

## Capital One Financial (COF)

**\$60.11** (As of 04/10/20)

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

Long Term: 6-12 Months

**Zacks Recommendation:** Underperform

(Since: 04/09/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**5-Strong Sell**

Zacks Style Scores:

VGM:A

Value: C

Growth: B

Momentum: A

### Summary

Shares of Capital One have underperformed the industry so far this year. The company has an impressive earnings surprise history. Its earnings have surpassed the Zacks Consensus Estimate in each of the trailing four quarters. Continuously increasing operating expenses, mainly due to higher marketing costs, are expected to hurt the company's bottom-line growth to an extent in the near term. Additionally, deteriorating credit quality remains a major near-term concern for the company and might hamper its financials. While a solid liquidity position, strength in credit card and online-banking businesses, efforts to expand inorganically and continuous increase in loan demand are expected to aid revenues, the decline in interest rates amid the Federal Reserve's accommodative policy stance will likely hamper growth to some extent in the near term.

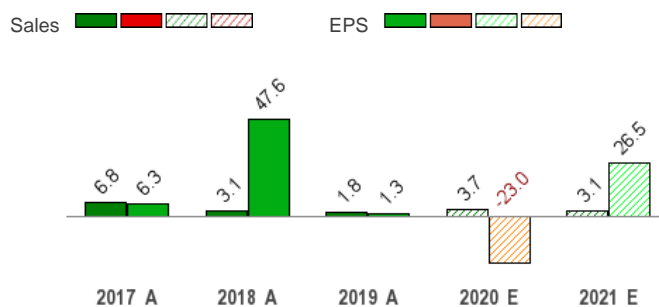
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	<b>\$107.59 - \$38.00</b>
20 Day Average Volume (sh)	<b>6,667,348</b>
Market Cap	<b>\$27.5 B</b>
YTD Price Change	<b>-41.6%</b>
Beta	<b>1.64</b>
Dividend / Div Yld	<b>\$1.60 / 2.7%</b>
Industry	<b>Financial - Consumer Loans</b>
Zacks Industry Rank	<b>Top 23% (58 out of 253)</b>

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	<b>6.0%</b>
Last Sales Surprise	<b>1.1%</b>
EPS F1 Est- 4 week change	<b>-25.7%</b>
Expected Report Date	<b>04/23/2020</b>
Earnings ESP	<b>-17.8%</b>

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	7,527 E	7,553 E	7,734 E	7,972 E	30,578 E
2020	7,331 E	7,226 E	7,392 E	7,680 E	29,647 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	\$2.60 E	\$2.92 E	\$3.23 E	\$2.40 E	\$10.74 E
2020	\$2.71 E	\$3.17 E	\$2.94 E	\$1.87 E	\$8.49 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	<b>5.0</b>
P/E F1	<b>7.1</b>
PEG F1	<b>1.0</b>
P/S TTM	<b>0.8</b>

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/10/2020. The reports text is as of 04/13/2020.

## Overview

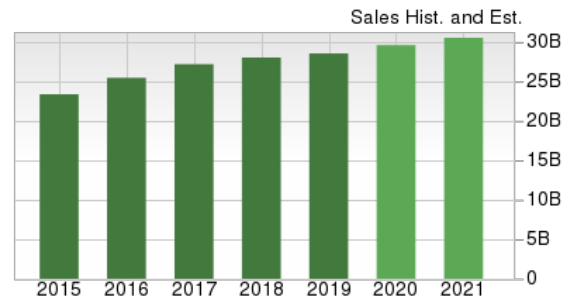
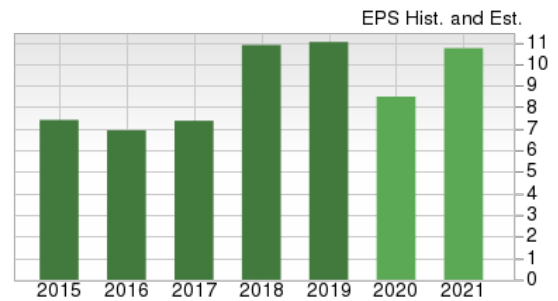
Headquartered in McLean, VA, Capital One Financial Corporation is primarily focused on consumer and commercial lending as well as deposit origination. Through its banking and non-banking subsidiaries, the company, founded in 1988, provides various financial products and services to consumers, small businesses 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 Dec 31, 2019, Capital One had total assets of \$390.4 billion, total loans held for investment of \$265.8 billion, total deposits of \$262.7 billion and shareholders' equity of \$58 billion.



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## Reasons To Sell:

- ▼ Elevated non-interest expenses remain a major concern for Capital One. Expenses witnessed a CAGR of 4.5% for the last five years (ended 2019). The increase was mainly due to a rise in marketing costs, which are likely to remain elevated given the rising loan growth opportunities. Further, continued investments in technology and infrastructure will keep expenses on a higher side.
- ▼ 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). Hence, the company's overall credit quality is likely to remain under pressure.
- ▼ Capital One's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 10.67% compares unfavorably with ROE of 16.68% for the industry and 16.74% for the S&P 500, reflecting that it is less efficient in using shareholders' funds compared with its peers.
- ▼ Shares of Capital One have outperformed the industry over the past year. However, the company's 2020 earnings estimates have moved 21.8% lower over the past seven days. Therefore, given the concerns and negative estimate revisions, 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.

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## 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%. 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. Revenue growth prospects look encouraging on the back of the company's solid credit card and online banking businesses amid the current economic slowdown.
  - Capital One's Credit Card segment is likely to continue showing strength. In 2019, Domestic Card, which accounted for more than 92% of the Credit Card net revenues, reflected strong loan growth and increasing purchase volume. 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. Management projects strong growth opportunities in card loans and purchase volumes despite an intense competitive environment.
  - Capital One's capital deployment activities remain decent. The company's 2019 capital plan, approved by the Federal Reserve in June 2019, include maintaining the quarterly dividend at the current level and authorization to buy back \$2.2 billion worth shares. As of Dec 31, 2019, nearly \$0.8 billion worth of buyback authorization remained. However, the company recently announced that it has suspended its share buyback program in response to the COVID-19 pandemic. Nevertheless, driven by a solid balance sheet position and continued earnings strength, the company will likely be able to sustain its capital deployment activities.
  - Further, Capital One seems undervalued when compared with the broader industry. Its current price-to-book ratio is below the industry average, while the price-to-sales ratio is in line with the industry level.
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## Last Earnings Report

### Capital One Beats on Q4 Earnings & Revenue Estimates

Capital One's fourth-quarter 2019 adjusted earnings of \$2.49 per share easily surpassed the Zacks Consensus Estimate of \$2.38. Also, it jumped 33% year over year.

Results reflect rise in net revenues, higher loan and deposit balances, and strength in card business. However, a rise in credit cost and higher operating expenses were the undermining factors.

After taking into consideration non-recurring items, net income available to common shareholders was \$1.04 billion or \$2.25 per share, down from \$1.17 billion or \$2.48 per share in the prior-year quarter.

For 2019, adjusted earnings of \$12.09 per share grew 11% year over year but lagged the consensus estimate of \$11.21. Net income available to common shareholders (as reported) declined 9% to \$5.19 billion.

### Revenues & Expenses Rise

Net revenues for the quarter were \$7.43 billion, up 6% from the prior-year quarter. The figure beat the Zacks Consensus Estimate of \$7.36 billion.

For 2019, net revenues increased 2% to \$28.59 billion. It surpassed the consensus estimate of \$28.56 billion.

Net interest income grew 4% to \$6.07 billion. Net interest margin inched down 1 basis point (bp) to 6.95%.

Non-interest income of \$1.36 billion increased 14% from the prior-year quarter. Lower service charges and other customer-related fees, and net securities losses were more than offset by rise in net interchange fees and other income.

Non-interest expenses of \$4.16 billion were up 1%, mainly owing to 23% rise in salaries and associate benefits costs and 6% increase in communications and data processing costs.

Efficiency ratio was 56.03%, down from 58.92% in the year-ago quarter. A decrease in efficiency ratio indicates improvement in profitability.

As of Dec 31, 2019, loans held for investment were \$265.8 billion, up 7% from the prior quarter. Total deposits, as of the same date, increased 2% sequentially to \$262.7 billion.

### Credit Quality: Mixed Bag

Net charge-off rate decreased 7 bps year over year to 2.60%. The 30-plus day performing delinquency rate declined 11 bps to 3.51%.

Also, allowance as a percentage of reported loans held for investment was 2.71%, down 23 bps. However, provision for credit losses rose 11% to \$1.82 billion.

### Profitability Ratios Decline, Capital Ratios Improve

Return on average assets was 1.23% at the end of the reported quarter, down from 1.38% in the year-ago quarter. Also, return on average common equity was 7.63%, down from 10.05% in the prior-year quarter.

As of Dec 31, 2019, Tier 1 risk-based capital ratio was 13.7%, up from 12.7% in the prior-year quarter end. Further, common equity Tier 1 capital ratio was 12.2% as of Dec 31, 2019, up from 11.2% on Dec 31, 2018.

### Share Repurchase Update

During the fourth quarter, the company repurchased 10 million shares for \$941 million.

### Walmart Partnership Impact

In late September 2019, Capital One launched the new Walmart co-brand and private label cards and on Oct 11, it closed the acquisition of the existing Walmart card portfolio, with on-boarding of \$8.1 billion in loans.

Driven by the revenue and loss sharing provisions, the acquired Walmart portfolio is expected to affect several Domestic Card metrics. The portfolio is projected to lower the Domestic Card charge-off rate by about 25 bps in 2020 (with some quarterly variability).

Additionally, the acquired portfolio will reduce the Domestic Card revenue margin by about 50 bps in the first three quarters of 2020, and by roughly 35 bps in the fourth quarter of 2020. This is because the revenue share on the acquired portfolio steps up in October 2020.

The charge-off rate and revenue margin impacts are expected to diminish over time as the acquired portfolio runs off.

Further, the existing Walmart portfolio is anticipated to increase Domestic Card delinquency rate by about 15 bps at 2020-end.

### Outlook

Operating efficiency ratio (net of adjustments) is expected to improve modestly in 2020. In 2021, the same is expected to rise to 42%, driven by the data center exit, continuing technology innovation and Walmart launch.

Quarter Ending **12/2019**

Report Date	Jan 21, 2020
Sales Surprise	1.08%
EPS Surprise	5.96%
Quarterly EPS	2.49
Annual EPS (TTM)	12.08

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With the momentum in domestic cards and retail deposits and the incremental Walmart marketing, management expects marketing costs for 2020 to be modestly high year over year.

Annual auto NCOs are expected to increase gradually in the near term.

The company anticipates the implementation of the CECL framework, to be adopted on Jan 1, 2020, to increase its allowance by 40%. Thus, the impact of adopting CECL, which will phase in over four years, is expected to lower the company's CET1 ratio by 16 bps in the first quarter of 2020.

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## Recent News

### Dividend Update

On Jan 29, Capital One announced a quarterly cash dividend of 40 cents per share. The dividend was paid out on Feb 21 to shareholders of record at the close of business on Feb 10.

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## Valuation

Capital One's shares are down 41.6% in the year-to-date period and 30.8% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 40.7% and 23.3% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 35.2% and 17.5%, respectively.

The S&P 500 index is down 13.4% in the year-to-date period and 4.3% in the past year.

The stock is currently trading at 5.12X forward 12 months earnings, which compares to 5.41X for the Zacks sub-industry, 13.30X for the Zacks sector and 18.16X for the S&P 500 index.

Over the past five years, the stock has traded as high as 12.72X and as low as 3.80X, with a 5-year median of 9.24X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$50 price target reflects 4.26X 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	5.12	5.41	13.3	18.16
	5-Year High	12.72	10.82	16.19	19.34
	5-Year Low	3.8	4.38	11.23	15.19
	5-Year Median	9.24	8.7	13.95	17.45
P/TB TTM	Current	0.64	0.67	2.5	10.5
	5-Year High	1.57	1.57	3.97	12.78
	5-Year Low	0.45	0.49	1.97	6.02
	5-Year Median	1.17	1.21	3.45	9.15
P/S F12M	Current	0.91	0.86	4.93	3.08
	5-Year High	2.07	2.07	6.65	3.44
	5-Year Low	0.67	0.74	4.93	2.54
	5-Year Median	1.49	1.5	6.03	3.01

As of 04/09/2020

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## Industry Analysis Zacks Industry Rank: Top 23% (58 out of 253)



## Top Peers

Ally Financial Inc. (ALLY)	Outperform
MR. COOPER GROUP INC (COOP)	Outperform
Navient Corporation (NAVI)	Outperform
Discover Financial Services (DFS)	Neutral
First Cash, Inc. (FCFS)	Neutral
Santander Consumer USA Holdings Inc. (SC)	Neutral
SLM Corporation (SLM)	Neutral
Wells Fargo & Company (WFC)	Underperform

Industry Comparison Industry: Financial - Consumer Loans				Industry Peers		
	COF Underperform	X Industry	S&P 500	ALLY Outperform	DFS Neutral	SC Neutral
<b>VGM Score</b>	<b>A</b>	-	-	<b>B</b>	<b>A</b>	<b>A</b>
Market Cap	27.50 B	539.18 M	19.66 B	6.30 B	12.09 B	5.60 B
# of Analysts	9	3	13	4	9	7
Dividend Yield	2.66%	0.00%	2.18%	4.52%	4.49%	5.33%
<b>Value Score</b>	<b>C</b>	-	-	<b>A</b>	<b>A</b>	<b>A</b>
Cash/Price	0.71	0.67	0.06	0.79	0.79	0.54
EV/EBITDA	5.78	6.53	11.72	7.04	6.55	9.26
PEG Ratio	0.96	0.43	2.04	0.25	0.79	3.13
Price/Book (P/B)	0.48	0.76	2.66	0.44	1.09	0.77
Price/Cash Flow (P/CF)	2.99	2.93	10.44	2.11	4.14	1.93
P/E (F1)	6.73	4.34	17.51	3.97	4.80	6.25
Price/Sales (P/S)	0.81	0.81	2.12	0.99	0.86	0.71
Earnings Yield	14.12%	23.07%	5.65%	25.19%	20.81%	15.98%
Debt/Equity	0.95	1.87	0.70	2.36	2.28	5.36
Cash Flow (\$/share)	20.13	4.49	7.01	7.96	9.48	8.57
<b>Growth Score</b>	<b>B</b>	-	-	<b>D</b>	<b>B</b>	<b>A</b>
Hist. EPS Growth (3-5 yrs)	12.44%	12.44%	10.92%	17.52%	13.70%	0.79%
Proj. EPS Growth (F1/F0)	-22.97%	9.24%	-1.14%	14.05%	-10.12%	-7.64%
Curr. Cash Flow Growth	17.70%	17.70%	5.93%	-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	1.04	3.20	1.24	1.03	1.30	62.53
Debt/Capital	48.84%	65.09%	42.36%	70.24%	68.43%	84.26%
Net Margin	16.40%	12.62%	11.64%	26.82%	20.94%	12.66%
Return on Equity	10.67%	16.68%	16.74%	10.35%	26.59%	13.64%
Sales/Assets	0.09	0.24	0.54	0.04	0.13	0.17
Proj. Sales Growth (F1/F0)	3.68%	2.65%	0.45%	2.65%	0.95%	8.49%
<b>Momentum Score</b>	<b>A</b>	-	-	<b>C</b>	<b>B</b>	<b>C</b>
Daily Price Chg	5.98%	5.15%	2.48%	10.58%	5.35%	10.43%
1 Week Price Chg	-23.56%	-18.88%	-4.40%	-24.03%	-25.72%	-20.17%
4 Week Price Chg	-5.53%	-7.40%	11.26%	-14.05%	-12.63%	-11.18%
12 Week Price Chg	-41.60%	-38.49%	-20.02%	-45.29%	-53.12%	-28.36%
52 Week Price Chg	-30.31%	-33.13%	-11.31%	-41.93%	-47.63%	-24.84%
20 Day Average Volume	6,667,348	447,976	3,931,994	9,188,937	6,592,987	1,896,406
(F1) EPS Est 1 week change	-21.84%	0.00%	-0.12%	-0.59%	-5.58%	0.00%
(F1) EPS Est 4 week change	-25.72%	-0.57%	-5.78%	-0.59%	-7.77%	-3.70%
(F1) EPS Est 12 week change	-24.70%	-3.41%	-7.64%	0.50%	-13.82%	-6.62%
(Q1) EPS Est Mthly Chg	6.19%	0.00%	-10.13%	-6.25%	6.10%	-4.14%



## 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	C
Growth Score	B
Momentum Score	A
VGM Score	A

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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