



1Q16 Financial Results

April 19, 2016

# Notice

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The following slides are part of a presentation by Discover Financial Services (the "Company") in connection with reporting quarterly financial results and are intended to be viewed as part of that presentation. No representation is made that the information in these slides is complete. For additional financial, statistical, and business related information, as well as information regarding business and segment trends, see the earnings release and financial supplement included as exhibits to the Company's Current Report on Form 8-K filed today and available on the Company's website ([www.discover.com](http://www.discover.com)) and the SEC's website ([www.sec.gov](http://www.sec.gov)).

The information provided herein includes certain non-GAAP financial measures. The reconciliations of such measures to the comparable GAAP figures are included at the end of this presentation, which is available on the Company's website and the SEC's website.

The presentation contains forward-looking statements. You are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date on which they are made, which reflect management's estimates, projections, expectations or beliefs at that time, and which are subject to risks and uncertainties that may cause actual results to differ materially. For a discussion of certain risks and uncertainties that may affect the future results of the Company, please see "Special Note Regarding Forward-Looking Statements," "Risk Factors," "Business – Competition," "Business – Supervision and Regulation" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 which is filed with the SEC and available at the SEC's website ([www.sec.gov](http://www.sec.gov)). The Company does not undertake to update or revise forward-looking statements as more information becomes available.

# 1Q16 Summary Financial Results

(\$MM, except per share data)	1Q16	1Q15	B / (W)	
			\$ Δ	% Δ
Revenue Net of Interest Expense	\$2,224	\$2,171	\$53	2%
Provision for Loan Losses	424	390	(34)	(9%)
Operating Expense	886	873	(13)	(1%)
Direct Banking	882	881	1	0%
Payment Services	32	27	5	19%
Total Pre-Tax Income	914	908	6	1%
<b>Pre-Tax, Pre-Provision Income<sup>(1)</sup></b>	<b>1,338</b>	<b>1,298</b>	<b>40</b>	<b>3%</b>
Income Tax Expense	339	322	(17)	(5%)
Net Income	\$575	\$586	(\$11)	(2%)
<b>Diluted EPS</b>	<b>\$1.35</b>	<b>\$1.28</b>	<b>\$0.07</b>	<b>5%</b>
<b>ROE</b>	<b>21%</b>	<b>21%</b>		

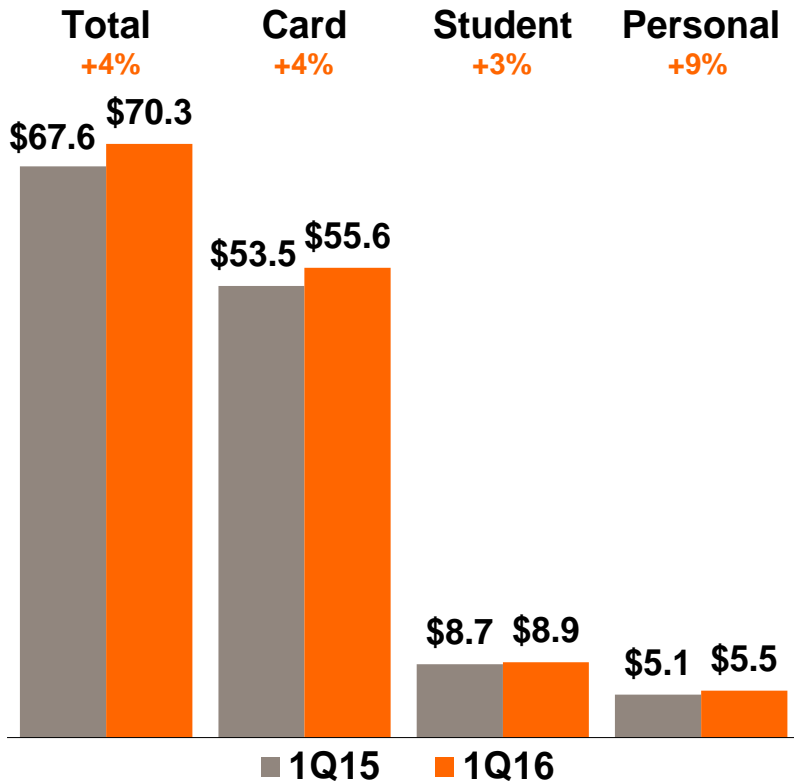
- Diluted EPS of \$1.35, up 5% YOY
- Revenue net of interest expense of \$2.2Bn, up 2% YOY as the lack of mortgage income was offset primarily by loan growth
- Provision for loan losses increased \$34MM, or 9% due primarily to a \$22MM higher reserve build
- Expenses increased \$13MM, or 1% as the elimination of mortgage expenses was offset by higher anti-money laundering and compliance program expenses

## Note(s)

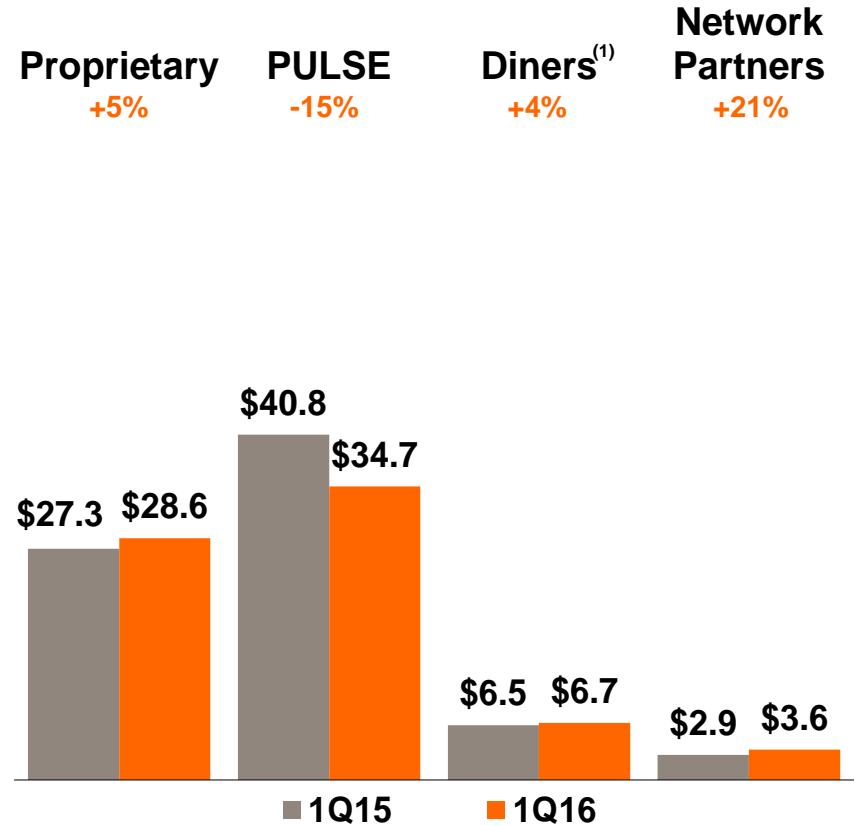
1. Pre-tax, pre-provision income, which is derived by adding provision for loan losses to pre-tax income, is a non-GAAP financial measure which should be viewed in addition to, and not as a substitute for, the Company's reported results. Management believes this information helps investors understand the effect of provision for loan losses on reported results and provides an alternate presentation of the Company's performance; see appendix for a reconciliation

# 1Q16 Loan and Volume Growth

## Ending Loans (\$Bn)



## Volume (\$Bn)



Total Payments Volume down 5% YOY

**Note(s)**  
 1. Volume is derived from data provided by licensees for Diners Club branded cards issued outside of North America and is subject to subsequent revision or amendment

# 1Q16 Revenue Detail

(\$MM)	1Q16	1Q15	B / (W)	
			\$ Δ	% Δ
Interest Income	\$2,084	\$1,929	\$155	8%
Interest Expense	334	300	(34)	(11%)
Net Interest Income	1,750	1,629	121	7%
Discount/Interchange Revenue	565	536	29	5%
Rewards Cost	292	268	(24)	(9%)
Net Discount/Interchange Revenue	273	268	5	2%
Protection Products Revenue	61	71	(10)	(14%)
Loan Fee Income	80	81	(1)	(1%)
Transaction Processing Revenue	36	42	(6)	(14%)
Other Income	24	80	(56)	(70%)
Total Non-Interest Income	474	542	(68)	(13%)
Revenue Net of Interest Expense	<u>\$2,224</u>	<u>\$2,171</u>	<u>\$53</u>	<u>2%</u>
Direct Banking	\$2,156	\$2,097	\$59	3%
Payment Services	68	74	(6)	(8%)
Revenue Net of Interest Expense	<u>\$2,224</u>	<u>\$2,171</u>	<u>\$53</u>	<u>2%</u>

(\$MM)	1Q16	1Q15	Change	
			QOQ	YOY
Discover Card Sales Volume	\$27,552	\$26,379	(13%)	4%
Rewards Rate <sup>(1)</sup>	1.06%	1.02%	-12 bps	4 bps

- Net interest income of \$1.8Bn, up 7% YOY due primarily to loan growth and higher net interest margin
- Discount and interchange revenue of \$565MM, up 5% YOY driven primarily by an increase in card sales
- Rewards rate increased 4bps YOY driven by higher promotional and standard rewards
- Protection products revenue of \$61MM, down 14% YOY due to the prior suspension of new product sales
- Other income decreased by \$56MM primarily due to the lack of \$42MM in mortgage origination revenue as we exited the business last year

## Note(s)

1. Rewards cost divided by Discover card sales volume

# 1Q16 Net Interest Margin

(\$MM)	1Q16		1Q15	
	Average Balance	Rate	Average Balance	Rate
Credit Card	\$56,124	12.42%	\$54,038	12.05%
Private Student	8,967	7.02%	8,721	6.95%
Personal	5,503	12.20%	5,047	12.19%
Other	243	5.18%	342	4.23%
Total Loans	70,837	11.69%	68,148	11.37%
Other Interest-Earning Assets	14,253	0.70%	12,753	0.59%
Total Interest-Earning Assets	<u>\$85,090</u>	9.85%	<u>\$80,901</u>	9.67%
Direct to Consumer and Affinity	\$31,529	1.22%	\$28,891	1.25%
Brokered Deposits and Other	15,982	1.68%	17,034	1.51%
Interest Bearing Deposits	47,511	1.37%	45,925	1.35%
Borrowings	24,886	2.79%	22,586	2.65%
Total Interest-Bearing Liabilities	<u>\$72,397</u>	1.86%	<u>\$68,511</u>	1.78%

(%)	1Q16	Change	
		QOQ	YOY
Total Interest Yield	11.69%	20 bps	32 bps
NIM on Receivables	9.94%	19 bps	25 bps
NIM on Interest-Earning Assets	8.27%	8 bps	10 bps

- Total interest yield of 11.69% increased 32bps YOY driven primarily by higher card yield
- Credit card yield increased 37bps YOY due to portfolio mix and the prime rate increase
- Average direct to consumer and affinity deposits grew 9% YOY and made up 44% of total funding
- Funding costs on interest-bearing liabilities increased 8bps YOY to 1.86% primarily due to funding mix
- Net interest margin on receivables increased 25bps YOY due to higher total yield partially offset by higher funding costs

# 1Q16 Operating Expense Detail

(\$MM)	1Q16	1Q15	B / (W)	
			\$ Δ	% Δ
Employee Compensation and Benefits	\$345	\$331	(\$14)	(4%)
Marketing and Business Development	162	182	20	11%
Information Processing & Communications	88	88	0	0%
Professional Fees	160	127	(33)	(26%)
Premises and Equipment	24	24	0	0%
Other Expense	107	121	14	12%
<b>Total Operating Expense</b>	<b>\$886</b>	<b>\$873</b>	<b>(\$13)</b>	<b>(1%)</b>
Direct Banking	\$851	\$828	(\$23)	(3%)
Payment Services	35	45	10	22%
<b>Total Operating Expense</b>	<b>\$886</b>	<b>\$873</b>	<b>(\$13)</b>	<b>(1%)</b>
<b>Operating Efficiency<sup>(1)</sup></b>	<b>39.8%</b>	<b>40.2%</b>	<b>40 bps</b>	
<b>Adjusted Operating Efficiency<sup>(2)</sup></b>	<b>38.5%</b>	<b>38.6%</b>	<b>10 bps</b>	

- Employee compensation and benefits of \$345MM, up 4% YOY primarily due to higher regulatory and compliance staffing as well as higher compensation
- Marketing and business development expense of \$162MM, down 11% YOY primarily due to timing of advertising campaigns
- Professional fees of \$160MM, up 26% YOY. Look back related anti-money laundering remediation expenses were \$30MM in 1Q16 vs. \$15MM in 1Q15
- Other expense of \$107MM, down 12% YOY largely due to a \$20MM legal reserve in the prior year
- Prior year mortgage origination expense was \$37MM

## Note(s)

1. Defined as reported total operating expense divided by revenue net of interest expense
2. 1Q16 operating efficiency adjusted for \$30 million in look back related anti-money laundering remediation expenses. 1Q15 operating efficiency adjusted for \$15 million anti-money laundering and related compliance program expenses and \$20 million legal reserve addition; see appendix for a reconciliation. Management believes adjusted operating efficiency, which is a non-GAAP measure, provides investors with a useful metric to evaluate the ongoing operating performance of the Company

# 1Q16 Provision for Loan Losses and Credit Quality

(\$MM)	1Q16	1Q15	B / (W)	
			\$ Δ	% Δ
Net Principal Charge-off	\$372	\$360	(\$12)	(3%)
Reserve Changes build/(release)	52	30	(22)	(73%)
Total Provision for Loan Loss	\$424	\$390	(\$34)	(9%)

(%)	1Q16	Change	
		QOQ	YOY
<b>Credit Card Loans</b>			
Gross Principal Charge-off Rate	3.15%	21 bps	-6 bps
Net Principal Charge-off Rate	2.34%	16 bps	-6 bps
30-Day Delinquency Rate	1.68%	-4 bps	4 bps
Reserve Rate	2.86%	18 bps	7 bps
<b>Private Student Loans</b>			
Net Principal Charge-off Rate (excl. PCI Loans) <sup>(1)</sup>	0.85%	-45 bps	-18 bps
30-Day Delinquency Rate (excl. PCI Loans) <sup>(1)</sup>	1.92%	1 bps	26 bps
Reserve Rate (excl. PCI Loans) <sup>(1)</sup>	1.86%	-2 bps	-32 bps
<b>Personal Loans</b>			
Net Principal Charge-off Rate	2.45%	17 bps	23 bps
30-Day Delinquency Rate	0.97%	8 bps	21 bps
Reserve Rate	2.99%	17 bps	56 bps
<b>Total Loans</b>			
Gross Principal Charge-off Rate (excl. PCI Loans) <sup>(1)</sup>	2.92%	14 bps	-6 bps
Net Principal Charge-off Rate (excl. PCI Loans) <sup>(1)</sup>	2.21%	10 bps	-5 bps
30-Day Delinquency Rate (excl. PCI Loans) <sup>(1)</sup>	1.64%	-3 bps	7 bps
Reserve Rate (excl. PCI Loans) <sup>(1)</sup>	2.80%	15 bps	8 bps

## Note(s)

1. Excludes PCI loans which are accounted for on a pooled basis. Since a pool is accounted for as a single asset with a single composite interest rate and aggregate expectation of cash flows, the past-due status of a pool, or that of the individual loans within a pool, is not meaningful. Because the Company is recognizing interest income on a pool of loans, it is all considered to be performing

- Net charge-offs of \$372MM, up 3% YOY and reserve build of \$52MM both primarily due to loan growth
- Card net charge-off rate decreased 6bps YOY to 2.34%
- Card 30+ day delinquency rate of 1.68% increased 4bps YOY
- Student loan net charge-off rate excluding PCI loans of 0.85%, down 18bps YOY
- Personal loan net charge-off rate of 2.45%, up 23bps YOY



# Capital Position

## Capital Ratios

	Basel III Transition		
	1Q16	4Q15	1Q15
Total Risk Based Capital Ratio	16.8%	16.5%	17.6%
Tier 1 Risk Based Capital Ratio	15.0%	14.7%	15.6%
Tier 1 Leverage Ratio	12.8%	12.9%	13.3%
Common Equity Tier 1 Capital Ratio	14.3%	13.9%	14.8%
	Basel III Fully Phased-in		
Common Equity Tier 1 Capital Ratio <sup>(1)</sup>	14.2%	13.9%	14.7%

- Common Equity Tier 1 Capital Ratio (Basel III fully phased-in) of 14.2%, up 30bps sequentially due to the seasonal decline in loan balances

### Note(s)

1. Common Equity Tier 1 Capital Ratio (Basel III Fully Phased-in) is calculated using Basel III Fully Phased-in Common Equity Tier 1 Capital, a non-GAAP measure. The Company believes that the Common Equity Tier 1 Capital Ratio based on Fully Phased-in Basel III rules is an important complement to the existing capital ratios and for comparability to other financial institutions. For the corresponding reconciliation of Common Equity Tier 1 Capital and risk weighted assets calculated under Fully Phased-in Basel III rules to Common Equity Tier 1 Capital and risk weighted assets calculated under Basel III transition rules see appendix

# Appendix

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# Reconciliation of GAAP to Non-GAAP Data

	Quarter Ended	
	Mar 31, 2016	Mar 31, 2015
<b>(unaudited, in millions)</b>		
Provision for loan losses	\$424	\$390
Income before income taxes	914	908
Pre-tax, pre-provision income <sup>(1)</sup>	<u>\$1,338</u>	<u>\$1,298</u>
Revenue net of interest expense	\$2,224	\$2,171
Total operating expense	886	873
Excluding legal reserve addition	-	20
Excluding anti-money laundering and related compliance program expenses	30	15
Adjusted operating expense	<u>\$856</u>	<u>\$838</u>
Adjusted operating efficiency <sup>(2)</sup>	38.5%	38.6%

## Note(s)

1. Pre-tax, pre-provision income, which is derived by adding provision for loan losses to pre-tax income, is a non-GAAP financial measure which should be viewed in addition to, and not as a substitute for, the Company's reported results. Management believes this information helps investors understand the effect of provision for loan losses on reported results and provides an alternate presentation of the Company's performance
2. Adjusted operating efficiency is calculated using adjusted operating expense, a non-GAAP measure, divided by revenue net of interest expense. Management believes this information provides investors with a useful metric to evaluate the ongoing operating performance of the Company

# Reconciliation of GAAP to Non-GAAP Data (cont'd)

(unaudited, in millions)	Quarter Ended		
	Mar 31, 2016	Dec 31, 2015	Mar 31, 2015
GAAP Total Common Equity	\$10,756	\$10,715	\$10,651
Less: Goodwill	(255)	(255)	(257)
Less: Intangibles	(167)	(168)	(175)
Tangible Common Equity <sup>(1)</sup>	\$10,334	\$10,292	\$10,219
Common Equity Tier 1 Capital (Basel III Transition)	\$10,593	\$10,566	\$10,497
Adjustments Related to Capital Components During Transition <sup>(2)</sup>	(54)	(82)	(87)
Common Equity Tier 1 Capital (Basel III Fully Phased-in)	\$10,539	\$10,484	\$10,410
Risk Weighted Assets (Basel III Transition)	\$74,205	\$75,787	\$70,868
Risk Weighted Assets (Basel III Fully Phased-in) <sup>(3)</sup>	\$74,137	\$75,685	\$70,762
Common Equity Tier 1 Capital Ratio (Basel III Transition)	14.3%	13.9%	14.8%
Common Equity Tier 1 Capital Ratio (Basel III Fully Phased-in) <sup>(4)</sup>	14.2%	13.9%	14.7%

## Note(s)

1. Tangible Common Equity ("TCE"), a non-GAAP financial measure, represents common equity less goodwill and intangibles. A reconciliation of TCE to common equity, a GAAP financial measure, is shown above. Other financial services companies may also use TCE and definitions may vary, so users of this information are advised to exercise caution in comparing TCE of different companies. TCE is included because management believes that common equity excluding goodwill and intangibles is a more meaningful measure to investors of the true net asset value of the Company
2. Adjustments related to capital components for fully phased-in Basel III include the phase-in of the intangible asset exclusion
3. Key differences under fully phased-in Basel III rules in the calculation of risk weighted assets include higher risk weighting for past due loans and unfunded commitments
4. Common Equity Tier 1 Capital Ratio (Basel III Fully Phased-in) is calculated using Common Equity Tier 1 Capital (Basel III Fully Phased-in), a non-GAAP measure, divided by Risk Weighted Assets (Basel III Fully Phased-in)