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Jul 22, 2020

Navient Corporation (NAVI)

$7.60 (As of 07/21/20)

Price Target (6-12 Months): **$6.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 06/03/20) Prior Recommendation: Neutral	**Underperform**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**5-Strong Sell**
	Zacks Style Scores:	VGM:A
	Value: A | Growth: B | Momentum: C	

Summary

Shares of Navient 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 lagged in one of the trailing four quarters. Second-quarter results reflect a fall in expenses and rise in interest income. The company remains focused on leveraging asset recovery & processing businesses to boost the top line. However, Navient continues to struggle with regulatory claims and litigation burden due to practices in handling a large number of student loans. Increase in financing costs, subject to substantial volatility in capital markets, remains concerning. Further, unsustainable capital deployment activities keep us apprehensive. Also, the company's increasing operating expenses might impact bottom-line expansion to some extent.

Price, Consensus & Surprise

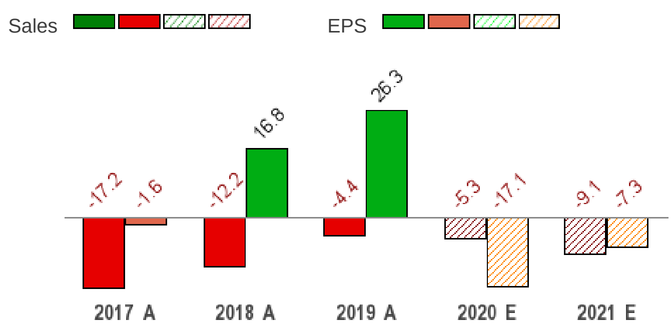
Data Overview

52 Week High-Low	$15.67 - $4.07
20 Day Average Volume (sh)	4,253,351
Market Cap	$1.5 B
YTD Price Change	-44.5%
Beta	1.87
Dividend / Div Yld	$0.64 / 8.4%
Industry	Financial - Consumer Loans
Zacks Industry Rank	Bottom 33% (168 out of 252)

Last EPS Surprise	91.7%
Last Sales Surprise	15.6%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	10/27/2020
Earnings ESP	-33.3%

P/E TTM	2.8
P/E F1	3.5
PEG F1	1.2
P/S TTM	0.3

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	297 E	300 E	298 E	305 E	1,020 E
2020	297 A	329 A	274 E	266 E	1,122 E
2019	285 A	293 A	312 A	294 A	1,185 A

EPS Estimates

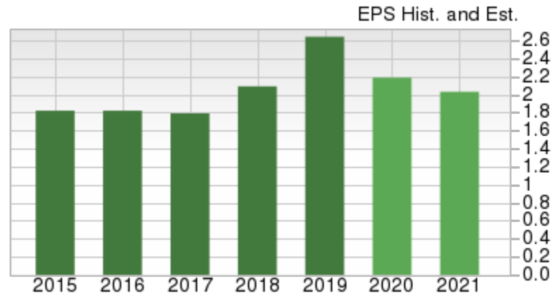
	Q1	Q2	Q3	Q4	Annual*
2021	$0.42 E	$0.42 E	$0.68 E	$0.59 E	$2.03 E
2020	$0.51 A	$0.92 A	$0.51 E	$0.45 E	$2.19 E
2019	$0.55 A	$0.74 A	$0.62 A	$0.67 A	$2.64 A

*Quarterly figures may not add up to annual.

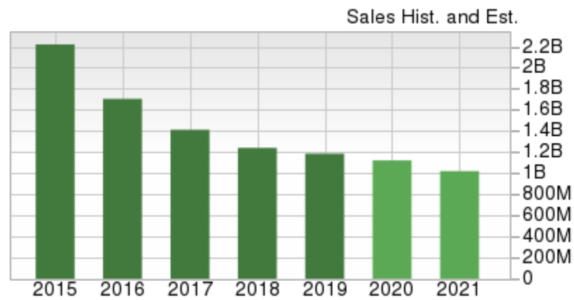
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 07/21/2020. The reports text is as of 07/22/2020.

Overview

Headquartered in Wilmington, DE, Navient is a leading provider of education loan management and business processing solutions for education, healthcare, and government clients at the federal, state and local levels. Navient is one of the four large servicers to the U.S. Department of Education ("ED") under its Direct Student Loan Program (DSLP).



In fourth-quarter 2017, Navient entered the Private Education Refinance Loan origination market, following which, the company reports through the following business segments:



- **Federal Education Loans:** In this segment, the company holds and acquires the Federal Family Education Loan Program (FFELP) loans and performs servicing and asset recovery services on its own loan portfolio, federal education loans owned by the U.S. Department of Education and other institutions.
- **Consumer Lending:** Under this segment, the company holds, originates and acquires consumer loans and performs servicing activities in its own loan portfolio. Originations and acquisitions leverage its servicing scale and generate incremental earnings and cash flow.
- **Business Processing:** In this segment, Navient performs business processing services for non-education related government and health care clients. The company provides services to more than 600 clients in the health care and public sectors.
- **Other Segment:** This segment mainly comprises activities such as corporate liquidity portfolio and the repurchase of debt, unallocated overhead (corporate overhead and certain information technology costs), restructuring/other reorganization expenses, regulatory-related costs, etc.

In November 2017, Navient acquired Earnest, a financial technology company in an all cash deal. On completion, it took over education refinancing loans of more than $500 million.

In August 2017, Navient acquired Duncan Solutions in order to expand presence in the municipal and toll services market.

As of Jun 30, 2020, Navient had total assets of $91 billion, FFELP loans of $60.9 billion and private education loan of $21.5 billion.

Reasons To Sell:

Navient’s top-line faces potential threat from lack of access to new loans and alternative sources of revenue. Ongoing litigation issues are an added concern. Also, rising costs are a headwind.

- We remain cautious owing to limited growth opportunities for Navient. Following the 2010 reform law, DSLP of the ED originates all federal student loans. As a result of this legislation, Navient’s interest income on its FFELP loan portfolio and fee-based revenue from servicing that portfolio and third-party FFELP loans will gradually decrease as existing FFELP loans are paid down, refinanced or repaid after default by guarantors. If Navient fails to acquire new loans or expand or develop alternative sources of revenue to replace or enhance its declining revenue from FFELP loan portfolio, its top line will be under pressure.

- Higher expenses remain another concern for Navient. Though operating expenses (on a core basis) declined in the first six months of 2020, it witnessed a CAGR of 1% over the last three years (ended 2019). Substantial volatility in the capital markets could increase Navient’s financing costs. Further, as per the Separation and Distribution Agreement, Navient Corporation stands liable for payment of all regulatory orders, except the penalty charges that are directly imposed on Sallie Mae Bank. Additionally, Navient is struggling with several litigation issues amid the heightened regulatory scrutiny over alleged anti-consumer practices in the U.S. student loan industry.

- Navient's capital deployment activities keep us apprehensive. The company last declared a 7% hike in its quarterly dividend in January 2015. Also, in October 2019, the company approved an additional share buyback program of up to $1 billion with immediate effect. As of Jun 30, 2020, it had $665 million of remaining share-repurchase authority. However, Navient's debt/equity ratio seems unfavorable compared with its industry average. Hence, we believe that the company’s capital deployment activities might not be sustainable in the long term.

- Interest earned on FFELP loans and private education loans is primarily indexed to 1-month LIBOR rates and either 1-month LIBOR rates or the 1-month Prime rate, respectively, whereas the cost of funds is primarily indexed to 3-month LIBOR rates. This leads to re-pricing risks related to these assets. In a gradually rising interest rate environment, this difference in timing may create pressure on net interest margin for FFELP and private education loans. On the other hand, relatively higher interest rates will lower Navient’s floor income.

Risks

- Following its separation from SLM Corporation in 2014, Navient continues to be the biggest portfolio holder of Private Education Loans and education loans insured or guaranteed under the FFELP. Further, Navient is a leading servicer of education loans. Also, the company remains focused on introducing new products leveraged with technology. The economic recovery and declining unemployment rate should further enhance its business prospects. Particularly, the specialized focus post split will be advantageous to Navient.

- Navient seems on track with initiatives that lays the foundation for independent growth. Strengthening its asset recovery and business process outsourcing capabilities, the company has entered into a number of acquisitions since 2015. In November 2017, it acquired Earnest, a financial technology and education-finance company serving consumers unable to get finance from traditional banks. We remain encouraged as the company is focused on growth opportunities to boost overall business.

- Shares of Navient have underperformed the industry over the past six months. The company's current-year earnings estimates have been unchanged over the past 30 days. Also, the stock seems undervalued as its price-to-book (P/B) and price-to-earnings (P/E) (F1) ratios are below the respective industry averages. Additionally, it has a Value Score of A. Therefore, given the progress on fundamentals, the stock has limited upside potential.

Last Earnings Report

Navient Q2 Earnings Beat Estimates as Provisions Fall

Quarter Ending	06/2020
Report Date	Jul 21, 2020
Sales Surprise	15.64%
EPS Surprise	91.67%
Quarterly EPS	0.92
Annual EPS (TTM)	2.72

Navient reported second-quarter 2020 core earnings per share of 92 cents that surpassed the Zacks Consensus Estimate of 48 cents. Also, the bottom line was above the year-ago quarter figure of 74 cents.

Core earnings excluded the impacts of certain other one-time items, including mark-to-market gains/losses on derivatives along with goodwill and acquired intangible asset amortization, and impairment.

Second-quarter results of Navient were supported by a rise in net interest income. Also, a fall in expenses and provisions were tailwinds. However, private education loans declined. Moreover, year-over-year decline in fee income was an undermining factor.

GAAP net income for the quarter was $125 million or 64 cents per share compared with $153 million or 64 cents per share in the year-ago quarter.

Net interest income Increase, Provisions Fall (on Core Earnings Basis)

Net interest income (NII) increased 11.1% year over year to $329 million.

Non-interest income declined 32.6% year over year to $163 million. The fall was mainly attributed to lower asset recovery and business processing along with servicing revenues.

Provision for loan losses fell 35.3% year over year to $44 million.

Total expenses declined 11.6% from the year-ago quarter to $214 million. Lower operating expenses mainly led to the fall.

Segment Performance

Federal Education Loans: The segment generated core earnings of $87 million, up 11.5% year over year. Higher revenues along with a fall in expenses posed as tailwinds.

As of Jun 30, 2020, the company’s FFELP loans were $60.9 billion, down 2.5% sequentially.

Consumer Lending: The segment reported core earnings of $54 million, up 2.4% year over year. Lower provisions and rise in revenues were the positives. Net interest margin was 3.2%, down 2 basis points.

Private education loan delinquencies of 30 days or more of $426 million were down $644 million from the prior-year quarter.

As of Jun 30, 2020, the company’s private education loans totaled $21.5 billion, down 3.9% from the prior quarter. Also, Navient originated $238 million of private education refinance loans in the quarter.

Business Processing: The segment reported core earnings of $6 million compared with $7 million in the year-ago quarter. Higher expenses and a fall in revenues led to the decline.

Source of Funding and Liquidity

In order to meet liquidity needs, Navient expects to utilize various sources, including cash and investment portfolio, issuance of additional unsecured debt, repayment of principal on unencumbered student-loan assets, and distributions from securitization trusts (including servicing fees). It might also issue term asset-backed securities (“ABS”).

During the reported quarter, Navient issued $1.3 billion in term ABS. Notably, it had $1.6 billion of cash as of Jun 30, 2020.

Capital-Deployment Activities

In the second quarter, the company paid out $31 million in common stock dividends. As of Jun 30, 2020, it had $665 million of remaining share-repurchase authority.

Recent News

Navient's Ratings Affirmed by Moody's, Outlook Negative - Jun 26, 2020

Navient Corporation's unsecured debt ratings and Corporate Family Rating have been affirmed by Moody's Investors Service as Ba3. Notably, the outlook has been changed to negative from stable.

Reasons Behind Downgrade of Outlook

The key reason behind the outlook downgrade is that Navient has declined to sign a new contract with the U.S. Department of Education ("DOE") to service federal direct student loans on account of "unfavorable economics". In Moody's opinion, the loss of the DOE contract might put downward pressure on the company's standalone assessment over the next 12-18 months.

Further, Moody's considers Navient to be exposed to high social risk in comparison to its peers. Also, the negative outlook is reflective of Moody's assessment that the U.S. economy will contract in 2020 due to the coronavirus crisis, which will have an unfavorable impact on the company's asset quality and profitability.

Ratings Rationale

Per Moody's, Navient's standalone assessment remains unchanged, after considering that the revenues foregone from the DOE contract are only a modest contributor to the bottom line, at present.

The company's Ba3 long-term ratings are reflective of its predictable, but declining earnings and the strong asset quality of the $84.8-billion legacy student loan portfolio. It also takes into account the likelihood that the company will take efforts to counter the decline in net income by growing newly-acquired origination business and continuing to modestly grow business services businesses.

Navient reported net income of $597 million in 2019 and unsecured debt outstanding as of Mar 31, 2020 totaled $9.5 billion compared with total assets of $93.2 billion. Thus, Moody's believes the company will repay unsecured debt largely from the equity investment in its loan portfolio. Therefore, Navient's greatest risk is considered to be a significant decline in portfolio cash flow resulting from increased loan charge-offs or a shrinking investment portfolio.

Also, Navient's exposure to several litigation issues amid the heightened regulatory scrutiny over alleged anti-consumer practices in the U.S. student loan industry is a concern. The Consumer Financial Protection Board and several state attorneys general have filed civil suits alleging that the bank violated Federal consumer financial laws in servicing federal and private student loans. Per Moody's, legal costs are expected to be manageable, but costs that materially increase the company's leverage could lead to a rating downgrade.

The ratings agency believes that a large servicing transfer of student loans will be a social risk under its ESG framework, given the increase in regulatory risks. Further, Moody's regards the coronavirus pandemic as a social risk under its ESG framework, given the substantial implications for public health and safety. Affirmation of Navient's ratings reflects the impact of the increased regulatory risks of a servicing transfer, along with the breadth and severity of the economic shock from the pandemic, and the deterioration in credit quality and profitability it has triggered.

What Can Trigger a Change in Moody's Ratings?

Though ratings upgrades are less likely in a year's time due to the negative outlook, rating for Navient can return to stable in case Moody's feels that any potential unfavorable impact from the current economic environment, as well as the loss of the direct loan servicing contract on the company's financial profile, particularly capital and profitability, were modest or effectively countered.

At the same time, ratings can go down if Navient's financial performance deteriorates or the value of its investment portfolio declines, for example, from rising delinquencies and defaults on the private student loan portfolio or a large increase in prepayment speeds on the Federal Family Education Loan Program (FFELP) portfolio.

Dividend Update

On May 21, Navient declared second-quarter 2020 common stock dividend of 16 cents per share. The dividend was paid on Jun 19 to shareholders on record as of Jun 5.

Valuation

Navient's shares are down 44.5% in the year-to-date period and 44.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 34.1% and 17.9% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 34.1% and 13.2%, respectively.

The S&P 500 Index is up 1.3% in the year-to-date period and 9% in the past year.

The stock is currently trading at 3.62X forward 12 months earnings, which compares to 11.6X for the Zacks sub-industry, 16.51X for the Zacks sector and 23.01X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 9.17X and as low as 1.6X, with a 5-year median of 6.58X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our $6 price target reflects 3.08X forward earnings.

The table below shows summary valuation data for NAVI

Valuation Multiples - NAVI

		Stock	Sub-Industry	Sector	S&P 500
	Current	3.62	11.6	16.51	23.01

	Current	[illegible]	[illegible]	[illegible]	[illegible]
P/E F12M	5-Year High	9.17	13.16	16.51	23.01
	5-Year Low	1.6	4.39	11.59	15.25
	5-Year Median	6.58	8.77	14.16	17.52
	Current	1.17	0.8	3.35	12.87
P/TB TTM	5-Year High	1.84	1.55	4	12.87
	5-Year Low	0.43	0.48	2.01	5.96
	5-Year Median	1.28	1.19	3.48	9.51
	Current	1.38	1	6.04	3.61
P/S F12M	5-Year High	3.73	1.97	6.66	3.61
	5-Year Low	0.88	0.72	4.96	2.53
	5-Year Median	2.77	1.49	6.06	3.02

As of 07/21/2020

Industry Analysis Zacks Industry Rank: Bottom 33% (168 out of 252)

Top Peers

Company (Ticker)	Rec	Rank
Ally Financial Inc. **(ALLY)**	Neutral	3
Citizens Financial Group, Inc. **(CFG)**	Neutral	3
MR. COOPER GROUP INC **(COOP)**	Neutral	2
Discover Financial Services **(DFS)**	Neutral	3
First Cash, Inc. **(FCFS)**	Neutral	3
PROVIDENT FIN **(FPLPY)**	Neutral	4
Santander Consumer USA Holdings Inc. **(SC)**	Neutral	3
SLM Corporation **(SLM)**	Underperform	5

Industry Comparison Industry: Financial - Consumer Loans

	NAVI	X Industry	S&P 500	ALLY	DFS	SC
				Industry Peers		
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	5	-	-	3	3	3
VGM Score	A	-	-	D	D	B
Market Cap	1.47 B	597.86 M	22.70 B	7.96 B	15.01 B	5.82 B
# of Analysts	3	2	14	6	8	6
Dividend Yield	8.43%	0.00%	1.81%	3.56%	3.59%	4.86%
Value Score	A	-	-	A	B	A
Cash/Price	2.71	0.69	0.06	0.78	0.75	0.43
EV/EBITDA	99.62	6.35	13.09	6.29	6.36	9.46
PEG Ratio	1.21	2.94	3.03	NA	5.76	NA
Price/Book (P/B)	0.72	1.01	3.12	0.59	1.65	1.13
Price/Cash Flow (P/CF)	2.64	3.13	12.23	2.68	5.17	2.11
P/E (F1)	3.62	11.26	22.36	33.68	40.30	231.19
Price/Sales (P/S)	0.32	0.83	2.42	1.27	1.07	0.73
Earnings Yield	28.85%	8.77%	4.31%	2.95%	2.49%	0.44%
Debt/Equity	39.70	2.30	0.75	2.30	2.87	7.82
Cash Flow ($/share)	2.88	4.49	6.94	7.96	9.48	8.57
Growth Score	B	-	-	F	D	D
Hist. EPS Growth (3-5 yrs)	6.79%	10.98%	10.82%	12.24%	12.65%	1.28%
Proj. EPS Growth (F1/F0)	-17.17%	-27.72%	-9.08%	-82.98%	-86.60%	-97.26%
Curr. Cash Flow Growth	12.54%	14.13%	5.51%	-1.59%	7.14%	20.07%
Hist. Cash Flow Growth (3-5 yrs)	-5.09%	9.07%	8.55%	-4.75%	4.70%	25.86%
Current Ratio	10.48	3.42	1.31	0.99	1.26	63.41
Debt/Capital	97.54%	68.95%	44.41%	69.68%	72.97%	88.66%
Net Margin	7.38%	8.25%	10.54%	10.87%	15.39%	9.32%
Return on Equity	19.67%	13.91%	15.38%	5.82%	20.38%	10.95%
Sales/Assets	0.05	0.24	0.54	0.03	0.13	0.17
Proj. Sales Growth (F1/F0)	-5.28%	-0.19%	-2.40%	-5.73%	-5.14%	0.34%
Momentum Score	C	-	-	F	F	B
Daily Price Chg	7.58%	1.06%	0.86%	0.42%	3.20%	2.43%
1 Week Price Chg	3.46%	0.28%	3.82%	5.82%	1.26%	1.65%
4 Week Price Chg	-0.07%	-1.74%	3.42%	9.95%	-10.66%	-4.18%
12 Week Price Chg	1.54%	13.16%	9.22%	31.50%	22.34%	23.36%
52 Week Price Chg	-44.56%	-31.07%	-3.38%	-36.73%	-41.99%	-29.59%
20 Day Average Volume	4,253,351	285,488	2,069,527	6,265,056	3,914,040	905,989
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-18.63%	-28.03%	9.30%
(F1) EPS Est 4 week change	0.00%	0.00%	0.13%	-19.42%	-27.91%	487.50%
(F1) EPS Est 12 week change	-18.33%	-30.42%	-3.85%	-15.84%	-81.71%	-96.72%
(Q1) EPS Est Mthly Chg	-1.92%	0.00%	0.00%	-28.71%	-17.17%	4.44%

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	B
Momentum Score	C
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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