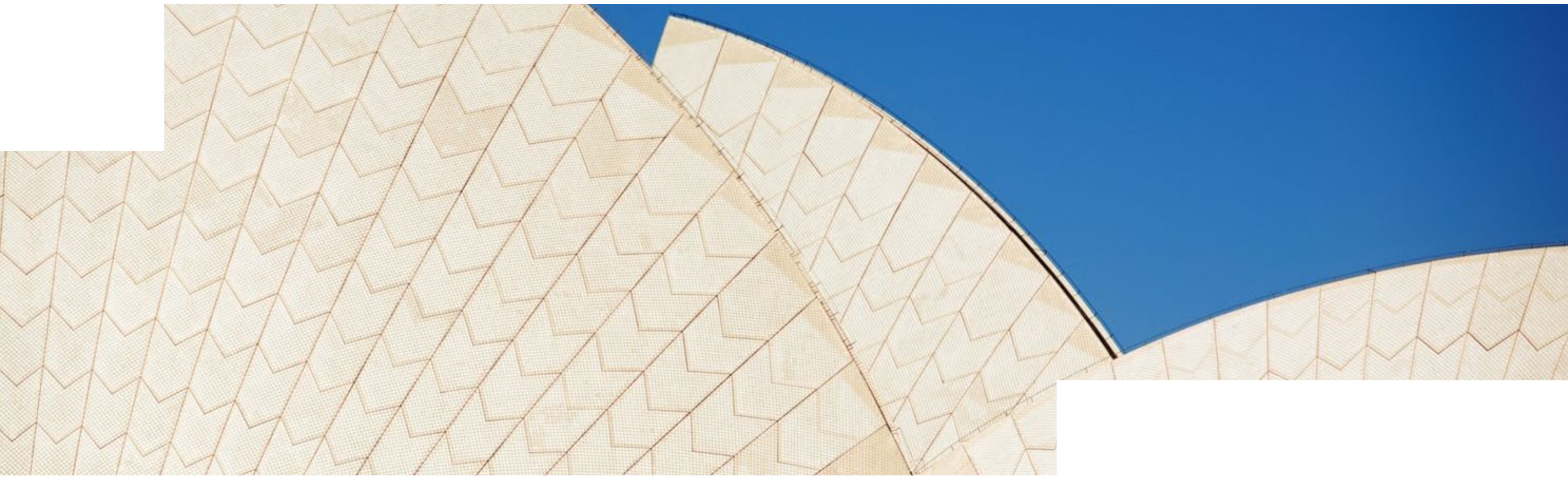
FRB Philadelphia Panel

September 2020

Equity Research | Americas/United States



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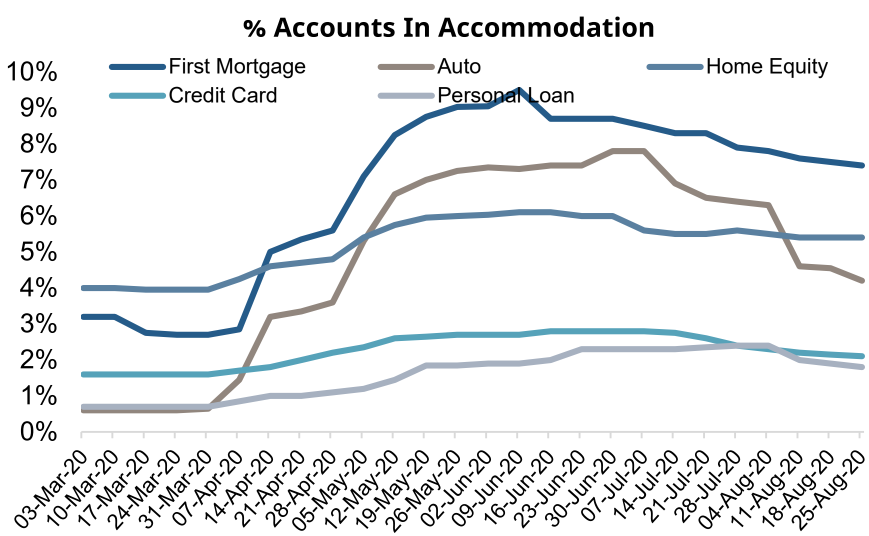
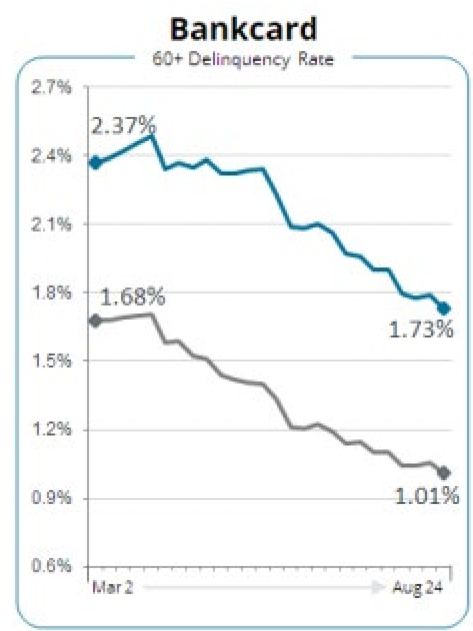
Credit Cards Outlook

2020 Outlook

- **Loan growth:** Balance growth will continue to remain pressured in the short term, but should recover somewhat in 2H as the economy reopens. Issuers with bigger exposure to T&E will see slower recovery
- **Credit quality:** Credit quality so far has been relatively unscathed due to the benefits from the stimulus. Consumers being conservative and responsible in paying down debt (payment rate is still strong) is also a contributor. As forbearance programs and stimulus come to an end, we will see the true impact of the pandemic on credit
- **Competition:** Though new accounts will be significantly down in 2020, we haven't seen rewards competition easing off among existing card offers. In fact, issuers have been quick to roll out new relevant concessions and benefits to incentivize cardholders to spend or at least not cancel their cards in this environment
- **Rewards:** Because of the pandemic, consumers' preference could shift towards cash back rewards going forward – likely increasing rewards costs



Source: Equifax



Source: Equifax

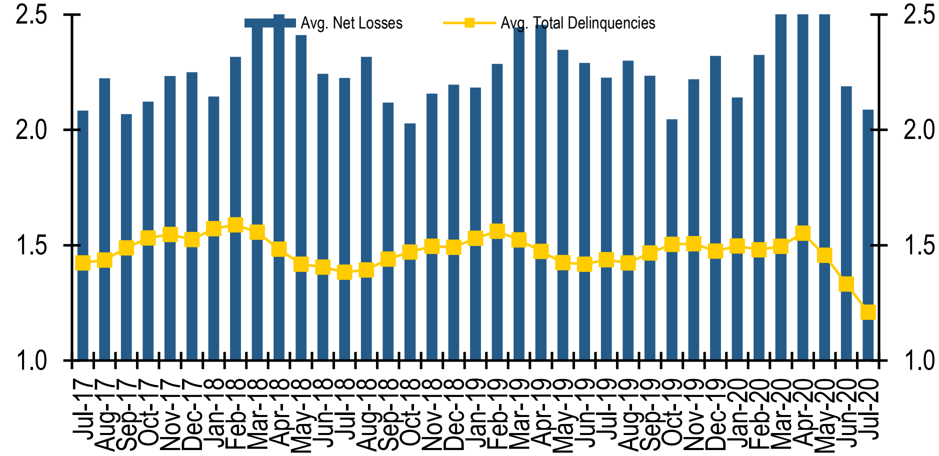
Credit Cards

2020 Credit Has Been Helped By Stimulus & Forbearance

It remains uncertain if such measures will be renewed

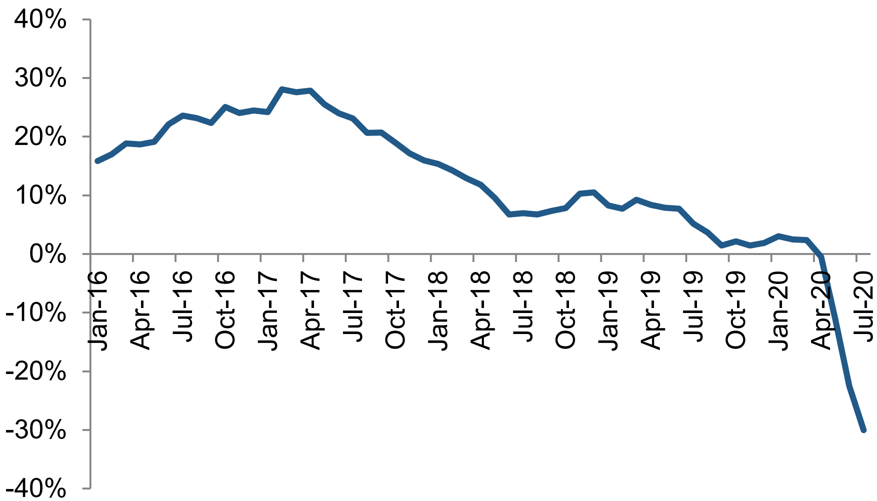
- This will likely depend on the progress of economic reopening and unemployment going forward
- Accommodation is now declining across most products – we attribute this to consumers being responsible in this environment and thus paying down debt

Credit Card Trust Net Losses (%) and Delinquencies (%)



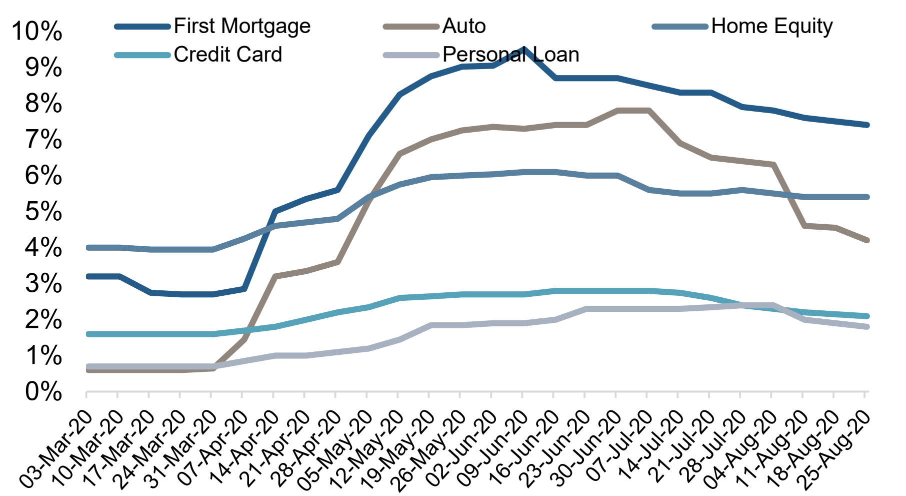
Source: Company Data, Credit Suisse estimates

Credit Card Y/Y Dollar Delinquencies Growth



Source: Based on sum of dollar delinquencies of AXP's U.S. Cardmember loans, DFS's credit card loans, COF's domestic card loans, SYF's total loans and ADS' total loans

% Accounts In Accommodation



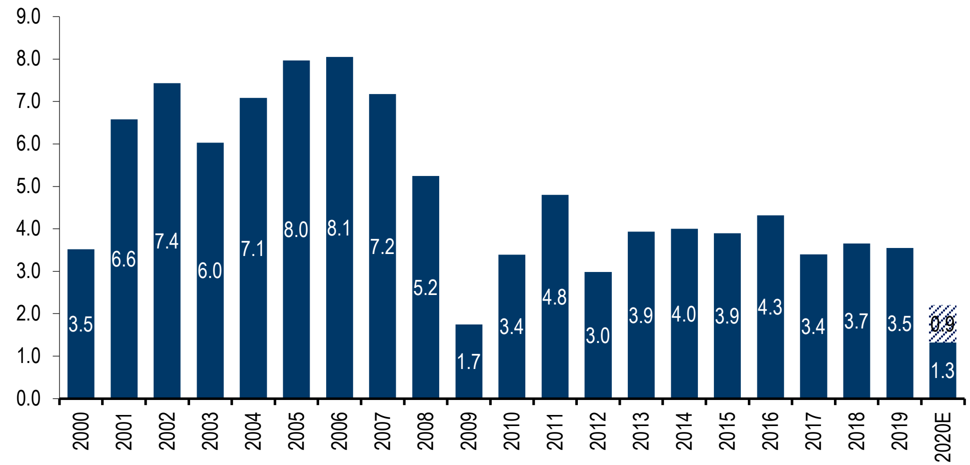
Source: Equifax

Credit Card Competition
Marketing

2020 mail volume likely down 40% y/y

- Issuers have now pulled back significantly on marketing, particularly direct mail, though volume has recovered somewhat from the bottom. With mail down 70%
- Our 2020 forecast is down 40% y/y

Credit Card Mail Volume, 2000-2020E (in billions)



Source: Mintel Comperemedia, Credit Suisse estimates

in millions

	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Y/Y	M/M
Citibank	26	36	33	29	47	41	45	42	36	34	1	0	0	-99%	38%
Capital One	59	68	52	53	61	41	45	37	52	28	4	0	5	-92%	1799%
Chase	17	10	15	23	24	12	34	31	27	18	5	1	5	-71%	366%
American Express (1)	22	24	13	13	14	29	28	23	27	2	0	1	24	7%	4382%
Discover	50	54	47	45	38	35	41	40	44	30	16	11	16	-68%	43%
Bank of America	19	29	22	25	26	20	18	22	22	29	4	9	7	-64%	-22%
Barclays	1	2	1	2	2	2	1	2	0	0	0	0	1	-39%	#DIV/0!
Credit One Bank	15	15	13	16	15	12	12	12	10	6	2	1	2	-89%	21%
US Bank	8	5	9	5	5	2	7	3	6	2	0	0	2	-78%	2097%
Wells Fargo	19	24	18	19	17	16	14	13	13	16	14	14	4	-77%	-68%
Top 10 Mailers	**236**	**265**	**223**	**229**	**248**	**209**	**246**	**226**	**238**	**164**	**48**	**38**	**65**	**-72%**	**74%**
Credit Card	**297**	**339**	**285**	**316**	**317**	**257**	**305**	**290**	**297**	**212**	**70**	**57**	**96**	**-68%**	**69%**
Charge Card	3	3	4	0	1	11	7	5	4	1	0	0	3	-1%	#DIV/0!
Total Mailings	**300**	**341**	**289**	**317**	**318**	**268**	**313**	**295**	**302**	**213**	**70**	**57**	**99**	**-67%**	**74%**

Source: Mintel Comperemedia, Credit Suisse estimates.

(1) Includes charge card

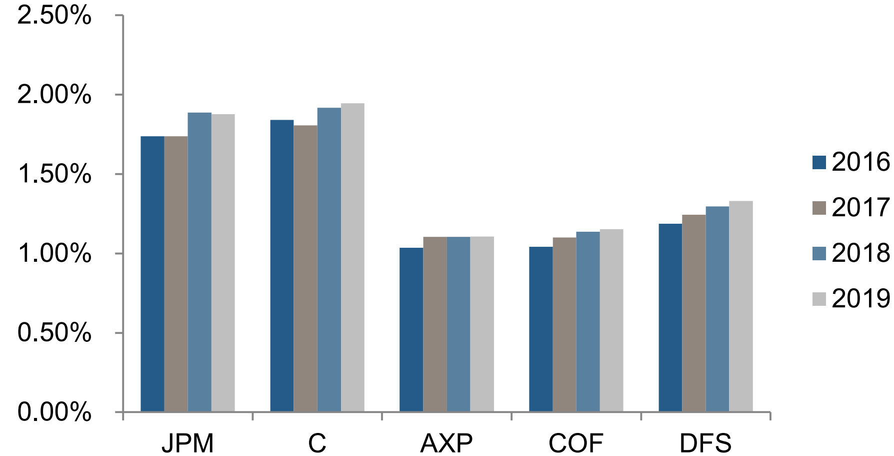
Card Rewards Continue To Be Competitive

Marketing

Are We Still In A War?

- Front-end rewards now average ~50,000 points, with up to 100,000 points offers periodically. 150,000 point offers have been seen
- Large banks have been "investing" in this business: Slowing spend could spur another wave
- Card industry competition has been lately focused on spenders, i.e. AMEX's core segment, thus driving a rewards price war
- New rewards are 1.5%-2% cash, or aggressive co-brand promotions. It could be tough for AXP to continue to manage rewards costs
- There has been some tick up in rewards pressure from new product launches, as well as benefit refreshes for existing products (e.g. Amex Gold and Green). That being said, AXP has done a good job in managing rewards expense for its own branded card portfolio
- Issuers have been quick to add new relevant benefits to their cards in this environment
- Not a lot of big contracts are up now, mostly smaller to mid-sized. SYF's Gap contract could be up for renewal this year

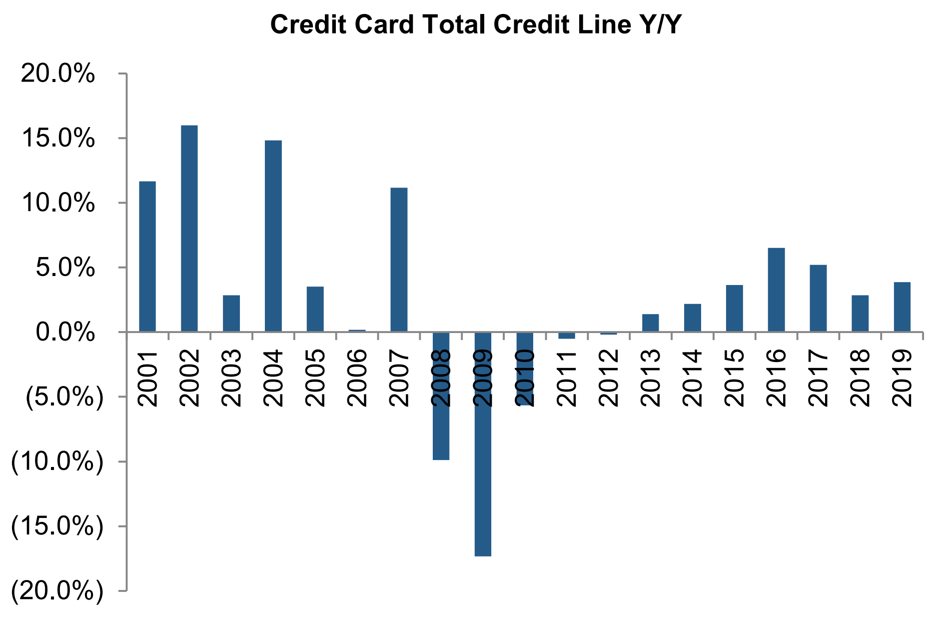
Rewards Costs as a Percentage of Purchase Volume



Source: Company data, Credit Suisse estimates. Purchase volume numbers used in our calculations are adjusted to reflect the spend that we believe accrues rewards. AXP purchase volume excludes GNS and large corporate. JPM and C rewards costs include partner payment

Credit Card Line & Utilization

- Utilization rate is now substantially down due to the pandemic
- Card credit supply has increased over the past couple of years, 2Q20 total line is only down ~1% from 4Q19, while unused line is actually up ~1.5% from 4Q19
- Some issuers are managing line more actively than others (e.g. SYF and COF are being active). Actions include credit line reduction, closure of inactive accounts



Source: FDIC

Regulatory Response

- Federal Reserve has halted share repurchase and restricted dividend payment – these measures will likely remain in place in the short term
- The Fed has also become more cautious in terms of stress test, running alternative scenarios on top of typical severely adverse scenarios while requiring banks to resubmit their capital plans later this year
- Earlier in the pandemic, multiple regulators issued an interagency statement urging banks to work “prudently” with borrowers who are unable to meet obligations. Under current circumstances, covid-related loan modifications need not be reported as TDR. Current loans with covid deferral are not considered past due
- CARES Act also makes it easier for banks to suspend reporting loans as TDRs, for accounts impacted by the pandemic
- FDIC also indicated that it will work with affected institutions to reduce examination burdens
- Banks/Issuers have offered deferrals month to month to remain “flexible”; strong consumer performance has allowed this to be effective

Outlook

How will issuers act if economic challenges continue to persist?

Has CECL worsened the credit impact of this downturn?

How will forbearance perform without a renewal of stimulus?

Disclosures

Valuation, Methodology and Risks

Target Price and Rating
Valuation Methodology and Risks: (12 months) for American Express Co. (AXP.N)

Method: Our $80 target price and Underperform rating for American Express Co. are based on ~14x our 2021 EPS estimate. We rate AXP Underperform as we expect its total return will be lower than the typical stock in our coverage.

Risk: Risks to our Underperform rating and $80 target price for American Express Co. are that competition will pressure revenues at American Express and credit costs will rise.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for Bank of America Corp. (BAC.N)

Method: We arrive at our $31 target price for BAC using a weighted average of our blue sky scenario (5% weight; $47 valuation derived via the discounting of the incremental earnings as if they will be dividended out over time), downside scenario (40% weight; $18 valuation applying 0.9x to our downside scenario 2020E tangible book value), and base case discounted cash flow analysis (55% weight; $39 valuation applying 10% cost of capital and 3% terminal growth rate). Valuation and total return potential drive our Outperform rating.

Risk: Risks to our $31 target price and Outperform rating for BAC are the macro environment, a changed regulatory landscape, and management succession.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for Barclays (BARC.L)

Method: We value Barclays on a sum of the parts (SOTP) basis, which reflects the different return and growth profiles of the company's business areas. We calculate P/E or P/TBV multiples assuming different sustainable ROTE levels for the different businesses and different cost of equity (COE) and growth. We are using 2021E as our valuation year. Our sustainable ROTE assumption is 6.4% (at 13.5% CET1) and we use a 12.0% CoE. We assign a 1.0x multiple to surplus capital relative to target, incorporating any distributions beyond 2020, and reach a 12-month forward TP of 125p. Given the limited upside potential to our target price and in the context of up/downside potential relative to other UK banks, we rate the shares Neutral.

Risk: Risks to our Neutral rating and 125p target price include: (i) management's execution on its strategy to deliver operational leverage in the Corporate & Investment Bank; (ii) volatility could affect capital markets volumes and hence IB revenues; (iii) changes to the UK macro outlook post the UK's departure from the EU, including changes to interest rates; (iv) political uncertainty as the deadline for EU trade negotiation of 31 December 2020 draws closer; and (v) changes in the GBPUSD exchange rate given c60% of Barclays profits are in USD.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for Capital One Financial Corp. (COF.N)

Method: Our $72 target price for COF is 7x our 2021 EPS estimate. We rate COF Outperform as we expect its total return will be higher than the typical stock in our coverage.

Risk: Risks to COF's Outperform rating and $72 target price are deterioration in credit losses and larger reserve builds beyond expectations, a full-fledged economic recession, either in the US or the UK, and the current economic and regulatory environment.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for Citigroup Inc. (C.N)

Method: We arrive at our $75 target price for C using a weighted average of our blue sky scenario (5% weight; $123 valuation derived via the discounting of the incremental earnings as if they will be dividended out over time), grey sky scenario (40% weight; $38 valuation applying 0.5x to our downside scenario 2020E tangible book value), and base case discounted cash flow analysis (55% weight; $98 valuation applying 10.0% cost of capital and 2.5% terminal growth rate). Valuation and total return potential drive our Outperform rating.

Risk: Primary risks to our $75 target price and Outperform rating include global economic growth, realization of operating leverage, and competitive positioning in the GCB.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for Discover Financial Services (DFS.N)

Method: Our Outperform rating and our $65 target price for Discover Financial Services are ~9x our 2021 EPS estimate. Discover's forward P/E has ranged from 8x to 12x since 2013. We rate Discover Outperform as we expect its total return to exceed its peers.

Risk: Risks to our Outperform rating and $65 target price for DFS are the execution into other consumer lending products, the competitive nature of the major card networks, Discover's smaller size, and lower penetration among merchants and cardmembers. The lower merchant discount rate mitigates risks related to industry pricing pressures.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for JPMorgan Chase & Co. (JPM.N)

Method: We arrive at our $122 target price for JPM using a weighted average of our blue sky scenario (5% weight; $172 valuation derived via the discounting of the incremental earnings as if they will be dividended out over time), downside scenario (40% weight; $83 valuation applying 1.3x to our downside scenario 2020E tangible book), and base case discounted cash flow analysis (55% weight; $147 target price applying 10% cost of capital and 3% terminal growth rate). Valuation and total return potential drive our Outperform rating. Beyond valuation and implied total return, additional qualitative factors supporting confidence in the assumptions underlying our valuation and Outperform rating include balance sheet optimization progress and prospects, above-average organic revenue growth, operating leverage, and above-average returns.

Risk: Risks to our $122 target price and Outperform rating for JPM are macro environment, a changed regulatory landscape and management succession.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for Synchrony Financial (SYF.N)

Method: Our Outperform rating, which helps drive our $32 target price for Synchrony Financial, is ~9x our 2021 EPS estimate. This multiple is a discount to peers given the regulatory risk and credit risk. We rate Synchrony Financial Outperform as we expect its total return to exceed that of the average stock we cover.

Risk: Risks to our Outperform rating and $32 target price for Synchrony Financial are (1) the loss of retail partnerships and portfolios, (2) decreased spending by consumers, (3) regulatory risk, and (4) credit losses higher than expected.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for U.S. Bancorp (USB.N)

Method: We arrive at our $41 target price for USB using a weighted average of our blue sky scenario (5% weight; $54 valuation derived via the discounting of the incremental earnings as if they will be dividended out over time), downside scenario (40% weight; $28 valuation applying 1.2x to our downside scenario 2020E tangible book value), and base case discounted cash flow analysis (55% weight; $48 valuation applying 9% cost of capital and 3% terminal growth rate). Valuation and total return potential drive our Underperform rating. Whether USB can improve its revenue growth prospects and sustain its performance premium (and valuation) relative to peers is the ongoing challenge.

Risk: Primary risks to our $41 target price and Underperform rating include macro risks, heightened competition and sufficient investment spending to sustain organic growth.

Target Price and Rating
Valuation Methodology and Risks: (12 months) for Wells Fargo & Company (WFC.N)

Method: We arrive at our $33 target price for WFC using a a weighted average of our blue sky scenario (5% weight; $45 valuation derived via the discounting of the incremental earnings as if they will be dividended out over time), downside scenario (40% weight; $19 valuation applying 0.6x to our downside scenario 2020E tangible book value), and base case discounted cash flow analysis (55% weight; $42 valuation applying 10.5% cost of capital and 3% terminal growth rate). Valuation and total return potential drive our Neutral rating. Beyond valuation and implied total return, additional qualitative factors supporting confidence in the assumptions underlying our valuation and Neutral rating include the consistency and quality of Wells Fargo's earnings growth and returns.

Risk: Primary risks to our $33 target price and Neutral rating for WFC include macroeconomic risk, regulatory pressure/heightened oversight, litigation and related costs.

Companies Mentioned *(Price as of 14-Sep-2020)*

Alliance Data (ADS.N, $46.33)
American Express Co. (AXP.N, $107.27)
Bank of America Corp. (BAC.N, $25.75)
Barclays (BARC.L, 103.62p)
Capital One Financial Corp. (COF.N, $74.64)
Citigroup Inc. (C.N, $48.15)
Discover Financial Services (DFS.N, $57.99)
JPMorgan Chase & Co. (JPM.N, $102.47)
Synchrony Financial (SYF.N, $26.96)
U.S. Bancorp (USB.N, $37.87)
Wells Fargo & Company (WFC.N, $24.81)

Disclosure Appendix

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