



### Capital One Financial Corporation

#### Fixed Income's Take

Capital One remains one of our favorite credits in the specialty finance space, in part because of its more conservative, bondholder-friendly trajectory, but also because, in our view, Capital One has a proven ability to properly price consumer credit across the various prime and subprime spectrums. We view the acquisition of Hibernia as a credit positive but recognize that it will take some time before the full benefits of having access to retail-generated deposits will flow through the operating structure. From an on- and off-balance sheet liquidity perspective, Capital One remains very impressive. Likewise, capital levels leave us sleeping well at night. Overall, we believe that the Capital One management team has taken this company down a very positive path—especially from a bondholder's perspective.

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#### Equity's Take

In our opinion, Capital One (COF) is the credit card company that best anticipated a deceleration in U.S. credit card growth and invested in diversified businesses several years ago. These actions by management best exemplify why we believe Capital One is ahead of the curve in the U.S. consumer finance sector. Capital One can generate earnings with faster-growing, higher-credit quality assets in its Auto Finance and Global Financial Services divisions. We rate shares of COF Outperform due to potential earnings growth of 10-15% and an ROE of 20%. Our valuation range for shares of COF over the next 12 months is \$86-95, based on an 11-12x P/E multiple on our 2006 EPS estimate of \$7.90. Our 2005 EPS estimate is \$6.85.

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#### Asset-Backed Securities' Take

Capital One's credit card master trust shows consistently higher excess spread than market benchmark issuers. COMET BBBs offer value 4 bps-6 bps behind benchmark BBB issues. The credit performance for COPAR prime auto ABS is among the best in the industry. Newer vintages of the subprime COAFT shelf have losses comparable to those of some "midprime" issuers. COAFT is the benchmark issuer for the subprime market but prices cheap to midprime issuers with comparable performance.

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*Please see the disclosure appendix of this publication for certification and disclosure information.*

## Capital One Financial Corp. Fixed Income's Take

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*We believe Capital One has what it takes to be successful in the long term.*

A couple of years ago, in response to changing market conditions and negative sentiment around monoline card companies that served the subprime marketplace, Capital One packed up its bags and began its journey down a more conservative, bondholder-friendly path. Along the way, Capital One picked up a higher level of product diversification, more prime balance to its books, and a more conservative lower-cost deposit focus. Capital One began its journey with a fair share of skeptics eyeing its every move; however, operating under this microscope set the stage for this once-monoline to prove its mettle. Today, we see a company that has grown up quite a bit and has seemingly learned a lot while on the road to becoming a more balanced entity. The trek, however, continues...next stop Louisiana! From a bondholders perspective, we believe Capital One figured it out—if you want to give yourself the best shot to exist as a standalone specialty finance company, it helps to look and smell just like a bank. We believe Capital One has what it takes to be successful in the long term—an ability to properly price consumer credit in varying markets, increasing levels of deposit funding, growing diversification, and a drive to offer a competitive products in creative ways. We remain favorable on the fundamentals of this credit—continuing to appreciate its bondholder-friendly trajectory.

In terms of diversification, this once solely credit-card focused lender has morphed into a more diverse specialty finance player, although it has not in any way lost traction on its positioning in the credit card market. With its auto finance, installment lending and home equity businesses, Capital One is positioned to continue growing despite the challenges currently facing the U.S. credit card industry (namely slower growth). We believe that this more diversified positioning has helped Capital One to outperform its nearest rival, MBNA, on profitability and overall fundamentals.

*Capital One is on its way to becoming more banklike on its own.*

The fact that MBNA is set to be bought by Bank of America begs the question of whether or not Capital One is next on the block. Unlike Capital One, MBNA had been dealing with (pretty public) portfolio attrition, more apparent margin compression, and a notable increase in losses related to bankruptcy filings. On top of these issues, MBNA was feeling the burn of not having established more diversification, which we believe, could have helped it weather better the currently challenging U.S. card market. Capital One is on its way to becoming more banklike in and of itself. After its long search for an entity to help solidify lower-cost funding and add even more diversification, Capital One decided this past March to purchase Hibernia Corp. The acquisition of Hibernia (expected to close in the third quarter of this year) should bode well for the company's diversification efforts—with an eye toward mortgage-related asset classes. Bondholders should gain more comfort from Capital One's funding diversity as it gains access to retail-generated deposits. Hibernia has local scale in Louisiana and growth potential most notably in the Texas marketplace. In our view, Capital One's more banklike trajectory doesn't negate a purchase of the company by a larger banking entity, but helps to put it in a position to stand on its own if Fairbanks (Capital One's CEO) so desires.

Capital One's growth story is pretty difficult to beat. The company has managed to grow its managed loan portfolio almost entirely on an organic basis. When it does enter into an acquisition, Capital One is known for not biting off more than it can chew. Overall, the company has made a number of small acquisitions in the past couple of years including eSmartLoan, HFS Group, Inslogic and Onyx. These acquisitions, however, were aimed at adding growth to the company's non-card businesses—Capital One has not purchased any bulk credit card portfolios. Instead, through purely organic growth, the company has raised its credit card managed loans to more than \$46 billion by the end of the first quarter of 2005. The Hibernia acquisition will mark the largest buy to date, but Capital One plans on running the Louisiana-based bank "as is" and concurrent with its existing platform—Capital One does not have designs to "take over" the culture or day to day management of Hibernia's operations. Capital One's style is to watch and learn and then grow opportunistically from there. We anticipate this will be the case with the Hibernia set of businesses.

*Card growth has been organic in nature.*

Although it has been a bumpy ride for Capital One over the past couple of years, the company has gained the respect of debtholders and rating agencies along the way—helped by its time-tested ability to properly price credit across the prime and subprime spectrums. Currently, Capital One looks like it is poised for higher ratings. After the company announced its intention to acquire Hibernia, all three rating agencies moved positively on the credit. Moody's and Fitch reacted with slightly more gusto, placing the company's ratings on Review for Upgrade and Watch Positive, respectively. S&P, which has tended to be more conservative on this credit in the past, reacted positively, but with a milder Positive Outlook. Within our specialty finance coverage space, Capital One is the only name (outside of MBNA, now) that we believe should get a ratings bump up this year—adding a rosier glow to current fundamentals, in our opinion.

*Ratings are poised for upgrade.*

While the environment for credit card lending has grown somewhat more difficult, Capital One continues to perform well, especially on the asset quality front. Its charge-offs and delinquencies are among the industry's lowest. For the month of May, managed losses fell 12 bps (sequentially) to reach a very attractive 4.10%. Delinquencies, while up a touch, likewise looked just fine at 3.43%. Capital One's push into higher quality loans over the past couple of years has certainly paid off in terms of asset quality. More impressive, perhaps, has been the company's ability to cut costs and build efficiencies while gaining more prime and superprime presence. This, combined with superior asset quality, has culminated in an improving ROMA for this past year (up from 1.52% to 1.73%). The company plans to ease back into the subprime waters, but we are not worried about these potentially more risky assets—we have confidence in Capital One's ability to manage and price the subprime consumer.

Also helping us to feel more than comfortable with this credit from a bondholder's perspective is what we believe to be a very strong on- and off-balance sheet liquidity position. At the end of the first quarter, Capital One had approximately \$20.7 billion in available liquidity. On top of cash, conduit and credit facilities, the company had issued enough subordinated pieces of credit card-asset backed securities so that its AAA issuance capacity amounted to \$14.4 billion or 18 months worth of funding needs (as of the end of the first quarter). Adding this "capacity" to the company's other liquidity sources brings total available liquidity to over \$35 billion.

*On- and off-balance sheet liquidity continues to look stellar.*

## Capital One Financial Corp. Equity's Take

### Investment Appraisal

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In our opinion, Capital One (COF-NYSE) is the credit card company that best anticipated a deceleration in the U.S. credit card market growth in 2005 and invested in diversification ahead of the curve. As of March 31, 2005, managed loan portfolios for Capital One's Global Financial Services (GFS) and Auto Finance divisions grew 23% and 50% (including the Onyx acquisition) year over year, respectively, versus U.S. Card at 3%.

Capital One's early adoption of a diversified model means that the company is already set up to accommodate growth in other areas of consumer lending including home equity and auto finance. Additionally, the company announced plans to acquire Hibernia bank (HIB), which will increase the deposit base, lower funding costs, and allow strategic cross-selling of products.

Capital One currently trades at approximately 9.5x our 2006 estimate, down from a 2005 high of \$83.80 on January 3. The company reported Q1 2005 EPS of \$1.99, beating our estimate and consensus. Currently, we believe that the low multiple on shares of COF represents a good value for 10-15% earnings growth over the next two years. The credit card companies in our universe, on average, trade at approximately 12x FY2006 EPS estimates.

We anticipate a 20% ROE in 2005 and 2006. We believe the appropriate valuation range for COF shares over the next 12 months is \$86-95. This range is based on a 11-12x P/E multiple on our 2006 estimate of \$7.90.

### Capital One Positioned For Success, In Our Opinion

Capital One's diversified business model can boost returns in several ways: tapping faster-growing consumer lending niches, improving cost of funds, and expanding the customer base to better manage credit quality. As previously mentioned, GFS and Auto Finance generated double-digit asset growth year over year, while U.S. Card slowed to a low to mid-single-digit pace.

Capital One's diversification effort extends to funding and liquidity. As of year end 2004, break down of capital and total managed liabilities was 43% off-balance sheet securitizations, 27% deposits, 9% capital, 9% auto securitizations, 7% unsecured debt, and 5% other liabilities. With the acquisition of HIB, Capital One will have access to an additional \$18 billion in deposits.

Credit quality improvement has been evident thus far in 2005. Net charge-off rates declined 70 bps year over year to 4.13% from 4.83% in Q1 2005. With Capital One's focus on credit risk management, we anticipate charge-off rates will continue to improve through the balance of 2005 and level off around 4% with the inclusion of Hibernia later this year.

*Scarcity Value: The Last "Monoline." Bank of America's plan to acquire MBNA (KRB) creates scarcity value for Capital One as the last remaining large independent card company.*

## Overview Of Business Lines

**U.S. Card** - *Managed Portfolio Size: \$46.6 billion, Loan Growth Year Over Year: 3%, Revenue: \$2.0 billion, Revenue Contribution To Total: 70%, Net Income: \$458.2 million; at March 31, 2005.*

*Capital One is the nation's fifth-largest credit card issuer.*

U.S. Card is Capital One's largest and slowest growing business line. As of Q1 2005, management lowered growth expectations in U.S. Card to be in line with industry growth, or about 5%. Previously, we were modeling a slightly higher growth rate of 7%.

Capital One continues to improve credit quality in U.S. Card by selectively originating higher quality assets and moving up the credit spectrum. Loss rates in U.S. Card fell 68 bps year over year to 4.73% in Q1 05.

**Global Financial Services** - *Managed Portfolio Size: \$21.7 billion, Loan Growth Year Over Year: 23%, Revenue: \$646.6 million, Revenue Contribution To Total: 21%, Net Income: \$70.5 million; at March 31, 2005.*

*Global Financial Services is fast growing with a 24% leap in 2004.*

GFS includes lending portfolios in the U.K., Canada and Continental Europe while U.S. operations include small business, installment loans, patient finance and home equity. One new business is Capital One Home Loans, formed by the February 2005 acquisition of eSmartloan, an online originator of home equity loans and mortgages. Capital One Home Loans is a brokerage model, so the business does not add to loan growth, however it adds to profitability.

**Auto Finance** - *Managed Portfolio Size: \$13.3 billion, Loan Growth Year Over Year: 50%, Revenue: \$260.8 million, Revenue Contribution To Total: 9%, Net Income: \$35.6 million; at March 31, 2005.*

*Capital One is a top-ten, noncaptive auto finance provider in the U.S.*

Capital One's acquisition of Onyx Acceptance Corp, which was executed in Q1 2005, added \$2.8 billion in loans to the Auto portfolio. Excluding the Onyx deal, Auto Finance loans grew 19% year over year. Making strategic acquisitions is only part of Capital One's effort to add to the Auto Finance platform. Recently, Capital One started partnering with community banks to offer auto loans that the banks cannot make.

The Agent Banking Auto Finance Program, only a few months old, is an arrangement where the bank pays for marketing, while Capital One is responsible for processing, servicing, and funding the loan. Capital One hopes to extend this program to larger retail banks that do not want to operate their own direct auto lending programs.

**Hibernia Acquisition** - On March 6, 2005, Capital One announced a long-awaited bank acquisition. Capital One will acquire Hibernia Corp (HIB) in a \$5.3 billion cash and stock deal which is expected to close on or before September 30, 2005. Capital One's potential benefits of acquiring a bank are deposit funding, asset growth, cross selling of products, and the possibility of issuing debit cards.

*Hibernia is a retail and commercial bank based in Louisiana.*

While U.S. credit card growth is slowing, debit card volumes are increasing at a double-digit pace. Credit card transactions have been growing at a mid- to high-single-digit pace since 2001 while the number of debit transactions have been increasing 20-30% year over year. Through the Hibernia acquisition, Capital One has the option to expand into debit cards, if it so chooses.

## Capital One Financial Corp. Asset-Backed Securities' Take

### Credit Cards

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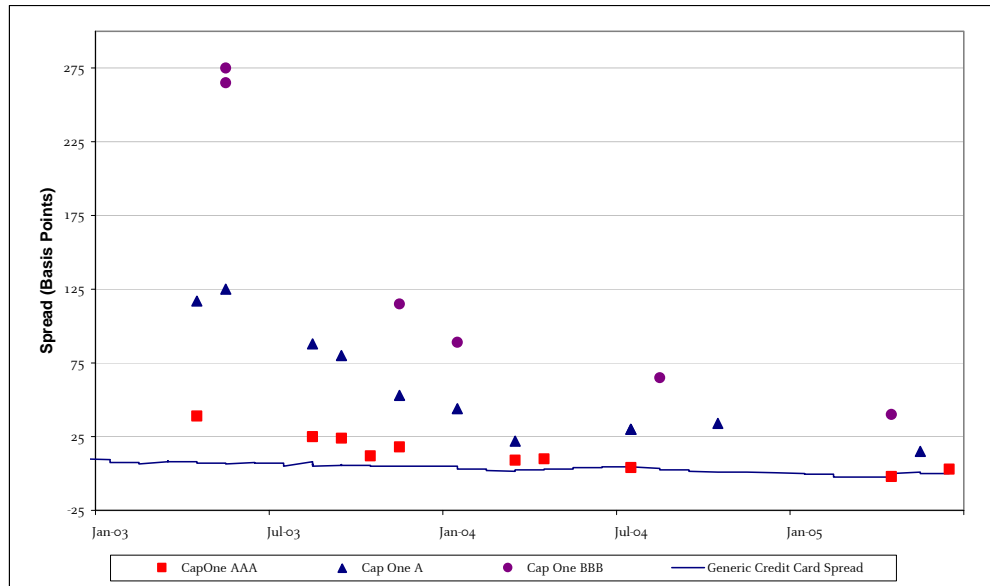
*Capital One cards have superior performance metrics...*

COF has \$29.5 billion in credit card ABS outstanding, \$17.5 billion of which was issued since October 2002 under the de-linked COMET trust. Credit metrics have been good. Charge-offs are in line with or better than industry peers. Excess spread, which provides the first loss cushion to the investor, is consistently higher than industry benchmarks. Excess spread averages around 1.5x charge-offs, much higher than the industry at a 1.0x multiple.

The COMET program has seen dramatic spread tightening across the credit curve since the confidence crisis of late 2002 and early 2003 (Exhibit 1). As Capital One expands its auto franchise and diversifies funding sources through bank acquisitions, the monoline risk in the name is diminishing. COMET AAAs now price in line with industry benchmarks. In BBB cards, the spread concession of about 5 bps for COMET offers value for superior performance metrics and diminishing risk versus benchmark names.

### Exhibit 1

COMET New Issue Pricing  
Three- and Five-Year Spread to Libor



Source: Wachovia Securities

*...despite significant tightening, BBB's offer value versus benchmark names.*

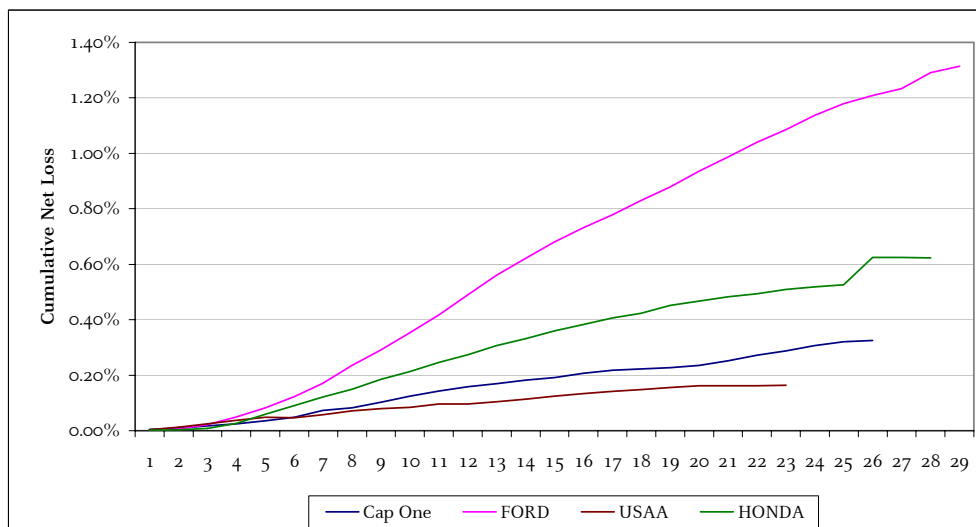
### Prime Autos

*Prime auto performance is among the best in the industry.*

Capital One Prime Auto Receivables (COPAR) program has some of the best credit performance in the industry, rivaled only by that of USAA. Cumulative losses for the 2003 vintage (Exhibit 2) are only about one-third those of prime names such as Ford or Daimler Chrysler. Honda, which trades several basis points tighter, has losses that are more than 1.5x those of COPAR.

When determining credit enhancement, rating agencies do not give credit for cumulative losses below 1%. Given their historically low losses, programs like COPAR will tend to be overenhanced. Our stress analysis shows that A rated COPAR tranches can take about 6x historical losses before suffering a principal write-down, which puts their credit risk more in line with most AAA auto ABS.

**Exhibit 2**  
Prime Auto Receivables 2003 Vintage  
Issuer Comparison



Source: Intex Solutions, Inc., and Wachovia Securities.

### Subprime Autos

Capital One Auto Finance Trust (COAFT) is COF's subprime auto ABS issuance vehicle. COAFT is the benchmark name in subprime autos. As such, "fair" value for COAFT will always look slightly rich to other subprime issuers. This is evidenced by their recent senior/subordinated deal, COAFT 2005-B-SS, which priced extremely aggressively.

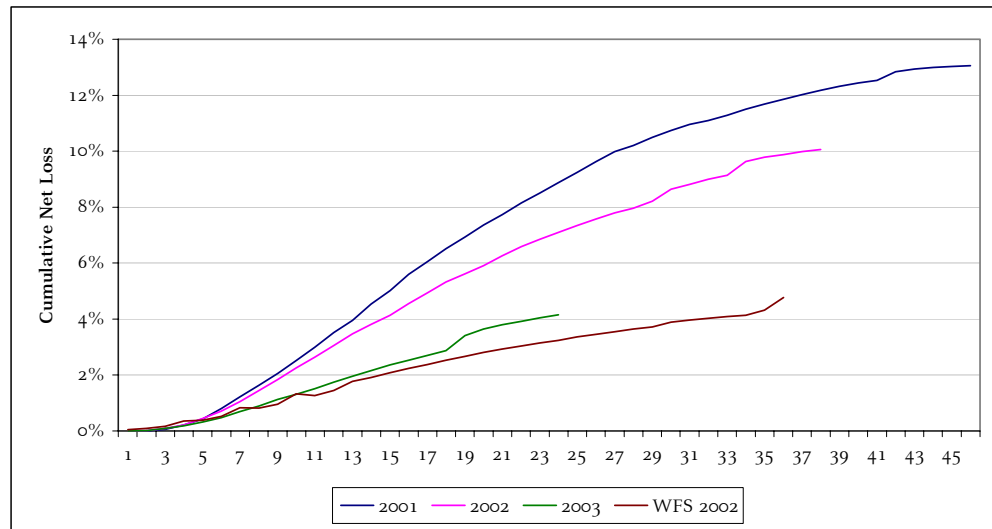
*Subprime autos offer wider spreads but comparable performance to mid-prime issuers.*

Pricing, however, is only half the story. Performance graphs (Exhibit 3) show significant credit improvements in each successive vintage. In fact, losses on the 2003 vintage are more in line with "midprime" issuers such as WFS, which is shown for comparison. The improved performance is from increased emphasis on direct underwriting and precedes the acquisition of the midprime ONYX platform, which has not yet been integrated into the COPAR and COAFT programs.

Three-year AAAs trade about 3 bps–4 bps wider for COAFT than for WFS. If the performance for COAFT continues its improving trend, it is clearly possible for this differential to tighten.

### Exhibit 3

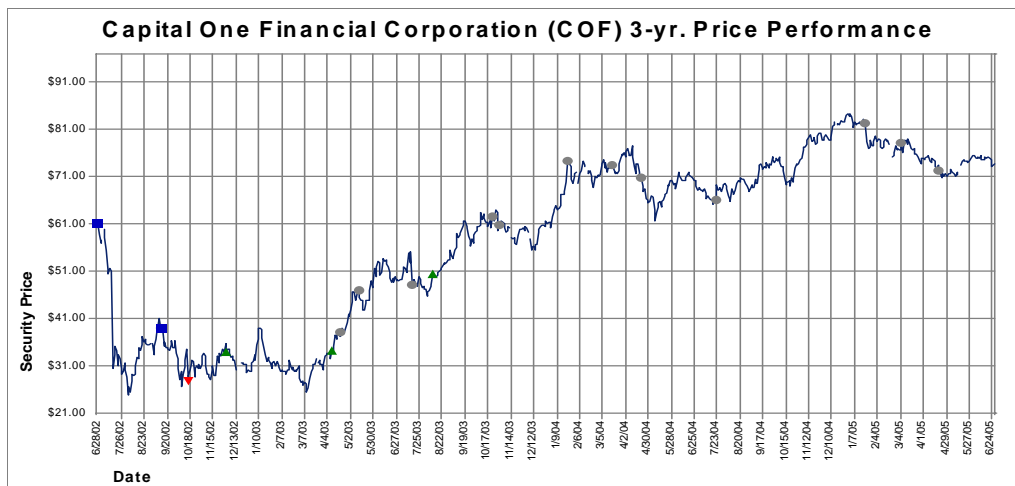
Capital One Auto Finance Trust  
Cumulative Net Losses by Vintage



Source: Intex Solutions, Inc., and Wachovia Securities.

## Disclosure Appendix

### Required Disclosures



Date	Close Price (\$)	Rating Code	Target Price (\$)	Val. Rng. Low	Val. Rng. High
6/28/2002	Whitney				
6/28/2002	61.05	SR	NE	NE	NE
9/13/2002	Houck				
9/13/2002	38.92	3	NE	NE	NE
10/16/2002	27.85	4	NE	NE	NE
12/3/2002	34.00	3	NE	NE	NE
4/10/2003	34.36	2	NE	31.00	42.00
4/22/2003	38.18	2	NE	29.00	43.00
5/13/2003	47.00	2	NE	38.00	48.00
7/17/2003	48.17	2	NE	45.00	55.00
8/12/2003	50.47	1	NE	52.00	62.00
10/23/2003	62.45	1	NE	66.00	72.00
10/31/2003	60.77	1	NE	71.00	77.00
1/22/2004	74.15	1	NE	81.00	87.00
3/17/2004	73.34	1	NE	82.00	89.00
4/22/2004	70.65	1	NE	98.00	105.00
7/22/2004	66.00	1	NE	84.00	91.00
1/20/2005	82.10	1	NE	96.00	104.00
3/7/2005	78.08	1	NE	95.00	103.00
4/21/2005	72.24	1	NE	86.00	95.00

Source: Wachovia Capital Markets, LLC estimates and Bridge data

Beginning 01/04/2003 stock valuation range replaces target price

<b>Symbol Key</b>	<b>Rating Code Key</b>
◆ Rating Scale Conversion	1 Outperform
● Rating, Target Price and/or Val. Rnge. Chng.	2 Market Perform
▼ Rating Downgrade	3 Underperform
▲ Rating Upgrade	SR Suspended
■ Analyst Change	NR Not Rated
□ Split Adjustment	NE Not Estimate

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