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MARKETS

Warren Buffett's Berkshire Validates Another Credit-Card Company

Synchrony investment is a vote of confidence for largest U.S. store credit-card issuer

Berkshire Hathaway already owns $12.8 billion in American Express's shares and smaller stakes in Visa and Mastercard.
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By AnnaMaria Andriotis
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Warren Buffett's Berkshire Hathaway Inc. BRK.A **0.26%** ▲ is increasingly betting on the growing credit-card industry.

On Monday, Berkshire Hathaway disclosed it bought nearly 17.5 million shares of Synchrony Financial SYF **+0.45%** ▲ in the second quarter totaling nearly $521 million. That is a vote of confidence for the largest U.S. store credit-card issuer, whose shares rose more than 4% on Tuesday.

Berkshire Hathaway already owns $12.8 billion in American Express Co.'s shares and smaller stakes in Visa Inc. and Mastercard Inc. While Synchrony's cards are mostly geared at the mass market with its cardholders comprising shoppers at stores ranging from Wal-Mart Stores Inc. to Dick's Sporting Goods Inc., American Express is more geared at affluent consumers. Coupled together, the holdings increase Berkshire Hathaway's exposure to credit cards, an industry where overall outstanding balances in June were up about 6% from a year ago, according to the latest data from the Federal Reserve.

Bill Smead, chief executive of asset management firm Smead Capital Management Inc., said that Synchrony's relatively cheap stock price likely played a role in the purchase. Synchrony's shares fell in late April after the company increased its outlook for full year 2017 charge-offs. Since the beginning of the year, Synchrony shares are down 14.8% compared with a 10% increase in the S&P 500.

Most of Synchrony's loan volume is tied to store credit cards that it issues. Those include a mix of cards that can be used only in the store that they are issued for and co-branded cards that can be used anywhere. Synchrony's net charge-off rate, which reflects the dollar amount of balances it wrote off as a loss compared with its total average loan balances, increased by more than 0.90 percentage point from a year prior to 5.42% in the second quarter. The company also continues to set aside more money to

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cover future losses, with provisions rising 30% in the second quarter from a year prior.

Synchrony's high interest rates, which run up to the high 20%-range for many Synchrony cards, can offset some concern.

Berkshire "must like the way their spread is set up despite the fact that there are defaults," said Mr. Smead, whose firm is a Berkshire shareholder.

A representative for Berkshire Hathaway didn't have an immediate comment. A spokesman for Synchrony declined to comment.

The purchase of Synchrony was further notable in that it came at the same time that Berkshire sold its holdings of General Electric Co. , unloading nearly 10.6 million shares. Synchrony Financial spun out of General Electric in 2015.

Paul Lountzis, president of Lountzis Asset Management LLC, a Berkshire Hathaway shareholder, said Synchrony is well capitalized. Its board recently approved a share repurchase program of $1.64 billion for the four quarters through June 2018, above the consensus estimates that averaged around $1.4 billion.

The store credit-card market is less competitive than the rest of the credit- card industry, with less than a handful of very large players. Synchrony accounts for about 38% of outstanding store-card balances, according to trade publication the Nilson Report. Its longstanding relationships with many merchants increase the chances that Synchrony will remain a dominant player in a market where retailers want to see that lenders have delivered on driving more store sales and loyalty.

"It's always better to be an incumbent and have all those long standing relationships going back many years," said Mr. Lountzis. The firm "appeals to a different audience" than American Express.

By comparison, American Express mostly lends to affluent cardholders and its losses are among the lowest in the industry. Its Chief Executive Kenneth Chenault at a conference in June said that he had no desire to enter the store credit-card market, referring to it as a "very cyclical, volatile business. When you have good days, they can be really good, but those bad days are really, really bad."

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