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Discover Financial Services
Form 10-Q
August 02, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2016

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 001-33378

DISCOVER FINANCIAL SERVICES

(Exact name of registrant as specified in its charter)

Delaware

36-2517428

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

2500 Lake Cook Road,
Riverwoods, Illinois 60015

(224) 405-0900

(Address of principal executive offices, including zip code) (Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

As of July 29, 2016, there were 403,627,107 shares of the registrant's Common Stock, par value \$0.01 per share, outstanding.

DISCOVER FINANCIAL SERVICES

Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2016

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Except as otherwise indicated or unless the context otherwise requires, "Discover Financial Services," "Discover," "DFS," "we," "us," "our," and "the Company" refer to Discover Financial Services and its subsidiaries.

We own or have rights to use the trademarks, trade names and service marks that we use in conjunction with the operation of our business, including, but not limited to: Discover[®], PULSE[®], Cashback Bonus[®], Discover Cashback Checking[®], Discover it[®], Freeze ItSM, Discover[®] Network and Diners Club International[®]. All other trademarks, trade names and service marks included in this quarterly report on Form 10-Q are the property of their respective owners.

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

DISCOVER FINANCIAL SERVICES

Condensed Consolidated Statements of Financial Condition

	June 30, 2016	December 31, 2015
	(unaudited)	
	(dollars in millions, except share amounts)	
Assets		
Cash and cash equivalents	\$10,617	\$ 9,572
Restricted cash	98	99
Other short-term investments	1,050	—
Investment securities (includes \$2,313 and \$2,963 at fair value at June 30, 2016 and December 31, 2015, respectively)	2,471	3,084
Loan receivables		
Loan receivables	71,924	72,385
Allowance for loan losses	(1,949)	(1,869)
Net loan receivables	69,975	70,516
Premises and equipment, net	708	693
Goodwill	255	255
Intangible assets, net	167	168
Other assets	2,170	2,412
Total assets	\$87,511	\$ 86,799
Liabilities and Stockholders' Equity		
Deposits		
Interest-bearing deposit accounts	\$48,104	\$ 47,094
Non-interest bearing deposit accounts	423	437
Total deposits	48,527	47,531
Long-term borrowings	24,681	24,650
Accrued expenses and other liabilities	2,906	3,343
Total liabilities	76,114	75,524
Commitments, contingencies and guarantees (Notes 9, 12 and 13)		
Stockholders' Equity:		
Common stock, par value \$0.01 per share; 2,000,000,000 shares authorized; 562,355,187 and 560,679,352 shares issued at June 30, 2016 and December 31, 2015, respectively	5	5
Preferred stock, par value \$0.01 per share; 200,000,000 shares authorized; 575,000 shares issued and outstanding and aggregate liquidation preference of \$575 at June 30, 2016 and December 31, 2015	560	560
Additional paid-in capital	3,932	3,885
Retained earnings	14,188	13,250
Accumulated other comprehensive loss	(174)	(160)
Treasury stock, at cost; 155,823,385 and 139,000,423 shares at June 30, 2016 and December 31, 2015, respectively	(7,114)	(6,265)
Total stockholders' equity	11,397	11,275
Total liabilities and stockholders' equity	\$87,511	\$ 86,799

Upon adoption of ASU 2015-03, Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, certain balances as of December 31, 2015 have been restated to reflect the classification of debt

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issuance costs as a direct deduction of the related liability. See Note 1: Background and Basis of Presentation for additional information.

The table below presents the carrying amounts of certain assets and liabilities of Discover Financial Services' consolidated variable interest entities ("VIEs") which are included in the condensed consolidated statements of financial condition above. The assets in the table below include those assets that can only be used to settle obligations of the consolidated VIEs. The liabilities in the table below include third-party liabilities of consolidated VIEs only and exclude intercompany balances that eliminate in consolidation. The liabilities also exclude amounts for which creditors have recourse to the general credit of Discover Financial Services.

	June 30,	December 31,
	2016	2015
	(unaudited)	
	(dollars in millions)	
Assets		
Restricted cash	\$98	\$ 99
Loan receivables	\$32,419	\$ 30,551
Allowance for loan losses allocated to securitized loan receivables	\$(899)	\$ (811)
Other assets	\$5	\$ 5
Liabilities		
Long-term borrowings	\$16,662	\$ 16,735
Accrued expenses and other liabilities	\$14	\$ 12

See Notes to the Condensed Consolidated Financial Statements.

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Condensed Consolidated Statements of Income

	For the Three Months Ended June 30, 2016		For the Six Months Ended June 30, 2015	
	2016	2015	2016	2015
	(unaudited)			
	(dollars in millions, except per share amounts)			
Interest income				
Credit card loans	\$1,734	\$1,620	\$3,467	\$3,226
Other loans	331	308	657	612
Investment securities	10	12	21	25
Other interest income	15	7	29	13
Total interest income	2,090	1,947	4,174	3,876
Interest expense				
Deposits	166	155	328	307
Short-term borrowings	—	—	—	1
Long-term borrowings	173	156	345	303
Total interest expense	339	311	673	611
Net interest income	1,751	1,636	3,501	3,265
Provision for loan losses	412	306	836	696
Net interest income after provision for loan losses	1,339	1,330	2,665	2,569
Other income				
Discount and interchange revenue, net	265	298	538	566
Protection products revenue	59	68	120	139
Loan fee income	79	80	159	161
Transaction processing revenue	39	40	75	82
Gain on investments	—	—	—	8
Gain on origination and sale of mortgage loans	—	26	—	66
Other income	23	27	47	59
Total other income	465	539	939	1,081
Other expense				
Employee compensation and benefits	340	326	685	657
Marketing and business development	198	199	360	381
Information processing and communications	89	90	177	178
Professional fees	150	153	310	280
Premises and equipment	23	23	47	47
Other expense	106	136	213	257
Total other expense	906	927	1,792	1,800
Income before income tax expense	898	942	1,812	1,850
Income tax expense	282	343	621	665
Net income	\$616	\$599	\$1,191	\$1,185
Net income allocated to common stockholders	\$602	\$586	\$1,164	\$1,159
Basic earnings per common share	\$1.47	\$1.33	\$2.81	\$2.61
Diluted earnings per common share	\$1.47	\$1.33	\$2.81	\$2.61
Dividends declared per common share	\$0.30	\$0.28	\$0.58	\$0.52

See Notes to the Condensed Consolidated Financial Statements.

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DISCOVER FINANCIAL SERVICES

Condensed Consolidated Statements of Comprehensive Income

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
	(unaudited)			
	(dollars in millions)			
Net income	\$616	\$599	\$1,191	\$1,185
Other comprehensive income (loss), net of taxes				
Unrealized gain (loss) on available-for-sale investment securities, net of tax	4	(10)	18	(10)
Unrealized (loss) gain on cash flow hedges, net of tax	(6)	11	(32)	(12)
Other comprehensive (loss) income	(2)	1	(14)	(22)
Comprehensive income	\$614	\$600	\$1,177	\$1,163

See Notes to the Condensed Consolidated Financial Statements.

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DISCOVER FINANCIAL SERVICES

Condensed Consolidated Statements of Changes in Stockholders' Equity

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Treasury Stock	Total Stockholders' Equity
(unaudited)									
(dollars in millions, shares in thousands)									
Balance at December 31, 2014	575	\$ 560	558,194	\$ 5	\$ 3,790	\$ 11,467	\$ (138)	\$ (4,550)	\$ 11,134
Net income	—	—	—	—	—	—	—	—	—