Sallie Mae (NASDAQ:SLM)

20-Nov-2024

Chapter Head: Lovish Kalia

Portfolio Managers: Cedric Bax and Noel Myrtaj

Analysts: Bay Shen, Cristian Silva, Mohit Mahi, Savannah Van Bauwel, Sophia Libourkine

Table of Contents

Source(s):

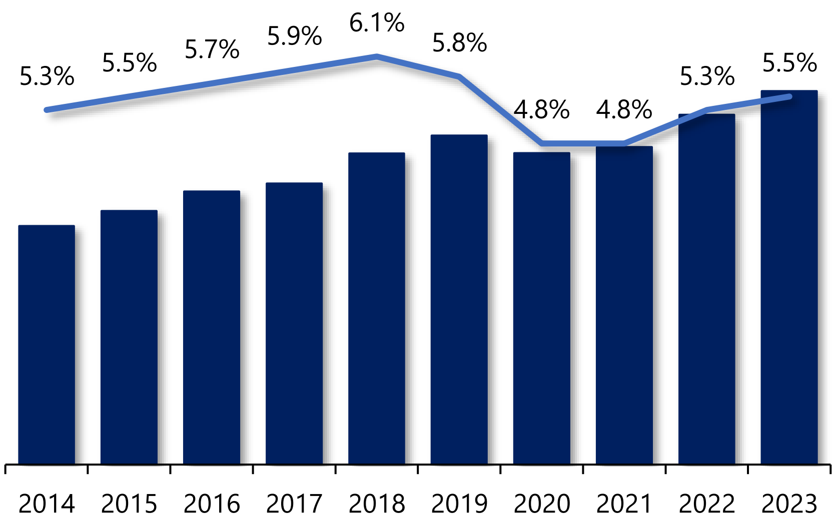
Company Overview

Leading Private Education Loan Lender in the United States

BUSINESS OVERVIEW

- Sallie Mae (SLM) is a bank that offers private education loans to students or families to finance higher education in the US
- It offers online savings account to fund its lending
- Revenue is mostly generated from net interest, but they also sells loans through securitizations, making a gain-on-sale
- SLM has strong net interest margins of 5-6% throughout the cycle, with less sensitivity than most banks
- Credit trends are attractive, with NCO averaging 1% of loans (average FICO of 748, and 87% is cosigned)
- SLM only originates and services its own loans: it does not engage in riskier consolidation / refinancing loans

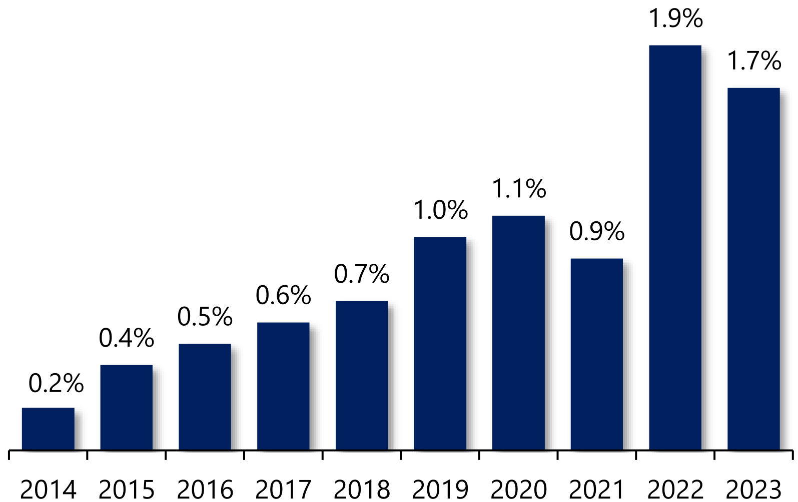
LOAN ORIGINATIONS AND NIM (US Millions $)



KEY METRICS

Share Price	**$23.97**
52-Week Range	$13.93-$24.59
Market Capitalization	$5.1B
Shares Outstanding	218M
LTM ROE	34%

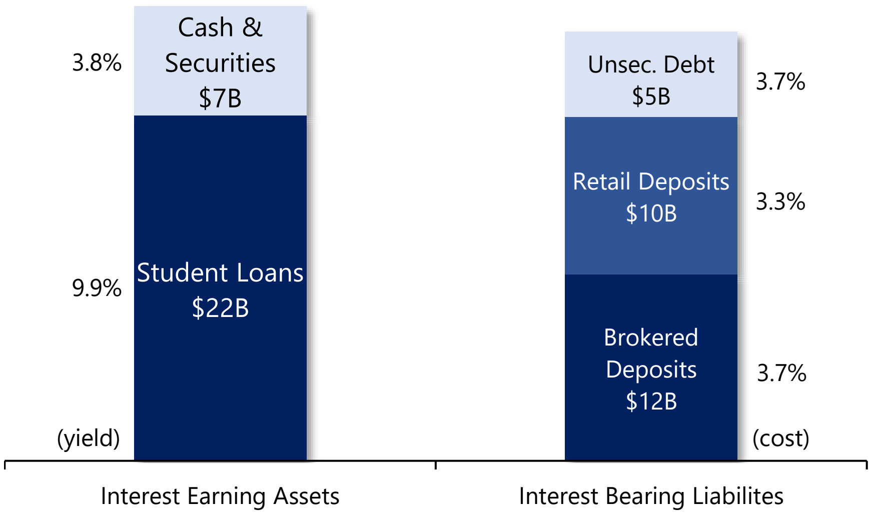
SLM NET CHARGE-OFFS AS A % OF LOANS



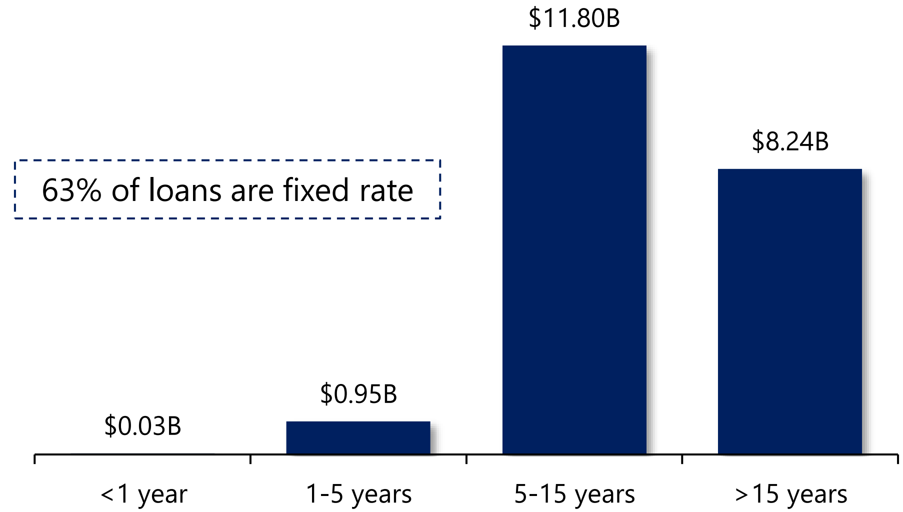
Business Overview

Loans and Deposits Breakdown

FUNDING BASE SUPPORT HIGH-RATE LOANS



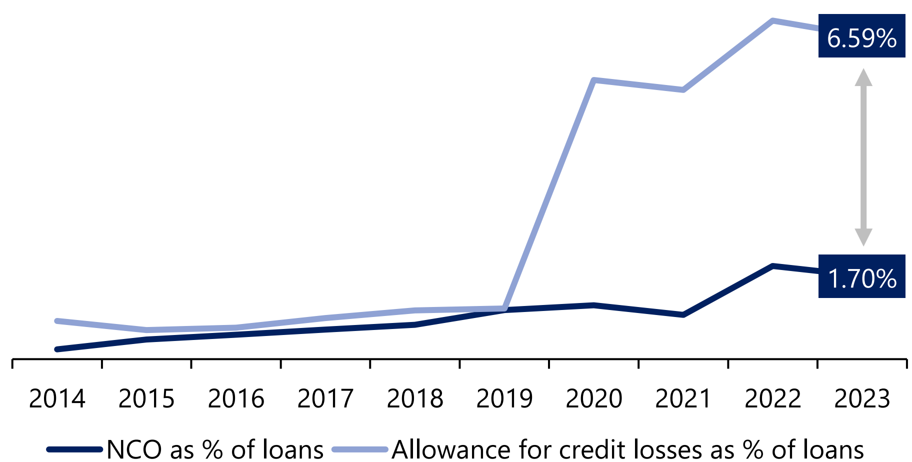
LOAN MATURITIES (US$)



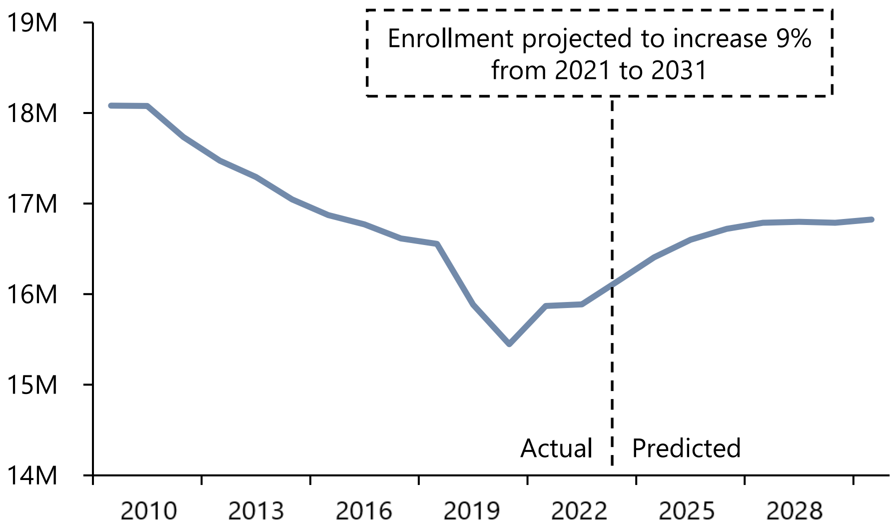
STRONG FUNDING BASE & CONSERVATIVE RESERVING

- Earning assets are mostly high-yielding student loans, matched by deposits (split between retail and brokered)
- Retail deposits are generated through online-only platform with little upkeep costs or reinvestment needs (it has historically been able to grow 10%+ to match loan growth)
- Debt is mostly fixed, low-cost debt was issued in 2020 – 2021 at 3.9%, with maturities in the next few years
- Management is cautious with reserving: NCO coverage is currently 4x, and we are at the peak of the cycle
- There's plenty of room for management to book less PCL in the next few years, driving EPS

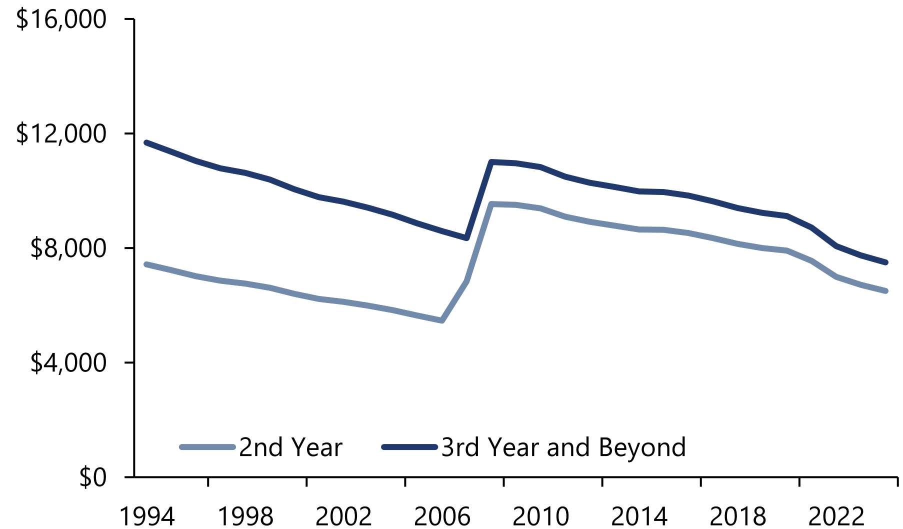
NCO AND ALLOWANCE FOR CREDIT LOSS (% OF LOANS)



UNDERGRADUATE STUDENT ENROLLMENT



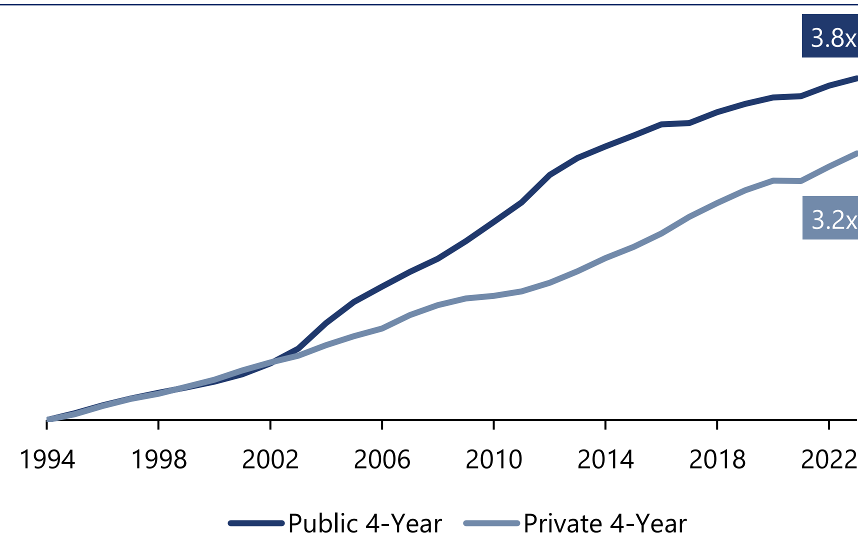
FEDERAL LENDING AMOUNTS



REAL GROWTH IN TUITION COSTS

- Enrollment is projected to rise by 9% from 2021-2031 after a downward prior to the COVID-19 pandemic
- Cost of tuition has risen substantially since 1994, outpacing inflation by 3-4x over that time period
- Meanwhile, federal student loan limits have been on a structural decline since the GFC
- The combination of rising tuition and higher demand for education while federal support is decreasing drives more students to rely on private loans as gap funding
- The originations market should grow ~5% CAGR over the next few years, faster than most lending markets

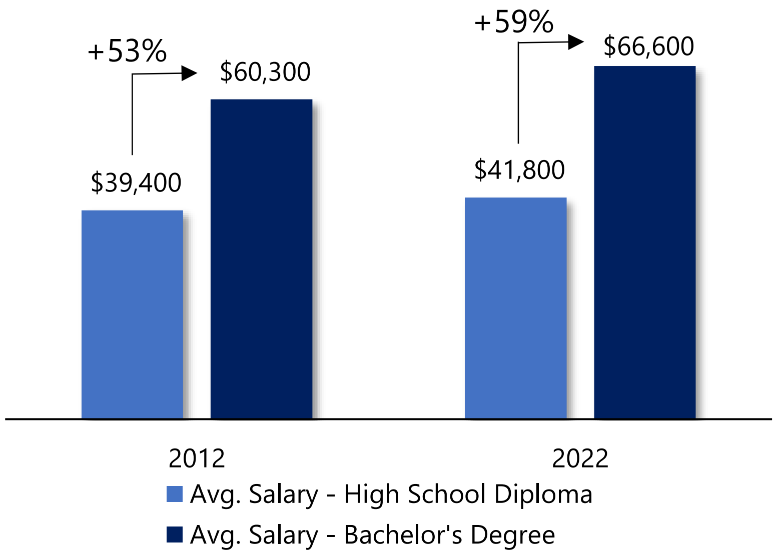
REAL GROWTH IN TUITION COSTS



Industry Overview

High education ROI give lenders bargaining power; the industry has structurally good credit

COLLEGE EDUCATION IS WORTH THE COST OF LOANS



THE INDUSTRY HAS OUTSTANDING CONSUMER CREDIT

- Student aid has decreased by 14% in real terms since 2008
  - School grants have grown, but are mostly needs-based for expensive programs
- Who still needs private loans after exhausting all other options? Mid-/high- income families in expensive programs
  - Those in expensive institutions who don't qualify for need-based grants slip through the cracks of student aid
- **The private student loan market is mostly comprised of mid-/high income families, leading to low credit losses**
- Having exclusively degree holders as clients also helps filter out consumers with worse credit

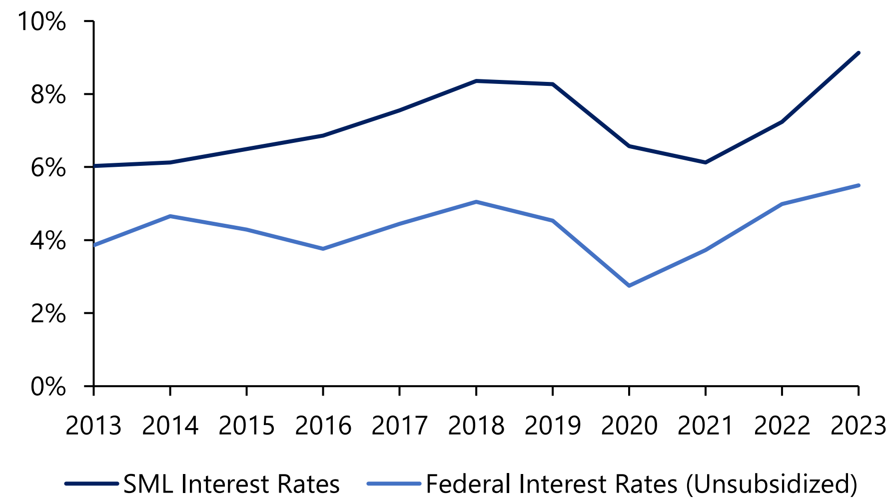
PRIVATE LENDERS HAVE BARGAINING POWER

- Getting a degree correlates with increased lifetime earnings. There's still a strong ROI on education for individuals
- Degree holders also typically experience lower unemployment rates, providing greater job security
- This ensures a healthy demand outlook, and also lets private lenders charge high rates (currently around 10%)
- The bargaining power of lenders also allow them to get inflexible terms and conditions

< 3% of SLM private loans default

Private loans are *not* dischargeable in bankruptcy

PRIVATE LOAN RATES ~300bps HIGHER THAN FEDERAL



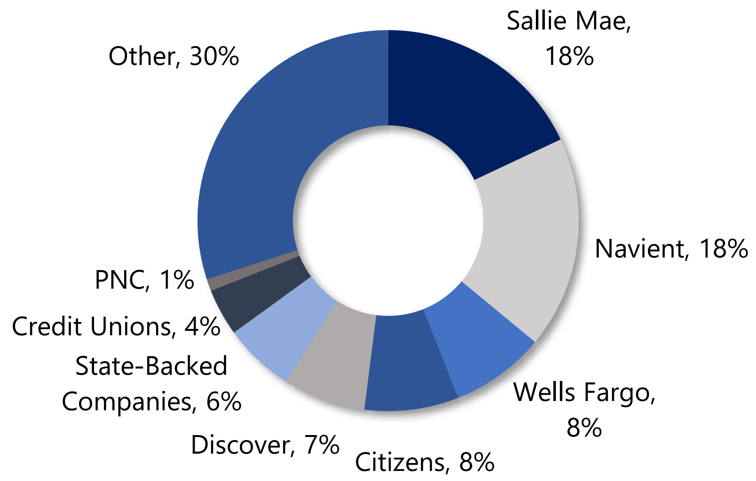
Thesis I: Distribution Advantage

Customer Acquisition & Cost Base

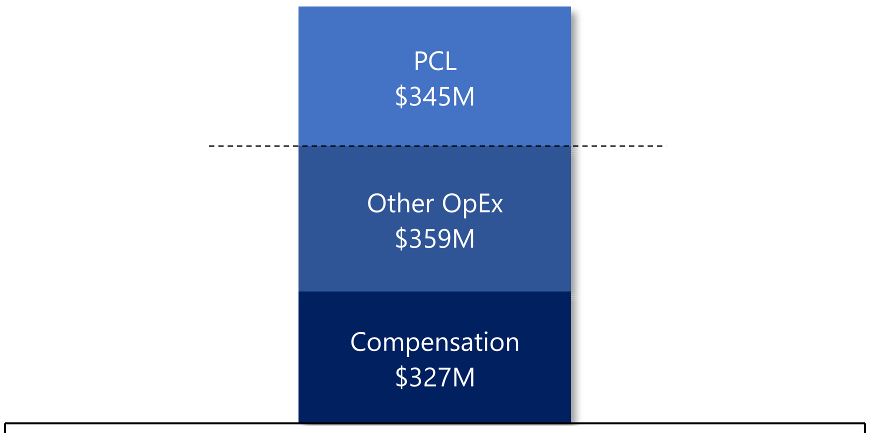
SUPERIOR BRAND AND NETWORK

- SLM is THE trustworthy brand in the industry
  - Schools are risk averse due to the prevalence of student loan scandals in the past, and university student loan offices do not economically benefit from choosing one lender over another, making SLM the default option
- SLM has the largest loan origination network
  - Active relationships with 2,400 colleges, and is the preferred lender for 98% of them
  - 50%-60% market share in originations
- Players are exiting the space (BOFA, WF, JPM, Discover)
  - Sallie Mae's pure-play business model allows unit economics to avoid being impacted by compliance

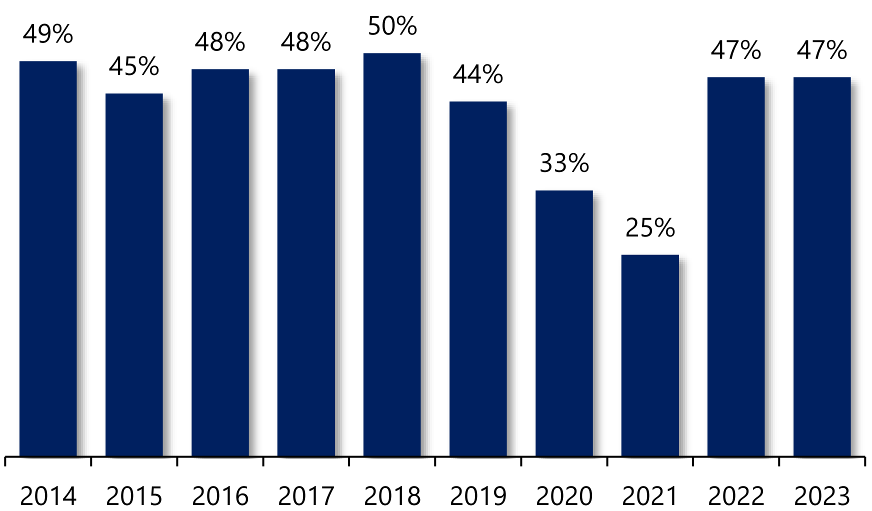
STUDENT LOAN BALANCES MARKET SHARE



NON-INTEREST COST BREAKDOWN



EFFICIENCY RATIO[1] EXCEEDS MOST BANKS



1: Efficiency ratio does not include gains on sale, but includes PCLs. The ratio including GOS is 5%-10% higher

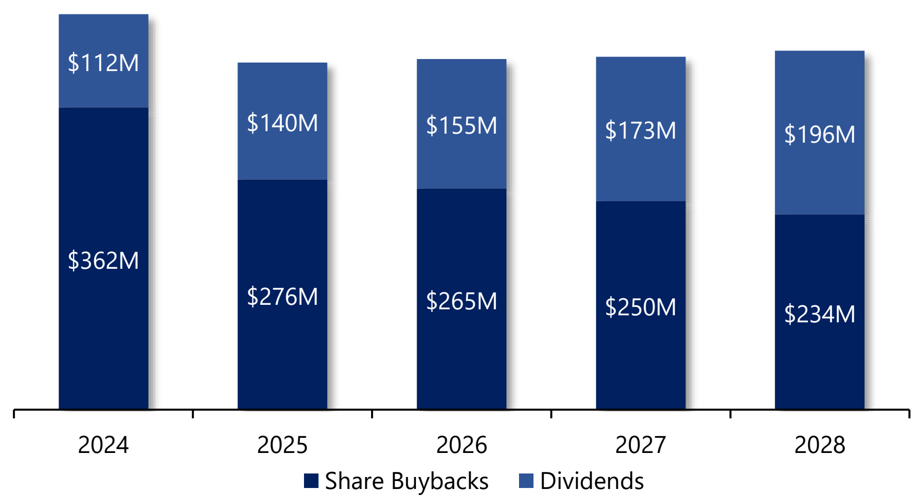
Thesis II: Balance Sheet Growth

After years of stagnation, book value per share will grow

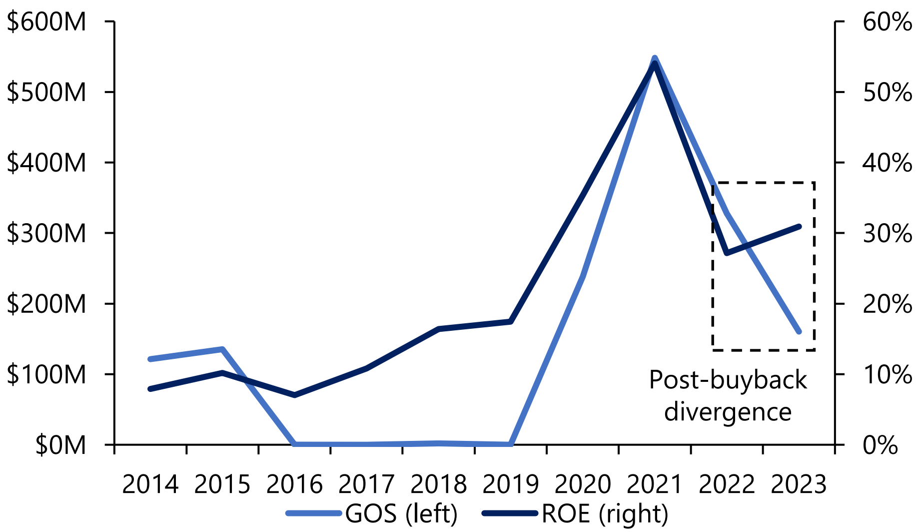
SLM'S MAJOR CATALYST IS BALANCE SHEET GROWTH

- SLM has kept its balance sheet flat since 2020 to accommodate CECL phase-ins
  - It sold out loans through ABS to offset originations
- With now ~$2.5B of net originations annually, the balance sheet can grow much faster than the overall market
  - SLM expecting 6% - 7% balance sheet growth while reducing securitizations
- **25% - 30% ROE is achievable** even with decreased securitization which diverges from mkt. expectations that expects a reversion to 15%
- Mgmt. expects to **return approx. 10% of market cap to shareholders** over the next five years

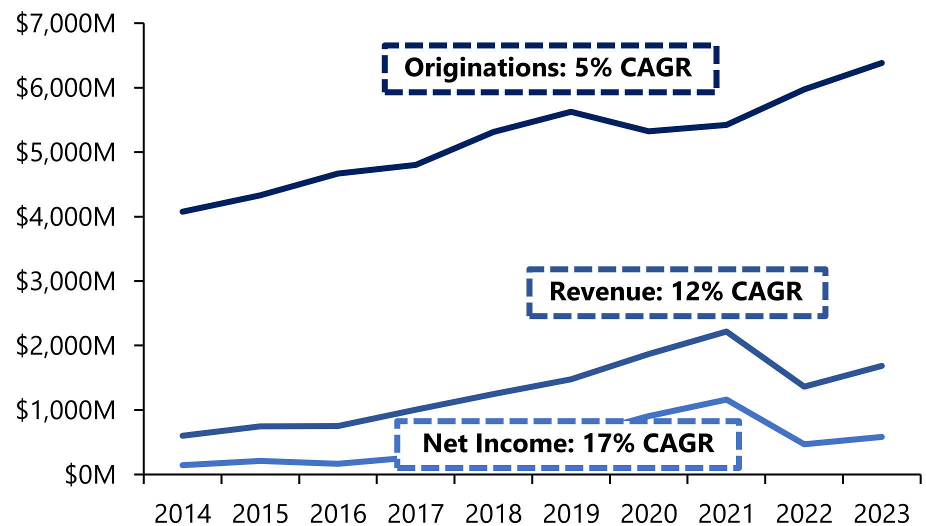
PROJECTED RETURNS TO SHAREHOLDERS



RETURN ON EQUITY AND GAIN ON SALE



SLM OUTPERFORMS THE OVERALL MARKET GROWTH



Risks

POLICY HEADLINE RISK: ARE PRIVATE LOANS AT RISK

- There has been a lot of talk over the last few years around student loan forgiveness and related regulation

Mitigation:

- **These discussion only ever involved federal loans**, and never threatened actions against private loans
  - There is great misunderstanding in the public and investor community, by our estimation
- It would not make sense for governments to meddle in private loans past GFC, considering the consumer bases
- SLM was affected by the loan forgiveness, but only to the minor extent that prepayments increased (customers had their federal loans slashed and received stimulus packages)

FINTECHS ARE RISING

- While large, diversified lenders have exited the market, pure-play, PE-backed fintechs have been entering
- There's a threat that these lenders will undercut rates, though for now pricing has been rational
  - SLM certainly has a lower cost of funding

Mitigation:

- SLM's preferred lender network remains untouched
- Even College Ave (private), the most established Fintech that only relies on web traffic, gets <10% the traffic of SLM (which doesn't account for SLM's vast network of college financing offices)

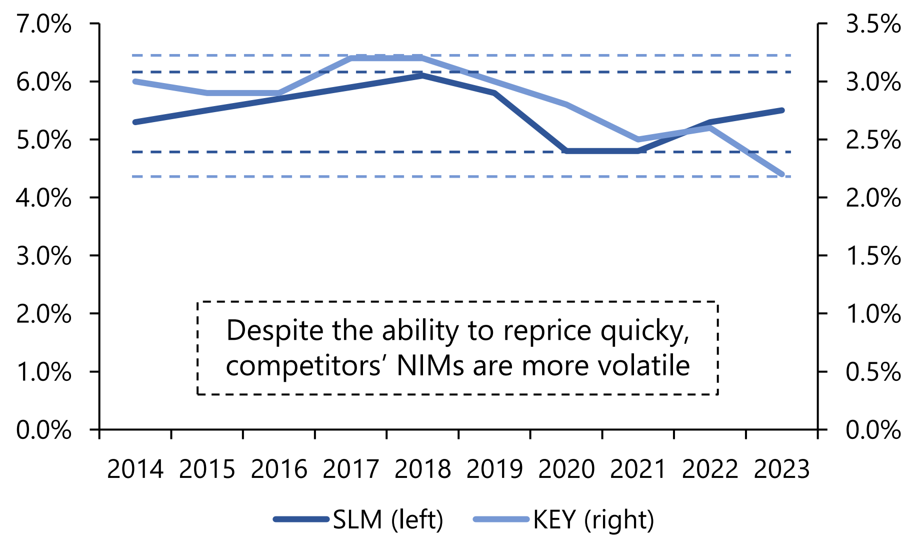
CYCLICALITY IN LENDING

- All lenders are exposed to common macro risks, mostly relating to credit losses, NIM compression and loan growth

Mitigation:

- SLM's NIM is more resilient than the industry (5% +/-1% is much better than 2% +/-1%)
- The growth drivers are largely idiosyncratic and secular rather than cyclical
  - There's also a counter-cyclical element: when the economy goes bad, people turn towards school
- On credit losses, the private loan customer base naturally filters out bad customers

SLM HAS LESS NIM SENSITIVITY



Comparable Company Analysis

sallie mae

Company Name	Equity Value ($M)	Share Price ($)	P / TBV LTM	P / TBV 2023A	P / TBV 2024E	P / B LTM	P / B 2023A	P / B 2024E	P / E LTM	P / E 2023A	P / E 2024E
Navient Corporation	$1,653	$15.11	0.8x	2.7x	2.5x	0.6x	2.2x	2.1x	10.3x	4.6x	11.0x
OneMain Holdings, Inc.	$5,566	$46.47	4.0x	1.5x	1.4x	1.8x	1.5x	1.4x	9.5x	8.6x	9.8x
SoFi Technologies, Inc.	$11,912	$10.99	2.7x	1.7x	1.7x	1.9x	1.2x	1.2x	55.6x	nmf	91.0x
Nelnet, Inc.	$4,072	$112.34	1.3x	1.3x	1.3x	1.2x	1.1x	1.1x	26.0x	19.2x	18.0x
Ally Financial Inc.	$10,488	$34.42	0.8x	1.9x	1.8x	0.8x	1.7x	1.5x	11.9x	11.3x	11.4x
Median	**$5,566**	**$34.42**	**1.3x**	**1.7x**	**1.7x**	**1.2x**	**1.5x**	**1.4x**	**11.9x**	**9.9x**	**11.4x**
Average	**$6,738**	**$43.87**	**1.9x**	**1.8x**	**1.7x**	**1.3x**	**1.5x**	**1.5x**	**22.7x**	**10.9x**	**28.2x**
SLM Corporation	**$4,655**	**$21.90**	**2.6x**	**1.8x**	**1.8x**	**2.5x**	**1.5x**	**1.5x**	**7.0x**	**7.8x**	**7.7x**

Company Name	Equity Value ($M)	Share Price ($)	Revenue Growth 2023E	Revenue Growth 2024E	Net Income Growth 2023E	Net Income Growth 2024E	Operating Metrics PCL Ratio	Operating Metrics CET1 Ratio	Return Metrics (LTM) Div. Yield	Return Metrics (LTM) ROA	Return Metrics (LTM) ROE
Navient Corporation	$1,653	$15.11	(42.7%)	(38.2%)	(43.8%)	(58.5%)	0.28%	14.1%	4.2%	0.3%	5.6%
OneMain Holdings, Inc.	$5,566	$46.47	52.5%	5.4%	(25.4%)	(12.6%)	0.20%	12.7%	9.0%	2.4%	18.8%
SoFi Technologies, Inc.	$11,912	$10.99	35.4%	20.3%	82.0%	327.0%	0.38%	12.3%	0.0%	0.7%	3.7%
Nelnet, Inc.	$4,072	$112.34	(14.4%)	6.8%	14.1%	7.2%	0.27%	12.2%	1.0%	0.8%	4.0%
Ally Financial Inc.	$10,488	$34.42	2.5%	(0.1%)	(45.9%)	(0.8%)	0.18%	13.5%	3.5%	0.5%	6.4%
Median	**$5,566**	**$34.42**	**2.5%**	**5.4%**	**(25.4%)**	**(0.8%)**	**0.27%**	**12.7%**	**3.5%**	**0.7%**	**5.6%**
Average	**$6,738**	**$43.87**	**6.7%**	**(1.2%)**	**(3.8%)**	**52.5%**	**0.26%**	**13.0%**	**3.5%**	**0.9%**	**7.7%**
SLM Corporation	**$4,655**	**$21.90**	**29.7%**	**(3.9%)**	**27.7%**	**1.3%**	**0.32%**	**15.2%**	**5.0%**	**2.2%**	**33.8%**

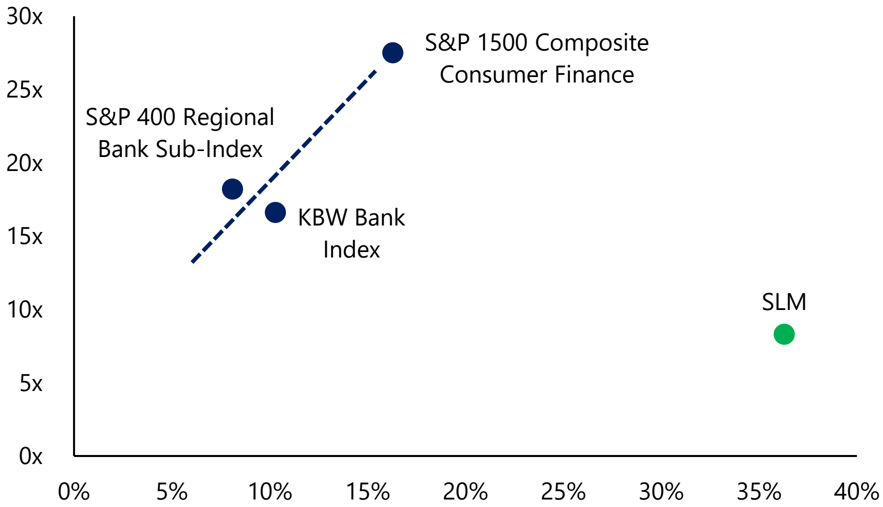
Commentary

- Our comparable set includes other student loan players (Navient, Nelnet), and consumer finance companies with deposit bases
  - There are no pure-play public competitors, so we did not use comparable company analysis as an input for our price target
- On P/E, SLM is at a major discount
  - We base much of our case on outstanding ROE (30%+ against the industry's 6-7%) while trading significantly below peers
- P/B is elevated, but it is not indicative of overvaluation
  - Because the balance sheet was kept flat for years (and revenues , book value is artificially depressed and should grow significantly

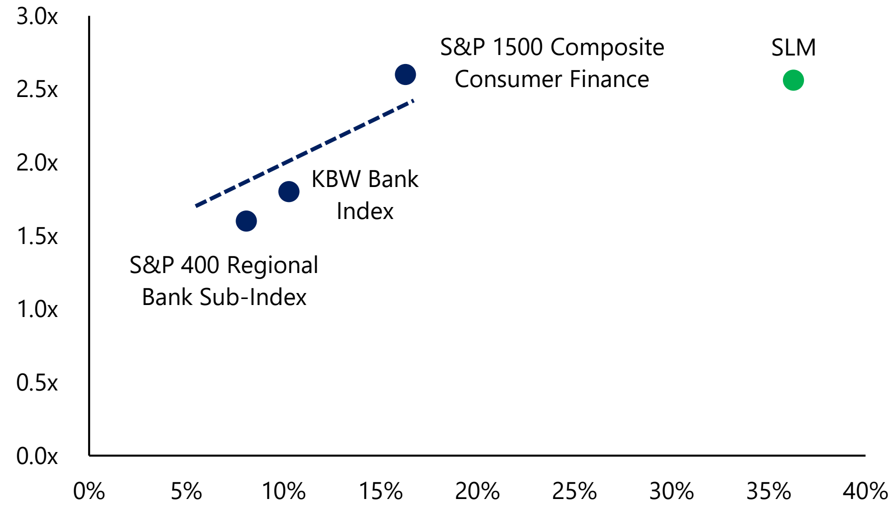
Regression & Multiples Analysis

SLM is an amazing opportunity in the consumer finance / banking space

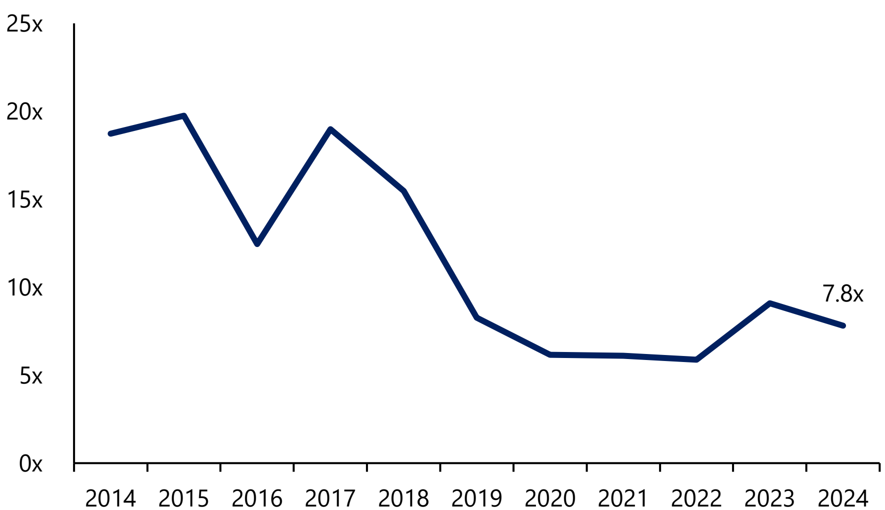
LTM P/E & ROCE



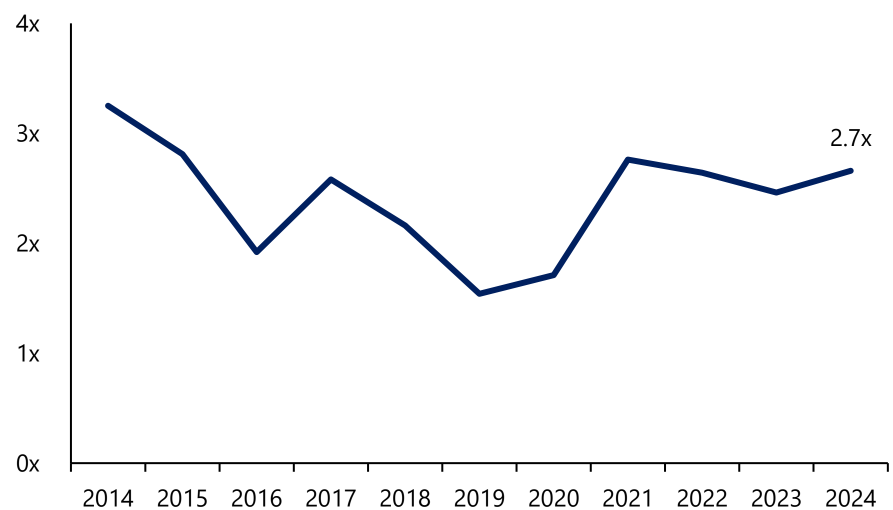
LTM P/B & ROCE



LTM P/E



P/TB



Dividend Discount Model

Dividend Discount Model												
US Millions, FY End Dec 31	**2020**	**2021**	**2022**	**2023**	**2024Q1-Q2**	**2024Q3-Q4**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
Net interest income	**$1,481**	**$1,395**	**$1,489**	**$1,562**	**$757**	**$754**	**$1,511**	**$1,563**	**$1,610**	**$1,698**	**$1,785**	**$1,869**
% Growth rate	*(6.5%)*	*(5.8%)*	*6.7%*	*4.9%*	*(4.4%)*	*(2.1%)*	*(3.3%)*	*3.5%*	*3.0%*	*5.5%*	*5.1%*	*4.7%*
Gains on Sale & Other	**$331**	**$632**	**$335**	**$247**	**$316**	**$134**	**$450**	**$301**	**$294**	**$287**	**$280**	**$273**
% Growth rate	–	*90.9%*	*(47.0%)*	*(26.3%)*	*91.5%*	*69.6%*	*82.2%*	*(33.1%)*	*(2.3%)*	*(2.4%)*	*(2.4%)*	*(2.5%)*
Total revenue	$1,812	$2,027	$1,824	$1,809	$1,073	$888	$1,961	$1,864	$1,904	$1,985	$2,065	$2,142
% Growth rate	*8.4%*	*11.9%*	*(10.0%)*	*(0.8%)*	*12.1%*	*4.2%*	*8.4%*	*(4.9%)*	*2.2%*	*4.3%*	*4.0%*	*3.8%*
Provision for credit losses	($93)	$33	($634)	($345)	($29)	($67)	($96)	($70)	($73)	($77)	($81)	($86)
PCL ratio (%)	*0.4%*	*(0.2%)*	*3.2%*	*1.7%*	*0.6%*	*1.0%*	*0.5%*	*0.5%*	*0.5%*	*0.5%*	*0.5%*	*0.5%*
Non-interest expenses	($565)	($519)	($559)	($683)	($322)	($328)	($650)	($657)	($660)	($679)	($696)	($710)
Income before taxes (IBT)	$1,154	$1,541	$631	$781	$722	$493	$1,215	$1,138	$1,171	$1,229	$1,287	$1,346
Efficiency ratio (%)	*38.1%*	*37.2%*	*37.5%*	*43.7%*	*42.5%*	*43.5%*	*43.0%*	*42.0%*	*41.0%*	*40.0%*	*39.0%*	*38.0%*
Income tax expense	($273)	($379)	($162)	($197)	($184)	($123)	($307)	($284)	($293)	($307)	($322)	($336)
Effective tax rate (%)	*23.7%*	*24.6%*	*25.7%*	*25.2%*	*25.5%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*
Net income	**$881**	**$1,162**	**$469**	**$584**	**$538**	**$370**	**$908**	**$853**	**$878**	**$922**	**$966**	**$1,009**
Net income margin (%)	*48.6%*	*57.3%*	*25.7%*	*32.3%*	*50.1%*	*41.6%*	*46.3%*	*45.8%*	*46.1%*	*46.4%*	*46.8%*	*47.1%*
Preferred dividends	($17)	($10)	($5)	($9)	($18)	($18)	($18)	($18)	($18)	($18)	($18)	($18)
Net income attributable to common shareholders	$864	$1,152	$464	$575	$520	$352	$890	$835	$860	$904	$948	$991
% Growth rate	*49.5%*	*33.3%*	*(59.7%)*	*23.9%*	*38.6%*	*78.6%*	*54.7%*	*(6.1%)*	*3.0%*	*5.1%*	*4.9%*	*4.6%*
Common dividends paid	**$46**	**$60**	**$113**	**$101**	**$73**	**$73**	**$133**	**$167**	**$215**	**$271**	**$284**	**$297**
Payout ratio (%)	*5.3%*	*5.2%*	*24.4%*	*17.6%*	*28.1%*	*20.8%*	*15.0%*	*20.0%*	*25.0%*	*30.0%*	*30.0%*	*30.0%*
Repurchases	**$559**	**$1,531**	**$713**	**$350**	**$112**	**$199**	**$311**	**$251**	**$215**	**$181**	**$190**	**$198**
Payout ratio (%)	*64.7%*	*132.9%*	*153.7%*	*60.9%*	*43.1%*	*56.7%*	*35.0%*	*30.0%*	*25.0%*	*20.0%*	*20.0%*	*20.0%*
CET1 ratio	**14.0%**	**14.1%**	**12.9%**	**12.3%**	**13.4%**	**14.0%**	**14.0%**	**13.8%**	**13.6%**	**13.4%**	**13.2%**	**13.0%**
ROCE	**24.1%**	**60.7%**	**31.4%**	**35.3%**	**57.8%**	**35.7%**	**45.2%**	**36.7%**	**33.1%**	**30.7%**	**28.6%**	**26.8%**
Dividend per share						**$0.33**	**$0.64**	**$0.86**	**$1.16**	**$1.54**	**$1.68**	**$1.83**

Three Cases Assumptions (average over forecast period)							
US Millions, FY End Dec 31	**NIM**	**Loan Growth**	**PCL Ratio**	**P/B Exit**	**P/E Exit**	**Share price**	**Delta**
Bull Case	5.6%	6.3%	0.3%	1.7x	8.5x	$37.5	56.6%
Base Case	5.4%	5.8%	0.5%	1.5x	7.0x	$30.2	26.1%
Bear Case	5.2%	5.2%	1.2%	1.3x	5.5x	$23.0	(3.8%)

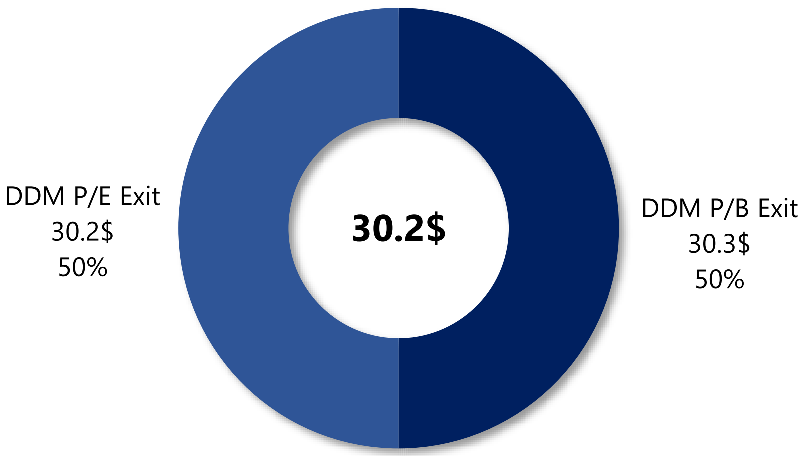
Commentary

- We used a dividend discount model on a per-share basis to take into account the effects of repurchases on share count
- Most of the differences between our bull, base, and bear cases involve macro factors
  - One idiosyncratic risk we took into account is the growth in deposits

Recommendation

We rate SLM as a **BUY** with an implied upside of 26%

Price Target Calculation



Recommendation

- Based on our research, we recommend a BUY on SLM Corp, with a price target of ~30$ (26% upside), using the P/E and P/B exits of our DDM
- The imminent shift to balance sheet growth is a good entry point; we expect not only great financial results but also more investor interest due to higher earnings visibility
- Despite strong recent performance due to earnings and the Trump win, we believe SLM's best days are still ahead

5%-6% NIM, **30% ROCE**, and **above-average growth** in a **resilient sector**, all that for **8x 2025 P/E**

DDM Output

- Our 7x P/E exit is incredibly conservative (implies a ~1x decline, meaning the risk-reward is incredibly attractive
- We expect P/B to decline as the balance sheet grows
  - For both P/B and P/E, the risk is to the upside

P / B Exit - Base Case	
Cumulative PV of Dividends	5.7
Terminal Book Value	28.6
Exit P / B Multiple	1.5x
Terminal Value	42.9
PV of Terminal Value	24.6
Implied Share Price	**30.3**
Implied Margin of Safety	**26.3%**

P / E Exit - Base Case	
Cumulative PV of Dividends	5.7
Terminal Earnings	6.1
Exit P / E Multiple	7.0x
Terminal Value	42.7
PV of Terminal Value	24.5
Implied Share Price	**30.2**
Implied Margin of Safety	**26.2%**

Thesis Recap

Extremely Attractive Industry

Declining Competition

Imminent Balance Sheet Growth

APPENDIX

Valuation Details

sallie mae

KEY KPIS AND VALUATION DRIVERS

Key Assumptions																
US Millions, FY End Dec 31	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
Net Interest Margin	5.3%	5.5%	5.7%	5.9%	6.1%	5.8%	5.3%	5.5%	5.6%	5.8%	5.6%	5.5%	5.4%	5.4%	5.3%	5.4%
Student Loan Growth	19.9%	22.3%	30.2%	22.7%	19.9%	10.8%	(10.5%)	(5.3%)	(3.5%)	3.5%	(5.6%)	5.3%	6.6%	6.9%	6.9%	7.6%
PCL ratio	0.7%	0.7%	0.6%	0.9%	0.8%	1.0%	0.4%	(0.2%)	3.2%	1.7%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%
ROCE	14.9%	18.2%	13.8%	14.2%	20.3%	20.5%	24.1%	60.7%	31.4%	35.3%	45.2%	36.7%	33.1%	30.7%	28.6%	26.8%
CET1 Ratio	15.0%	14.4%	12.6%	11.9%	12.1%	12.2%	14.0%	14.1%	12.9%	12.3%	14.0%	13.8%	13.6%	13.4%	13.2%	13.0%

- PCL bookings are low going forward, reflecting the extra reserves that were built over the last few years
- CET1 Ratio would stabilize around ~12.8%, which leaves an adequate buffer. The company is not acquisitive.
- We expect above-average ROCE over the forecast period, stabilizing around ~25%
- Increasing student loan growth reflects decreasing securitizations

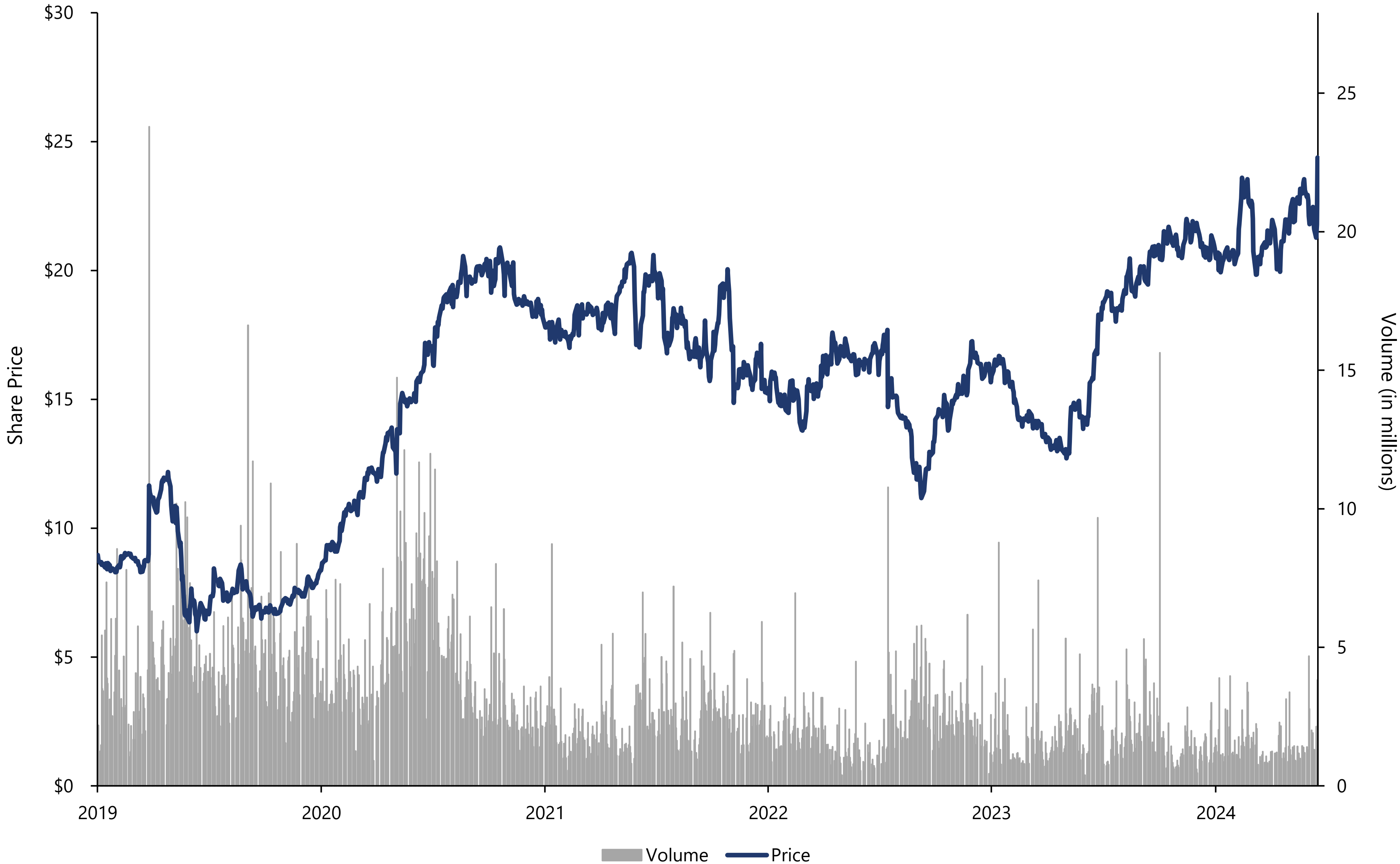
PRICE TARGET AND COST OF EQUITY CALCULATIONS

P / B Exit - Base Case	
Cumulative PV of Dividends	5.7
Terminal Book Value	28.6
Exit P / B Multiple	1.5x
Terminal Value	42.9
PV of Terminal Value	24.6
Implied Share Price	**30.3**
Implied Margin of Safety	**26.3%**

P / E Exit - Base Case	
Cumulative PV of Dividends	5.7
Terminal Earnings	6.1
Exit P / E Multiple	7.0x
Terminal Value	42.7
PV of Terminal Value	24.5
Implied Share Price	**30.2**
Implied Margin of Safety	**26.2%**

Cost of Equity Calculation	Current	Optimal
Median Unlevered Beta	0.63	0.39
Debt/Equity	1.1x	2.4x
SLM Tax Rate	25.2%	23.4%
Re-Levered Beta	**1.16**	**1.11**
Risk-Free Rate	4.0%	4.0%
Equity Risk Premium	6.0%	6.0%
Cost of Equity	**11.0%**	**10.7%**

Share Price Performance



The analysis and conclusions derived by Investa Insight are based on publicly available information and is strictly for educational use. Investa Insight may include statements, estimates, and projections which are prepared with respect to, among other things, a historical and anticipated operating performance of the companies that Investa Insight analyzes. Investa Insights is not liable for inaccuracy with projections.

Investa Insights will assume no responsibility or liability for any errors or inaccuracy contained that may be made of such information by the viewer. This content is in no shape associated with the views or opinions of the University or student union of said University that is represented in the pitch.