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Investors losing interest in Visa

Rising consumer debt, shaky economy make plastic seem less than fantastic

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By DALE JACKSON

From Wednesday's Globe and Mail

The honeymoon appears to be over for newly listed **Visa Inc.** The stock more than doubled in less than two months after its $29-billion (U.S.) initial public offering in March - only to be cut down 9 per cent in the past two months.

Worse yet, the marriage between credit card stocks and investors is being rocked by rising consumer debt and the worsening economy.

International ratings agency Fitch Ratings predicts losses from defaults on outstanding balance payments for all credit card issuers will rise to at least 7 per cent by the end of the year. In May, credit card companies were expecting defaults to reach 6.4 per cent.

MasterCard Inc., which went public in May, 2006, is also feeling the pinch. The stock is still up 63.6 per cent from last year but has lost over 10 per cent of its value in the past month.

Analysts remain positive on both stocks. Last quarter, MasterCard reported that profit more than doubled and Visa posted a 28-per-cent earnings increase from the previous year.

UBS Securities analyst Adam Frisch has buy ratings on both. "The global secular growth story of paper to plastic should go unabated for the foreseeable future, both in the U.S. and much higher growth regions around the globe," he says in a recent report on Visa.

The report also mentions a "consumer spending slowdown" as a risk and includes slower growth in cross-border transactions and pricing pressure from large banks.

Citigroup analyst Patrick Burton has a less enthusiastic "hold/high risk" rating on Visa and MasterCard. In his most recent report, he says slow U.S. economic growth could hit MasterCard's bottom line, but Visa, the world's largest credit card issuer, appears to have more exposure.

"Visa is highly leveraged to consumer spending and global travel trends, and weaker-than-expected economic growth could have a greater-than-expected adverse impact on purchase volumes and transactions processed - and ultimately the company's earnings," he says.

Stephen Wood, a senior portfolio strategist at New York-based Russell Investment Group, has been steering his clients away from any financial stocks, including credit card stocks. "The concern is that consumer debt is of deteriorating quality," he says of credit card losses among the more diversified financial services companies such as banks.

Default risk aside, the slumping economy and rising consumer debt levels are not motivating credit card holders to look for better borrowing terms, says Dave Trahair, a Toronto-based chartered accountant and consumer debt specialist.

While the benchmark U.S. lending rate fell to 2 per cent, Visa, MasterCard and American Express have been generating huge profits. Customers often pay 18 to 20 per cent on balances.

"It's a hassle to apply for a different credit card and transfer everything over, so most people continue to do what they do, which is an advantage to the credit card companies," Mr. Trahair says.

High rates and a sluggish economy didn't stop U.S. consumers from borrowing $34-billion in the first three months of this year - the biggest increase in seven years. According to data compiled by Oppenheimer & Co. Inc., card users paid only 19.8 per cent of their balances in May compared with 20.7 per cent a year earlier. A recent survey by Statistics Canada shows 40 per cent of Canadian credit card holders regularly pay interest on their monthly balances.

Capital One recently introduced a card that caps interest payments at 0.9 percentage points above prime, but most traditional card holders continue to reject the long-standing option of paying their balances with a much lower consumer loan or secured line of credit.

Mr. Trahair says there could be a tipping point where consumers wise up to high credit card rates - but that's a long way off. "Human nature is not all of the sudden going to change."

Other major publicly traded, pure-play credit card companies include American Express Co., Discover Financial Services LLC and Capital One Financial Corp. They differ from Visa and MasterCard because they lend directly to customers and, as a result, take on greater risk. Visa and MasterCard issue cards through financial institutions, which assume much of the risk. Most major banks own a stake in credit card companies.

Of the 18 analysts who cover American Express, seven have a buy rating, eight have a hold rating and three are advising clients to sell.

Capital One lost $4.16-billion in defaults last year and its stock took an 18-per-cent hit on its value last month. Five analysts have buy ratings, seven have hold ratings and six recommend selling.

Discover Financial Services - which has lost almost half its market value since being spun off by Morgan Stanley in June, 2007 - has two buy ratings, seven holds and three sells.

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at Business News Network.

VISA (V)

Close: $79.06 (U.S.), up $3.44

MASTERCARD (MA)

Close: $264.24, up $18.15

AMERICAN EXPRESS (AXP)

Close: $41.55, up $1.96

DISCOVER FINANCIAL (DFS)

Close: $14.17, up 75¢

CAPITAL ONE (COF)

Close: $41.06, up $3.73