ARGUS RESEARCH COMPANY

ANALYST QUICK NOTES

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Discover Financial Services (NYSE: DFS: BUY)
Target Price: $77
Stephen Biggar
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Investment Thesis

- Shares off about 8% from $74 high reached in January.
- See trends remaining favorable:
  - Card loan growth of 6% in 4Q accelerated from 5% pace for most of 2016:
  - Management raised its 2017 loan growth guidance to 5.5%-7.5%, from 5% growth in 2016.
- We see this recent acceleration as compelling given that DFS has been less aggressive than peers in promoting high-rewards programs.
- Focus on the prime revolver segment (the most profitable in the credit card market) with a travel rewards card has been paying off.
- Macro trends intact with consumer spending surprising to the upside.
- International expansion remains a significant opportunity for Discover, as its domestic credit card portfolio still accounts for 80% of average earning assets.
- On loan growth, credit quality, and ROA measures, Discover has outperformed most of its major card peers in recent quarters.
- DFS has the largest share buyback yield among large credit card competitors. Its $1.95 billion buyback represents 7% of market capitalization. Following share issuances for compensation, we look for the average share count to decline by at least 4% in 2017.
- Prime rate increases in December and March will favorably impact margins:
  - NIM was 9.99% in 4Q, should continue slight upward path.
- Revenue headwind from decline in protection products, suspended 4Q14, will further diminish.
- We continue to see credit cost as manageable in light of healthy loan growth.
- Argus is at $6.14 for 2017 EPS ($6.08 consensus): $6.77 for 2018 ($6.77 consensus).
- At 11.1-times our 2017 EPS estimate, shares trading at low end of 10-13 historical range:
  - Compelling story in consumer financials following run-up in global and regional bank valuations.

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