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BUSINESS DAY

Didn't Pay Your Macy's Bill? Expect a Text From Citigroup

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NEW YORK — When consumers have trouble making ends meet, bills from retailers that have gone bankrupt or closed tend to go toward the bottom of the pile.

The trouble for lenders like Citigroup Inc is that the debt is actually owed to them.

Citigroup, the fourth-largest U.S. bank by assets, said on Friday that it is having trouble collecting on store-branded cards, which is leading to higher losses.

To reverse that trend, the bank has been stepping up its outreach to shoppers who finance purchases from chains like Macy's and Sears with Citigroup store-brand credit cards which the bank has stood behind for more than a decade. The bank recently doubled the number of text messages it sends to borrowers.

"We've begun to see some evidence of progress, but it's slower than what we had originally targeted," said Chief Financial Officer John Gerspach.

He expects to charge-off 4.6 percent of the store-branded credit card portfolio this year, up from an earlier forecast of 4.35 percent.

Credit cards is the only major consumer business in the United States that Citigroup has been trying to grow since refashioning itself after the 2008 financial crisis. It is an important lever for Chief Executive Officer Michael Corbat to hit financial targets he has not yet met.

Store-branded cards are a special focus for Citigroup because they have generated strong profits lately. Last year, that slice of the card business contributed $1.26 billion worth of profits for Citigroup, some 8.4 percent of income from continuing operations across the entire bank.

Investors and analysts have started to worry that Citigroup will experience ripple effects from growing problems in the brick-and-mortar retail sector, where bankruptcies, store closures, emergency financing and distressed acquisitions have become the norm.

Citigroup appears to be most at risk from relationships with Macy's Inc, Sears Holdings Corp, Office Depot Inc and Staples Inc, Moody's Investors Service said in a recent report. Moody's expects such chains to be closing stores in coming years.

The cards Citigroup issues for those chains often cannot be used elsewhere, so when stores close, customers are likely to spend and borrow less, analysts said.

Another problem: Retailers generally expect banks to lend to less creditworthy customers than they do with general purpose cards. While retailers share in losses, they are ready to take more chances on loans in order to sell more merchandise, especially when they are struggling to generate revenue.

People with FICO credit ratings of less than 660, which some consider the bottom for prime borrowers, accounted for 25 percent of money owned to Citigroup on store-branded cards as of the end of March. That was twice the proportion inside the rest of the card portfolio, which carries the Citi brand.

Citigroup has been trying to transition some store-brand cards to the type that can be used at other merchants. The broader purpose store cards now represent one-third of the bank's retail services business, Gerspach said.

And while collections have gotten more difficult, Gerspach was optimistic that customers are still shopping, with spending up 2 percent on store-branded cards during the second quarter compared with the year-ago period. Gerspach said the spending increase shows store closings are not affecting the business.

Charles Peabody of Compass Point Research & Trading predicts Gerspach will have to raise loss estimates again before year-end. Citigroup's biggest competitor in private label store cards, Synchrony Financial, now expects losses in the 5-to-low-5 percent range, up from earlier guidance of between 4.75 percent and 5 percent, he noted.

Synchrony and Citigroup together have two-thirds of the market as measured by outstanding balances, according to The Nilson Report. (http://tmsnrt.rs/2urg19R)

Citigroup's big bank rivals in general purpose credit cards do not compete in private label store cards. JPMorgan Chase & Co exited the business after headaches from issuing cards for Circuit City, an electronics retailer that went belly up.

Citigroup also considered jettisoning its store-branded business as its loss rates hit 12 percent during the Great Recession. But it could not find a buyer at the right price, and within a few years it had started to produce attractive returns again.

By 2013, Corbat was bolstering the business by acquiring a loan portfolio pegged to cards used at electronics retailer Best Buy, which is generally seen as coping well with the shift to internet sales.

Competition for deals with the more promising retailers has heated up since then. When Citigroup renewed its deal with Home Depot Inc last year, it had to make concessions to the retailer. Income from the business dropped 17 percent in 2016.

Picking the right retailer partners can be tricky when even iconic brands are struggling to survive, said Brian Foran, a bank analyst at Autonomous Research.

"The broad thing that investors are struggling with," he said, "is the future growth of this business, and what happens when retailers go bankrupt."

(Reporting by David Henry in New York; editing by Lauren Tara LaCapra and Riham Alkousaa)