

Ally Financial Inc. (ALLY)

\$29.95 (As of 01/10/20)

Price Target (6-12 Months): **\$32.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 10/07/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:B

Value: A

Growth: D

Momentum: C

Summary

Shares of Ally Financial have outperformed the industry over the past year. Also, it has an impressive earnings surprise history, having surpassed the Zacks Consensus Estimate in each of the trailing four quarters. Further, its efforts to diversify revenues, acquisition of Health Credit Services, rise in consumer loan demand and improving net finance revenues are likely to continue supporting profitability, in the near term. Additionally, the company's impressive capital-deployment actions reflect a strong balance sheet position. However, mounting operating expenses (due to organic and inorganic expansion strategy) will likely hurt bottom-line. Worsening credit quality remains a key concern. Presence of high level of debt might hamper its financials. Moreover, the earnings estimates have been going down ahead of its fourth quarter 2019 results.

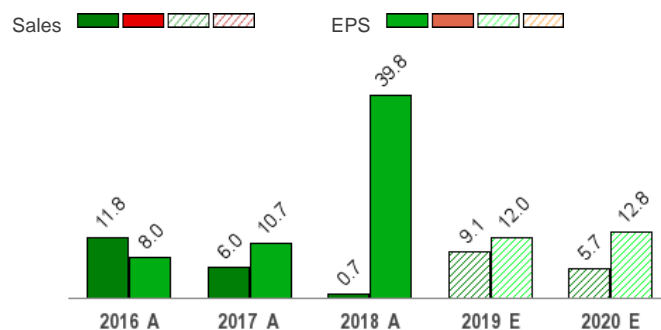
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$35.42 - \$24.15
20 Day Average Volume (sh)	3,069,916
Market Cap	\$11.4 B
YTD Price Change	-2.0%
Beta	1.27
Dividend / Div Yld	\$0.68 / 2.3%
Industry	Financial - Consumer Loans
Zacks Industry Rank	Bottom 29% (180 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	3.1%
Last Sales Surprise	2.8%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	01/22/2020
Earnings ESP	-2.5%

P/E TTM	8.1
P/E F1	7.1
PEG F1	0.5
P/S TTM	1.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,620 E	1,649 E	1,699 E	1,777 E	6,693 E
2019	1,598 A	1,552 A	1,601 A	1,636 E	6,334 E
2018	1,403 A	1,458 A	1,505 A	1,438 A	5,804 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.91 E	\$1.02 E	\$1.07 E	\$1.18 E	\$4.22 E
2019	\$0.80 A	\$0.97 A	\$1.01 A	\$0.95 E	\$3.74 E
2018	\$0.68 A	\$0.83 A	\$0.91 A	\$0.92 A	\$3.34 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 01/10/2020. The reports text is as of 01/13/2020.

Overview

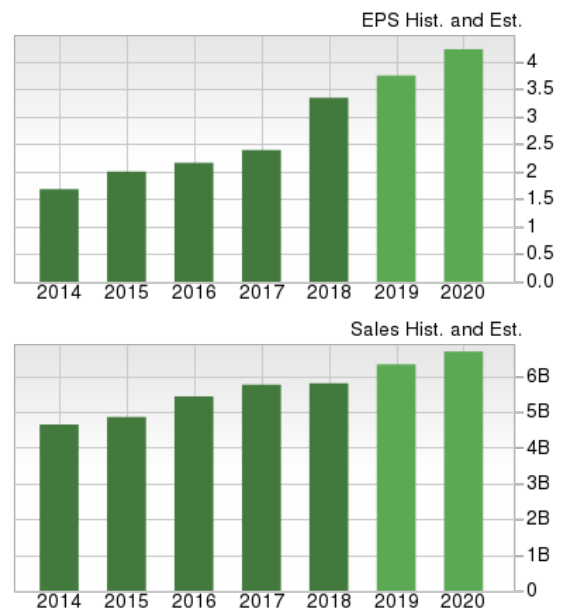
Founded in 1919, Detroit, MI-based Ally Financial Inc. is a diversified financial services company providing a broad array of financial products and services, primarily to automotive dealers and their customers. It operates as a financial holding company (FHC) and a bank holding company (BHC). Ally Bank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

The company operates through the following four business segments:

- **Automotive Finance** (comprising 69.9% of total net revenues in 2018) 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** (17.8%) offers both consumer finance protection and insurance products. It also provides consumer financial and insurance products and underwrites selected commercial insurance coverages.
- **Mortgage Finance** (3.2%) includes the management of the company's held-for-investment consumer mortgage loan portfolio.
- **Corporate Finance** (4.2%) provides senior secured leveraged cash flow and asset-based loans largely to U.S.-based middle market companies.

Corporate and Other (5.2%) 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 October 2019, the company acquired Health Credit Services LLC.



Reasons To Buy:

- ▲ Growth in one of the key sources of revenues – net financing revenues and other interest income – remains a major positive for Ally Financial. It witnessed a CAGR of 6.8% over the last five years (2014-2018), with the uptrend continuing in the first nine months of 2019. Strong originations, retail loan growth and rise in deposit balances are expected to keep the growth momentum intact.
- ▲ Ally Financial has been witnessing a steady improvement in net interest margin (NIM) over the past several years. NIM has grown from 1.40% in 2012 to 2.65% in 2018. Further, NIM expanded slightly in the first nine months of 2019. Despite flattening of the yield curve, along with the Fed's accommodative stance, NIM is likely to get some support from rising consumer loan demand and management's efforts to become a diversified banking company.
- ▲ 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. 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. The company has an efficient share repurchase program in place. Following the Fed's announcement that the bank is no longer required to take part in annual stress tests, in April 2019, the company authorized share repurchase of up to \$1.25 billion worth of shares. As of Sep 30, 2019, it had nearly 0.9 billion worth shares were left to be repurchased. Moreover, as part of its 2018 capital plan, the company hiked its quarterly dividend twice – 15.4% in July 2018 and 13.3% in January 2019. 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 its broader industry. Its current price/book (P/B) and PEG ratios are lower than the respective industry averages. Moreover, the stock has a Value Score of A.

Ally Financial's efforts to diversify revenue base and rise in demand for consumer loans will aid profitability. Further, it will enhance shareholder value through efficient capital deployments.

Reasons To Sell:

- ▼ Mounting operating expenses remain a concern for Ally Financial. Over the last four years (ended 2018), expenses witnessed a CAGR of 5.7%. The increasing trend continued during the first nine months of 2019. 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 declined in 2018, the same witnessed a CAGR of 19.1% and 15.2%, respectively, over the last five years (2014-2018). The increasing trend continued in the first nine months of 2019. Steadily deteriorating credit quality is expected to dampen its financials.
- ▼ High debt levels could restrict Ally Financial from procuring additional finance for working capital, capital expenditures, acquisitions or other purposes. As of Sep 30, 2019, the company's long-term debt was around \$35.7 billion (nearly 20% of total assets). Interest expenses on long-term debt constituted 25.3% of its total net revenues for the nine-month period ended Sep 30, 2019. Though the company is undertaking measures to restructure its balance sheet, we believe such high level of debt may negatively impact its access to liquidity and increase borrowing costs in the unsecured market.
- ▼ Though Ally Financial is trying to diversify its operations, it primarily focuses on providing auto loans. Hence, the company's performance is largely dependent on the overall health of the Auto industry. Notably, in August 2018, it exited from transportation equipment finance and the RV business. Any deterioration in the auto sector can considerably hamper the overall performance of the company.
- ▼ Ally Financial's trailing 12-month return on equity (ROE) undercuts its growth potential. Although the company's ROE of 10.69% gradually improved over the years, it compares unfavorably with ROE of 13.80% for the industry, reflecting that it is less efficient in using shareholder funds.
- ▼ Shares of Ally Financial have outperformed the industry over the past year. However, the company's 2019 earnings estimates have moved marginally lower over the past seven days. Given the concerns and downward estimate revisions, the stock has limited upside potential.

Continuously rising expenses are likely to hurt Ally Financial's bottom-line growth. Further, deteriorating credit quality and presence of high level of debt act as headwinds for its financials.

Last Earnings Report

Ally Financial Beats Q3 Earnings on Higher Revenues

Ally Financial's third-quarter 2019 adjusted earnings of \$1.01 per share surpassed the Zacks Consensus Estimate of 98 cents. The bottom line comes in 11% higher than the year-ago quarter's reported figure.

Results were driven by improvement in revenues and growth in deposit balances. Also, capital ratios were impressive. However, higher non-interest expenses, along with rise in provision for loan losses, acted as major headwinds.

After taking into consideration non-recurring items, net income available to common shareholders (GAAP basis) was \$381 million, increasing 2% from the prior-year quarter.

Revenues Improve, Expenses Rise

Total net revenues came in at \$1.60 billion, up 6% year over year. Further, the figure surpassed the Zacks Consensus Estimate of \$1.56 billion.

Total non-interest expenses flared up 4% year over year to \$838 million. The upside stemmed from an increase in all components of expenses except insurance losses and loss adjustment expenses.

Credit Quality: Mixed Bag

Non-performing loans of \$929 million as of Sep 30, 2019 were down 3% from the prior-year quarter end.

However, provision for loan losses increased 13% year over year to \$263 million. The rise was mainly due to higher net charge-offs and asset growth.

Strong Balance Sheet, Capital Ratios Improve

Total net finance receivables and loans amounted to \$127.33 billion as of Sep 30, 2019, decreasing marginally from the previous quarter. Deposits totaled \$119.23 billion, increasing 2.5% sequentially.

As of Sep 30, 2019, total capital ratio was 12.8%, improving 12.7% from the prior-year quarter end. Tier I capital ratio was 11.2% as of Sep 30, 2019, up from 11.1% as of Sep 30, 2018.

Share Repurchases

During the reported quarter, the company repurchased shares worth \$300 million.

Outlook

For 2019, NIM is likely to be relatively stable. Further, in 2020 NIM is likely to expand, due to changes in balance sheet dynamics.

Despite volatile rate environment and some quarter-over-quarter fluctuations, net interest income (NII) is likely to grow over the next several quarters.

Due to seasonality, expenses related to technology and marketing will flare up in the fourth quarter. This, along with the closure of Health Credit Services' buyout, will escalate its operating expenses by \$25-\$30 million.

Also, efficiency ratio for 2019 is anticipated to be unchanged or down 1% year over year.

Net charge-off ratios for 2019 will likely outperform the 1.4-1.6% range, which was provided by the company earlier.

Moreover, CECL's impact is anticipated to be around 25% in 2020.

Quarter Ending 09/2019

Report Date	Oct 16, 2019
Sales Surprise	2.84%
EPS Surprise	3.06%
Quarterly EPS	1.01
Annual EPS (TTM)	3.70

Recent News

Ally Financial Completes Acquisition of Health Credit Services – Oct 1, 2019

Ally Financial has closed the deal to acquire Health Credit Services LLC, a point-of-sale payment provider. The transaction, announced in July, will help the company further enhance its product offerings.

Health Credit Services, based in Charlotte, NC, has roughly 85 employees. It is now an indirect subsidiary of Ally Bank. Notably, the existing management team of the firm will continue to lead operations.

Diane Morais, Ally Bank's president of consumer and commercial banking products stated, "The addition of health care services financing aligns well with Ally's strategy to expand our digital product offerings. In addition to being a leader in the healthcare financing segment, HCS has a customer-centric philosophy that makes it a natural fit with Ally. The powerful combination of the HCS expertise in point-of-sale financing and the fact that the technology, cultures and customer-focused mindsets at our respective companies are in alignment, provides a strong foundation for future expansion in the segment."

Dividend Update

On Oct 8, 2019, Ally Financial declared a quarterly dividend of 17 cents per share. The dividend was paid on Nov 15 to shareholders of record as of Nov 1.

Valuation

Ally Financial's shares are up 21.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 21.1% and 14.4%, over the past year, respectively.

The S&P 500 index is up 25.6% in the past year.

The stock is currently trading at 7.08X forward 12 months earnings, which compares to 7.91X for the Zacks sub-industry, 14.88X for the Zacks sector and 18.88X for the S&P 500 index.

Over the past five years, the stock has traded as high as 13.05X and as low as 5.80X, with a 5-year median of 8.22X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$32 price target reflects 7.57X 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	7.08	7.91	14.88	18.88
	5-Year High	13.05	10.85	16.21	19.34
	5-Year Low	5.8	6.33	12.01	15.17
	5-Year Median	8.22	8.89	13.98	17.44
P/B TTM	Current	0.79	0.89	2.82	4.46
	5-Year High	1.01	1.22	2.89	4.47
	5-Year Low	0.55	0.75	1.83	2.85
	5-Year Median	0.77	0.96	2.5	3.61
P/S F12M	Current	1.7	1.39	6.53	3.5
	5-Year High	2.27	2.05	6.61	3.5
	5-Year Low	1.31	1.1	5.2	2.54
	5-Year Median	1.81	1.52	6.04	3

As of 01/10/2020

Industry Analysis Zacks Industry Rank: Bottom 29% (180 out of 254)



Top Peers

Credit Acceptance Corporation (CACC)	Neutral
Encore Capital Group Inc (ECPG)	Neutral
Ford Motor Company (F)	Neutral
General Motors Company (GM)	Neutral
Huntington Bancshares Incorporated (HBAN)	Neutral
CarMax, Inc. (KMX)	Neutral
PRA Group, Inc. (PRAA)	Neutral
Santander Consumer USA Holdings Inc. (SC)	Neutral

Industry Comparison Industry: Financial - Consumer Loans				Industry Peers		
	ALLY Neutral	X Industry	S&P 500	CACC Neutral	HBAN Neutral	SC Neutral
VGM Score	B	-	-	D	F	B
Market Cap	11.38 B	1.10 B	24.03 B	8.19 B	14.85 B	7.76 B
# of Analysts	6	3	13	3	10	7
Dividend Yield	2.27%	0.00%	1.78%	0.00%	4.17%	3.85%
Value Score	A	-	-	F	B	A
Cash/Price	0.31	0.29	0.04	0.05	0.12	0.29
EV/EBITDA	8.41	8.41	14.04	12.84	9.66	1.44
PEG Ratio	0.53	0.62	2.02	1.44	2.68	1.61
Price/Book (P/B)	0.81	1.19	3.32	3.44	1.39	1.06
Price/Cash Flow (P/CF)	4.02	6.00	13.52	14.65	8.09	3.38
P/E (F1)	7.10	6.58	18.82	15.87	10.93	8.07
Price/Sales (P/S)	1.84	1.35	2.63	5.66	2.63	1.00
Earnings Yield	14.09%	14.44%	5.31%	6.30%	9.18%	12.40%
Debt/Equity	2.47	1.65	0.72	1.75	0.92	0.00
Cash Flow (\$/share)	7.45	2.89	6.94	29.73	1.78	6.75
Growth Score	D	-	-	C	F	C
Hist. EPS Growth (3-5 yrs)	17.19%	10.75%	10.56%	23.16%	12.14%	-0.53%
Proj. EPS Growth (F1/F0)	12.77%	8.71%	7.49%	-21.62%	2.30%	-0.15%
Curr. Cash Flow Growth	4.27%	26.38%	14.83%	37.91%	19.75%	35.94%
Hist. Cash Flow Growth (3-5 yrs)	5.70%	5.02%	9.00%	17.03%	15.58%	36.75%
Current Ratio	1.05	2.25	1.23	29.49	0.91	0.79
Debt/Capital	71.20%	61.80%	42.99%	63.69%	45.33%	0.00%
Net Margin	26.29%	12.28%	11.08%	44.69%	25.24%	12.33%
Return on Equity	10.69%	13.80%	17.16%	29.54%	13.83%	13.20%
Sales/Assets	0.03	0.24	0.55	0.21	0.05	0.17
Proj. Sales Growth (F1/F0)	5.67%	5.67%	4.20%	2.86%	1.19%	6.86%
Momentum Score	C	-	-	B	F	F
Daily Price Chg	-0.93%	-0.89%	-0.33%	0.64%	-1.24%	-0.57%
1 Week Price Chg	-0.65%	-1.09%	-0.30%	-0.30%	-2.05%	-0.52%
4 Week Price Chg	-6.17%	-4.09%	1.71%	-1.48%	-7.82%	-3.67%
12 Week Price Chg	-1.90%	-0.49%	6.05%	-6.11%	1.41%	-9.91%
52 Week Price Chg	23.40%	8.67%	22.39%	4.76%	14.49%	19.15%
20 Day Average Volume	3,069,916	188,556	1,580,816	127,997	8,293,628	820,664
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.08%	-2.32%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-0.23%	-0.27%	-3.34%
(F1) EPS Est 12 week change	-2.03%	-0.95%	-0.50%	-43.86%	-1.42%	-6.30%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-0.68%	-18.48%

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	A
Growth Score	D
Momentum Score	C
VGM Score	B

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.

Disclosures

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