

## Capital One Financial (COF)

**\$64.27** (As of 08/20/20)

Price Target (6-12 Months): **\$67.00**

Long Term: 6-12 Months

**Zacks Recommendation:**
**Neutral**

(Since: 07/21/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

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

**4-Sell**

Zacks Style Scores:

VGM:B

Value: B

Growth: D

Momentum: A

### Summary

Shares of Capital One have underperformed the industry so far this year. The company's earnings surpassed the Zacks Consensus Estimate in two of the trailing four quarters. Its second-quarter 2020 results were hurt by a rise in provisions and weak consumer activity. Near-zero interest rates are likely to hamper revenues to some extent. Moreover, deteriorating credit quality remains a key near-term concern and might hurt the financials. Further, the company has cut its dividend by 75%. However, strength in card business, inorganic growth and a solid liquidity position are expected to aid profitability. Furthermore, as the consumers gradually regain confidence in the economic recovery, there is likely to be a rise in demand for consumer loans, going forward. This, in turn, is expected to support its non-interest income in the upcoming quarters.

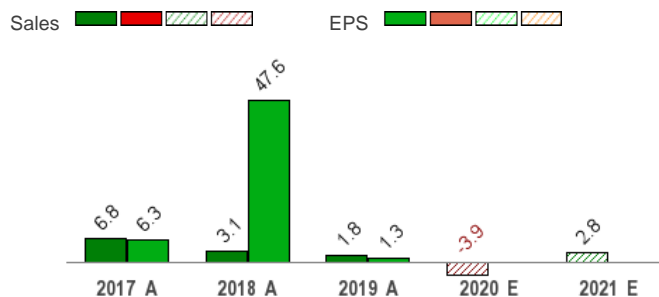
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	<b>\$107.59 - \$38.00</b>
20 Day Average Volume (sh)	<b>2,616,971</b>
Market Cap	<b>\$29.3 B</b>
YTD Price Change	<b>-37.6%</b>
Beta	<b>1.73</b>
Dividend / Div Yld	<b>\$0.40 / 0.6%</b>
Industry	<b><a href="#">Financial - Consumer Loans</a></b>
Zacks Industry Rank	<b>Bottom 29% (180 out of 252)</b>

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



Last EPS Surprise	<b>-28.8%</b>
Last Sales Surprise	<b>-4.7%</b>
EPS F1 Est- 4 week change	<b>19.3%</b>
Expected Report Date	<b>10/22/2020</b>
Earnings ESP	<b>0.0%</b>
P/E TTM	<b>54.5</b>
P/E F1	<b>NA</b>
PEG F1	<b>NA</b>
P/S TTM	<b>0.9</b>

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	6,890 E	6,992 E	7,144 E	7,304 E	28,257 E
2020	7,249 A	6,556 A	6,823 E	7,055 E	27,492 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	\$0.42 E	\$1.72 E	\$2.75 E	\$2.82 E	\$6.62 E
2020	-\$3.02 A	-\$1.61 A	\$1.55 E	\$0.97 E	-\$2.47 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.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/20/2020. The reports text is as of 08/21/2020.

## Overview

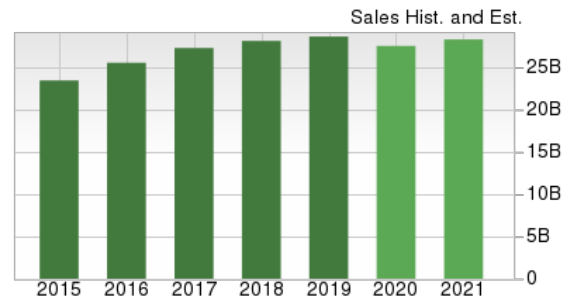
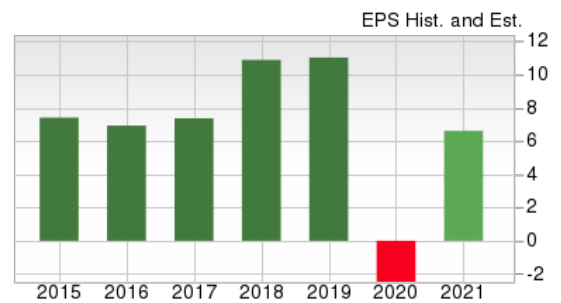
Headquartered in McLean, VA, Capital One Financial Corporation is primarily focused on consumer and commercial lending as well as deposit origination. Through its banking and non-banking subsidiaries, the company, founded in 1988, provides various financial products and services to consumers, small businesses 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 Jun 30, 2020, Capital One had total assets worth \$421.3 billion, total loans held for investment of \$251.5 billion, total deposits of \$304.2 billion and shareholders' equity of \$56 billion.



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## Reasons To Buy:

- ▲ 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 have driven 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. Though revenues declined in first-half 2020 (mainly due to weakness in consumer activities) amid the coronavirus-induced economic slowdown, revenue prospects look encouraging on the back of the company's solid credit card and online banking businesses.
- ▲ As of Jun 30, 2020, Capital One had total debt (securitized debt obligations plus other debt) worth \$44.9 billion. Notably, over the second quarter, the company significantly improved its liquidity position. Its cash and cash equivalents showed a balance of \$55.8 billion at the end of the second quarter, which grew substantially from the prior-quarter level of \$24.9 billion. Also, its current total debt to total capital of 44.2% represents a decline from the first-quarter level. Thus, the company seems to be well positioned in terms of its liquidity profile and hence is expected to be able to continue to meet debt obligations in the near term even if the economic situation worsens.
- ▲ Capital One's Credit Card segment is likely to continue showing strength. In the first six months of 2020, Domestic Card, which accounted for almost 92% of the Credit Card net revenues, reflected solid loans held for investment balance. Further, the Walmart partnership and the 2017 acquisition of Cabela's Incorporated's credit card operations consistently bode well. Strong growth opportunities in card loans and purchase volumes are expected despite an intense competitive environment.
- ▲ Further, Capital One seems undervalued 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.

Strength in credit card and online-banking operations, decent loan growth, robust balance sheet position and strategic inorganic expansion initiatives will support Capital One's profitability.

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## Reasons To Sell:

- ▼ After slashing rates thrice last year, the Federal Reserve cut the rates to near zero in March with an aim to cushion the U.S. economy from coronavirus-induced mayhem. However, this has hindered Capital One's net interest income (NII) growth and contracted net interest margin (NIM) over the last several quarters. A similar trend is expected to continue in the near term as the central bank signaled no rate hike in the near future.
- ▼ Capital One's asset quality has been deteriorating. Provision for credit losses and net charge-off (NCO) 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). Due to the concerns related to the coronavirus outbreak, both provisions and NCOs increased in the first half 2020 as well. The company's overall credit quality is likely to remain under pressure in the short term.
- ▼ While Capital One's recent capital plan included maintaining dividend payout at 40 cents per share, based on the Fed's new cumulative earnings rule the company has lowered the same to 10 cents in July. This represents a cut of 75% from the prior payout. Also, the company has suspended its share buyback program. Thus, this will likely hurt shareholder value.
- ▼ 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 persisted in the first half 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 trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 1.67% compares unfavorably with ROE of 14.19% for the industry and 14.67% 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 estimate for loss is pegged at \$2.47 per share, which has widened over the past 60 days. Thus, given the concerns, the price performance is not expected to improve anytime soon.

Near-zero interest rates and a deteriorating asset quality are major near-term headwinds and might affect Capital One's finances. Also, mounting expenses are expected to limit bottom-line growth.

## Last Earnings Report

### Capital One Posts Wider-Than-Expected Q2 Loss, Revenues Down

Capital One's second-quarter 2020 adjusted loss of \$1.61 per share was wider than the Zacks Consensus Estimate of a loss of \$1.25. The year-ago quarterly earnings were \$3.37 per share.

The results reflect a drastic surge in provisions amid coronavirus-related uncertainty. Also, a decline in loan balance, lower interest rates and weak consumer activity were headwinds. However, improvement in the deposit balance and robust capital ratios offered some support.

After taking into consideration non-recurring items, net loss available to common shareholders was \$1.01 billion or \$2.21 per share versus net income of \$1.53 billion or \$3.24 per share in the prior-year quarter.

### Revenues & Loans Down, Expenses Stable

Total net revenues were \$6.56 billion, down 8% from the prior-year quarter. The figure also missed the Zacks Consensus Estimate of \$6.88 billion.

Net interest income fell 5% from the prior-year quarter to \$5.46 billion. Net interest margin also fell 102 basis points (bps) to 5.78% due to lower yields on interest-earning assets.

Non-interest income of \$1.10 billion decreased 20% from the prior-year quarter. Lower service charges and other customer-related fees, along with net interchange fees were the primary reasons for the decline.

Non-interest expenses of \$3.77 billion were on par with the year-ago number. Rise in other costs, and salaries and associate benefit expenses were largely offset by fall in marketing costs and amortization of intangibles.

Efficiency ratio was 57.50%, up from 53.05% in the year-ago quarter. A rise in efficiency ratio indicates deterioration in profitability.

As of Jun 30, 2020, loans held for investment were \$251.5 billion, down 4% from the prior quarter. Total deposits, as of the same date, increased 13% sequentially to \$304.2 billion.

### Credit Quality: Mixed Bag

Provision for credit losses jumped significantly on a year-over-year basis to \$4.25 billion. The rise was largely due to economic uncertainty due to the coronavirus pandemic. Also, allowance — as a percentage of reported loans held for investment — was 6.69%, up 377 bps.

However, net charge-off rate decreased 10 bps year over year to 2.38%. Further, the 30-plus day performing delinquency rate declined 106 bps to 2.09%.

### Capital Ratios Improve

As of Jun 30, 2020, Tier 1 risk-based capital ratio was 14.2%, up from 13.8% in the comparable prior-year period. Further, common equity Tier 1 capital ratio was 12.4% as of Jun 30, 2020, up from 12.3% in the corresponding period of 2019.

Quarter Ending 06/2020

Report Date	Jul 21, 2020
Sales Surprise	-4.65%
EPS Surprise	-28.80%
Quarterly EPS	-1.61
Annual EPS (TTM)	1.18

## Recent News

### Capital One to Pay \$80M Penalty Over Data Breach Incident - Aug 6, 2020

Capital One has agreed to pay \$80 million in fine to U.S. banking regulator over a data breach incident that occurred last year. The cyberattack exposed personal information of 106 million credit card holders of the bank in the United States and Canada.

In the consent order, the Office of the Comptroller of the Currency (OCC) stated that Capital One did not “establish effective risk assessment processes prior to migrating significant information technology operations to the public cloud environment.” The OCC also noted that even after concerns related to cyber security were raised during an internal audit, the top management didn't take proper action.

Under the terms of the OCC order, Capital One is required to take adequate steps to ensure that its computer system has sufficient security and submit the plans for review. The company faces a similar oversight from the Federal Reserve.

Capital One in a statement said, “Safeguarding our customers' information is essential to our role as a financial institution. In the year since the incident, we have invested significant additional resources into further strengthening our cyber defenses, and have made substantial progress in addressing the requirements of these orders.”

The cyberattack — one of the largest data breach incidents in the recent past — on Capital One's system compromised nearly 140,000 Social Security numbers and 80,000 bank account numbers.

### Dividend Update

On Jul 31, Capital One announced a quarterly cash dividend of 10 cents per share, marking a cut of 75% from the prior payout. The dividend was paid out on Aug 20 to shareholders of record at the close of business on Aug 10.

## Valuation

Capital One's shares are down 37.5% in the year-to-date period and 25% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 29.3% and 16.6% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 25.5% and 7.6%, respectively.

The S&P 500 index is up 4.7% in the year-to-date period and 15.7% in the past year.

The stock is currently trading at 19.29X forward 12 months earnings, which compares to 10.64X for the Zacks sub-industry, 16.50X for the Zacks sector and 22.77X 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 Neutral recommendation indicates that the stock will perform in line with the market. Our \$67 price target reflects 20.12X 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	19.29	10.64	16.5	22.77
	5-Year High	52.97	13.16	16.5	22.77
	5-Year Low	3.69	4.39	11.6	15.25
	5-Year Median	9.19	8.77	14.26	17.58
P/TB TTM	Current	0.71	0.73	3.33	13.2
	5-Year High	1.5	1.49	4	13.26
	5-Year Low	0.46	0.48	2.01	5.96
	5-Year Median	1.14	1.19	3.48	9.58
P/S F12M	Current	1.05	0.95	6.22	3.7
	5-Year High	1.8	1.82	6.67	3.7
	5-Year Low	0.64	0.72	4.97	2.53
	5-Year Median	1.45	1.49	6.06	3.05

As of 08/20/2020

## Industry Analysis Zacks Industry Rank: Bottom 29% (180 out of 252)



## Top Peers

Company (Ticker)	Rec	Rank
MR. COOPER GROUP INC (COOP)	Outperform	1
Ally Financial Inc. (ALLY)	Neutral	3
Discover Financial Services (DFS)	Neutral	4
JPMorgan ChaseCo. (JPM)	Neutral	3
Navient Corporation (NAVI)	Neutral	3
Santander Consumer USA Holdings Inc. (SC)	Neutral	3
SLM Corporation (SLM)	Neutral	3
Wells FargoCompany (WFC)	Neutral	4

Industry Comparison Industry: Financial - Consumer Loans				Industry Peers		
	COF	X Industry	S&P 500	ALLY	DFS	SC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	3	4	3
VGM Score	B	-	-	B	B	B
Market Cap	29.35 B	620.05 M	23.46 B	8.17 B	15.30 B	5.38 B
# of Analysts	5	2.5	14	6	8	6
Dividend Yield	0.62%	0.00%	1.65%	3.48%	3.52%	5.17%
Value Score	B	-	-	A	A	A
Cash/Price	1.78	0.77	0.07	2.26	0.91	0.40
EV/EBITDA	1.43	5.09	13.34	3.48	5.09	9.51
PEG Ratio	NA	0.19	3.00	NA	NA	NA
Price/Book (P/B)	0.52	1.01	3.12	0.59	1.78	1.10
Price/Cash Flow (P/CF)	3.19	3.56	12.60	2.74	5.27	1.99
P/E (F1)	NA	12.51	21.61	26.43	49.38	120.21
Price/Sales (P/S)	0.90	0.91	2.44	1.30	1.12	0.67
Earnings Yield	-3.84%	6.26%	4.43%	3.80%	2.02%	0.82%
Debt/Equity	0.79	1.90	0.76	2.11	2.70	8.30
Cash Flow (\$/share)	20.13	4.49	6.93	7.96	9.48	8.57
Growth Score	D	-	-	F	D	F
Hist. EPS Growth (3-5 yrs)	-2.92%	10.51%	10.44%	12.24%	6.74%	-3.50%
Proj. EPS Growth (F1/F0)	-122.38%	-34.49%	-5.53%	-77.78%	-88.86%	-95.05%
Curr. Cash Flow Growth	17.70%	14.13%	5.20%	-1.59%	7.14%	20.07%
Hist. Cash Flow Growth (3-5 yrs)	7.85%	9.07%	8.52%	-4.75%	4.70%	25.86%
Current Ratio	0.96	3.09	1.33	0.99	1.18	58.77
Debt/Capital	44.16%	65.56%	44.50%	67.85%	70.63%	89.25%
Net Margin	0.74%	7.74%	10.13%	10.87%	7.65%	3.47%
Return on Equity	1.67%	14.19%	14.67%	5.85%	10.45%	4.50%
Sales/Assets	0.08	0.24	0.51	0.03	0.12	0.17
Proj. Sales Growth (F1/F0)	-3.85%	0.00%	-1.54%	-5.35%	-4.60%	0.78%
Momentum Score	A	-	-	A	A	A
Daily Price Chg	-2.18%	-0.53%	-0.59%	-1.89%	-1.71%	-1.39%
1 Week Price Chg	5.66%	1.62%	1.09%	5.45%	5.66%	-6.01%
4 Week Price Chg	-1.73%	0.38%	1.91%	2.15%	-3.27%	-6.99%
12 Week Price Chg	-6.23%	9.37%	6.82%	18.94%	0.95%	-1.45%
52 Week Price Chg	-25.03%	-29.54%	1.47%	-30.10%	-37.32%	-34.80%
20 Day Average Volume	2,616,971	317,654	1,873,576	3,458,434	2,877,812	969,871
(F1) EPS Est 1 week change	2.31%	0.00%	0.00%	1.22%	1.25%	25.00%
(F1) EPS Est 4 week change	19.35%	13.17%	1.79%	17.26%	-16.86%	80.85%
(F1) EPS Est 12 week change	-7.43%	9.60%	3.35%	0.20%	-49.52%	213.33%
(Q1) EPS Est Mthly Chg	2.33%	4.33%	0.42%	4.35%	39.84%	39.01%

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## 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.

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### 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>B</b>
Growth Score	<b>D</b>
Momentum Score	<b>A</b>
VGM Score	<b>B</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.

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