

Equity Research

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Financials

Santander Consumer USA Holdings

SC Posts Emphatic 1Q15 Earnings Beat Driven by Benign Credit; Raising Price Target to \$28 (from \$26)

Investors seeking confirmation of Santander Consumer USA's (SC) improving trends in both credit and loan growth from its 1Q15 results following an almost 29% increase in the company's shares since January 30 received exactly what they were looking for this morning when SC posted an emphatic earnings beat.

SC **\$23.01**

12 month target \$28.00

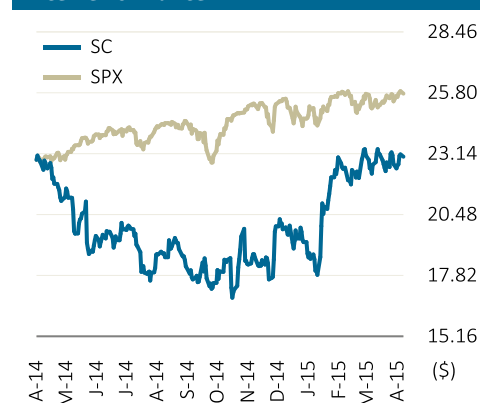
Upside 21.7%

BUY

52 week range \$16.85 - \$23.34

Market Cap (m) \$8,207

Price Performance



Source: IDC

- ▶ SC reports 1Q15 earnings per diluted common share of \$0.81, significantly outpacing the consensus estimate of \$0.66 and our estimate of \$0.54.
- ▶ Given ongoing concerns about potential credit deterioration at SC stemming from its concentration on subprime auto loans, one of the main takeaways from the quarter was that credit remained benign. The company's net charge-off ratio of 6.7% in 1Q15 was down from 8.6% in 4Q14 while its delinquency ratio declined to 3.2% during the quarter from 4.5% in the prior quarter.
- ▶ Meanwhile, SC's 1Q15 loan originations were strong at \$7.4bn, up from \$6.1bn in 4Q14 and \$7.3bn in the prior year period.
- ▶ SC's solid operating 1Q15 performance was reflected in its return profile, as its return on average equity of 31.2% was up sequentially from 29.1%, while its return on average assets increased by 40bps sequentially to 3.5%.
- ▶ **We are reiterating our BUY recommendation on Santander Consumer USA while raising our price target to \$28 (from \$26) based on 10x the company's 2015E EPS of \$2.78.**
- ▶ **Valuation:** Our price target of \$28 on SC is based on 10x the company's 2015E EPS of \$2.78.

Estimates

	1Q14 A	2Q14 A	3Q14 A	4Q14 A	FY14 A	1Q15 A	2Q15 E	3Q15 E	4Q15 E	FY15 E	FY16
Net Income (Adj.)	81	246	191	247	767	289	253	236	218	996	-
Diluted EPS (Adj.)	0.23	0.69	0.54	0.69	2.15	0.81	0.71	0.66	0.60	2.78	-
Operating Income	130	390	282	409	1,210	431	401	375	345	1,552	-

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

Source: Company Research Estimates and Company Estimates

- ▶ SC's provision for credit losses increased by \$46mm during 1Q15 to \$606mm, an increase attributed by management to higher retained asset balances and retained portfolio mix rather than a deterioration in credit. Moreover, the higher average assets and the mix of those assets should result in a future benefit to the company's earnings.
- ▶ While SC has been incurring higher regulatory and compliance costs as it works toward achieving a non-objection from the Federal Reserve on its CCAR submission after failing the test twice for qualitative reasons, the company's expense ratio nevertheless declined to 2.2% in 1Q15 from 3.8% in 4Q14 and 2.4% in the prior year period. SC's efficiency ratio was 18.9% in 1Q15, down from 19.1% in 4Q14 and 27.0% in the prior year period.

Income Statement

Santander Consumer USA Operating Model	Dec-11	Dec-12	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Dec-15
\$ millions	2011A	2012A	2013A	1Q14A	2Q14A	3Q14A	4Q14A	2014A	1Q15A	2Q15E	3Q15E	4Q15E	2015E
Total finance and other interest income	2,594.51	2,948.50	3,934.02	1,287.70	1,383.26	1,443.49	1,455.21	5,569.66	1,570.29	1,586.10	1,582.11	1,573.52	6,312.02
Interest expense	418.53	374.03	408.79	124.45	128.31	129.14	141.31	523.20	148.86	150.35	149.98	149.16	598.35
Leased vehicle expense	-	-	121.54	120.07	179.14	200.40	240.64	740.24	273.06	264.87	263.55	262.23	1,063.71
Net interest margin	2,175.99	2,574.48	3,403.69	1,043.19	1,075.81	1,113.96	1,073.27	4,306.22	1,148.37	1,170.87	1,168.59	1,162.12	4,649.95
Provision for loan losses	819.22	1,122.45	1,852.97	698.59	589.14	769.69	559.24	2,616.66	605.98	658.86	681.72	703.24	2,649.81
Profit sharing			78.25	32.16	24.06	10.56	8.15	74.93	13.52	13.65	13.79	13.93	54.88
Net interest margin after provisions & profit sharing	1,356.77	1,452.02	1,472.48	312.43	462.62	333.71	505.88	1,614.64	528.87	498.36	473.08	444.96	1,945.26
Gain on sale of receivables	-	-	40.69	35.81	21.60	38.02	21.33	116.77	21.25	22.31	23.42	24.60	91.58
Servicing fee income	251.39	34.14	25.46	10.41	22.10	20.55	19.58	72.63	24.80	25.30	25.81	26.32	102.23
Fees, commissions and other	201.14	261.55	245.41	89.30	95.03	91.40	92.55	368.28	101.13	103.16	105.22	107.32	416.83
Total other income	452.53	295.69	311.57	135.52	138.73	149.96	133.46	557.67	147.18	150.76	154.45	158.24	610.64
Salary and benefit expense	213.69	225.16	305.06	201.92	93.69	88.94	98.09	482.64	100.54	101.55	103.58	105.65	411.31
Servicing and repossession expense	155.86	136.55	147.54	48.43	45.65	50.74	56.20	201.02	58.83	59.41	60.60	61.81	240.66
Other operating costs	187.54	197.45	246.36	68.10	71.89	62.23	76.16	278.38	86.01	86.87	88.61	90.38	351.88
Total costs and expenses	557.08	559.16	698.96	318.45	211.23	201.91	230.46	962.04	245.38	247.83	252.79	257.85	1,003.85
Income before taxes	1,252.21	1,188.55	1,085.09	129.51	390.12	281.77	408.88	1,210.27	430.68	401.29	374.74	345.35	1,552.05
Income taxes	464.03	453.62	389.42	48.04	143.64	90.40	161.56	443.64	141.43	148.48	138.65	127.78	556.34
Net income	788.18	734.93	695.67	81.47	246.48	191.37	247.32	766.63	289.25	252.81	236.08	217.57	995.72
Noncontrolling interests	(19.98)	(19.93)	1.82	-	-	-	-	-	-	-	-	-	-
Net income attributable to Santander Consumer USA	768.20	715.00	697.49	81.47	246.48	191.37	247.32	766.63	289.25	252.81	236.08	217.57	995.72
Change in unrealized gains (losses) on cash flow hedges	(5.68)	7.27	9.56	-	-	-	-	-	-	-	-	-	-
Change in unrealized gains (losses) on investments	(6.34)	(4.94)	(3.25)	-	-	-	-	-	-	-	-	-	-
Other comprehensive income	(12.02)	2.33	6.31	-	-	-	-	-	-	-	-	-	-
Comprehensive income	776.16	737.27	701.98	81.47	246.48	191.37	247.32	766.63	289.25	252.81	236.08	217.57	995.72
Earnings per share	\$3.13	\$2.07	\$2.01	\$0.23	\$0.69	\$0.54	\$0.69	\$2.15	\$0.81	\$0.71	\$0.66	\$0.60	\$2.78
Dividends per share			\$0.84	\$0.15	\$0.15			\$0.30					
Shares outstanding	245.78	346.16	346.18	356.33	356.38	355.92	355.86	355.86	356.65	357.65	358.65	359.65	358.15

Source: BTIG Research Estimates and Company Documents

Appendix: Analyst Certification and Other Important Disclosures

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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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Company-Specific Regulatory Disclosures

Santander Consumer USA Holdings (SC)

Valuation

Our price target of \$28 is based on 10x our 2015E earnings per share of \$2.78

Risks

Primary risks to our recommendation include reduced access to funding; higher-than-expected default rates, particularly on nonprime receivables; poor portfolio performance that triggers credit enhancement provisions on the company's revolving credit facilities or secured structured financings; inability to meet certain milestones and metrics that could result in the termination of the company's agreement with Chrysler; adverse changes in interest rates; adverse economic conditions; and regulatory risks.

Santander Consumer USA Holdings (SC)



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

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
22-Jan-14	25.25	31	Mark Palmer	BUY
04-Nov-14	17.29	26	Mark Palmer	BUY

Other Disclosures

Additional Information Available Upon Request

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