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Amid turmoil, subprime lending is still paying off for AmeriCredit

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The Fort Worth auto lender has had strong growth in new loans and profits.

Will people give up their home before their car?

That's one potential explanation for why AmeriCredit hasn't been badly hurt by the crisis in the subprime mortgage market.

A more flattering notion is that AmeriCredit is a better, safer operator than its brethren in the mortgage business.

Or maybe it's just a timing issue. The current slowdown is still in the early stages, so the worst hasn't hit yet.

Whatever the reason, the Fort Worth auto lender, which makes most of its loans to subprime borrowers, has been relatively spared from the subprime contagion. It's had strong growth in new loans and profits, and on Tuesday, it even managed to line up an additional $1 billion in funding for future loans.

Meanwhile, the housing bust and global credit crunch are taking a toll. Foreclosures have soared, home builders have lost billions, and dozens of mortgage companies have gone under. But the biggest impact on AmeriCredit, at least so far, has been on its stock price; company shares are down 32 percent this year.

In the fiscal year ended in June, AmeriCredit earned a record $360 million in net income, and loan originations increased 36 percent, helped by a pair of acquisitions. Most important, credit losses declined sharply for the quarter and were the lowest in its history.

The company did scale back profit projections for next year; the top range is now $350 million, down from $375 million earlier in the year, in part because it expects to pay more to borrow. But most folks could live with that.

AmeriCredit primarily gives high-interest loans to people with spotty credit histories. It uses a proprietary scorecard to evaluate borrowers, not just credit scores, and doesn't play any of the easy-credit games that overheated the housing market.

That means no low-doc loans, no 100 percent financing, no piggyback deals, and no car loans to speculators, Chief Executive Dan Berce said.

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"Even though some might think it's the same as the subprime-mortgage market, it's actually very different," Berce said Monday at a Lehman Bros. financial conference.

AmeriCredit does have some indirect exposure to subprime mortgages. About 38 percent of its customers are homeowners and up to 30 percent have adjustable-rate loans, the company estimates.

As adjustables reset to market rates, many homeowners can't handle the higher payments. And because the bust has hurt home values, they can't sell or refinance, either.

That's led to the surge in foreclosures and the expectation that strapped, subprime borrowers would start defaulting on car loans, too. That sounds logical — the conventional wisdom is that people will pay their mortgage before any other debt — but it hasn't happened that way.

As a group, more AmeriCredit homeowners continue to pay on time, as they have historically. And the performance gap between homeowners and non-homeowners has remained the same for at least the past two years.

In other words, no sign of strain among AmeriCredit homeowners, at least not in the form of late payments or rising defaults.

Net charge-offs in AmeriCredit's core business have been unchanged the past two years. On the entire portfolio, which includes higher-quality loans generated by companies it acquired, charge-offs declined from 5.2 percent in fiscal '05 to 4.7 percent in fiscal '07.

There has been a slight uptick in late payments recently, although the company attributes that to seasonal factors, not a mortgage overhang. Tuesday's announcement that it secured $1 billion in new funds also eased concerns that AmeriCredit might have trouble selling its loan portfolios to investors during the current credit crunch — or that it would have to pay much more to do it.

The economic indicator that most threatens AmeriCredit is the unemployment rate. When people lose jobs, defaults soar — and the August jobs report showed a decline in jobs for the first time in four years.

In 2003, AmeriCredit almost ran out of money, as defaults rose and lenders balked. Its stock price fell to $1.55. This time around, it says it's better prepared. It has been growing more moderately than in the early part of the decade; it has added businesses that make prime and near-prime loans, reducing the risk (and interest earnings) of the entire portfolio; and it's sitting on a lot more cash.

On June 30, AmeriCredit had $910 million in unrestricted cash; four years ago, it had $316 million.

"We're obviously in a good position with liquidity," Berce told analysts in a conference call last month. "And [it's] fortunate we didn't aggressively buy back stock in March, April and May."

Fortunate, because the price was much higher then, and cash is even more valuable today.

At about $17 a share, the current price may be tempting. A few weeks ago, AmeriCredit Chairman Clifton Morris bought almost $3 million worth of stock in the open market, which is his way of saying it's a bargain.

Morris, who founded the company, has a history of betting big on AmeriCredit when Wall Street turns sour.

In late 2001, Morris, Berce and another executive spent $3.6 million to buy shares at about $30 each. A year later, Morris spent an additional $3.5 million when the stock hit $7.

Within six months, the investments had lost almost all their value. A year later, the price was back to $20 and briefly kissed $30 again in 2006.

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