

Equity Research

June 14, 2016

Mark Palmer

(212) 588-6582
mpalmer@btig.com

Giuliano Bologna

(212) 588-6583
gbologna@btig.com

Financials

Synchrony Financial

Reiterating Buy and \$42 PT as Credit Normalization Stokes Fears Despite "Benign" Credit Environment

While weak sales figures reported by department stores and other major retailers had caused some investors to take a cautious stance toward Synchrony Financial (SYF, Buy, \$42 PT) in recent weeks, the company's shares this morning suffered their biggest-ever single-day decline due to another factor: a "softening" in the ability of some of SYF's private label credit card (PLCC) to pay their bills.

- ▶ SYF, in conjunction with CFO Brian Doubles' appearance at an investor conference this morning, announced in a regulatory filing that management had completed their loss forecast and expected a 20-30bps increase in its net charge off rates over the next 12 months. As a consequence, SYF anticipates higher reserve builds that will be reflected in a 20-30bps increase in the company's allowance coverage ratio from the 5.50% it reported in 1Q16.
- ▶ While we appreciate investors' concerns about SYF's announcement, particularly insofar as more than a quarter of SYF's loan receivables have FICO scores of 660 or below, we also note that Doubles in his presentation noted that the company continued to see the credit environment as "benign" even as management anticipated a "softening" in consumers' ability to pay off their PLCC balances.
- ▶ **We are reiterating our Buy recommendation on SYF and price target of \$42** based on 12.5x our FY18E earnings per share of \$3.33 – a reduction of \$0.02 from our previous estimate. We are also reducing our FY16E EPS to \$2.65 (from \$2.75) and our FY17E EPS to \$3.00 (from \$3.07) based on the anticipated higher reserve builds.
- ▶ **Valuation:** Our price target of \$42 is based on 12.5X our 18E EPS estimate of \$3.33 per diluted share.

SYF

12 month target

\$30.44

\$42.00

BUY

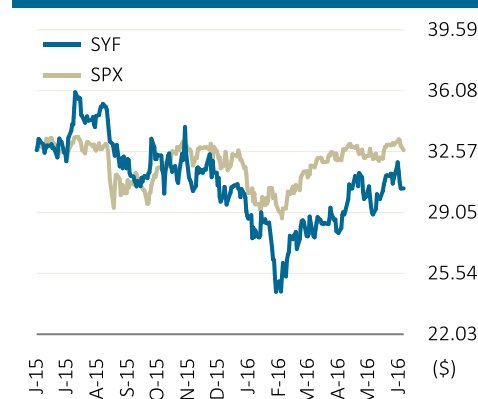
52 week range

\$24.48 - \$35.99

Market Cap (m)

\$25,433

Price Performance



Source: IDC

Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 A	2Q16 E	3Q16 E	4Q16 E	FY16 E	FY17 E
Diluted EPS (Adj.)	0.66	0.65	0.69	0.65	2.65	0.70	0.62	0.65	0.69	2.65	3.00
Operating Income	883	861	919	868	3,531	928	828	864	907	3,527	3,913

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

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

- ▶ We observe that SYF's credit metrics had been at unusually low levels prior to the announcement such that normalization should have been expected given the late stage in the credit cycle. As such, we believe the magnitude of the sell-off in SYF shares is unwarranted insofar as there is no evidence at this point that this credit normalization will evolve into something materially worse, and given that the company's underlying fundamentals remain solid.
- ▶ We also note that SYF has a likely catalyst for share price appreciation in the offing: the pending announcement of the results of the Federal Reserve's evaluation of the capital plan the company submitted in April. We believe the announcement, which is expected to occur this month, is likely to result in the initiation of share buybacks that will provide support to SYF's share price as well as the initiation of a common dividend that will attract income-focused investors.
- ▶ Insofar as SYF reported a common equity Tier 1 ratio of 18.1% as of March 31, the company has substantial capital reserves such that we doubt that the company's expected higher reserve builds would have any impact on the Fed's response to its capital plan.

Income Statement

Synchrony Financial - Operating Model	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	Dec-18
(\$ millions)	2012A	2013A	2014A	1Q15A	2Q15A	3Q15A	4Q15A	2015A	1Q16A	2Q16E	3Q16E	4Q16E	2016E	2017E	2018E
Interest and fees on loans	10,300	11,295	12,216	3,140	3,166	3,379	3,494	13,179	3,498	3,428	3,575	3,751	14,251	15,287	16,261
Interest on investment securities	9	18	26	10	11	13	15	49	22	22	22	23	89	93	97
Total interest income	10,309	11,313	12,242	3,150	3,177	3,392	3,509	13,228	3,520	3,450	3,597	3,773	14,341	15,380	16,358
Total interest expense	745	742	922	275	270	289	301	1,135	311	312	313	314	1,251	1,322	1,431
Net interest income	9,564	10,571	11,320	2,875	2,907	3,103	3,208	12,093	3,209	3,138	3,284	3,459	13,090	14,058	14,927
Retailer share arrangements	(1,984)	(2,373)	(2,575)	(660)	(621)	(723)	(734)	(2,738)	(670)	(701)	(732)	(770)	(2,872)	(3,126)	(3,315)
Net interest income (after retail share)	7,580	8,198	8,745	2,215	2,286	2,380	2,474	9,355	2,539	2,437	2,552	2,689	10,218	10,931	11,612
Provision for loan losses	2,565	3,072	2,917	687	740	702	823	2,952	903	908	948	1,028	3,787	4,124	4,427
Net interest income (post provision)	5,015	5,126	5,828	1,528	1,546	1,678	1,651	6,403	1,636	1,529	1,605	1,661	6,431	6,807	7,185
Total other income	484	500	485	101	120	84	87	392	92	115	91	95	393	405	413
Employee cost	620	698	866	239	250	268	285	1,042	280	286	291	297	1,154	1,155	1,177
Professional fees	451	486	607	162	156	162	165	645	146	149	152	155	602	602	614
Marketing and business development	208	269	460	82	108	115	128	433	94	96	98	100	387	388	395
Informaiton processing	165	193	212	63	74	77	83	297	82	84	85	87	338	338	345
Other	679	838	709	200	217	221	209	847	198	202	206	210	816	817	833
Total other expenses	2,123	2,484	2,927	746	805	843	870	3,264	800	816	832	849	3,297	3,299	3,364
Earnings before provision for income taxes	3,376	3,142	3,386	883	861	919	868	3,531	928	828	864	907	3,527	3,913	4,234
Income taxes	(1,257)	(1,163)	(1,277)	(331)	(320)	(345)	(321)	(1,317)	(346)	(310)	(324)	(340)	(1,321)	(1,467)	(1,588)
Net earnings	2,119	1,979	2,109	552	541	574	547	2,214	582	517	540	567	2,206	2,445	2,646
Diluted EPS	\$ 3.00	\$ 2.81	\$ 2.74	\$ 0.66	\$ 0.65	\$ 0.69	\$ 0.65	\$ 2.65	\$ 0.70	\$ 0.62	\$ 0.65	\$ 0.69	\$ 2.65	\$ 3.00	\$ 3.33
Diluted shares outstanding	705	705.3	769.7	833.8	835.4	835.8	835.8	835.2	835.5	837.6	832.6	827.6	833.3	815.1	795.1
Tax rate			37.7%	37.5%	37.2%	37.5%	37.0%	37.3%	37.3%	37.5%	37.5%	37.5%	37.4%	37.5%	37.5%
Book value per share	\$6.50	\$8.45	\$12.56	\$13.24	\$13.86	\$14.55	\$15.08	\$15.08	\$15.80	\$16.38	\$17.13	\$17.92	\$17.92	\$21.39	\$25.29
Tangible book value per share	\$4.81	\$6.68	\$10.80	\$11.43	\$12.03	\$12.64	\$13.11	\$13.11	\$13.83	\$14.41	\$15.15	\$15.92	\$15.92	\$19.34	\$23.20

Source: BTIG Estimates and Company Reports

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.

Regulatory Disclosures

Analyst Stock Ratings Definitions

BTIG LLC's ("BTIG") ratings, effective May 10, 2010, are defined as follows:

BUY – A stock that is expected at initiation to produce a positive total return of 15% or greater over the 12 months following the initial recommendation. The BUY rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

SELL – A stock that is expected at initiation to produce a negative total return of 15% or greater over the next 12 months following the initial recommendation. The SELL rating may be maintained following initiation as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

NEUTRAL – A stock that is not expected to appreciate or depreciate meaningfully over the next 12 months.

NOT RATED – A stock that is not rated but that is covered by BTIG.

Distribution of Ratings and Investment Banking Clients

BTIG must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "buy", "neutral" or "sell" rating. The said ratings are updated on a quarterly basis. BTIG must also disclose the percentage of subject companies within each of these three categories for whom the member has provided investment banking services within the previous twelve months. **Stocks under coverage as of the end of the most recent calendar quarter (March 31, 2016): 182**

Distribution of BTIG's Research Recommendations (as of March 31, 2016):

BUY: 62.6%; NEUTRAL: 34.1%; SELL: 3.3%

Distribution of BTIG's Investment Banking Services (as of March 31, 2016):

BUY: 92.9%; NEUTRAL: 7.1%; SELL: 0%

For purposes of FINRA ratings distribution rules, BTIG's stock ratings of Buy, Neutral and Sell fall into Buy, Hold and Sell categories, respectively.

Company Valuation and Risk Disclosures

Synchrony Financial (SYF, Buy, \$42 PT)

Valuation: Our price target of \$42 is based on 12.5X our 18E EPS estimate of \$3.33 per diluted share.

Risks: The primary risks to our valuation include concentration of revenue on a small number of Retail Card partners, dependence of operating results on performance of the company's partners, dependence of operating results on the company's ability to retain existing partners and to attract new partners, dependence of operating results on the active and efficient promotion of the company's products by its partners, competition in the U.S. credit card market and dependence on loan securitization.

Synchrony Financial (SYF)



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

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
31-Jul-14	23	30	Mark Palmer	Buy
22-Dec-14	29.85		Mark Palmer	Neutral
20-Apr-15	30.90	36	Mark Palmer	Buy
21-Jul-15	35.68	42	Mark Palmer	Buy

Company-Specific Regulatory Disclosures

BTIG LLC expects to receive or intends to seek compensation for investment banking services in the next 3 months from: Synchrony Financial (SYF)

Other Disclosures

Additional Information Available Upon Request

General Disclosures

Research reports produced by BTIG LLC ("BTIG") are published for and intended to be distributed solely to BTIG institutional and corporate clients. Recipients of BTIG reports will not be considered clients of BTIG solely because they may have received such BTIG report.

The equity research analyst(s) responsible for the preparation of this report receives compensation based upon a variety of factors, including the quality and accuracy of research, internal/client feedback, and overall Firm revenues.

BTIG reports are based on public information and BTIG considers the same to be reliable, comprehensive information, but makes no representation or warranty that the reports are accurate or complete. BTIG opinions and information provided in this report are as of the date of the report and may change without notice.

This research report is not an offer to buy or sell or solicitation of an offer to buy or sell any security in any jurisdiction where such an offer or solicitation would be illegal. This research report was not drafted specifically for any particular individual or entity and is not a personal recommendation to participate in any particular trading

strategy or transaction. Any recipient of this research report should obtain independent advice specific to their personal circumstances before undertaking any investment activity and must make their own independent evaluation of any securities or financial instruments.

Facts, views or opinions presented in this report have not been reviewed by, and may not reflect information known to, employees or other professionals in the "BTIG Group" (BTIG Group includes, but is not limited to, BTIG and its parents, subsidiaries and/or affiliates). BTIG Group employees, including Sales Representatives and Traders, may provide oral or written commentary or advice that may be inconsistent with the opinions and/or views expressed in this research report. BTIG Group employees and/or its affiliates not involved in the preparation of this research report may have investments in securities or derivatives of securities of companies mentioned in this report that are inconsistent with the views discussed in this report.

Investors in securities products bear certain risks in conjunction with those investments. The value of, and income from, any investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors within or beyond the companies control. Recipient of the research reports should be aware that investments in equity securities may pose significant risks due to the inherent uncertainty associated with relying on forecasts of various factors that can affect the earnings, cash flow and overall valuation of a company. Any investment in equity securities should be undertaken only upon consideration of issues relating to the recipient's overall investment portfolio and objectives (such as diversification by asset class, industry or company) as well as time horizon and liquidity needs. Further, past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. There may be time limitations on the exercise of options or other rights in any securities transactions.

Investing in foreign markets and securities, including ADRs, is subject to additional risks such as currency fluctuation, limited information, political instability, economic risk, and the potential for illiquid markets. Investing in emerging markets may accentuate these risks. Non-U.S. reporting issuers of foreign securities, however, may not make regular or complete public disclosure relating to their financial condition or the securities that they issue.

The trademarks and service marks contained herein are the property of their respective owners. Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability of any damages of any kind relating to such data. The report or any portion hereof may not be reprinted, sold or redistributed without the written consent of BTIG. This report is intended only for use by the recipient. The recipient acknowledges that all research and analysis in this report are the property of BTIG and agrees to limit the use of all publications received from BTIG within his, or her or its, own company or organization. No rights are given for passing on, transmitting, re transmitting or reselling the information provided.

Jurisdiction and Dissemination

BTIG is a U.S. broker-dealer and member of FINRA and SIPC.

BTIG Australia Limited ACN 128 554 601, member of ASIC and ASX; BTIG Hong Kong Limited, an Exchange Participant of SEHK and licensed and regulated by the SFC; BTIG Ltd, member of the LSE, authorized and regulated by the FSA; and BTIG Singapore Pte Ltd, registered and licensed with MAS; are all separate but affiliated entities of BTIG. Unless governing law permits otherwise, you must contact a BTIG entity in your home jurisdiction for further information, or if you want to use our services in effecting a transaction.

Issues and approved for distribution in the UK and EEA by BTIG Ltd. to eligible counterparties and professional clients only. Issued and distributed in Australia to "wholesale clients" only by BTIG Australia Limited. In Singapore and Hong Kong, further information may be obtained from BTIG Singapore Pte Ltd and BTIG Hong Kong Limited, respectively.

