

## Equity Research

February 2, 2016

### Mark Palmer

(212) 588-6582  
mpalmer@btig.com

### Giuliano Bologna

(212) 588-6583  
gbologna@btig.com

## ALLY

12 month target

**\$16.09**

\$32.00

## BUY

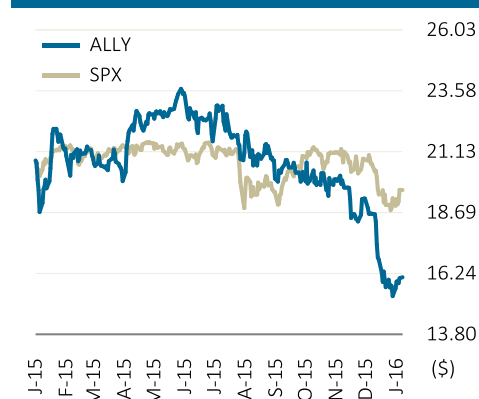
52 week range

\$15.33 - \$23.66

Market Cap (m)

\$7,764

### Price Performance



Source: IDC

## Financials

### Ally Financial, Inc.

#### 4Q15 Earnings Beat Overshadowed by Management's Pushback Against Credit Fears and Effort to Force Sale

In the face of investor frustration with its sagging stock price, an activist challenge from a hedge fund and qualms about its continued aggressive approach to loan and lease originations at what is perceived to be a late stage in the credit cycle, Ally Financial (ALLY, Buy, \$32 PT) CEO Jeff Brown this morning defended his company's strategy, addressed fears that an auto-lending bubble is forming and dismissed the idea that a sale of the firm would represent the best means of maximizing shareholder value.

- ▶ Almost lost in the shuffle today was the 4Q15 earnings beat ALLY posted: adjusted earnings per diluted share of \$0.52 beat the consensus estimate of \$0.51 and our estimate of \$0.50. The beat was aided by a solid loan origination print of \$9.3bn, up from \$9.0bn in the prior-year period. And, at a time when concerns about credit are at an elevated level, ALLY's metrics were benign, including a net charge-off ratio of 0.72% and a loan loss provision of \$240mm that was not indicative of significant deterioration.
- ▶ Moreover, ALLY guided to adjusted EPS growth of 15% in 2016 and reiterated its expectation that it will initiate a common dividend and a share repurchase program later this year.
- ▶ **We are reiterating our Buy recommendation on ALLY and price target of \$32** based on 1.1x FY16E tangible book value per share of \$28.88. We agree with Brown's suggestion during the company's 4Q15 conference call that technical factors likely have contributed to the underperformance of ALLY shares. We believe that with the stock trading at just 0.69x its tangible book value as of YE15, it is pricing in wholesale credit deterioration when the company's credit metrics tell a different story.
- ▶ **Valuation:** Our \$32 price target is based on 1.1X FY16E tangible book value of \$28.88.

## Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 E	2Q16 E	3Q16 E	4Q16 E	FY16 E	FY17 E
Diluted EPS (Adj.)	0.52	0.46	0.51	0.52	2.01	0.58	0.53	0.61	0.58	2.30	2.49
Tangible BVPS	25.55	25.47	26.06	26.28	26.28	26.72	27.15	28.02	28.88	28.88	31.06

Source: BTIG Research Estimates and Company Documents (\$ in millions, except per share amount)

*Please Read: Important disclosures and analyst's certification appear in Appendix*

- ▶ Management adopted a more aggressive tone in addressing concerns about their approach during the company's first quarterly conference call since disclosing that it had been targeted by an activist hedge fund, which management said was pushing for a sale of the firm. Brown emphasized that ALLY had maintained its "strong risk discipline," a response to concerns that the company had been over-aggressively pursuing higher volumes from non-General Motors (GM, Not Rated) business to diversify away from the automaker given the potential for it to move more of its business to its captive finance arm, GM Financial.
- ▶ ALLY CFO Chris Halmy joined in the defense of the company's approach and the increase in its percentage of loan originations from the subprime category to 14% in 4Q15 from about 10% at the beginning of the year, in particular pointing out that the company's loss rate in the category was just 3% and that it recorded just \$75mm in subprime charge-offs during 4Q15.
- ▶ As we have stated, the fact that ALLY is in the midst of a transition in which it has been diversifying its loan originations away from GM and toward non-GM "growth channels" – combined with the fact that the stock is trading close to its all-time low – makes us believe that considering a sale of the company at this point would be premature. We believe ALLY shares are likely to trade significantly higher than their current valuation as the company continues to diversify away from GM and if it receives approval from the Federal Reserve to initiate a capital return program in the coming months. As such, we think the time for ALLY to consider a sale would be after the catalysts have played out and the stock is trading higher, such that a takeout at a premium would truly maximize shareholder value.

## Income Statement

Ally Financial - Operating Model	Dec-11	Dec-12	Dec-13	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Dec-16	Dec-17
\$ millions	2011A	2012A	2013A	2014A	1Q15A	2Q15A	3Q15A	4Q15A	2015A	1Q16E	2Q16E	3Q16E	4Q16E	2016E	2017E
Interest and fees on finance receivables and loans	4,189	4,539	4,529	4,457	1,074	1,118	1,166	1,212	4,570	1,228	1,244	1,256	1,268	4,996	5,222
Interest on loans held-for-sale	180	98	20	1	24	14	2	-	40	-	-	-	-	-	-
Interest on trading assets	8	10	-	-	-	-	-	-	-	-	-	-	-	-	-
Interest and dividends on available for sale investment securities	350	292	325	367	88	93	102	98	381	98	99	99	100	397	405
Interest bearing cash	15	24	10	8	2	2	2	2	8	-	-	-	-	-	-
Operating leases	1,929	2,379	3,209	3,558	896	860	830	812	3,398	804	796	788	780	3,168	3,043
<b>Total financing revenue &amp; other interest</b>	<b>6,671</b>	<b>7,342</b>	<b>8,093</b>	<b>8,391</b>	<b>2,084</b>	<b>2,087</b>	<b>2,102</b>	<b>2,124</b>	<b>8,397</b>	<b>2,131</b>	<b>2,139</b>	<b>2,143</b>	<b>2,148</b>	<b>8,560</b>	<b>8,670</b>
Interest on deposits	615	645	654	664	172	177	181	188	718	195	199	203	206	802	864
Interest on short-term borrowings	61	71	63	52	11	12	13	13	49	13	13	13	13	52	52
Interest on long-term debt	3,930	3,336	2,602	2,067	429	419	410	404	1,662	431	431	431	431	1,722	1,722
<b>Total interest expense</b>	<b>4,606</b>	<b>4,052</b>	<b>3,319</b>	<b>2,783</b>	<b>612</b>	<b>608</b>	<b>604</b>	<b>605</b>	<b>2,429</b>	<b>638</b>	<b>642</b>	<b>646</b>	<b>650</b>	<b>2,576</b>	<b>2,638</b>
Depreciation expense on operating assets	941	1,399	1,995	2,233	622	563	528	536	2,249	525	515	504	494	2,039	1,881
<b>Pre-provision net finance revenue</b>	<b>1,124</b>	<b>1,891</b>	<b>2,779</b>	<b>3,375</b>	<b>850</b>	<b>916</b>	<b>970</b>	<b>983</b>	<b>3,719</b>	<b>967</b>	<b>982</b>	<b>992</b>	<b>1,004</b>	<b>3,945</b>	<b>4,151</b>
Provision for loan losses	161	329	501	457	116	140	211	240	707	198	201	203	239	841	879
<b>Post-provision net finance revenue</b>	<b>963</b>	<b>1,562</b>	<b>2,278</b>	<b>2,918</b>	<b>734</b>	<b>776</b>	<b>759</b>	<b>743</b>	<b>3,012</b>	<b>769</b>	<b>781</b>	<b>790</b>	<b>765</b>	<b>3,104</b>	<b>3,272</b>
Servicing fees	525	409	126	31	10	10	12	13	45	-	-	-	-	-	-
Servicing asset valuation and hedge activities	(434)	(4)	(213)	-	-	-	-	-	-	-	-	-	-	-	-
<b>Total servicing income (loss)</b>	<b>91</b>	<b>405</b>	<b>(87)</b>	<b>31</b>	<b>10</b>	<b>10</b>	<b>12</b>	<b>13</b>	<b>45</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Insurance premiums and service revenue earned	1,153	1,055	1,012	979	233	237	236	234	940	234	238	237	235	945	954
Gain on mortgage and automotive loan	229	379	55	7	46	1	(2)	-	45	-	-	-	-	-	-
Loss on extinguishment of debt	(64)	(148)	(59)	(202)	(198)	(156)	-	(3)	(357)	-	-	-	-	-	-
Other gain on investments	258	146	180	181	55	45	6	49	155	45	45	45	45	180	180
Other income (losses)	621	737	383	280	97	74	80	63	250	63	63	63	63	253	255
<b>Total other revenue</b>	<b>2,288</b>	<b>2,574</b>	<b>1,484</b>	<b>1,276</b>	<b>243</b>	<b>211</b>	<b>332</b>	<b>356</b>	<b>1,078</b>	<b>342</b>	<b>346</b>	<b>345</b>	<b>343</b>	<b>1,377</b>	<b>1,389</b>
Compensation and benefits expense	993	1,106	1,019	947	255	236	235	237	963	242	247	252	254	994	1,023
Insurance losses and loss adjustment expense	452	454	405	410	56	122	61	54	293	55	120	60	53	287	281
Other operating expenses	1,983	2,062	1,981	1,591	384	366	378	377	1,505	386	368	380	379	1,513	1,528
<b>Total noninterest expense</b>	<b>3,428</b>	<b>3,622</b>	<b>3,405</b>	<b>2,948</b>	<b>695</b>	<b>724</b>	<b>674</b>	<b>668</b>	<b>2,761</b>	<b>683</b>	<b>734</b>	<b>691</b>	<b>686</b>	<b>2,794</b>	<b>2,832</b>
<b>Income (loss) from continuing operations before taxes</b>	<b>(177)</b>	<b>514</b>	<b>357</b>	<b>1,246</b>	<b>282</b>	<b>263</b>	<b>417</b>	<b>431</b>	<b>1,329</b>	<b>428</b>	<b>393</b>	<b>444</b>	<b>422</b>	<b>1,688</b>	<b>1,829</b>
Income tax expense (benefit)	42	(856)	(59)	321	103	94	144	155	496	141	130	146	139	557	603
<b>Net income (loss) from continuing operations</b>	<b>(219)</b>	<b>1,370</b>	<b>416</b>	<b>925</b>	<b>179</b>	<b>169</b>	<b>273</b>	<b>276</b>	<b>833</b>	<b>287</b>	<b>263</b>	<b>297</b>	<b>283</b>	<b>1,131</b>	<b>1,225</b>
Income (loss) from discontinued operations	62	(174)	(55)	225	397	13	(5)	(13)	392	-	-	-	-	-	-
<b>Net income (loss)</b>	<b>(157)</b>	<b>1,196</b>	<b>361</b>	<b>1,150</b>	<b>576</b>	<b>182</b>	<b>268</b>	<b>263</b>	<b>1,225</b>	<b>287</b>	<b>263</b>	<b>297</b>	<b>283</b>	<b>1,131</b>	<b>1,225</b>
<b>Adjusted EPS (diluted)</b>				<b>\$ 1.64</b>	<b>\$ 0.52</b>	<b>\$ 0.46</b>	<b>\$ 0.51</b>	<b>\$ 0.52</b>	<b>\$ 2.01</b>	<b>\$ 0.58</b>	<b>\$ 0.53</b>	<b>\$ 0.61</b>	<b>\$ 0.58</b>	<b>\$ 2.30</b>	<b>\$ 2.49</b>
Diluted shares outstanding (millions)				481.93	482.78	483.69	484.40	484.85	483.93	486.06	487.52	482.52	477.52	483.40	483.51
Book value per share				\$ 31.88	\$ 33.00	\$ 29.55	\$ 30.14	\$ 27.72	\$ 27.72	\$ 28.16	\$ 28.58	\$ 29.46	\$ 30.33	\$ 30.33	\$ 32.50
Tangible book value per share				\$ 24.43	\$ 25.55	\$ 25.47	\$ 26.06	\$ 26.28	\$ 26.28	\$ 26.72	\$ 27.15	\$ 28.02	\$ 28.88	\$ 28.88	\$ 31.06

Source: BTIG Research Estimates and Company Documents

## Appendix: Analyst Certification and Other Important Disclosures

### Analyst Certification

I, Mark Palmer, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

I, Giuliano Bologna, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

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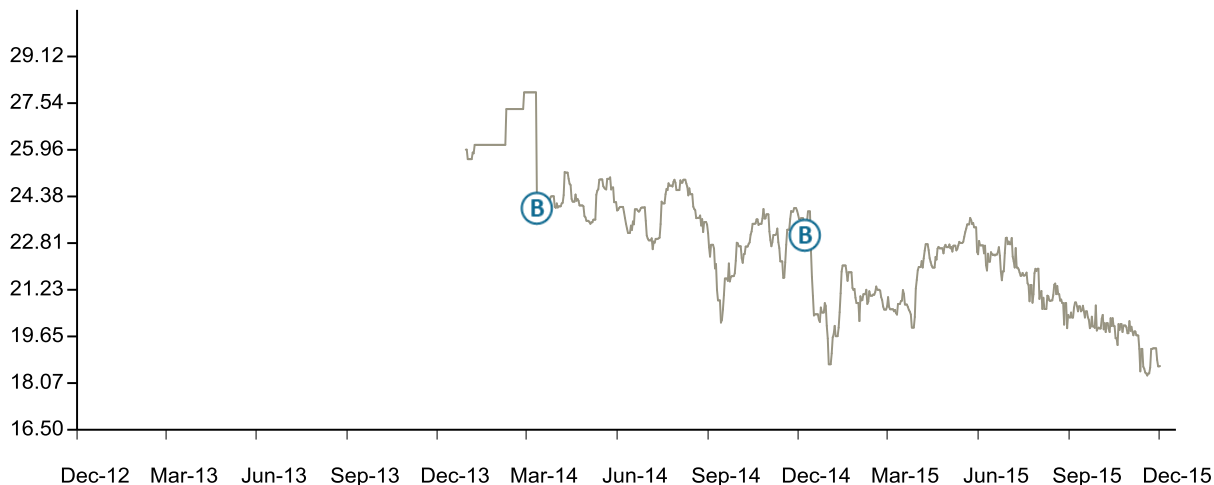
#### Ally Financial, Inc. (ALLY, Buy)

**Valuation:** Our \$32 price target is based on 1.1X FY16E tangible book value of \$28.88

**Risks:** Primary risks to our recommendation include the potential negative impact of ALLY's loss of exclusivity privileges with General Motors and Chrysler, dependence on the performance and prospects of the U.S. automotive finance market, dependence on capital and liquidity such that disruption of funding sources and access to the capital markets could negatively impact its business, dependence on ability to maintain relationships with dealers, regulatory restrictions that could impede Ally Bank's ability to grow deposits and thereby reduce the company's funding costs, and Federal Reserve stress tests that could impede the company's future ability to return capital if failed.

## Ally Financial, Inc. (ALLY)

(\$)



*Note: Closing Price and Target Price have been adjusted for corporate actions.*

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
10-Apr-14	23.98	31	Mark Palmer	Buy
06-Jan-15	23.06	32	Mark Palmer	Buy

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Additional Information Available Upon Request

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