

Ally Financial Inc. (ALLY)

\$15.78 (As of 05/08/20)

Price Target (6-12 Months): **\$16.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 05/05/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: B

Growth: F

Momentum: F

Summary

Ally Financial's shares have underperformed the industry so far this year. The company's earnings surpassed the Zacks Consensus Estimate in two and met in one of the trailing four quarters. Its first-quarter 2020 results were hurt by an increase in credit costs along with lower revenues. Mounting expenses (due to organic and inorganic expansion strategy) are expected to continue hampering bottom-line growth to an extent. Moreover, presence of high levels of debt and deteriorating credit quality remain major near-term concerns. However, the company's efforts to diversify revenues, rise in consumer loan demand and strong balance sheet position will likely support profitability. The company's initiatives to expand through buyouts (including the deal to buy CardWorks) are expected to be accretive to earnings, going forward.

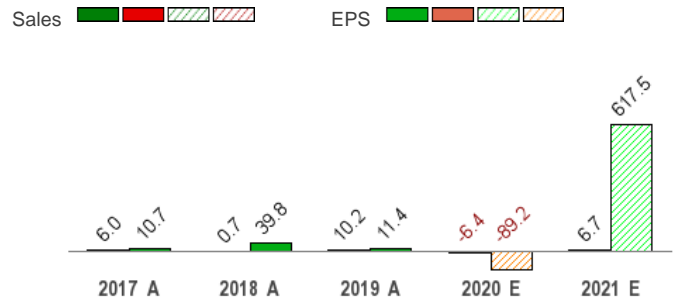
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$35.42 - \$10.22
20 Day Average Volume (sh)	6,897,109
Market Cap	\$5.9 B
YTD Price Change	-48.4%
Beta	1.60
Dividend / Div Yld	\$0.76 / 4.8%
Industry	Financial - Consumer Loans
Zacks Industry Rank	Bottom 21% (199 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-163.8%
Last Sales Surprise	-12.0%
EPS F1 Est- 4 week change	-90.2%
Expected Report Date	07/16/2020
Earnings ESP	0.0%
P/E TTM	6.3
P/E F1	39.5
PEG F1	2.9
P/S TTM	1.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,550 E	1,524 E	1,571 E	1,623 E	6,388 E
2020	1,412 A	1,493 E	1,499 E	1,584 E	5,987 E
2019	1,598 A	1,552 A	1,601 A	1,643 A	6,394 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.55 E	\$0.61 E	\$0.69 E	\$0.81 E	\$2.87 E
2020	-\$0.44 A	\$0.33 E	\$0.38 E	\$0.41 E	\$0.40 E
2019	\$0.80 A	\$0.97 A	\$1.01 A	\$0.95 A	\$3.72 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/08/2020. The reports text is as of 05/11/2020.

Overview

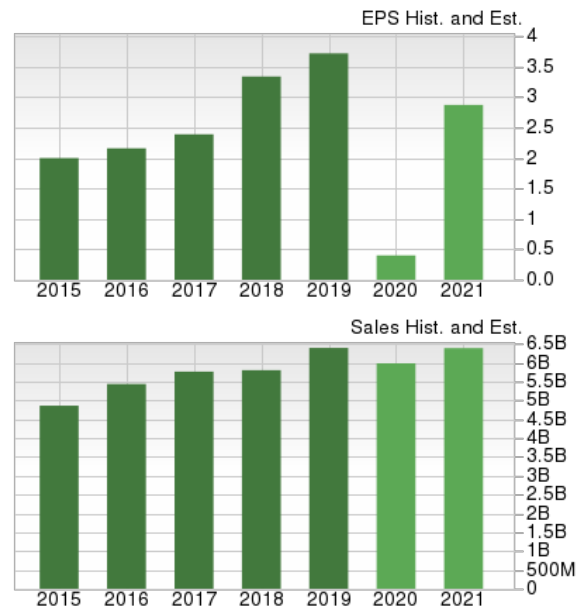
Founded in 1919, Detroit, MI-based Ally Financial Inc. is a diversified financial services company providing a broad array of financial products and services, primarily to automotive dealers and their customers. It operates as a financial holding company (FHC) and a bank holding company (BHC). Ally Bank is an indirect, wholly-owned banking subsidiary of Ally Financial.

The company operates through the following four business segments:

- **Automotive Finance** (comprising 68.7% of total net revenues in 2019) provides retail installment sales financing, loans, and leases; term loans and other lines of credit to dealers; fleet financing, and vehicle remarketing services to consumers and automotive dealers.
- **Insurance** (20.8%) offers both consumer finance protection and insurance products. It also provides consumer financial and insurance products and underwrites selected commercial insurance coverages.
- **Mortgage Finance** (3.0%) includes the management of the company's held-for-investment consumer mortgage loan portfolio.
- **Corporate Finance** (4.4%) provides senior secured leveraged cash flow and asset-based loans largely to U.S.-based middle market companies.

Corporate and Other (3.1%) consists of centralized corporate treasury activities, the residual impacts of corporate funds-transfer pricing, asset liability management activities and the amortization of the discount associated with debt issuances and bond exchanges.

In 2016, Ally Financial acquired TradeKing, a digital wealth management firm. In 2019, the company acquired Health Credit Services LLC.



Reasons To Buy:

- ▲ Growth in one of the key sources of revenues – total financing revenues and other interest income – remains a major positive for Ally Financial. It witnessed a CAGR of 4.1% over the last five years (2015-2019). While the same declined in the first quarter of 2020; strong origination volumes, retail loan growth and rise in deposit balances are expected to keep the momentum intact.
- ▲ Ally Financial has been witnessing a steady improvement in net interest margin (NIM) over the past several years. While NIM declined slightly in first-quarter 2020 due to lower interest rates, the same has grown from 1.40% in 2012 to 2.67% in 2019. In fact, rising consumer loan demand and management's efforts to become a diversified banking company are expected to continue to offer support in the near term despite near-zero interest rates, which might offset NIM growth to some extent.
- ▲ As part of its strategy to diversify into banking products, Ally Financial has forayed into the mortgage business, which is supporting the company's earnings growth. The company is also making efforts to enhance digital offerings and introduce products to further boost its profitability. In February 2020, the company announced that it will acquire CardWorks. The deal is expected to be accretive to earnings in the near term. Notably, its wealth management and online brokerage initiatives related to the credit card offerings remain impressive. Also, acquisitions of TradeKing and Health Credit Services (a point-of-sale payment provider) will aid in improving its product offerings.
- ▲ Ally Financial has come a long way in improving its balance sheet and fundamentals. This has resulted in the company's robust capital deployment actions. In January 2020, the company announced 11.8% dividend hike. This followed two hikes – 13.3% in January 2019 and 15.4% in July 2018. Also, the company had share repurchase authorization in place, which it has currently suspended amid the coronavirus outbreak. Nevertheless, driven by its capital strength, earnings growth and favorable dividend payout ratio, the company will be able to sustain enhanced capital deployment activities.
- ▲ Further, Ally Financial seems undervalued compared with the broader industry. Its current price/book (P/B) and price/cash flow (P/CF) ratios are lower than the respective industry averages. The stock has a Value Score of B.

Ally Financial's initiatives to diversify revenue base and rise in demand for consumer loans will aid profitability. Further, expansion through opportunistic buyouts will be earnings accretive.

Reasons To Sell:

- ▼ Ally Financial has been witnessing a persistent rise in expenses. Over the last five years (ended 2019), expenses witnessed a CAGR of 5.6%, with the uptrend continuing in the first quarter. With the company launching products, seeking opportunistic buyouts and expanding into newer areas of operations, expenses are expected to remain elevated.
- ▼ Worsening asset quality is a headwind for Ally Financial. Although the company's provision for loan losses and net-charge offs (NCOs) declined in 2018, the same witnessed a CAGR of 9% and 12.5%, respectively, over the last five years (2015-2019). Moreover, owing to the concerns related to the coronavirus outbreak, both provisions and NCOs witnessed a rise in the first quarter of 2020. Steadily deteriorating credit quality is expected to dampen the company's financials.
- ▼ As of Mar 31, 2020, Ally Financial had total debt worth \$40.6 billion, significantly higher than the cash and cash equivalents balance of \$6.2 billion. Moreover, interest expenses on long-term debt constituted 24.6% of its total net revenues in first-quarter 2020. While the company's total debt to total capital of 69.68% has declined in the first quarter on a sequential basis, it compares unfavorably with the industry average of 65.85%. Further, its current times-interest-earned ratio of 1.67 declined from the prior quarter and is lower than the industry average of 3.72. Thus, we believe that such high levels of debt may negatively impact its access to liquidity and increase borrowing costs in the unsecured market. Also, it increases the company's credit risk, which might result in a default in repayment of interest and/or debt if economic situation worsens.
- ▼ Ally Financial's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 6.92% compares unfavorably with ROE of 17.31% for the industry, reflecting that it is less efficient in using shareholder funds.
- ▼ Shares of Ally Financial have underperformed the industry so far this year. Also, the company's 2020 earnings estimates have been revised more than 90% lower over the past 30 days. Given the concerns and downward estimate revisions, the price performance is not expected to improve in the near term.

Continuously rising expenses are expected to hurt Ally Financial's bottom-line growth. Deteriorating credit quality and presence of high level of debt might hamper the company's financials.

Last Earnings Report

Ally Financial Posts Q1 Loss on Higher Provisions & Costs

Ally Financial's first-quarter 2020 adjusted loss was 44 cents per share against the Zacks Consensus Estimate for earnings of 71 cents. The figure deteriorated from the year-ago quarterly earnings of 80 cents per share.

Results reflected substantial reserve build to combat coronavirus-related concerns, which in turn resulted in increase in credit costs. Further, decline in revenues, rise in operating expenses and lower loan balance were headwinds. However, growth in deposit balance was impressive.

After considering non-recurring items, net loss available to common shareholders (on a GAAP basis) was \$319 million or 85 cents per share versus net income of \$374 million or 92 cents per share recorded in the prior-year quarter.

Revenues Down, Expenses Rise

Total net revenues were \$1.41 billion, declining 28.5% year over year. The figure also lagged the Zacks Consensus Estimate of \$1.61 billion.

Net financing revenues were up 1.2% from the prior-year number to \$1.15 billion. The rise was driven by higher retail auto portfolio yield and balance, and liability mix shift, which were partly offset by lower commercial auto balance and portfolio yield.

Adjusted net interest margin was 2.68%, down 1 basis point (bps).

Total other revenues of \$266 million declined 42.9% from the prior-year level.

Total non-interest expenses increased 10.8% year over year to \$920 million. The rise was mainly due to an increase in all cost components.

Adjusted efficiency ratio at the end of the first quarter was 52.3%, up from 48.9% recorded in the comparable year-ago period. A rise in efficiency ratio indicates deterioration in profitability.

Credit Quality Worsens

Non-performing loans of \$1.46 billion as of Mar 31, 2020 were up 47.7% from the corresponding period of 2019. Further, net charge-off rate was 0.84%, up 11 bps.

Also, provision for loan losses surged to \$903 million from \$282 million recorded in the prior-year quarter. The drastic increase was due to reserve build, primarily driven by coronavirus-induced economic slowdown.

Strong Balance Sheet & Capital Ratios

Total net finance receivables and loans amounted to \$124.9 billion as of Mar 31, 2020, decreasing 1.6% from the fourth quarter. Deposits totaled \$122.3 billion, increasing 1.3% sequentially.

As of Mar 31, 2020, total capital ratio was 12.8%, improving from 12.5% in the comparable period of last year. Tier I capital ratio was 10.9% as of Mar 31, 2020, down from 11.0% in the corresponding period of 2019.

Share Repurchases

During the quarter, the company repurchased shares worth \$104 million. However, in mid-March, it suspended the share buyback plan through second-quarter 2020 amid coronavirus concerns.

Quarter Ending 03/2020

Report Date	Apr 20, 2020
Sales Surprise	-11.99%
EPS Surprise	-163.77%
Quarterly EPS	-0.44
Annual EPS (TTM)	2.49

Recent News

Ally Financial to Acquire CardWorks for \$2.65 Billion - Feb 18, 2020

Ally Financial agreed to acquire CardWorks, Inc. for \$2.65 billion. The deal, which is expected to close in the third quarter of 2020, is subject to customary regulatory approvals and closing conditions.

Headquartered in Woodbury, NY; CardWorks is a privately held U.S. credit card issuer. It is focused on the non-prime segment, with a complementary full-spectrum unsecured servicing operation, which includes third-party servicing and recovery capabilities.

Ally Financial's CEO, Jeffrey J. Brown, said, "CardWorks represents an industry-leading credit card platform in the U.S., and this acquisition serves as an important milestone in Ally's evolution to be a full-service financial provider for our customers. Beyond the compelling strategic rationale and financial enhancements this transaction brings, CardWorks is an ideal cultural fit for Ally."

Terms of the Deal

Ally Financial is expected to fund the transaction with \$1.35 billion in cash and \$1.30 billion in its common stock. Notably, the final consideration is subject to closing equity, and other adjustments and fill-or-kill rights.

Per the deal, CardWorks' subsidiary, Merrick Bank, will merge with Ally Bank.

The chairman, CEO and founder of CardWorks, Don M. Berman, currently owns 70% of the company. Per the agreement, he will receive a combination of cash and Ally Financial's shares as his consideration.

However, shares of Ally Financial's common stock, which Mr. Berman will be granted, will be subject to a lock-up agreement, which will restrict the sale or transfer of 100% of his shares until the one-year anniversary of the closing date. At this point, he will be allowed to sell or transfer up to one-third of his shares.

Subsequent to which, on each anniversary, Mr. Berman will have the right to sell or transfer up to another one-third of his shares. Thus, three years after the completion of the transaction, he will be permitted to sell or transfer remaining shares of Ally Financial's common stock.

Financial Impact & Benefits

Ally Financial's Core return on tangible common equity (ROTCE) is expected to improve by 100-150 basis points (bps) in 2021 and 2022. Moreover, the transaction will likely provide up to 100 bps of adjusted EPS accretion for the company over the same period.

Further, Ally Financial's CET1 capital ratio is expected to remain largely unchanged pro forma for the acquisition. The company expects to maintain a 9% CET1 target. Notably, Ally Financial has planned to repurchase shares worth up to \$1 billion, which is part of its previously announced \$1.25-billion share repurchase program.

The deal complements Ally Financial's market-leading auto finance, insurance and commercial product lines. The acquisition of CardWorks is expected to enhance Ally Financial's award-winning direct bank deposit and consumer product platform.

Moreover, post the acquisition, Ally Financial will be able to better achieve its long-term objectives, which include offering differentiated consumer products supported by a growing and low-cost deposit base.

Berman stated, "In leveraging Ally's commitment to innovation and adaptiveness, the combined company will be well positioned to meet the financial needs of our ever-growing customer base and deliver sustainable growth and performance."

Dividend Update

On Apr 16, Ally Financial declared a quarterly dividend of 19 cents per share. The dividend will be paid out on May 15 to shareholders of record as of May 1.

Valuation

Ally Financial's shares are down 50.6% in the year-to-date period and 48.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 43.1% and 27% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 39.9% and 21.1%, respectively.

The S&P 500 index is down 10.4% in the year-to-date period but up marginally over the past year.

The stock is currently trading at 11.90X forward 12 months earnings, which compares to 13.02X for the Zacks sub-industry, 14.98X for the Zacks sector and 20.81X for the S&P 500 index.

Over the past five years, the stock has traded as high as 14.94X and as low as 2.68X, with a 5-year median of 8.03X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$16 price target reflects 12.60X forward earnings.

The table below shows summary valuation data for ALLY

Valuation Multiples - ALLY					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	11.9	13.02	14.98	20.81
	5-Year High	14.94	13.02	16.18	20.81

P/TB TTM	5-Year High	2.68	4.38	11.24	15.19
	5-Year Low	8.03	8.73	13.94	17.44
	Current	0.42	0.66	2.41	10.89
	5-Year High	1.02	1.57	4	12.78
	5-Year Low	0.31	0.48	1.99	6.02
P/S F12M	5-Year Median	0.79	1.2	3.47	9.2
	Current	0.92	0.87	4.98	3.25
	5-Year High	2.27	2.01	6.7	3.44
	5-Year Low	0.65	0.74	4.98	2.54
	5-Year Median	1.77	1.5	6.06	3.01

As of 05/07/2020

Industry Analysis Zacks Industry Rank: Bottom 21% (199 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Credit Acceptance Corporation (CACC)	Neutral	3
Encore Capital Group Inc (ECPG)	Neutral	3
Ford Motor Company (F)	Neutral	3
PRA Group Inc (PRAA)	Neutral	4
General Motors Company (GM)	Underperform	5
Huntington Bancshares Incorporated (HBAN)	Underperform	3
CarMax Inc (KMX)	Underperform	5
Santander Consumer USA Holdings Inc (SC)	Underperform	3

Industry Comparison Industry: Financial - Consumer Loans				Industry Peers		
	ALLY	X Industry	S&P 500	CACC	HBAN	SC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Underperform	Underperform
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	D	-	-	C	D	D
Market Cap	5.89 B	516.81 M	20.19 B	6.04 B	8.77 B	5.07 B
# of Analysts	3	2.5	14	3	12	6
Dividend Yield	4.82%	0.00%	2.12%	0.00%	6.94%	5.57%
Value Score	B	-	-	D	C	A
Cash/Price	1.06	0.79	0.06	0.11	0.22	0.45
EV/EBITDA	5.89	5.89	11.95	9.31	7.28	9.37
PEG Ratio	2.92	0.46	2.60	NA	3.82	NA
Price/Book (P/B)	0.44	0.83	2.75	2.66	0.83	0.99
Price/Cash Flow (P/CF)	1.98	3.05	10.78	9.19	4.97	1.84
P/E (F1)	39.45	6.77	19.85	16.94	18.80	201.57
Price/Sales (P/S)	0.95	0.84	2.03	4.06	1.57	0.64
Earnings Yield	2.53%	12.55%	4.83%	5.90%	5.32%	0.51%
Debt/Equity	2.30	1.93	0.75	1.93	0.93	7.82
Cash Flow (\$/share)	7.96	4.49	7.01	36.22	1.74	8.57
Growth Score	F	-	-	B	C	D
Hist. EPS Growth (3-5 yrs)	15.39%	10.98%	10.87%	23.63%	10.88%	1.28%
Proj. EPS Growth (F1/F0)	-89.25%	-42.47%	-9.87%	-43.16%	-63.78%	-97.26%
Curr. Cash Flow Growth	-1.59%	17.70%	5.88%	18.61%	-4.72%	20.07%
Hist. Cash Flow Growth (3-5 yrs)	-4.75%	9.07%	8.55%	19.03%	12.14%	25.86%
Current Ratio	0.99	3.42	1.24	35.47	0.89	63.41
Debt/Capital	69.68%	65.84%	44.23%	65.84%	45.42%	88.66%
Net Margin	16.46%	9.47%	10.68%	44.06%	19.65%	9.32%
Return on Equity	6.92%	17.31%	16.36%	29.25%	10.40%	10.95%
Sales/Assets	0.03	0.24	0.55	0.21	0.05	0.17
Proj. Sales Growth (F1/F0)	-6.37%	0.00%	-2.26%	-3.49%	-1.62%	0.12%
Momentum Score	F	-	-	B	F	F
Daily Price Chg	4.64%	3.71%	2.40%	5.75%	4.85%	2.47%
1 Week Price Chg	8.88%	8.30%	0.53%	11.05%	5.02%	15.19%
4 Week Price Chg	-6.24%	0.38%	2.68%	4.96%	-4.16%	-4.42%
12 Week Price Chg	-52.27%	-39.30%	-19.20%	-23.29%	-38.87%	-41.65%
52 Week Price Chg	-46.31%	-37.94%	-8.44%	-32.02%	-36.30%	-25.87%
20 Day Average Volume	6,897,109	350,685	2,398,409	309,395	11,911,829	1,081,834
(F1) EPS Est 1 week change	0.00%	-3.01%	0.00%	0.00%	-7.85%	-83.21%
(F1) EPS Est 4 week change	-90.20%	-23.74%	-6.95%	0.00%	-49.77%	-97.02%
(F1) EPS Est 12 week change	-90.51%	-25.62%	-15.68%	-4.30%	-64.39%	-97.17%
(Q1) EPS Est Mthly Chg	-65.05%	-38.21%	-13.12%	0.00%	-56.69%	-114.26%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	F
Momentum Score	F
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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