

Capital One Financial (COF)

\$58.35 (As of 07/09/20)

Price Target (6-12 Months): **\$50.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 06/23/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)
3-Hold

Zacks Style Scores:

VGM: C

Value: B

Growth: C

Momentum: F

Summary

Shares of Capital One have underperformed the industry so far this year. The company's earnings have surpassed the Zacks Consensus Estimate in three of the trailing four quarters. Persistently increasing expenses mainly due to higher marketing costs are expected to hamper the company's bottom-line growth to an extent in the near term. Moreover, deteriorating credit quality remains a major near-term concern and might hurt financials. Further, near-zero interest rates amid the Federal Reserve's accommodative policy stance will likely hamper top-line growth to an extent in the near term. While strength in credit card and online-banking businesses, efforts to expand inorganically, and continued rise in loan demand despite the coronavirus-related mayhem are expected to aid revenues; a stretched valuation limits the stocks upside potential.

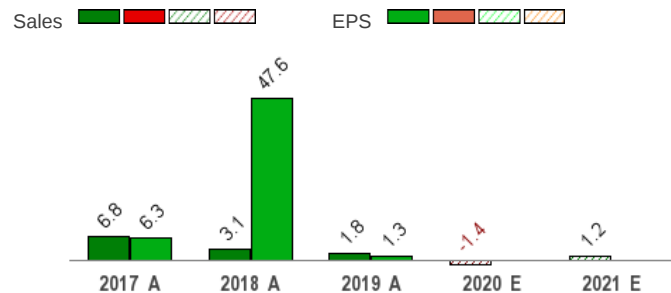
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$107.59 - \$38.00
20 Day Average Volume (sh)	3,857,383
Market Cap	\$26.6 B
YTD Price Change	-43.3%
Beta	1.75
Dividend / Div Yld	\$1.60 / 2.7%
Industry	Financial - Consumer Loans
Zacks Industry Rank	Bottom 29% (179 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-424.7%
Last Sales Surprise	-0.1%
EPS F1 Est- 4 week change	-16.1%
Expected Report Date	07/21/2020
Earnings ESP	-398.2%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	6,917 E	6,939 E	7,126 E	7,245 E	28,533 E
2020	7,249 A	6,925 E	7,011 E	7,135 E	28,197 E
2019	7,083 A	7,124 A	6,959 A	7,427 A	28,593 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.38 E	\$1.41 E	\$2.60 E	\$2.49 E	\$6.79 E
2020	-\$3.02 A	\$0.07 E	\$0.90 E	\$0.30 E	-\$2.76 E
2019	\$2.90 A	\$3.37 A	\$3.32 A	\$2.49 A	\$11.02 A

*Quarterly figures may not add up to annual.

P/E TTM	9.5
P/E F1	NA
PEG F1	NA
P/S TTM	0.8

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 07/09/2020. The reports text is as of 07/10/2020.

Overview

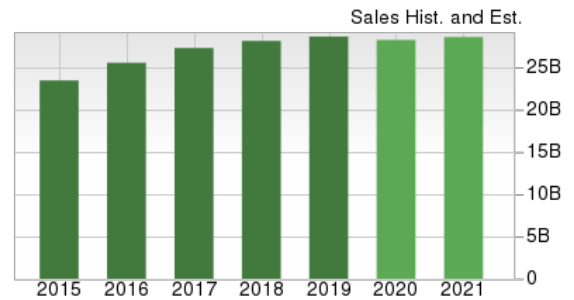
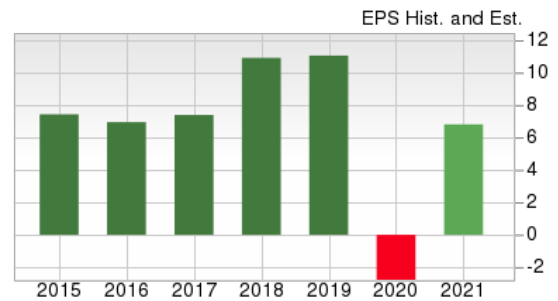
Headquartered in McLean, VA, Capital One Financial Corporation is primarily focused on consumer and commercial lending as well as deposit origination. Through its banking and non-banking subsidiaries, the company, founded in 1988, provides various financial products and services to consumers, small businesses and commercial clients in the U.S.

Capital One's principal subsidiaries include Capital One Bank (USA), National Association (COBNA) and Capital One, National Association (CONA). The company reports results of its business through the following operating segments:

- The **Credit Card** segment (contributed 64.2% of total net revenues in 2019) includes domestic consumer and small business card lending, domestic national small business lending, national closed end installment lending and the international card lending businesses in Canada and the U.K.
- The **Commercial Banking** segment (9.8%) includes lending, deposit gathering and treasury management services to commercial real estate and middle-market customers. The segment also includes the financial results of a national portfolio of small ticket commercial real estate loans that are in run-off mode. The commercial and industrial customers include companies with annual revenues between \$10 million–\$1.0 billion.
- The **Consumer Banking** segment (25.8%) comprises branch-based lending and deposit gathering activities for small businesses and retail customers, national deposit gathering, consumer mortgage lending and servicing activities as well as national automobile lending.

The **Other** category (0.2%) includes management of corporate investment portfolio and asset/liability management by centralized Corporate Treasury group.

As of Mar 31, 2020, Capital One had total assets of \$396.9 billion, total loans held for investment of \$263 billion, total deposits of \$269.7 billion and shareholders' equity of \$56.8 billion.



Reasons To Sell:

- ▼ Capital One has been witnessing a persistent rise in expenses, which witnessed a CAGR of 4.5% for the last five years (ended 2019). The increase was mainly due to a rise in marketing costs. The uptrend in expenses continued in the first quarter of 2020. As the company continues to make investments in technology and infrastructure, overall costs are expected to remain elevated in the near term.
- ▼ Capital One's asset quality has been deteriorating. Provision for credit losses and net charge-off (NCO) rates has been steadily rising. Though provisions and NCOs declined in 2018, these witnessed a CAGR of 8.3% and 14.1%, respectively, over the last five years (2015-2019). Owing to the concerns related to the coronavirus outbreak, both provisions and NCO rates increased in first-quarter 2020 as well. Hence, the company's overall credit quality is likely to remain under pressure.
- ▼ As of Mar 31, 2020, Capital One had total debt (securitized debt obligations plus other debt) worth \$55.7 billion, significantly higher than the cash and cash equivalents balance of \$24.9 billion. The company's times-interest-earned was 3.01 in the first quarter of 2020, which has been persistently declining over the past several quarters. Moreover, its first-quarter total debt to total capital of 49.31% increased sequentially. These show that the company's current liquidity position may not be sufficient to make interest payments if economic situation worsens further. In fact, both S&P Global Ratings and Moody's Investors Service have lowered the company's ratings outlook to negative as it is likely to face significant strain on its asset quality and earnings in the coming quarters in case economic slowdown lasts longer-than-expected.
- ▼ Capital One's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 5.73% compares unfavorably with ROE of 13.91% for the industry and 15.75% for the S&P 500, reflecting that it is less efficient in using shareholders' funds compared with its peers.
- ▼ Shares of Capital One have underperformed the industry so far this year. Moreover, the company's current year earnings estimate is a loss of \$2.76 per share, which has widened over the past 30 days. Given the concerns, the stock has limited upside potential.

Continuously mounting operating expenses are expected to hamper Capital One's bottom-line growth. Further, deteriorating asset quality is a major near-term concern and might hurt its financials.

Risks

- Revenue growth remains a major positive for Capital One. The company's top line depicts a five-year (2015-2019) CAGR of 6.4%, with the uptrend continuing in first-quarter 2020. Steady loan growth and opportunistic acquisitions over the past years continue to support revenues. In 2019, the company acquired KippsDeSanto and thus, forayed into the M&A market. Moreover, acquisitions of Beech Street Capital and GE's healthcare unit reflect the company's revenue diversifying efforts. Despite the virus-induced economic slowdown, revenue growth prospects look encouraging on the back of the company's solid credit card and online banking businesses.
 - Capital One's Credit Card segment is likely to continue showing strength. In first-quarter 2020, Domestic Card, which accounted for more than 91% of the Credit Card net revenues, reflected rise in loans held for investment and increasing purchase volumes on a year-over-year basis. Further, the Walmart partnership and the 2017 acquisition of Cabela's Incorporated's credit card operations are likely to provide the company with a solid platform for growth. Strong growth opportunities in card loans and purchase volumes are expected despite an intense competitive environment.
 - Capital One's capital deployment activities remain decent. Following the clearance of 2020 stress test, the company plans to maintain its dividend payout at the current level for the third quarter 2020. Also, the company has suspended its share buyback program.
 - Further, Capital One seems undervalued right now when compared with the broader industry. Its current price/cash flow and price/book ratios are lower than the respective industry averages. Also, it has a Value Score of B.
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Last Earnings Report

Capital One Records Q1 Loss, Provisions Surge & Revenues Rise

Capital One's first-quarter 2020 adjusted loss was \$3.02 per share against the Zacks Consensus Estimate for earnings of \$2.56. The year-ago quarterly earnings were \$2.90 per share.

The results reflect a drastic surge in provisions amid coronavirus-related mayhem. Further, decline in loan balance, rise in operating expenses and lower interest rates were headwinds. However, higher interest income and improvement in deposit balance offered some support.

After taking into consideration non-recurring items, net loss available to common shareholders was \$1.42 billion or \$3.10 per share versus net income of \$1.35 billion or \$2.86 per share in the prior-year quarter.

Quarter Ending **03/2020**

Report Date	Apr 23, 2020
Sales Surprise	-0.13%
EPS Surprise	-424.73%
Quarterly EPS	-3.02
Annual EPS (TTM)	6.16

Revenues & Expenses Rise

Total net revenues were \$7.25 billion, up 2% from the prior-year quarter. The figure missed the Zacks Consensus Estimate of \$7.26 billion.

Net interest income grew 4% from the prior-year quarter to \$6.03 billion. Net interest margin fell 8 basis points (bps) to 6.78% due to lower yields on interest-earning assets.

Non-interest income of \$1.22 billion decreased 5% from the prior-year quarter. Lower service charges and other customer-related fees, and net interchange fees were the primary reasons for the decline.

Non-interest expenses of \$3.73 billion were up 2% from the year-ago quarter, mainly owing to higher salaries and associate benefits costs, and occupancy and equipment costs.

Efficiency ratio was 51.44%, down from 51.83% in the year-ago quarter. A decrease in efficiency ratio indicates improvement in profitability.

As of Mar 31, 2020, loans held for investment were \$263 billion, down 1% from the prior quarter. Total deposits, as of the same date, increased 3% sequentially to \$269.7 billion.

Credit Quality Worsens

Provision for credit losses jumped significantly on a year-over-year basis to \$5.42 billion. The rise was largely due to economic uncertainty due to the coronavirus pandemic, and deterioration in the oil and gas industry.

Net charge-off rate increased 8 bps year over year to 2.72%. Also, allowance — as a percentage of reported loans held for investment — was 5.35%, up 231 bps.

However, the 30-plus day performing delinquency rate declined 28 bps to 2.95%.

Capital Ratios Improve

As of Mar 31, 2020, Tier 1 risk-based capital ratio was 13.7%, up from 13.4% in the comparable prior-year period. Further, common equity Tier 1 capital ratio was 12.0% as of Mar 31, 2020, up from 11.9% in the corresponding period of 2019.

Share Repurchase Update

During the quarter, Capital One repurchased 3.7 million shares. In mid-March, the company suspended its share buyback plan through second-quarter 2020.

Outlook

Owing to the concerns related to coronavirus outbreak and its impact, the company has withdrawn the 2020 efficiency ratio guidance provided earlier. Also, the company no longer expects efficiency ratio in 2021 to rise to 42%.

Recent News

Dividend Update

On Apr 30, Capital One announced a quarterly cash dividend of 40 cents per share. The dividend was paid out on May 21 to shareholders of record at the close of business on May 11.

Valuation

Capital One's shares are down 43.3% in the year-to-date period and 35.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 34.5% and 20.2% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 31.7% and 16%, respectively.

The S&P 500 index is down 1.4% in the year-to-date period but up 6.2% in the past year.

The stock is currently trading at 26.08X forward 12 months earnings, which compares to 11.87X for the Zacks sub-industry, 16.14X for the Zacks sector and 22.62X for the S&P 500 index.

Over the past five years, the stock has traded as high as 52.97X and as low as 3.69X, with a 5-year median of 9.19X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$50 price target reflects 22.35X forward earnings.

The table below shows summary valuation data for COF

Valuation Multiples - COF					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	26.08	11.87	16.14	22.62
	5-Year High	52.97	13.16	16.27	22.62
	5-Year Low	3.69	4.39	11.59	15.27
	5-Year Median	9.19	8.77	14.58	17.59
P/TB TTM	Current	0.63	0.78	3.26	12.51
	5-Year High	1.55	1.54	3.95	13.49
	5-Year Low	0.46	0.51	2.05	6.34
	5-Year Median	1.15	1.2	3.46	9.6
P/S F12M	Current	0.94	0.98	6.04	3.53
	5-Year High	2.07	1.97	6.7	3.53
	5-Year Low	0.64	0.72	4.96	2.52
	5-Year Median	1.46	1.49	6.07	3.04

As of 07/09/2020

Industry Analysis Zacks Industry Rank: Bottom 29% (179 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Ally Financial Inc. (ALLY)	Neutral	5
MR. COOPER GROUP INC (COOP)	Neutral	2
Discover Financial Services (DFS)	Neutral	3
JPMorgan ChaseCo. (JPM)	Neutral	3
Santander Consumer USA Holdings Inc. (SC)	Neutral	4
Wells FargoCompany (WFC)	Neutral	3
Navient Corporation (NAVI)	Underperform	5
SLM Corporation (SLM)	Underperform	4

Industry Comparison Industry: Financial - Consumer Loans				Industry Peers		
	COF	X Industry	S&P 500	ALLY	DFS	SC
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	5	3	4
VGM Score	C	-	-	D	C	B
Market Cap	26.57 B	639.37 M	21.19 B	7.11 B	14.23 B	5.56 B
# of Analysts	5	2	14	6	8	6
Dividend Yield	2.74%	0.00%	1.96%	3.99%	3.79%	5.08%
Value Score	B	-	-	B	A	A
Cash/Price	0.91	0.75	0.07	0.85	0.75	0.43
EV/EBITDA	4.73	6.19	12.56	6.12	6.19	9.40
PEG Ratio	NA	2.27	2.85	NA	4.44	NA
Price/Book (P/B)	0.47	0.97	3.00	0.53	1.56	1.08
Price/Cash Flow (P/CF)	2.90	3.05	11.41	2.39	4.90	2.02
P/E (F1)	NA	12.02	20.79	26.28	31.07	NA
Price/Sales (P/S)	0.79	0.79	2.19	1.15	1.01	0.70
Earnings Yield	-4.73%	7.04%	4.52%	3.83%	3.23%	-0.52%
Debt/Equity	0.97	2.30	0.76	2.30	2.87	7.82
Cash Flow (\$/share)	20.13	4.49	6.94	7.96	9.48	8.57
Growth Score	C	-	-	F	D	D
Hist. EPS Growth (3-5 yrs)	9.59%	10.98%	10.90%	15.39%	12.65%	1.28%
Proj. EPS Growth (F1/F0)	-125.05%	-33.74%	-9.99%	-80.51%	-83.54%	-102.97%
Curr. Cash Flow Growth	17.70%	14.13%	5.51%	-1.59%	7.14%	20.07%
Hist. Cash Flow Growth (3-5 yrs)	7.85%	9.07%	8.55%	-4.75%	4.70%	25.86%
Current Ratio	1.02	3.42	1.30	0.99	1.26	63.41
Debt/Capital	49.31%	68.95%	44.46%	69.68%	72.97%	88.66%
Net Margin	8.26%	8.29%	10.62%	16.46%	15.39%	9.32%
Return on Equity	5.73%	13.91%	15.75%	6.92%	20.38%	10.95%
Sales/Assets	0.09	0.24	0.55	0.03	0.13	0.17
Proj. Sales Growth (F1/F0)	-1.38%	-0.05%	-2.52%	-7.26%	-5.15%	0.34%
Momentum Score	F	-	-	D	D	B
Daily Price Chg	-4.95%	-3.90%	-1.52%	-3.15%	-4.58%	-5.62%
1 Week Price Chg	-0.02%	0.67%	3.66%	3.24%	0.37%	-2.13%
4 Week Price Chg	-11.75%	-5.38%	0.36%	1.06%	-5.99%	-4.36%
12 Week Price Chg	16.68%	27.46%	10.41%	40.49%	46.58%	37.06%
52 Week Price Chg	-35.67%	-33.33%	-8.70%	-39.87%	-42.36%	-32.91%
20 Day Average Volume	3,857,383	345,453	2,339,510	5,887,520	4,763,866	971,260
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-16.15%	0.00%	0.00%	-12.12%	-10.41%	32.00%
(F1) EPS Est 12 week change	-129.23%	-39.97%	-7.77%	-80.03%	-81.08%	-103.45%
(Q1) EPS Est Mthly Chg	2.66%	0.00%	0.00%	-10.17%	-0.91%	30.39%

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	C
Momentum Score	F
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.

Disclosures

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