Synchrony Financial
Form 10-Q
July 28, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
001-36560
(Commission File Number)
SYNCHRONY FINANCIAL
(Exact name of registrant as specified in its charter)

Delaware	51-0483352
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

777 Long Ridge Road

Stamford, Connecticut	06902
(Address of principal executive offices)	(Zip Code)

(Registrant's telephone number, including area code) (203) 585-2400

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 ý 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 ý 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. (Check one):

Large accelerated filer ý	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
The number of shares of the registrant's common stock, par value $0.001 per share, outstanding as of July 25, 2016 was 833,925,364.

Synchrony Financial

Certain Defined Terms

Except as the context may otherwise require in this report, references to:

- "we," "us," "our" and the "Company" are to SYNCHRONY FINANCIAL and its subsidiaries;
- "Synchrony" are to SYNCHRONY FINANCIAL only;
- "GE" are to General Electric Company and its subsidiaries;
- "GECC" are to General Electric Capital Corporation (a subsidiary of GE) and its subsidiaries;
- the "Bank" are to Synchrony Bank (a subsidiary of Synchrony);
- the "Bank Term Loan" are to the term loan agreement, dated as of July 30, 2014, among Synchrony, as borrower, JPMorgan Chase Bank, N.A., as administrative agent, and the lenders from time to time party thereto, as amended;
- the "GECC Term Loan" are to the term loan agreement, dated as of July 30, 2014, among Synchrony, as borrower, GECC, as administrative agent, and the other Lenders party thereto, as amended;
- "FICO" score are to a credit score developed by Fair Isaac & Co., which is widely used as a means of evaluating the likelihood that credit users will pay their obligations; and
- "EMV" are to new security technology that utilizes embedded security chips in our credit cards.

For a description of certain other terms we use, including "active account" and "purchase volume," see the notes to "Item 7. Management's Discussion and Analysis—Other Financial and Statistical Data" in our Annual Report on Form 10-K for the year ended December 31, 2015 (our "2015 Form 10-K"). There is no standard industry definition for many of these terms, and other companies may define them differently than we do.

We provide a range of credit products through programs we have established with a diverse group of national and regional retailers, local merchants, manufacturers, buying groups, industry associations and healthcare service providers, which, in our business and in this report, we refer to as our "partners." The terms of the programs all require cooperative efforts between us and our partners of varying natures and degrees to establish and operate the programs. Our use of the term "partners" to refer to these entities is not intended to, and does not, describe our legal relationship with them, imply that a legal partnership or other relationship exists between the parties or create any legal partnership or other relationship. The "average length of our relationship" with respect to a specified partner, group of partners or programs is measured on a weighted average basis by interest and fees on loans for the year ended December 31, 2015 for those partners or for all partners participating in a program, based on the date each partner relationship or program, as applicable, started.

Unless otherwise indicated, references to "loan receivables" do not include loan receivables held for sale.

"Synchrony" and its logos and other trademarks referred to in this report, including CareCredit®, Quickscreen®, Dual Card™ and eQuickscreen™ belong to us. Solely for convenience, we refer to our trademarks in this report without the ™ and ® symbols, but such references are not intended to indicate that we will not assert, to the fullest extent under applicable law, our rights to our trademarks. Other service marks, trademarks and trade names referred to in this report are the property of their respective owners.

On our website at www.synchronyfinancial.com, we make available under the "Investors-SEC Filings" menu selection, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after such reports or amendments are electronically filed with, or furnished to, the SEC. Materials that we file or furnish to the SEC may also be read and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. Also, the SEC maintains an Internet site at www.sec.gov that contains reports, proxy and information statements, and other information that we file electronically with the SEC.

Cautionary Note Regarding Forward-Looking Statements:

Various statements in this Quarterly Report on Form 10-Q may contain “forward-looking statements” as defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), which are subject to the “safe harbor” created by those sections. Forward-looking statements may be identified by words such as “expects,” “intends,” “anticipates,” “plans,” “believes,” “seeks,” “targets,” “outl “estimates,” “will,” “should,” “may” or words of similar meaning, but these words are not the exclusive means of identifying forward-looking statements.

Forward-looking statements are based on management’s current expectations and assumptions, and are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. As a result, actual results could differ materially from those indicated in these forward-looking statements. Factors that could cause actual results to differ materially include global political, economic, business, competitive, market, regulatory and other factors and risks, such as: the impact of macroeconomic conditions and whether industry trends we have identified develop as anticipated; retaining existing partners and attracting new partners, concentration of our revenue in a small number of Retail Card partners, promotion and support of our products by our partners, and financial performance of our partners; higher borrowing costs and adverse financial market conditions impacting our funding and liquidity, and any reduction in our credit ratings; our ability to securitize our loans, occurrence of an early amortization of our securitization facilities, loss of the right to service or subservice our securitized loans, and lower payment rates on our securitized loans; our ability to grow our deposits in the future; changes in market interest rates and the impact of any margin compression; effectiveness of our risk management processes and procedures, reliance on models which may be inaccurate or misinterpreted, our ability to manage our credit risk, the sufficiency of our allowance for loan losses and the accuracy of the assumptions or estimates used in preparing our financial statements; our ability to offset increases in our costs in retailer share arrangements; competition in the consumer finance industry; our concentration in the U.S. consumer credit market; our ability to successfully develop and commercialize new or enhanced products and services; our ability to realize the value of strategic investments; reductions in interchange fees; fraudulent activity; cyber-attacks or other security breaches; failure of third parties to provide various services that are important to our operations; our transition to a replacement third-party vendor to manage the technology platform for our online retail deposits; disruptions in the operations of our computer systems and data centers; international risks and compliance and regulatory risks and costs associated with international operations; alleged infringement of intellectual property rights of others and our ability to protect our intellectual property; litigation and regulatory actions; damage to our reputation; our ability to attract, retain and motivate key officers and employees; tax legislation initiatives or challenges to our tax positions and state sales tax rules and regulations; a material indemnification obligation to GE under the tax sharing and separation agreement with GE (the "TSSA") if we cause the split-off from GE or certain preliminary transactions to fail to qualify for tax-free treatment or in the case of certain significant transfers of our stock following the split-off; obligations associated with being an independent public company; regulation, supervision, examination and enforcement of our business by governmental authorities, the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and the impact of the Consumer Financial Protection Bureau's (the “CFPB”) regulation of our business; changes to our methods of offering our CareCredit products; impact of capital adequacy rules and liquidity requirements; restrictions that limit our ability to pay dividends and repurchase our common stock, and restrictions that limit Synchrony Bank’s ability to pay dividends to us; regulations relating to privacy, information security and data protection; use of third-party vendors and ongoing third-party business relationships; and failure to comply with anti-money laundering and anti-terrorism financing laws.

For the reasons described above, we caution you against relying on any forward-looking statements, which should also be read in conjunction with the other cautionary statements that are included elsewhere in this report and in our public filings, including under the heading “Risk Factors” in our 2015 Form 10-K. You should not consider any list of such factors to be an exhaustive statement of all of the risks, uncertainties, or potentially inaccurate assumptions that could cause our current expectations or beliefs to change. Further, any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update or revise any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events, except as otherwise may be required by the federal securities laws.

PART I. FINANCIAL INFORMATION

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this quarterly report and in our 2015 Form 10-K. The discussion below contains forward-looking statements that are based upon current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these expectations. See “Cautionary Note Regarding Forward-Looking Statements.”

Introduction and Business Overview

We are one of the premier consumer financial services companies in the United States. We provide a range of credit products through programs we have established with a diverse group of national and regional retailers, local merchants, manufacturers, buying groups, industry associations and healthcare service providers, which we refer to as our “partners.” For the three and six months ended June 30, 2016, we financed $31.5 billion and $58.5 billion of purchase volume and had 65.5 million and 66.0 million average active accounts, respectively, and at June 30, 2016, we had $68.3 billion of loan receivables. For the three and six months ended June 30, 2016, we had net earnings of $489 million and $1,071 million, respectively, representing a return on assets of 2.4% and 2.6%, respectively.

We offer our credit products primarily through our wholly-owned subsidiary, the Bank. Through the Bank, we offer, directly to retail and commercial customers, a range of deposit products insured by the Federal Deposit Insurance Corporation (“FDIC”), including certificates of deposit, individual retirement accounts (“IRAs”), money market accounts and savings accounts. We also take deposits at the Bank through third-party securities brokerage firms that offer our FDIC-insured deposit products to their customers. We have expanded and continue to expand our online direct banking operations to increase our deposit base as a source of stable and diversified low cost funding for our credit activities. At June 30, 2016 we had $46.4 billion in deposits, which represented 71% of our total funding sources.

In November 2015, Synchrony Financial became a stand-alone savings and loan holding company following the completion of GE's exchange offer, in which GE exchanged shares of GE common stock for all of the shares of our common stock it owned (the “Separation”).

Our Sales Platforms

We conduct our operations through a single business segment. Our revenue activities are managed for the business as a whole. Substantially all of our operations are within the United States. We offer our credit products through three sales platforms (Retail Card, Payment Solutions and CareCredit). Those platforms are organized by the types of products we offer and the partners we work with, and are measured on interest and fees, loan receivables, new accounts and other sales metrics.

Retail Card

Retail Card is a leading provider of private label credit cards, and also provides Dual Cards and small and medium-sized business credit products. Our patented Dual Cards are credit cards that function as private label credit cards when used to purchase goods and services from our partners and as general purpose credit cards when used elsewhere. We offer one or more of these products primarily through 24 national and regional retailers with which we have ongoing program agreements. The average length of our relationships with these Retail Card partners is 19 years. Retail Card's revenue primarily consists of interest and fees on our loan receivables. Other income earned by the Retail Card sales platform primarily consists of interchange fees earned on Dual Card transactions (when the card is used outside of our partners' sales channels) and fees paid to us by customers who purchase our debt cancellation products, less loyalty program payments. In addition, the Retail Card sales platform includes the majority of our retailer share arrangements, which generally provide for payment to our partner if the economic performance of the program exceeds a contractually-defined threshold. Substantially all of the credit extended in this platform is on standard terms.

Payment Solutions

Payment Solutions is a leading provider of promotional financing for major consumer purchases, offering private label credit cards and installment loans. Payment Solutions offers these products through participating partners consisting of national and regional retailers, local merchants, manufacturers, buying groups and industry associations. Substantially all of the credit extended in Payment Solutions is promotional financing. Payment Solutions' revenue primarily consists of interest and fees on our loan receivables, including "merchant discounts," which are fees paid to us by our partners in almost all cases to compensate us for all or part of foregone interest revenue associated with promotional financing.

CareCredit

CareCredit is a leading provider of promotional financing to consumers for elective healthcare procedures, products or services, such as dental, veterinary, cosmetic, vision and audiology. CareCredit offers financing through a CareCredit-branded private label credit card that may be used across our network of CareCredit providers in which the vast majority are individual or small groups of independent healthcare providers. Substantially all of the credit extended in this platform is promotional financing. CareCredit's revenue primarily consists of interest and fees on our credit products and from merchant discounts. We also process general purpose card transactions for some providers as their acquiring bank within most of the credit card network associations, for which we obtain an interchange fee.

Our Credit Products

Through our platforms, we offer three principal types of credit products: credit cards, commercial credit products and consumer installment loans. We also offer a debt cancellation product.

The following table sets forth each credit product by type and indicates the percentage of our total loan receivables that are under standard terms only or pursuant to a promotional financing offer at June 30, 2016.

Credit Product	Standard Terms Only	Promotional Offer		Total
		Deferred Interest	Other Promotional	
Credit cards	66.3 %	16.9 %	12.8 %	96.0 %
Commercial credit products	2.0	—	—	2.0
Consumer installment loans	—	—	1.9	1.9
Other	0.1	—	—	0.1
Total	68.4 %	16.9 %	14.7 %	100.0 %

Credit Cards

We offer two principal types of credit cards: private label credit cards and Dual Cards:

- Private label credit cards. Private label credit cards are partner-branded credit cards (e.g., Lowe’s or Amazon) or program-branded credit cards (e.g., CarCareONE or CareCredit) that are used primarily for the purchase of goods and services from the partner or within the program network. In addition, in some cases, cardholders may be permitted to access their credit card accounts for cash advances. In Retail Card, credit under our private label credit cards typically is extended on standard terms only, and in Payment Solutions and CareCredit, credit under our private label credit cards typically is extended pursuant to a promotional financing offer.
- Dual Cards. Our patented Dual Cards are co-branded general purpose credit cards that function as private label credit cards when used to purchase goods and services from our partners and as general purpose credit cards when used elsewhere. Credit extended under our Dual Cards typically is extended under standard terms only. Currently, only our Retail Card platform offers Dual Cards. At June 30, 2016, we offered Dual Cards or co-branded credit cards through 17 of our 24 ongoing Retail Card programs.

Commercial Credit Products

We offer private label cards and Dual Cards for commercial customers that are similar to our consumer offerings. We also offer a commercial pay-in-full accounts receivable product to a wide range of business customers. We offer commercial credit products primarily through our Retail Card platform to the commercial customers of our Retail Card partners.

Installment Loans

In Payment Solutions, we originate installment loans to consumers (and a limited number of commercial customers) in the United States, primarily in the power product market (motorcycles, ATVs and lawn and garden). Installment loans are closed-end credit accounts where the customer pays down the outstanding balance in installments. Installment loans are assessed periodic finance charges using fixed interest rates.

Business Trends and Conditions

We believe our business and results of operations will be impacted in the future by various trends and conditions, including the following:

- Growth in loan receivables and interest income
- Extended duration of our Retail Card program agreements
- Increases in retailer share arrangement payments and other expense under extended program agreements
- Growth in interchange revenues and loyalty program costs
- Impact of regulatory developments
- Capital and liquidity levels; We continue to expect to maintain sufficient capital and liquidity resources to support our daily operations, our business growth, and our credit ratings as well as regulatory and compliance requirements in a cost effective and prudent manner through expected and unexpected market environments. As discussed in our 2015 Form 10-K, our Board of Directors (the "Board") intended to establish both dividend and share repurchase programs, and accordingly, on July 7, 2016, they approved a $0.13 quarterly common stock dividend as well as a share repurchase program of up to $952 million for the four quarters ending June 30, 2017. Our Board also declared our first quarterly cash dividend of $0.13 per share, payable on August 25, 2016 to holders of record at the close of business on August 12, 2016. While these programs have now been established, we continue to expect to maintain capital ratios well in excess of minimum regulatory requirements.
- Stable asset quality; During 2016, we have continued to note general improvement in the U.S. economy and our actual net charge-off rates have remained relatively stable, decreasing slightly by 14 basis points to 4.49% for the three months ended June 30, 2016, compared to 4.63% for the three months ended June 30, 2015. The assessment of our credit profile includes the evaluation of portfolio mix, account maturation, as well as broader consumer trends, such as payment behavior and overall indebtedness. During the second quarter of 2016, these factors contributed to an increase in our delinquent accounts and we are now estimating a 20-30 basis point increase in our net charge-off rate over the next twelve months. Accordingly, we also experienced a corresponding increase in our allowance coverage ratio, as we reserved for these forecasted losses inherent in our loan portfolio.

For a further discussion of these trends and conditions, see “Management's Discussion and Analysis of Financial Condition and Results of Operations—Business Trends and Conditions” in our 2015 Form 10-K. For a discussion of how these trends and conditions impacted the three and six months ended June 30, 2016, see “Results of Operations.”

Seasonality

In our Retail Card and Payment Solutions platforms, we experience fluctuations in transaction volumes and the level of loan receivables as a result of higher seasonal consumer spending and payment patterns that typically result in an increase of loan receivables from August through a peak in late December, with reductions in loan receivables occurring over the first and second quarters of the following year as customers pay their balances down.

The seasonal impact to transaction volumes and the loan receivables balance typically results in fluctuations in our results of operations, delinquency metrics and the allowance for loan losses as a percentage of total loan receivables between quarterly periods.

In addition to the seasonal variance in loan receivables discussed above, we also experience a seasonal increase in delinquency rates and delinquent loan receivables balances during the third and fourth quarters of each year due to lower customer payment rates resulting in higher net charge-off rates in the first and second quarters. Our delinquency rates and delinquent loan receivables balances typically decrease during the subsequent first and second quarters as customers begin to pay down their loan balances and return to current status resulting in lower net charge-off rates in the third and fourth quarters. Because customers who were delinquent during the fourth quarter of a calendar year have a higher probability of returning to current status when compared to customers who are delinquent at the end of each of our interim reporting periods, we expect that a higher proportion of delinquent accounts outstanding at an interim period end will result in charge-offs, as compared to delinquent accounts outstanding at a year end. Consistent with this historical experience, we generally experience a higher allowance for loan losses as a percentage of total loan receivables at the end of an interim period, as compared to the end of a calendar year. In addition, despite improving credit metrics such as declining past due amounts, we may experience an increase in our allowance for loan losses at an interim period end compared to the prior year end, reflecting these same seasonal trends.

Results of Operations

Highlights for the Three and Six Months Ended June 30, 2016

Below are highlights of our performance for the three and six months ended June 30, 2016 compared to the three and six months ended June 30, 2015, as applicable, except as otherwise noted.

- Net earnings decreased 9.6% to $489 million and 2.0% to $1,071 million for the three and six months ended June 30, 2016, respectively, driven by increases in provision for loan losses and other expense, partially offset by higher net interest income.
- Loan receivables increased 11.2% to $68,282 million at June 30, 2016 compared to June 30, 2015, primarily driven by higher purchase volume and average active account growth.
- Net interest income increased 10.5% to $3,212 million and 11.1% to $6,421 million for three and six months ended June 30, 2016, respectively, primarily due to higher average loan receivables.
- Retailer share arrangements increased 6.9% to $664 million and 4.1% to $1,334 million for the three and six months ended June 30, 2016, respectively, primarily as a result of growth and improved performance of the programs in which we have retailer share arrangements, partially offset by higher provision for loan losses and loyalty costs associated with these programs.
- Over-30 day loan delinquencies as a percentage of period-end loan receivables increased to 3.79% at June 30, 2016 from 3.53% at June 30, 2015, and the net charge-off rate decreased 14 basis points to 4.49% and increased 3 basis points to 4.59% for the three and six months ended June 30, 2016, respectively.
- Provision for loan losses increased by $281 million, or 38.0%, and $497 million or 34.8% for the three and six months ended June 30, 2016, respectively, due to a higher loan loss reserve build and receivable growth. Our allowance coverage ratio (allowance for loan losses as a percent of end of period loan receivables) increased to 5.70% at June 30, 2016, as compared to 5.38% at June 30, 2015.
- Other expense increased by $34 million, or 4.2%, and $88 million or 5.7% for three and six months ended June 30, 2016, respectively, driven by business growth.
- We continue to invest in our direct banking activities to grow our deposit base. Total deposits increased 7.1% to $46.4 billion at June 30, 2016, compared to December 31, 2015, driven primarily by growth in our direct deposits of 14.8% to $34.1 billion, partially offset by a reduction in our brokered deposits.

- On July 7, 2016, our Board approved a $0.13 quarterly common stock dividend as well as a share repurchase program of up to $952 million for the four quarters ending June 30, 2017. Our Board also declared our first quarterly cash dividend of $0.13 per share, payable on August 25, 2016 to holders of record at the close of business on August 12, 2016.

New and Extended Partner Agreements during the six months ended June 30, 2016

- We extended our Retail Card program agreement with Stein Mart, launched our new programs with Citgo and Marvel and announced our new partnerships with Cathay Pacific and Fareportal.
- We extended our Payment Solutions program agreements with La-Z-Boy, Ashley Homestore and Suzuki and launched our new program with Mattress Firm.
- In our CareCredit sales platform, we renewed our endorsements with the American Society of Plastic Surgeons and VCA Animal Hospitals.

Summary Earnings

The following table sets forth our results of operations for the periods indicated.

	Three months ended June 30,		Six months ended June 30,	
($ in millions)	2016	2015	2016	2015
Interest income	$3,515	$3,177	$7,035	$6,327
Interest expense	303	270	614	545
Net interest income	3,212	2,907	6,421	5,782
Retailer share arrangements				