

Ally Financial Inc. (ALLY)

\$15.75 (As of 04/13/20)

Price Target (6-12 Months): **\$18.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/14/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:C

Value: A

Growth: D

Momentum: D

Summary

Ally Financial's shares have underperformed the industry over the past three months. Yet, the company has an impressive earnings surprise history, having surpassed the Zacks Consensus Estimate in three and met in one of the trailing four quarters. The company's efforts to diversify revenues, rise in consumer loan demand, strong balance sheet and improving net finance revenues are likely to support profitability. Further, the company's initiatives to expand through opportunistic buyouts (including the deal to buy CardWorks) are expected to be accretive to earnings, going forward. However, mounting operating expenses (due to organic and inorganic expansion strategy) are expected to continue hampering bottom line to some extent. Additionally, presence of high levels of debt and deteriorating credit quality are major near-term concerns.

Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$35.42 - \$10.22
20 Day Average Volume (sh)	8,808,182
Market Cap	\$5.9 B
YTD Price Change	-48.5%
Beta	1.66
Dividend / Div Yld	\$0.76 / 4.8%
Industry	Financial - Consumer Loans
Zacks Industry Rank	Top 21% (52 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.0%
Last Sales Surprise	0.4%
EPS F1 Est- 4 week change	-5.9%
Expected Report Date	04/20/2020
Earnings ESP	-15.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,604 E	1,687 E	1,753 E	1,779 E	6,785 E
2020	1,610 E	1,622 E	1,641 E	1,703 E	6,563 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	\$0.95 E	\$0.95 E	\$1.12 E	\$1.15 E	\$4.45 E
2020	\$0.78 E	\$0.92 E	\$1.01 E	\$1.11 E	\$4.02 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.

P/E TTM	4.2
P/E F1	3.9
PEG F1	0.3
P/S TTM	0.9

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/13/2020. The reports text is as of 04/14/2020.

Overview

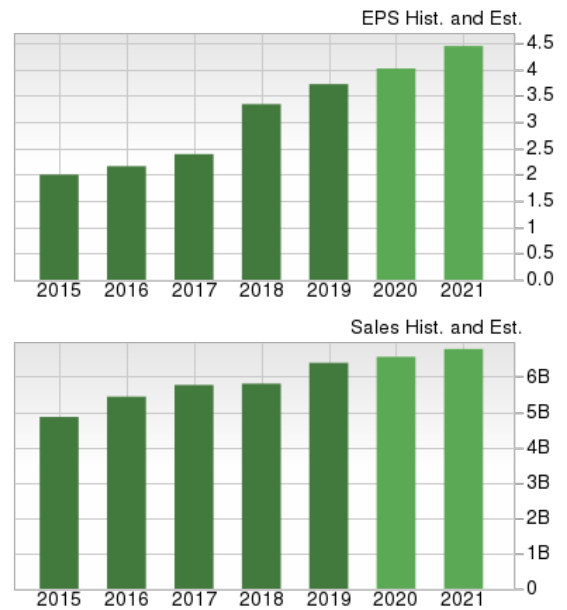
Founded in 1919, Detroit, MI-based Ally Financial Inc. is a diversified financial services company providing a broad array of financial products and services, primarily to automotive dealers and their customers. It operates as a financial holding company (FHC) and a bank holding company (BHC). Ally Bank 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 – net 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). Strong origination volume, 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 2.67% in 2019. While near-zero interest rates might have an adverse impact on NIM to some extent in the near term, rising consumer loan demand and management's efforts to become a diversified banking company will continue to offer support.
- ▲ 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, 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, 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 suspended amid the coronavirus outbreak. 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/earnings (P/E) (F1) ratios are lower than the respective industry averages. Moreover, the stock has a Value Score of A.

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:

- ▼ Mounting operating expenses remain a concern for Ally Financial. Over the last five years (ended 2019), expenses witnessed a CAGR of 5.6%. 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 9% and 12.5%, respectively, over the last five years (2015-2019). 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 Dec 31, 2019, the company's long-term debt was around \$34 billion (nearly 19% of total assets). Interest expenses on long-term debt constituted almost 25% of its total net revenues for 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.
- ▼ Ally Financial's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 10.35% compares unfavorably with ROE of 16.68% for the industry, reflecting that it is less efficient in using shareholder funds.
- ▼ Shares of Ally Financial have underperformed the industry over the past year. Also, the company's 2020 earnings estimates have moved nearly 1% 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 Q4 Earnings Meet Estimates, Revenues Up Y/Y

Ally Financial's fourth-quarter 2019 adjusted earnings of 95 cents per share were in line with the Zacks Consensus Estimate. The figure reflects an increase of 3.3% from the year-ago quarter.

Results were driven by an 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 headwinds.

After taking into consideration non-recurring items, net income available to common shareholders (GAAP basis) was \$378 million or 99 cents per share, up from \$290 million or 70 cents per share recorded in the prior-year quarter.

For 2019, adjusted earnings were \$3.72 per share, which lagged the Zacks Consensus Estimate of \$3.74. However, the bottom line was 11.4% higher than the year-ago figure. Net income available to common shareholders (GAAP basis) was \$1.72 billion or \$4.34 per share, increasing from \$1.26 billion or \$2.95 per share in 2018.

Revenues Improve, Expenses Rise

Total quarterly net revenues were \$1.64 billion, up 14.3% year over year. The figure marginally beat the Zacks Consensus Estimate.

For 2019, total net revenues were \$6.39 billion, up 10.2% year over year. Further, the figure surpassed the Zacks Consensus Estimate of \$6.35 billion.

Total quarterly non-interest expenses increased 9.5% year over year to \$880 million. The upside stemmed from an increase in all components of expenses.

Credit Quality: Mixed Bag

Non-performing loans of \$1.01 billion as of Dec 31, 2019, were down 7.3% from the prior-year quarter end.

However, provision for loan losses increased 3.8% year over year to \$276 million.

Balance Sheet Strong, Capital Ratios Improve

Total net finance receivables and loans amounted to \$126.97 billion as of Dec 31, 2019, decreasing marginally from the previous quarter. Deposits totaled \$120.75 billion, increasing 1.3% sequentially.

As of Dec 31, 2019, total capital ratio was 12.8%, improving from 12.3% from the prior-year quarter end. Tier I capital ratio was 11.2% as of Dec 31, 2019, up from 10.8% as of Dec 31, 2018.

Share Repurchases

During the fourth quarter, the company repurchased shares worth \$299 million.

2020 Outlook

Management expects adjusted earnings per share growth of 10-15%.

Further, NIM is expected to increase, driven by the changes in balance sheet dynamics. Total adjusted are projected to be up in the range of 6-9%.

Adjusted efficiency ratio is anticipated to be 50-150 basis points down.

Retail auto NCO rate is projected to be at the lower end of the 1.4-1.6% range. Nonetheless, this is higher than 1.29% recorded in 2019.

Core return of tangible common equity ratio is projected to be 12-13%.

Quarter Ending **12/2019**

Report Date	Jan 22, 2020
Sales Surprise	0.42%
EPS Surprise	0.00%
Quarterly EPS	0.95
Annual EPS (TTM)	3.73

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."

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 Jan 14, Ally Financial declared a quarterly dividend of 19 cents per share, representing a hike of 11.8% from the prior payout. The dividend was paid out on Feb 14 to shareholders on record as of Jan 31.

Valuation

Ally Financial's shares are down 46.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 35.2% and 17.6%, over the past year, respectively.

The S&P 500 index is down 4.6% in the past year.

The stock is currently trading at 3.57X forward 12 months earnings, which compares to 5.41X for the Zacks sub-industry, 13.29X for the Zacks sector and 18.10X for the S&P 500 index.

Over the past five years, the stock has traded as high as 13.05X and as low as 2.83X, with a 5-year median of 8.06X. Our Outperform recommendation indicates that the stock will perform better than the market. Our \$18 price target reflects 4.38X 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	3.57	5.41	13.29	18.1
	5-Year High	13.05	10.82	16.19	19.34
	5-Year Low	2.83	4.38	11.23	15.19
	5-Year Median	8.06	8.7	13.95	17.45
P/B	Current	0.41	0.52	2.13	3.69
	5-Year High	1.01	1.23	2.89	4.55
	5-Year Low	0.31	0.38	1.69	2.84
	5-Year Median	0.78	0.96	2.51	3.63
P/S F12M	Current	0.87	0.86	4.93	3.07
	5-Year High	2.27	2.07	6.65	3.44
	5-Year Low	0.68	0.74	4.93	2.54
	5-Year Median	1.79	1.5	6.03	3.01

As of 04/13/2020

Industry Analysis Zacks Industry Rank: Top 21% (52 out of 253)



Top Peers

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

Industry Comparison Industry: Financial - Consumer Loans				Industry Peers		
	ALLY Neutral	X Industry	S&P 500	CACC Neutral	HBAN Underperform	SC Neutral
VGM Score	C	-	-	C	F	A
Market Cap	5.90 B	542.74 M	19.08 B	5.30 B	8.89 B	5.15 B
# of Analysts	4	3	14	3	11	7
Dividend Yield	4.83%	0.00%	2.19%	0.00%	6.88%	5.80%
Value Score	A	-	-	D	B	A
Cash/Price	0.56	0.55	0.06	0.10	0.15	0.39
EV/EBITDA	6.96	6.35	11.58	8.62	7.59	9.16
PEG Ratio	0.28	0.42	2.06	1.33	1.92	3.08
Price/Book (P/B)	0.42	0.73	2.58	2.33	0.85	0.71
Price/Cash Flow (P/CF)	1.98	2.84	10.19	8.05	5.01	1.77
P/E (F1)	3.75	4.16	17.15	14.60	9.46	6.16
Price/Sales (P/S)	0.92	0.77	2.07	3.56	1.57	0.66
Earnings Yield	25.52%	24.08%	5.67%	6.85%	10.55%	16.21%
Debt/Equity	2.36	1.80	0.70	1.93	0.93	5.36
Cash Flow (\$/share)	7.96	4.49	7.01	36.22	1.74	8.57
Growth Score	D	-	-	B	F	A
Hist. EPS Growth (3-5 yrs)	17.52%	12.44%	10.92%	23.63%	12.41%	0.79%
Proj. EPS Growth (F1/F0)	8.00%	7.33%	-1.91%	-42.21%	-27.42%	-13.84%
Curr. Cash Flow Growth	-1.59%	17.70%	5.93%	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	1.03	3.40	1.24	35.47	0.90	62.53
Debt/Capital	70.24%	64.33%	42.36%	65.84%	45.51%	84.26%
Net Margin	26.82%	12.62%	11.64%	44.06%	24.95%	12.66%
Return on Equity	10.35%	16.68%	16.74%	29.25%	13.44%	13.64%
Sales/Assets	0.04	0.24	0.54	0.21	0.05	0.17
Proj. Sales Growth (F1/F0)	2.65%	2.65%	0.45%	-3.09%	0.28%	8.49%
Momentum Score	D	-	-	C	F	D
Daily Price Chg	-6.42%	-3.03%	-2.62%	-8.02%	-3.38%	-8.11%
1 Week Price Chg	40.48%	26.36%	16.01%	46.95%	32.14%	39.17%
4 Week Price Chg	-2.11%	0.00%	14.48%	-10.50%	3.44%	-4.65%
12 Week Price Chg	-48.28%	-40.17%	-21.69%	-35.28%	-40.72%	-34.31%
52 Week Price Chg	-46.54%	-36.46%	-14.14%	-36.11%	-35.22%	-31.81%
20 Day Average Volume	8,808,182	438,431	3,634,618	414,440	15,532,734	1,793,327
(F1) EPS Est 1 week change	-5.86%	0.00%	0.00%	-0.44%	-11.44%	-6.20%
(F1) EPS Est 4 week change	-5.86%	-0.44%	-5.74%	-0.87%	-27.62%	-10.16%
(F1) EPS Est 12 week change	-4.83%	-4.83%	-8.41%	-3.91%	-29.90%	-12.88%
(Q1) EPS Est Mthly Chg	-9.05%	0.00%	-10.28%	0.00%	-26.67%	-9.52%

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	D
VGM Score	C

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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