



1Q17 Financial Results

April 25, 2017

# Notice

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, 2016, 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.

# Vision, Strategic Objectives and Goal

## Vision

**Be the leading direct bank and payments partner**

## Focus areas and strategic objectives

### **Achieve profitable, disciplined growth**

- Excel at serving our customers; simple, secure experience with deep relationships
- Offer differentiated products
- Leverage payments network

### **Invest for the future**

- Build awareness and consideration
- Enhance capabilities and operating model

**Manage risk prudently**

## Goal

**Create long-term shareholder value**

# 1Q17 Highlights

## Profitable, disciplined growth

- Maintained loan growth momentum across all primary lending products (credit cards, student and personal loans)
- Increased earnings per share 6% to \$1.43 and returned \$620 million of capital
- Remained disciplined on risk-adjusted returns with 20% return on equity
- Grew revenue 5% over the prior year, with 8% growth in net interest income partially offset by higher rewards
- Restored PULSE volume growth

## Investments for the future

- Supported awareness and consideration with targeted marketing investments
- Continued to drive customer engagement with Cashback Match and 5% rotating rewards categories
- Achieved robust consumer deposit growth while holding deposit rates steady
- Submitted 2017 capital plan and intend to remain among industry leaders in capital payout ratio and shareholder yield

# 1Q17 Summary Financial Results

(\$MM, except per share data)	1Q17	1Q16	B / (W)	
			\$ Δ	% Δ
Revenue Net of Interest Expense	\$2,339	\$2,224	\$115	5%
Net Principal Charge-off	489	372	(117)	(31%)
Reserve Changes build/(release)	97	52	(45)	NM
Provision for Loan Losses	586	424	(162)	(38%)
Operating Expense	885	886	1	-%
Direct Banking	824	882	(58)	(7%)
Payment Services	44	32	12	38%
Total Pre-Tax Income	868	914	(46)	(5%)
Income Tax Expense	304	339	35	10%
Net Income	\$564	\$575	(\$11)	(2%)
<b>ROE</b>	<b>20%</b>	<b>21%</b>		
<b>Diluted EPS</b>	<b>\$1.43</b>	<b>\$1.35</b>	<b>\$0.08</b>	<b>6%</b>
Pre-Tax, Pre-Provision Income <sup>(1)</sup>	\$1,454	\$1,338	\$116	9%

## Highlights

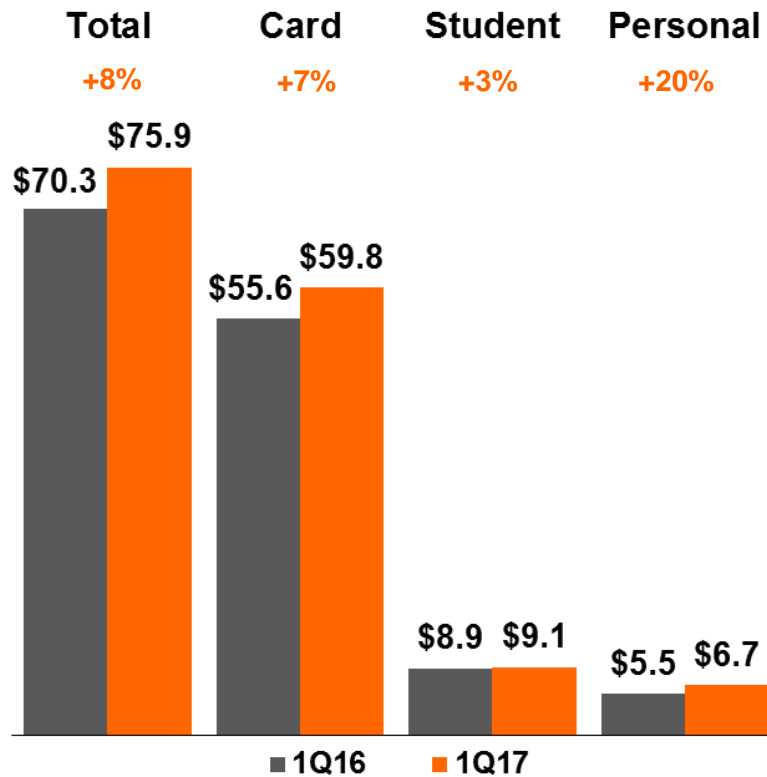
- Diluted EPS of \$1.43, up 6% YOY
- Revenue net of interest expense of \$2.3Bn, up 5% YOY as higher net interest income was partially offset by higher rewards expense
- Provision for loan losses increased \$162MM YOY (38%) on higher net charge-offs
- Expenses were flat, primarily driven by lower professional fees, partially offset by higher compensation and benefits and higher marketing spend

### Note(s)

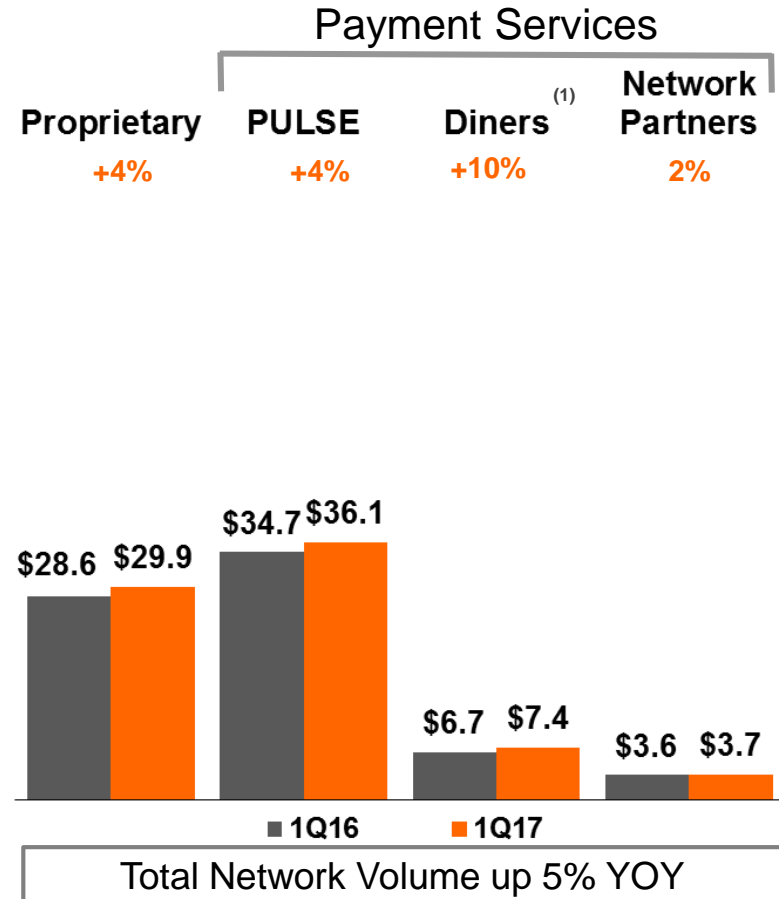
1. Pre-tax, pre-provision income, which is derived by adding provision for loan losses to pre-tax income, is a non-GAAP financial measure which should be viewed in addition to, and not as a substitute for, the Company's reported results. Management believes this information helps investors understand 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

# 1Q17 Loan and Volume Growth

## Ending Loans (\$Bn)



## Volume (\$Bn)



**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

# 1Q17 Revenue Detail

(\$MM)	1Q17	1Q16	B / (W)	
			\$ Δ	% Δ
Interest Income	\$2,278	\$2,084	\$194	9%
Interest Expense	386	334	(52)	(16%)
Net Interest Income	1,892	1,750	142	8%
Discount/Interchange Revenue	596	565	31	5%
Rewards Cost	363	292	(71)	(24%)
Net Discount/Interchange Revenue	233	273	(40)	(15%)
Protection Products Revenue	58	61	(3)	(5%)
Loan Fee Income	89	80	9	11%
Transaction Processing Revenue	39	36	3	8%
Other Income	28	24	4	17%
Total Non-Interest Income	447	474	(27)	(6%)
Revenue Net of Interest Expense	\$2,339	\$2,224	\$115	5%
Direct Banking	\$2,267	\$2,156	\$111	5%
Payment Services	72	68	4	6%
Revenue Net of Interest Expense	\$2,339	\$2,224	\$115	5%

(\$MM)	1Q17	1Q16	Change	
			QOQ	YOY
Discover Card Sales Volume	\$29,134	\$27,552	(10%)	6%
Rewards Rate <sup>(1)</sup>	1.25%	1.06%	-1 bp	19 bps

## Note(s)

1. Rewards cost divided by Discover card sales volume

## Highlights

- Net interest income of \$1.9Bn, up 8% YOY on higher loan growth and some NIM expansion
- Discount and interchange revenue of \$596MM, up 5% YOY, driven by increased card sales
- Net discount and interchange revenue declined \$40MM (15%) on higher rewards cost
- Rewards rate increased 19 bps YOY, driven by higher promotional rewards, primarily due to greater customer engagement in rotating 5% categories

# 1Q17 Net Interest Margin

(\$MM)	1Q17		1Q16	
	Average Balance	Rate	Average Balance	Rate
Credit Card	\$60,122	12.65%	\$56,124	12.42%
Private Student	9,197	7.29%	8,967	7.02%
Personal	6,582	12.18%	5,503	12.20%
Other	284	5.39%	243	5.18%
Total Loans	76,185	11.94%	70,837	11.69%
Other Interest-Earning Assets	16,243	0.89%	14,253	0.70%
Total Interest-Earning Assets	<u>\$92,428</u>	9.99%	<u>\$85,090</u>	9.85%
Direct to Consumer and Affinity	\$36,316	1.25%	\$31,529	1.22%
Brokered Deposits and Other	16,242	1.98%	15,982	1.68%
Interest Bearing Deposits	52,558	1.48%	47,511	1.37%
Borrowings	26,561	2.97%	24,886	2.79%
Total Interest-Bearing Liabilities	<u>\$79,119</u>	1.98%	<u>\$72,397</u>	1.86%

(% )	1Q17	Change	
		QOQ	YOY
Total Interest Yield	11.94%	6 bps	25 bps
NIM on Receivables	10.07%	-	13 bps
NIM on Interest-Earning Assets	8.30%	-17 bps	3 bps

## Highlights

- Net interest margin on receivables increased 13 bps YOY on higher card yield, partially offset by higher funding costs
- Credit card yield increased 23 bps YOY as the prime rate increased and portfolio mix changed
- Average direct to consumer and affinity deposits grew 15% YOY and composed 46% of total average funding
- Funding costs on interest-bearing liabilities increased 12 bps YOY driven by higher market rates and funding mix



# 1Q17 Operating Expense Detail

(\$MM)	1Q17	1Q16	B / (W)	
			\$ Δ	% Δ
Employee Compensation and Benefits	\$363	\$345	(\$18)	(5%)
Marketing and Business Development	168	162	(6)	(4%)
Information Processing & Communications	80	88	8	9%
Professional Fees	147	160	13	8%
Premises and Equipment	25	24	(1)	(4%)
Other Expense	102	107	5	5%
<b>Total Operating Expense</b>	<b>\$885</b>	<b>\$886</b>	<b>\$1</b>	<b>-%</b>
Direct Banking	\$849	\$851	\$2	-%
Payment Services	36	35	(1)	(3%)
<b>Total Operating Expense</b>	<b>\$885</b>	<b>\$886</b>	<b>\$1</b>	<b>-%</b>
<b>Operating Efficiency<sup>(1)</sup></b>	<b>37.9%</b>	<b>39.8%</b>	<b>190 bps</b>	
<b>Adjusted Operating Efficiency<sup>(2)</sup></b>	<b>37.9%</b>	<b>38.5%</b>	<b>60 bps</b>	

## Highlights

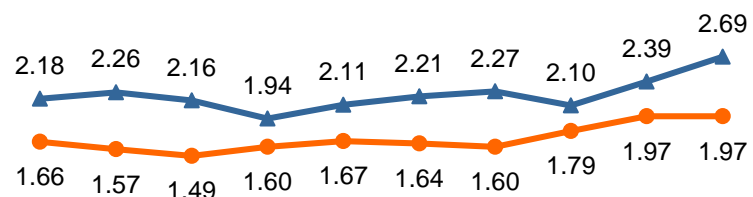
- Employee compensation and benefits up 5% YOY primarily on higher regulatory and compliance staffing, as well as higher average salaries
- Marketing and business development expenses increased 4% YOY, primarily driven by higher card acquisition and brand spend
- Professional fees down 8% YOY, primarily due to look back related anti-money laundering remediation expenses in 1Q16
- Operating efficiency improved 190 bps

### Note(s)

1. Defined as reported total operating expense divided by revenue net of interest expense
2. 1Q16 operating efficiency ratio adjusted for \$30 million in look back related anti-money laundering remediation expenses. Management believes adjusted operating efficiency, which is a non-GAAP measure, helps investors understand the effect of activities that are not expected to continue and provides investors with a useful metric to evaluate the company's ongoing operating performance; see appendix for a reconciliation

# Credit Performance Trends

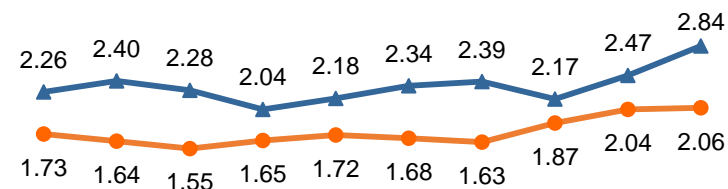
## Total Company Loans



4Q14 1Q15 2Q15 3Q15 4Q15 1Q16 2Q16 3Q16 4Q16 1Q17

▲ NCOs ex-PCI (%) ● 30 day DQ rate ex-PCI (%)

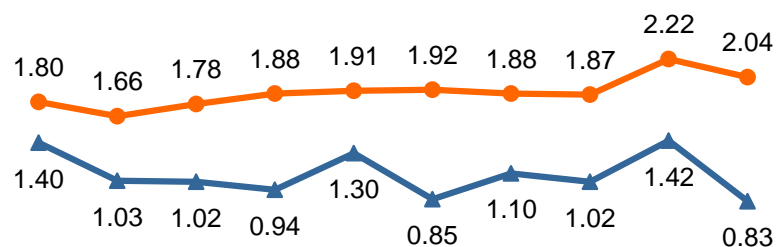
## Credit Card Loans



4Q14 1Q15 2Q15 3Q15 4Q15 1Q16 2Q16 3Q16 4Q16 1Q17

▲ NCO rate (%) ● 30 day DQ rate (%)

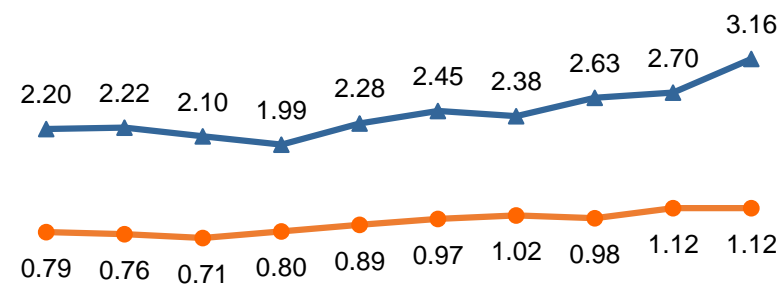
## Private Student Loans



4Q14 1Q15 2Q15 3Q15 4Q15 1Q16 2Q16 3Q16 4Q16 1Q17

▲ NCO rate ex-PCI (%) ● 30 day DQ rate ex-PCI (%)

## Personal Loans

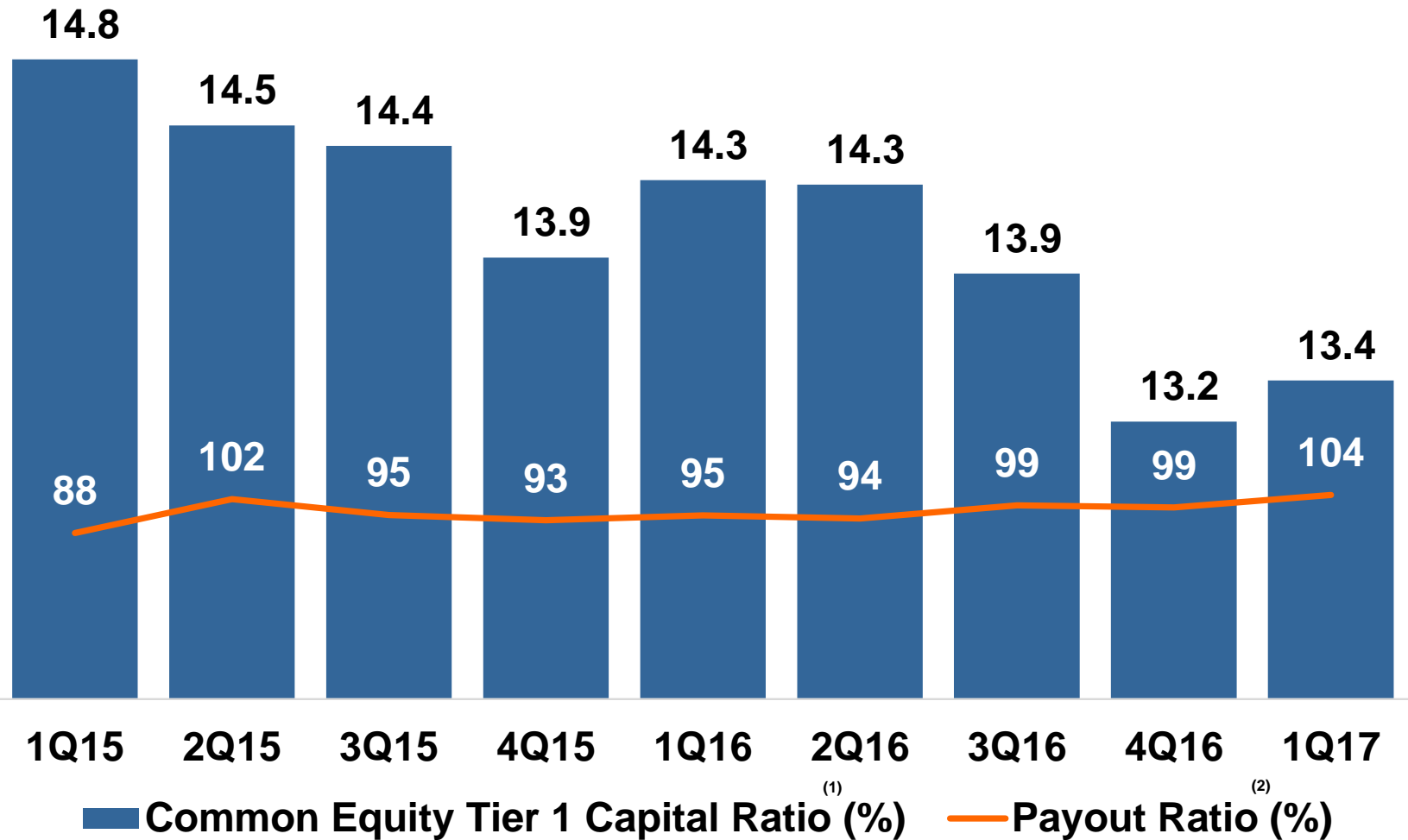


4Q14 1Q15 2Q15 3Q15 4Q15 1Q16 2Q16 3Q16 4Q16 1Q17

▲ NCO rate (%) ● 30 day DQ rate (%)

- Note(s)**
- 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

# Capital Trends



**Note(s)**

1. Common Equity Tier 1 Capital Ratio (Basel III Transition)
2. Payout Ratio is displayed on a trailing twelve month basis. This represents the trailing twelve months' Capital Return to Common Stockholders divided by the trailing twelve months' Net Income Allocated to Common Stockholders

# 1Q17 Financial Summary

## Profitability

- Net income of \$564MM and diluted EPS of \$1.43
- Revenue growth of 5% on higher net interest income, partially offset by higher rewards
- NIM of 10.07%, up 13 bps YOY
- Return on equity stable at 20%
- Efficiency ratio low at 38%

## Balance Sheet

- Total loans grew 8% (\$5.5Bn) YOY with strong contributions from all primary products
- Credit card loans grew 7% (\$4.1Bn) YOY as sales volume increased 6%
- Average DTC deposits grew 15% (\$4.8Bn) YOY with steady deposit rates

## Credit and Capital

- Credit fundamentals remain favorable relative to historical standards
- Card NCO rate of 2.84%, up 50 bps YOY, primarily on seasoning of recent loan growth
- Payout ratio of 104% (trailing twelve months)
- CET1 ratio of 13.4%, down 90 bps YOY, on capital return and loan growth

# Appendix

# Reconciliation of GAAP to Non-GAAP Data

	<u>Quarter Ended</u>	
	<u>Mar 31, 2017</u>	<u>Mar 31, 2016</u>
<b>(unaudited, in millions, except per share statistics)</b>		
Provision for loan losses	\$586	\$424
Income before income taxes	868	914
Pre-tax, pre-provision income <sup>(1)</sup>	<u>\$1,454</u>	<u>\$1,338</u>
Revenue net of interest expense	\$2,339	\$2,224
Total operating expense	885	886
Excluding anti-money laundering and related compliance program expenses	-	30
Adjusted operating expense	<u>\$885</u>	<u>\$856</u>
Adjusted operating efficiency <sup>(2)</sup>	37.9%	38.5%

## Note(s)

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