October 2014, Canadian Tire Financial Services (CTFS) and Scotiabank finalized a landmark partnership that saw Scotiabank acquire a 20% equity interest in the CTFS business for $500 million. One year on, it appears that this cash injection served to boost CTFS' capital ratios (chart 4), and also ensured ongoing access to funding at a reasonable cost. This is because the agreement also included a $2.25 billion in credit card financing for the CTFS business.

Apart from the financials, the deal with Scotia included a co-marketing agreement designed to drive growth with both companies. The deal involves integrating the marketing of Scotia's successful Scene/Cineplex loyalty program with Canadian Tire Corporation (CTC)'s lifestyle divisions, the idea being that customers can collect Scene rewards at Sport Chek and Mark's, driving traffic to those stores. Since then, CTC's same store sales have grown 3.7 per cent for Canadian Tire, 8.6 per cent for FGL Sports and 4.0 per cent at Marks as of Q2 2015.

On the banking side, analysis of Q2 cumulative data shows quite a leap (see chart 2), well above the normal growth trend (chart 1).

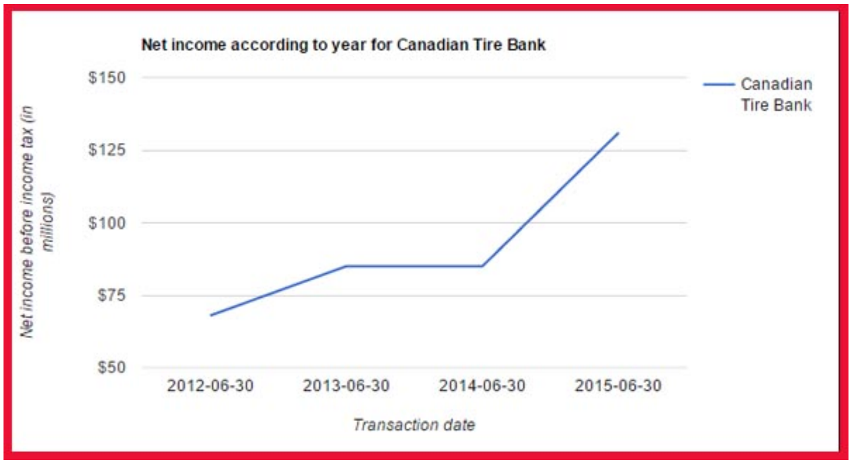

Chart 1, CTFS net income

Key securitization/financial facts

In 2015, Glacier sold $500-million of 5.25 year notes that pay 2.237 per cent annually, a price that represents a 119.6 basis point premium to a benchmark federal government bond. When it last sold five-year notes in September 2014, it paid 2.568% and a premium of 86 basis points. The Glacier medium term note program currently has raised $2.164 billion for Canadian Tire Bank by selling notes backed by receivables owed to the bank by its credit card-carrying customers. As at June 30, 2015, the CTB credit card receivable portfolio was $4.8 billion, up 2.5% over prior year.

Background on the deal

According to Duncan Fulton, SVP at Canadian Tire Corporation, "I think it's a major evolution of the Scene program from being just a loyalty and entertainment-based program, to now becoming Canada's largest and fastest growing entertainment and lifestyle loyalty program". (CBC, 2014)

In November 2014, CTC and Scotiabank began joint promotions of the new

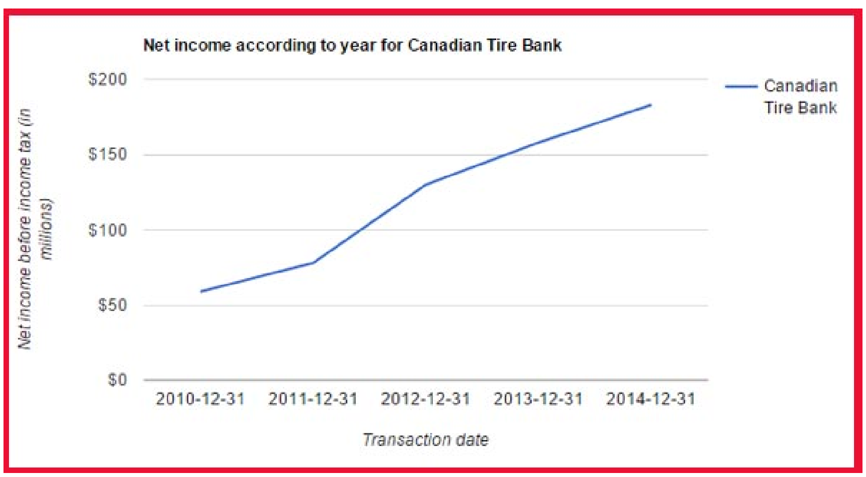

Chart 2, CTFS cumulative yearly Q2 revenue

Scene opportunity throughout Scotiabank's 1,100 branches, Sport Chek's 187 stores, and Cineplex's 163 theatres across Canada. The campaign includes previews before Cineplex films, and out-of-home advertising on Scotiabank's ATMs. It was co-created by **Sid Lee**, and Scotiabank's, **Bensimon Byrne**. (Fraser, 2013)

CTC's strategies can be traced back to comments made in 2009 by the former chief executive officer, Stephen Wetmore. He cited the loyalty program as one of the drivers of future growth for the company's retail operations as it faces growing competition from the world's "largest and most sophisticated retailers."[1]

Wetmore's 2009 comments, with respect to "sophisticated competitors", were likely weighed by the acknowledgement of the since deposed Target. Thoughts of Target were also likely considered in the more recent Scotia deal to sell part of its portfolio. After all, it was Target that set the precedent for selling its receivables when it sold its $7.9 billion credit card portfolio to TD bank in 2012. According to the Wall Street Journal, TD gained more than five million active Visa and private-label accounts from Target. Target will continue to oversee operations and customer service, incurring most of the operating costs, while TD will be responsible for risk and funding the portfolio, making it a seamless transaction, said Mr. Rhodes. Both companies agreed to share in the profits generated by the portfolios.

Cost of funds

The CTFS/Scotia deal is notable in that, despite these facilities, as chart 3 shows, its cost of funds has remained steady since 2011. This indicates that lowering the cost of funds was likely not at play in the Scotia agreement. Improving its capital position and ensuring secure liquidity in the event of market disruptions may have been its priority. This makes sense if you consider CTFS proven efficiency and industry leadership

Sens Deal

CTC has been investing heavily in untried co-marketing ventures over the last few years, including a **major co-branding deal with Senators Sports & Entertainment** in June of 2013. That deal saw some of CTC's brands become the official sponsor of everything to the Senators, from online and TV coverage to the Canadian Tire Centre's bars and restaurants and the uniforms worn by the stadium's employees (made by Mark's)

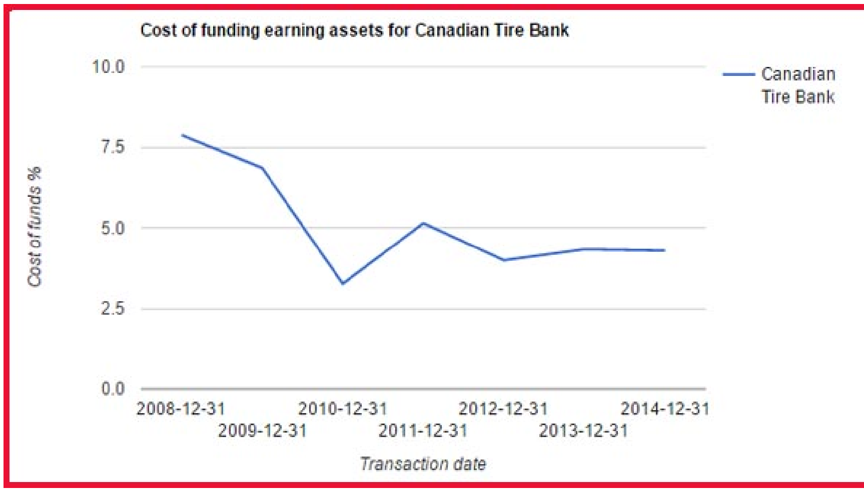

Chart 3, CTFS cost of funds

(CDN dollars in millions)		2014		2013
Allowance for credit losses, beginning of year	$	121.4	$	110.7
Net impairment for credit losses		274.7		262.2
Net impairment for fraud losses		5.0		4.8
Recoveries		59.8		59.1
Write-offs		(347.7)		(315.4)
Allowance for credit losses, end of year	$	113.2	$	121.4

Table 1, CTFS write-offs (source CTC 2014)

[1] Dana Flavelle, The Star, Ink May be fading on iconic gas money, May 15, 2009.

with respect to securing funding (see sidebar page 1). For example, compare its cost of funds against rival PC Financial: CTFS current cost of funds is 4.29%, versus PC Financials 6.1%. A rough calculation on how this impacts its portfolio puts CTFS $80 million ahead in consideration of the CTFS receivables.

Advantages to Scotia

Removing risk was a likely motivator for CTFS; Scotia was likely looking to increase its yield. CTFS has a superior return on assets and return on equity (charts 6 and 7). Another consideration may have been that Scotia anticipated that its cash injection would contribute to CTFS's improved capital position (chart 4) and, therefore, its ability to continue to grow its strong loan growth (chart 8).

Risk

According to First Annapolis, as reported in 2013, CTFS' "cards (write-offs) were on average 218 basis points higher than large banks, due to deeper underwriting, primarily store-based (non-targeted) acquisition channels, and mass-market product". (Weikel, 2014) Write-offs for 2014 were 6.22%.

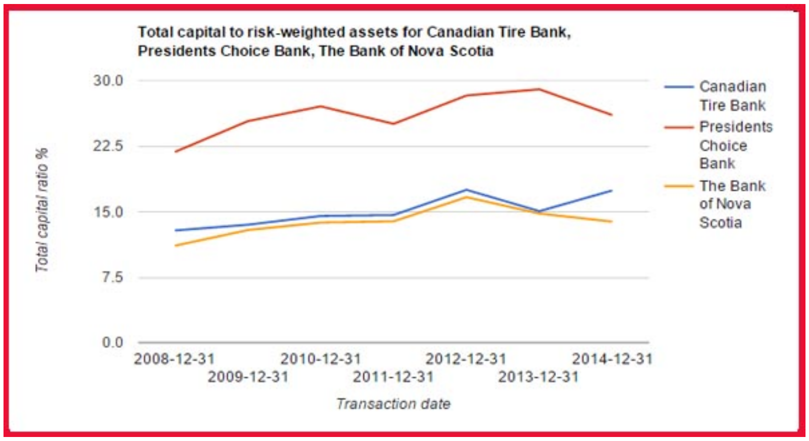

Chart 4, comparison capital to risk-weighted assets

Impairment allowances are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to net income. The carrying amount of impaired loans on the consolidated statement of financial position is reduced through the use of its impairment allowance accounts. However, losses expected from future events are not recognized. According to CTFS' financial reports (see table 1) 2014 write-offs were $347 million.

The significance of CTFS write-off risk can be illustrated in the example of Target US. TD US bought Targets US portfolio for the value of the receivables after a well-documented history of write-offs due to the retailer offering Red Card store accounts to consumers with [limited credit] histories, and to consumers attempting to repair their credit. The result was that at certain points of the credit crisis, Target's net write-offs reached 12-14 per cent of its credit card receivables. Eventually this proved too much for the retailer to bear, and January 2011, Target announced plans to actively pursue the sale of its credit card receivables portfolio. (Sibthorpe, 2015)

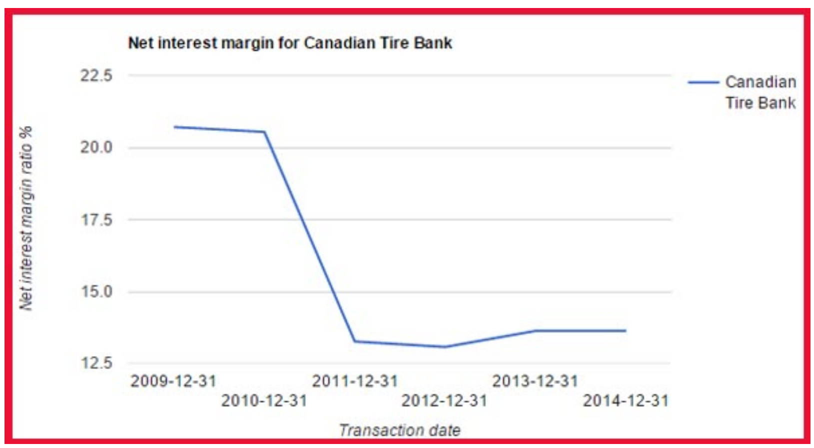

Chart 5, CTFS net interest margin

Canadian Tire's (CTC) - Canadian Tire Financial Services (CTFS) Scotia deal overview and risk assessment

September 9th, 2015, the Bank of Canada announced that it would keep the overnight rate at ½ per cent and consumer debt is at a record 164 per cent. This could lead to increased defaults and possible losses for CTFS. In light of this risk, and considering the fact that CTFS has an option to sell an additional 29% of its financial services business to Scotiabank within 10 years: what are they waiting for? /

Issuing Bank	Quarterly Average Credit Card Receivables (SB) (Exceptions Noted)			Quarterly Average Credit Card Receivables Growth (%Y/Y) (Exceptions Noted)		Annualized Quarterly Net Charge-offs (% A/R)[4]		
	4Q11	4Q12	4Q13	4Q12	4Q13	4Q12	4Q13	ΔY/Y (vs. 4Q12)
TD	$8.1	$14.2[2]	$15.3[3]	75.9%[2]	7.4%[3]	N/R	N/R	N/R
CIBC	$15.5	$15.1	$14.7	(2.6%)	(2.5%)	4.1%	3.5%	(68 bps)
RBC	$12.8	$13.3	$13.8	3.9%	3.8%	3.0%	2.6%	(42 bps)
BMO	$8.0	$7.8	$7.9	(2.8%)	0.7%	N/R	N/R	N/R
BNS	$8.9	$8.9	$4.0[5]	0.0%	(55.1%)[5]	N/R	N/R	N/R
NBC	$1.9[6]	$1.9[6]	$1.9[6]	N/A[6]	1.6%[6]	N/R	N/R	N/R
CTFS	$4.1	$4.1	$4.4	1.4%	7.6%	6.9%	5.7%	(118 bps)
PCF	$1.9	$2.1	$2.3	5.8%	11.8%	4.4%	4.2%	(20 bps)
Sum/Wtd. Avg.	$61.2	$67.4[2]	$64.3[3,5]	10.1%[2]	(4.6%)[3,5]	4.0%	3.4%	(60 bps)
Adjusted Sum/Wtd. Avg.[7]	$61.2	$58.9	$61.3	(3.8%)	4.1%	4.0%	3.4%	(60 bps)

Table 2, receivable comparison major Canadian programs

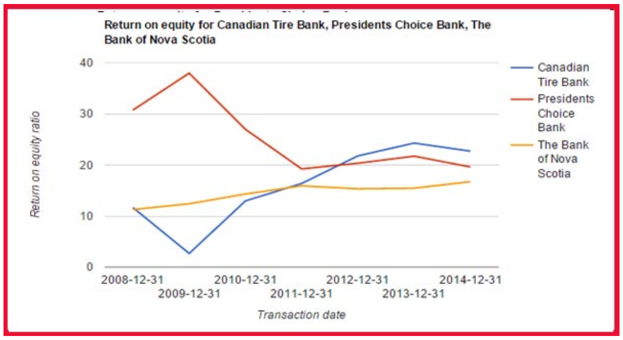

Chart 6, ROE CTFS vs Scotia vs PC Financial

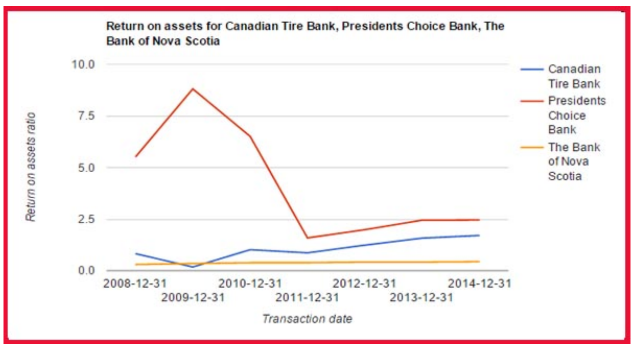

Chart 7, ROA CTFS vs Scotia vs PC Financial

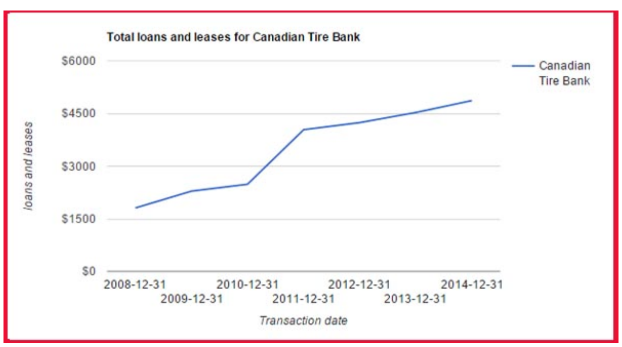

Chart 8 CTFS loans and leases

CTFS PROGRAM OVERVIEW

For patrons of Canadian Tire, the Options MasterCard provides a competitive reward value. There are four card options that offer different reward types. From occasional $.10 per litre in fuel savings to 3X and 5X rewards on promotional items. Typically, Canadian Tire rewards are 1.5% cashback that is used in Canadian Tire stores only.

Card drawbacks

- No free travel insurance and car insurance for business travelers;
- No car insurance;
- Interest rate higher than average at 19.99 to 25.99% compared to typical card interest is about 18.50%, while some cards can be as low as 9.9%.
- According to GreedyRates.ca, the Canadian Tire Cash Advantage Mastercard advertises a rewards rate of up to 1.5% cash back per dollar spent, but according to GreedyRates.ca's calculations it is difficult to get anywhere close. The Cash Advantage card offers an earn rate of 0.25% on the first $1,500 in purchases, 0.5% on purchases above $1,500 and up to $3,000, a full 1% on purchases above $3,000 and 1.5% on purchases above $24,000. You earn double that rate within Canadian Tire stores.
  The bottom line: If you spend $6,000 a year on your credit card, ($1,000 in store and $5,000 elsewhere) you're really getting around .6% cash back for every dollar spent – nowhere near the 1.5%!

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