



ally



ALPHA CHALLENGE
Kenan-Flagler Business School
The University of North Carolina

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ALLY continues to “Do it Right”

Thesis: Ally offers the potential for relative outperformance due to:

- 1 Significant earnings improvement and a favorable debt funding profile
- 2 Continuous diversification of revenues from expanded product offerings
- 3 Strong asset quality and persistent near-term consumer-related tailwinds

- Despite the fundamental and ratings improvement, Ally continues to trade wide of its peers
- We believe that Ally is amid a multiple upgrade cycle, with earnings surprises providing a catalyst for a 30-bps yield compression

ALLY 8.000 Sr Unsecured Notes 11/01/2031	
Recommendation	Buy
Current YTM	3.16%
Current Spread	161 bps
Target Spread	131 bps
Upside	30 bps

Company Overview

Ally Financial Inc. is a leading digital financial-services company

- Ally Financial Inc. has a leading automotive finance platform, offering both commercial and consumer lending products as well as insurance. Ally also continues to build out its leading direct-to-consumer online banks, which offers a retail brokerage, mortgage lending, personal lending and deposit products.
- Founded: 1914 (fka GMAC)
- Headquarters: Detroit, MI
- Employees: 9,500



Ally Key Figures

\$6.0 billion total net revenue year-to-date	\$179 billion total assets	~9.0+ million total customers
20,400+ dealer relationships	~13 million consumer auto applications	~\$40+ billion consumer auto originations
2.4+ million retail deposit customers	96% customer retention rate	9% multi-product relationship customers

Ally named “Best Internet Bank” by Kiplinger 2017 - 2021

Source: Ally annual report and Q3 press release

Strengths & Opportunities

Already the leading automotive finance provider, Ally is positioned well to capitalize on its strengths and opportunities

Improved
funding profile

- Ally continues to be a negative debt issuer by replacing expensive long-term debt with lower-cost deposits
- Coupled with the lower cost-deposits, new debt issuances and refinancings have come at a lower cost

Strategic Capital
Deployment

- Ally recently announced the acquisition of Fair Square Financial, a credit card provider, in an all-cash deal worth \$750 million that is expected to close by the end of the first quarter of 2022
- The deal is expected to add 100 – 125 bps to ROTCE in 2022 – 2023 and 150 bps over the medium term

Earnings
Diversification

- Ally's multi-product relationship customers account for 9% of customers, up from 2% in 2017
- Depositors drove 30% of Home Originations and 71% of self-directed and managed account growth in 3Q'21

High Asset
Quality

- Credit metrics have been strong with an NCO rate of 0.4% through 2021
- Ally continues to focus on the used vehicle segment that is supported by elevated car values

Capital Structure

ALLY is potentially amidst a multi-year multiple upgrade cycle

Ticker	Coupon	Maturity	Yield to Worst	Spread	Amount Outstanding	Rating
<i>Senior Unsecured Bonds</i>						
ALLY	4.125	2/13/2022	0.745	70.099	650,000,000	BBB-
ALLY	4.625	5/19/2022	0.587	48.083	400,000,000	BBB-
ALLY	3.050	6/5/2023	0.938	60.856	800,000,000	BBB-
ALLY	1.450	10/2/2023	0.994	54.681	1,200,000,000	BBB-
ALLY	3.875	5/21/2024	1.384	72.076	750,000,000	BBB-
ALLY	5.125	9/30/2024	1.427	61.195	700,000,000	BBB-
ALLY	4.625	3/30/2025	1.679	75.210	500,000,000	BBB-
ALLY	5.800	5/1/2025	1.645	71.694	750,000,000	BBB-
ALLY	2.200	11/2/2028	2.353	90.275	750,000,000	BBB-
ALLY	8.000	11/1/2031	3.158	161.318	1,995,021,000	BBB-
ALLY	8.000	11/1/2031	3.235	168.861	512,493,000	BBB-
<i>Total Senior Unsecured Bonds</i>					9,007,514,000	
<i>Subordinated Debt</i>						
<i>Total Subordinated Debt</i>					1,050,000,000	BB+
<i>Retail Term Notes</i>						
<i>Total Retail Term Notes</i>					207,857,000	NR
<i>Junior Subordinated Bonds</i>						
<i>Total Junior Subordinated Bonds</i>					2,350,000,000	BB-

Why this bond?

- Despite improvement in fundamentals and ratings, Senior Unsecured Bonds still offer upside relative to BBB-peers
- Best combination of **duration, liquidity, and credit spread compression**

Catalysts

Ally is poised for earnings surprises and is likely in a multi-year, multi-upgrade cycle

Earnings surprises

Management's guidance of ~15% ROTCE appears conservative due to the company being structurally more profitable than it was pre-pandemic. Credit conditions should not normalize until 2023 and the Company should benefit from rising rates.

Fair Square Financial

The Company announced that it will acquire Fair Square Financial in the first quarter of 2022, providing an opportunity to add credit cards. This will further diversify its operations, a key focus area for the rating agencies.

Emphasis on lower cost deposits is driving gains in ROTCE

Ally Financial – Main figures

\$m	FY18	FY19	FY20	Base Case			Downside Case			Upside Case		
				FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Net financing revenue	4,390	4,633	4,703	6,013	6,875	7,306	5,981	6,542	6,873	6,013	7,057	7,721
Provision for loan losses	(918)	(998)	(1,439)	(128)	(637)	(1,214)	(128)	(840)	(1,681)	(129)	(603)	(1,171)
Total other revenue	1,414	1,761	1,983	1,957	1,892	1,914	1,957	1,892	1,914	1,957	1,892	1,914
Net revenue	4,886	5,396	5,247	7,842	8,130	8,005	7,810	7,594	7,106	7,841	8,347	8,463
Noninterest expenses	(3,264)	(3,429)	(3,833)	(3,989)	(4,418)	(4,679)	(3,970)	(4,218)	(4,420)	(3,989)	(4,527)	(4,928)
Pre-tax income	1,622	1,967	1,414	3,853	3,712	3,326	3,840	3,376	2,686	3,852	3,819	3,535
Income tax expense	(359)	(246)	(328)	(737)	(779)	(698)	(735)	(709)	(564)	(737)	(802)	(742)
Net income from continuing operations	1,263	1,721	1,086	3,115	2,932	2,627	3,105	2,667	2,122	3,115	3,017	2,792
Earnings of Discontinued Operations	-	(6)	(1)	1	-	-	1	-	-	1	-	-
Net income	1,263	1,715	1,085	3,116	2,932	2,627	3,106	2,667	2,122	3,116	3,017	2,792
Key Metrics												
ROTCE	9.7%	12.3%	7.6%	18.0%	16.4%	14.4%	17.9%	15.1%	12.1%	18.0%	16.7%	15.1%
Deposits % of Total Funding	66.2%	75.3%	85.0%	90.5%	90.0%	90.0%	90.1%	88.0%	88.0%	90.5%	89.0%	89.0%
Debt % of Total Funding	33.8%	24.7%	15.0%	9.5%	10.0%	10.0%	9.9%	12.0%	12.0%	9.5%	11.0%	11.0%
CET1 ratio (Basel III)	9.14%	9.54%	10.64%	11.32%	10.34%	10.03%	11.32%	10.16%	9.53%	11.32%	10.40%	10.19%

- **Net financing revenue**

- Increase in average yield on assets due to higher origination yields (>7%)
- Decrease in cost of funding due to replacement of long-term debt with lower-cost deposits below 0.8%

- **ROTCE:**

- Assumes a normalization of credit metrics in late 2022 – early 2023
- Possible additional expansion due to addition of credit card from FSF



- **ROTCE ~15%**

- **CET1 ratio (Basel III) above 9% target**
- **Deposits exceed 90% of total funding sources**

Scenario Analysis

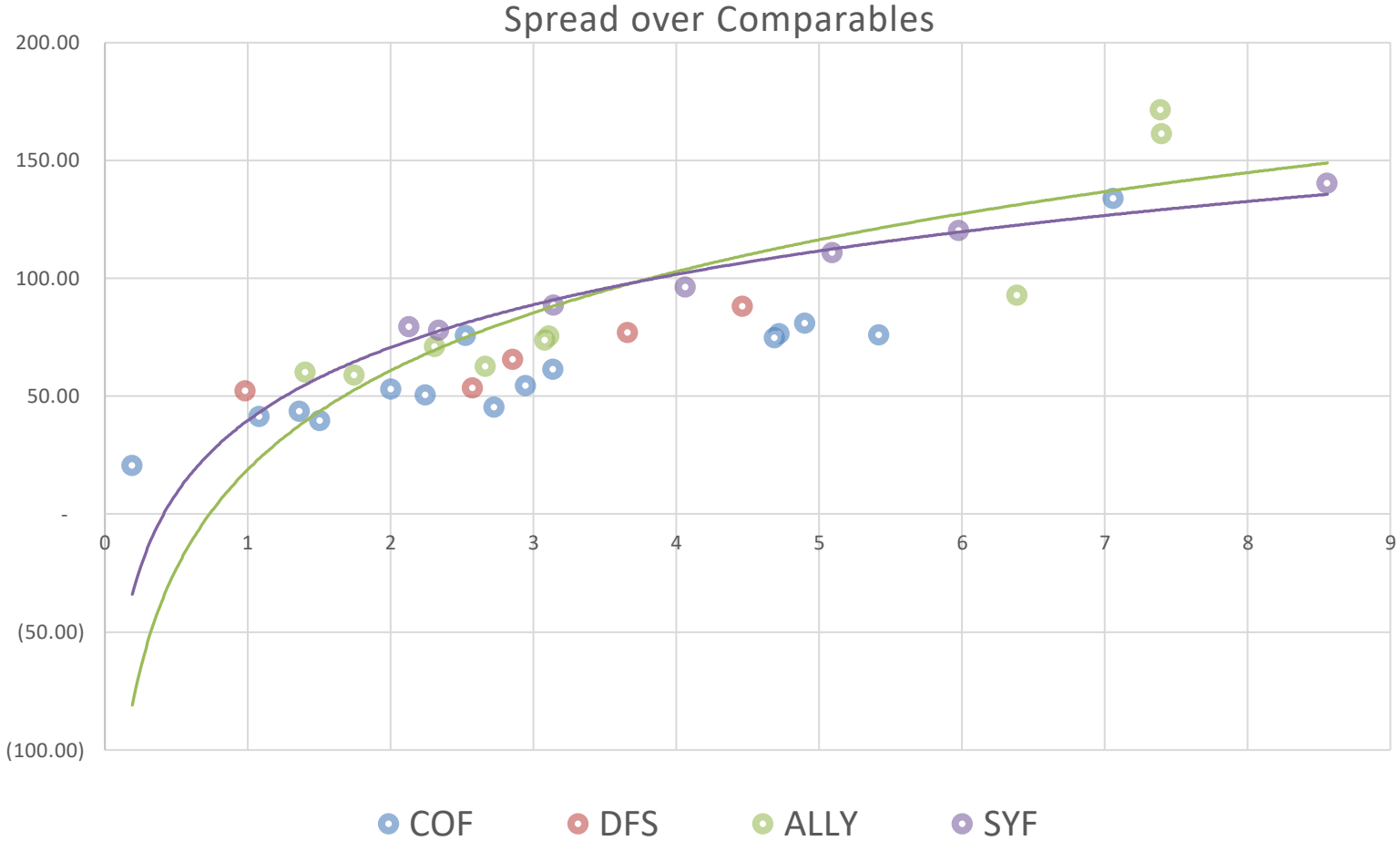
Ally's bonds have a greater potential for upside with limited downside risk

	Downside	Base	Upside
Spread Adjustment	+15 bps	-20 bps	-30 bps
Price	\$136.21	\$139.50	\$140.46
Total 1-Yr Return	2.35%*	4.68%	5.35%
Assumptions	Deteriorating economic conditions stifles consumer demand and increases loss occurrence.	Normalization of loan losses with continued NIM expansion due to growth in low-cost deposits and higher origination yields.	Higher than expected customer demand and resilient used car pricing leads to higher recoveries.

*Downside return assumes sale after a one-year holding period. YTM is 3.158%.

Valuation (1/2)

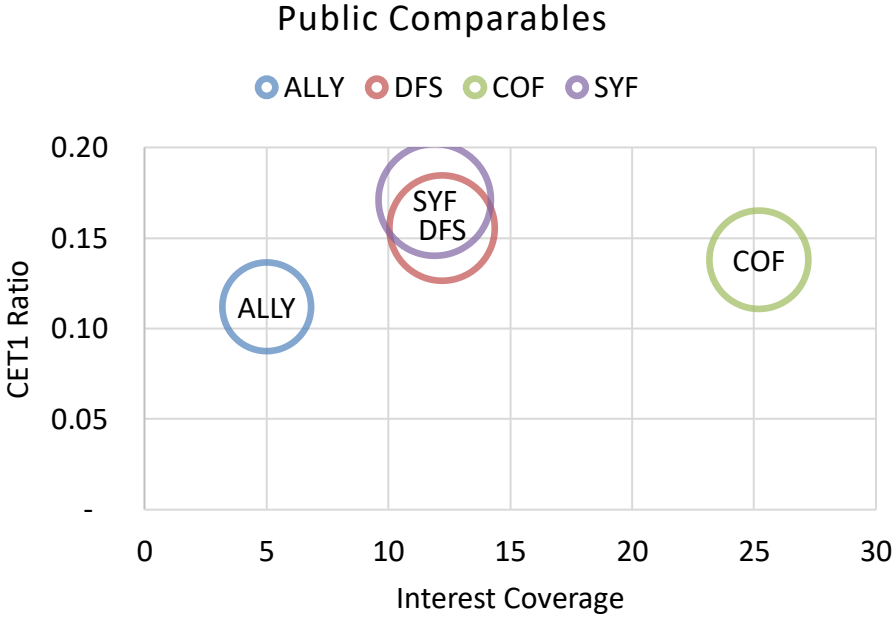
ALLY's 2031 bonds trade about 30 bps wide of SYF and will likely continue narrowing



Valuation (2/2)

ALLY's is well-positioned to continue improving its credit metrics and close the gap from its comps

	Interest Coverage	CET1 Ratio	Leverage Ratio
ALLY	5	11.2%	10%
DFS	12.2	15.5%	13.8%
COF	25.2	13.8%	12.2%
SYF	11.9	17.10%	15.5%



Risks & Mitigants

There are some risks to our rating, but they are managed well by Ally

Increased competition

- **Risk:** Ally competes with other financial institutions to expand relationships with dealers
- **Mitigant:** Ally's dealer-centric model and rewards program compels dealers to expand the amount of business with Ally
- **Risk:** Ally also competes with other banks for deposits, which may require Ally to offer higher deposit rates
- **Mitigant:** Ally has a 94% retention rate for deposit customers and already offers higher rates than the larger institutions

Deteriorating credit metrics

- **Risk:** Due to the pro-cyclical nature of automotive finance, an economic downturn can have adverse impacts on delinquencies, recoveries, and charge-offs
- **Mitigant:** Ally has focused on risk-adjusted returns across the credit spectrum and continues to diversify its customer base

Inability to execute on initiatives

- **Risk:** Ally may be unable to execute on its initiatives to broaden its product offerings, such as the acquisition of Fair Square Financial
- **Mitigant:** Ally's growth initiatives have significant overlap with its existing customer base and its multi-product customers account for 9% of customers, up from 2% since 2017

BUY Rating on ALLY 8.000 Senior Unsecured Bonds (11/01/2031)

- High ROTCE due to strict management of funding costs and expanding margins on assets
 - Ally is now structurally more profitable than it was pre-pandemic but has yet to receive the credit it deserves from the rating agencies
- Strategic capital deployment to expand its product offerings
- Undervalued relative to its BBB- comparables and should trade through SYF in the near term
- Poised for earnings surprises due to tailwinds in the consumer finance market and likely in a multi-year, multiple upgrade cycle
 - Catalyst for 20-30 bps yield compression

Questions?



Appendix



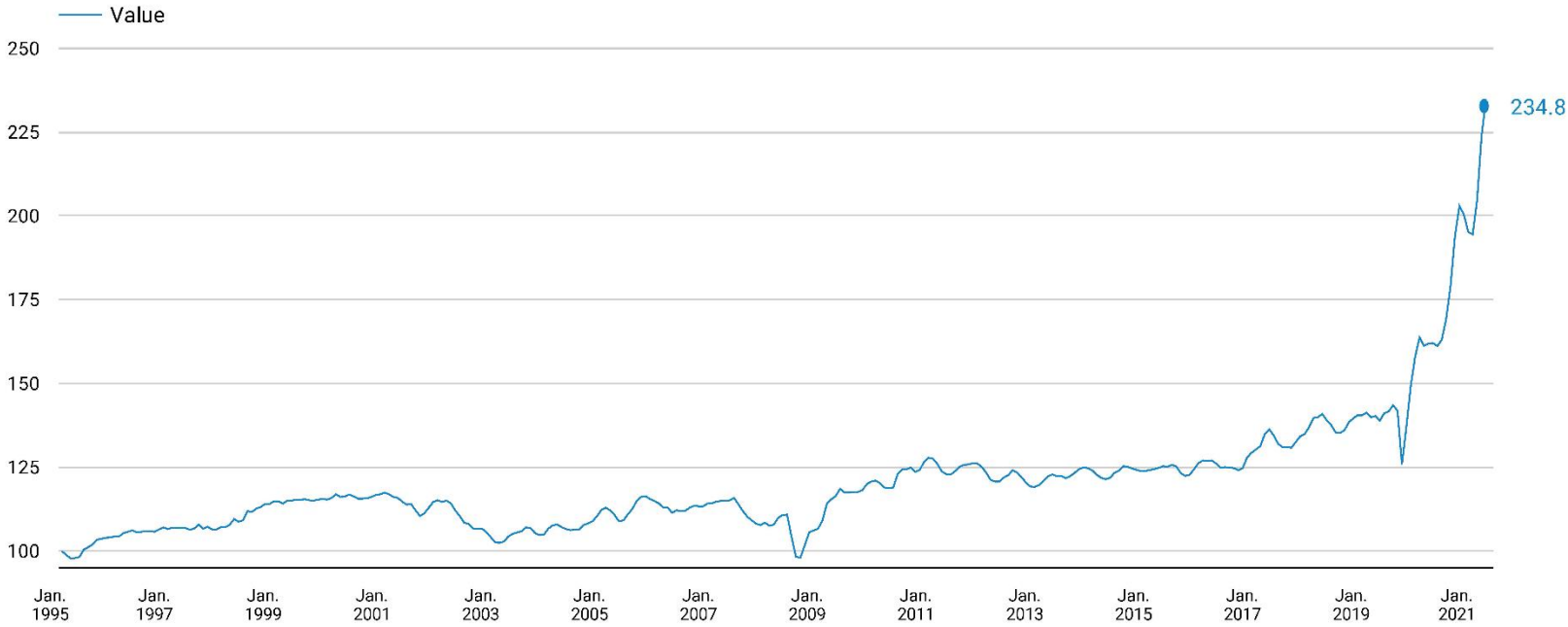
Porter's Forces	Description
Rivalry	High - Low levels of concentration among largest players, they account for approx. 25% of revenue. Difficult to differentiate products, compete on price, increasing consumer base, and cross selling products
Bargaining Power of Suppliers	Low - Suppliers are less of a concern in this industry which relies on streamlined technology processes to reduce costs
Bargaining Power of Buyers	Medium – Consumers have less power over the operators to influence prices. However, dealers may choose to work with other automotive finance providers to negotiate pricing
Substitutes	High - Difficult to differentiate financing products, so there is emphasis on elevating switching costs
Threat of New Entrants	Medium - Although there are not prohibitive fixed costs, the cost to comply with regulation, acquiring a consumer base, and establishing a dealership network deters many new entrants

Term	Description
Notes	8% Sr Unsecured Notes 11/01/2031
Issuer	Ally Financial
Principal Amount	1,995,021
Coupon Rate	8%
Maturity Date	Nov.1 2031
Covenants:	<ol style="list-style-type: none"> 1) Negative Pledge 2) Negative Covenant 3) Certain Sales of Assets 4) Merger Restrictions 5) Restrictive Covenant 6) Collective Action Clause
Events of default	<p>An event of default with respect to the notes is defined in the Indenture as being:</p> <ul style="list-style-type: none"> • default for 30 days in payment of any interest with respect to the notes; • default in the performance of any other covenant in the Indenture or the notes for 30 days after notice by the Trustee or holders of at least 25% in aggregate principal amount of the notes at the time outstanding; or • certain events of bankruptcy, insolvency or reorganization with respect to Ally

Used Vehicle Values

High used car values increase recoveries on Ally's increasing used vehicle portfolio

MANHEIM USED VEHICLE VALUE INDEX
Mid-November 2021



Interest Rate Environment

In rising rate environments, auto loan yields have expanded faster than rising deposit costs

Auto Loan Yield vs. Deposit Costs

