlook including mid-single digit growth in average loans and revenues, NIM around 19.2%, net loss rate of ~7% (discussed below) and positive operating leverage excluding gain on portfolio sale. Notably though, BFH now expects to invest an incremental \$30M of the portfolio sale gains in 2023, to accelerate its business transformation.

Credit guidance likely to be scrutinized

For 2Q, BFH expects loss rates to be 8%, as card processing transition impacts pressure the loss rate up by 100bps. However, this implies 2H23 loss rates average 6.5% to get to BFH's ~7% full-year guidance. BFH has confidence it can get there based on internal trends it is seeing in early-stage delinquencies and roll-rates. However, we expect investors will take a more 'show-me' approach and want to see progress in monthly reporting before they gain confidence in BFH's forecast.

0.7x Tangible book value – too cheap to ignore

We maintain a Buy rating on BFH. Following today's results, shares are trading at 70% of tangible book value and 50% of book value. We acknowledge the macro backdrop is challenging and there is also risk of missing credit guidance. Late fee regulation impairing BFH's earnings power is also likely a factor (see our report: [CFPB expert call takeaways and laying out the worst-case scenario](#)). Still, current valuation implies an impaired business model and minimal earnings over the next few years. We think that is unlikely. If the late fee rule is delayed, as BFH expects, it will have time to adjust business practices. And while there is earnings risk in the near-term, we think risk/reward is positively skewed and we maintain a Buy rating.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	16.03	4.46	10.54	10.94	14.02
GAAP EPS	16.03	4.46	10.54	10.94	14.02
EPS Change (YoY)	258.6%	-72.2%	136.3%	3.8%	28.2%
Consensus EPS (Bloomberg)			9.09	9.73	12.66
DPS	0.84	0.84	0.84	0.84	0.84
Valuation (Dec)					
P/E	1.7x	6.1x	2.6x	2.5x	2.0x
GAAP P/E	1.7x	6.1x	2.6x	2.5x	2.0x
Dividend Yield	3.1%	3.1%	3.1%	3.1%	3.1%

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Refer to important disclosures on page 8 to 10. Analyst Certification on page 5. Price Objective Basis/Risk on page 5.

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Stock Data

Price	27.41 USD
Price Objective	44.00 USD
Date Established	15-Mar-2023
Investment Opinion	C-1-7
52-Week Range	26.21 USD -58.25 USD
Mrkt Val / Shares Out (mn)	1,374 USD / 50.1
Average Daily Value	22.02 USD
BofA Ticker / Exchange	BFH / NYS
Bloomberg / Reuters	BFH US / BFH.N
ROE (2023E)	NA
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"](#).

PPNR: Pre-provision net revenue

NIM: Net interest margin

NII: Net interest income

NCO: Net charge-off

CET1: Common Equity Tier 1

iQprofileSM Bread Financial Holdings Inc

Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Interest Income	3,486	4,182	4,310	4,374	4,462
% change	1.0%	20.0%	3.1%	1.5%	2.0%
Net Fee Income	(214)	(356)	(31)	(281)	(301)
Securities Gains / (Losses)	NA	NA	NA	NA	NA
Total Operating Income	3,272	3,826	4,279	4,094	4,161
Operating Expenses	(1,683)	(1,933)	(2,076)	(2,052)	(2,081)
% change	-2.8%	14.8%	7.4%	-1.2%	1.4%
Provisions Expense	(543)	(1,593)	(1,470)	(1,304)	(1,136)
% change	-57.1%	193.2%	-7.7%	-11.3%	-13.0%
Operating Pre-Tax Income	1,045	300	733	737	945
Operating Net Income to Comm S/Hold.	798	223	528	549	704
GAAP Net Income	800	222	528	549	704

Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Total Assets	21,746	25,407	23,255	23,887	24,497
Average Interest Earning Assets	18,702	21,659	21,992	22,634	23,105
Total Gross Customer Loans	17,399	21,365	19,978	20,466	20,922
% change	3.7%	22.8%	-6.5%	2.4%	2.2%
Total Customer Deposits	11,027	13,826	13,731	13,317	13,132
% change	12.6%	25.4%	-0.7%	-3.0%	-1.4%
Tangible Equity	NA	NA	NA	NA	NA
Common Shareholders' Equity	2,086	2,265	2,827	3,376	4,080

Key Metrics (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Interest Margin	18.64%	19.31%	19.60%	19.33%	19.31%
Effective Tax Rate	23.7%	25.7%	28.0%	25.5%	25.5%
Loan / Deposit Ratio	157.8%	154.5%	145.5%	153.7%	159.3%
Tangible Common Equity / Assets	0%	0%	0%	0%	0%
ROA	NM	NM	NM	NM	NM
ROE	NM	NM	NM	NM	NM
RoTE	NA	NA	NA	NA	NA
Dividend Payout Ratio	5.2%	18.8%	8.0%	7.7%	6.0%
Efficiency Ratio (Cost / Income Ratio)	51.5%	50.5%	48.5%	50.1%	50.0%
Billings Growth	NA	NA	NA	NA	NA

Quality of Earnings (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Total Non-Interest Inc / Operating Inc	-6.5%	-9.3%	-0.7%	-6.9%	-7.2%
Loan Loss Reserves / Total Loans	11.77%	13.04%	14.71%	14.18%	13.55%

Company Sector

Financial Services-Consumer/Commercial

Company Description

Headquartered in Columbus, Ohio, Bread Financial is a financial services company providing simple, personalized payment, lending and saving solutions. Bread offers a comprehensive product suite of products including private label and co-brand credit cards, installment lending and buy now, pay later (split-pay).

Investment Rationale

We rate BFH a Buy. Since taking over new management has done a commendable job through the turnaround and is investing to reinvigorate growth. The macro backdrop is somewhat challenging, but we think BFH's valuation already reflects this. We see risk/reward as attractive.

Stock Data

Average Daily Volume

803,447

Quarterly Earnings Estimates

	2022	2023
Q1	4.20A	9.08A
Q2	0.25A	-0.33E
Q3	2.69A	2.50E
Q4	-2.68A	-0.72E

Parent-level debt remains a priority

BFH is focused on repaying upcoming debt maturities and highlighted its improved liquidity position. The company expects to refinance 2024 debt maturities before they become current (within 12 months of maturity). As of December 2022, there were \$556M of parent term loans that mature in July 2024 and an additional \$850M maturing in December 2024. As a result, we would expect BFH to act on at least one of the maturities in 2Q. Bread could dividend capital from the bank to the parent company in order to paydown a portion of upcoming maturities to reduce parent company debt, even as it refinances the remainder. Notably, the combined bank CET1 capital ratio has increased to 20.2% from 17.0% in 4Q22.

Key metrics

PPNR: at \$745M (\$515M core) came in above BofAe/cons at \$625M/\$555M. Relative to our forecast, the beat was driven by higher gain on sale revenue and OpEx prudence.

Ending loan balances: were \$18.1B was above our consensus-like \$17.8B estimate. 1Q NIM came in at 19.0%, squarely between BofA and consensus at 18.9%19.1%.

Credit / reserves: 1Q NCO rate of 7.00% was better than our consensus-like 7.40% estimate. Of note, the March NCO rate was 6.71%, a 104bps sequential improvement from February. BFH released \$241M in reserves and increased the reserve rate 78bps q/q to 12.31%.

Exhibit 1: Higher net interest income and gain on sale revenue, partially offset by higher provisions, drove the beat

Variance table

(\$ in millions)	Actual	Estimate	Variance	Var per share	Consensus
	Mar-23-A	Mar-23-E	(Actual - Est)		
Income Statement					
Interest on fees and loans	1,289.0	1,250.1	39	\$0.55	1,281.9
Interest on cash and investment securities	46.0	42.0	4	\$0.06	41.5
Total interest income	1,335.0	1,292.1	43	\$0.61	1,320.9
y/y growth	25%	21%			24%
Interest on deposits	117.0	133.1	(16)	\$0.23	114.1
Interest on borrowings	101.0	84.0	17	(\$0.24)	93.2
Total interest expense	218.0	217.0	1	(\$0.01)	205.9
Net interest income	1,117.0	1,075.0	42	\$0.60	1,115.2
y/y growth	13%	9%			13%
Interchange revenue, net of RSAs	(87.0)	(98.6)	12	\$0.16	(99.9)
Other revenue	259.0	200.0	59	\$0.84	58.3
Total non-interest revenue	172.0	101.4	71	\$1.00	(44.3)
y/y growth	-353%	-249%			-35%
Provision for credit losses	107.0	51.4	56	(\$0.79)	82.0
y/y growth	-45%	-73%			-58%
Total non-interest expense	544.0	551.3	(7)	\$0.10	535.2
y/y growth	28%	29%			26%
% of total revenue (excluding provisions)	42.2%	46.9%			50.0%
Income from continuing operations before income tax	638.0	573.8	64	\$0.91	473.0
y/y growth	111%	90%			57%
Provision for income taxes	183.0	146.3	37	(\$0.52)	120.0
tax rate	29%	26%			25%
Income from continuing operations	455.0	427.5	27	\$0.55	353.0
y/y growth	116%	103%			67%
Income from discontinued operations, net of tax	0.0	0.0	0	\$0.00	0.0
Net income	455.0	427.5	27	\$0.55	353.0
y/y growth	117%	104%			68%
EPS from continuing operations	\$9.08	\$8.55	\$0.53		\$7.36
y/y growth	116%	104%			75%
Average diluted shares outstanding	50.1	50.0			50.0
Other Key Metrics					
Pre-Provision Net Revenue	\$745.0	\$625.2			\$555.0
ROE	73.08%	68.99%			57.84%
Net interest margin	19.02%	18.93%			19.09%



Exhibit 1: Higher net interest income and gain on sale revenue, partially offset by higher provisions, drove the beat

Variance table

(\$ in millions)	Actual	Estimate	Variance	Var per share	Consensus
	Mar-23-A	Mar-23-E	(Actual - Est)		
Credit card and loan receivables, gross	18,060	17,809			17,850
y/y growth	7.23%	5.74%			5.98%
Average Loans	19,405	18,520			19,356
y/y growth	16.55%	11.23%			16.25%
Deposits	13,138	14,559			12,708
y/y growth	23.41%	36.76%			19.37%
Credit Sales	7,373	7,300			7,430
y/y growth	7.06%	6.00%			7.88%
Net Principal loss rate (Calc)	7.01%	7.40%			7.37%
y/y increase (BPS)	222.8	261.9			258.9
Reserve Ratio	12.31%	12.20%			12.16%
Reserve Build	(241)	(291)			(294)

Source: BofA Global Research estimates, company reports, Visible Alpha

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.

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
	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
	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
	DLocal	DLO	DLO US	Jason Kupferberg
	EngageSmart	ESMT	ESMT US	Jason Kupferberg
	EPAM Systems	EPAM	EPAM US	Jason Kupferberg
	Essent Group	ESNT	ESNT US	Mihir Bhatia
	Fidelity National Information Services	FIS	FIS US	Jason Kupferberg
	Fiserv Inc	FISV	FISV US	Jason Kupferberg
	FleetCor Technologies Inc.	FLT	FLT US	Mihir Bhatia
	Flywire	FLYW	FLYW US	Jason Kupferberg
	Global Payments Inc	GPV	GPV 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
	Owl Rock Capital Corporation	ORCC	ORCC US	Derek Hewett
	PayPal Holdings Inc	PYPL	PYPL US	Jason Kupferberg
	Radian Group Inc	RDN	RDN US	Mihir Bhatia
	Safehold, Inc	SAFE	SAFE US	Derek Hewett
	Shift4 Payments, Inc	FOUR	FOUR US	Jason Kupferberg
	Sixth Street Specialty Lending, Inc	TSLX	TSLX US	Derek Hewett
	SoFi Technologies Inc	SOFI	SOFI US	Mihir Bhatia
	Starwood Property Trust	STWD	STWD US	Derek Hewett
	TaskUs	TASK	TASK US	Cassie Chan
	Telus International	TIXT	TIXT US	Cassie Chan
	Telus International	YTIXT	TIXT CN	Cassie Chan
	Visa Inc.	V	V US	Jason Kupferberg



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

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	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
	Ellington Financial	EFC	EFC US	Derek Hewett
	Goldman Sachs BDC, Inc.	GSBD	GSBD US	Derek Hewett
	Golub Capital BDC, Inc.	GBDC	GBDC US	Derek Hewett
	Ladder Capital Corp	LADR	LADR US	Derek Hewett
	Paymentus	PAY	PAY US	Jason Kupferberg
	PennyMac Mortgage Investment Trust	PMT	PMT US	Derek Hewett
	Synchrony Financial	SYF	SYF US	Mihir Bhatia
	Thoughtworks	TWKS	TWKS US	Jason Kupferberg
	TPG Real Estate Finance Trust	TRTX	TRTX US	Derek Hewett
	TTEC Holdings	TTEC	TTEC US	Cassie Chan
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
	Enact Holdings	ACT	ACT US	Mihir Bhatia
	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
	Rocket Companies, Inc.	RKT	RKT US	Mihir Bhatia
	Western Union	WU	WU US	Jason Kupferberg

IQmethodSM 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 & 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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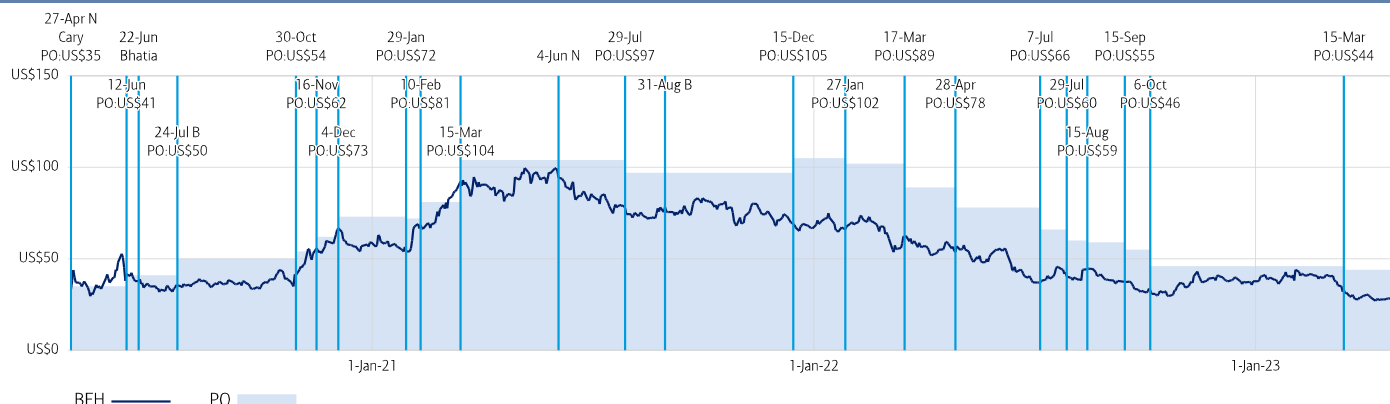
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Disclosures

Important Disclosures

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.

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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	152	52.41%	Buy	92	60.53%
Hold	73	25.17%	Hold	44	60.27%
Sell	65	22.41%	Sell	41	63.08%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1869	53.01%	Buy	1030	55.11%
Hold	827	23.45%	Hold	476	57.56%
Sell	830	23.54%	Sell	389	46.87%

^{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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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
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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