3 Reasons Why Bank of Nova Scotia and Canadian Tire Have Teamed Up

Description

Some rumours just happen to be true. On Thursday morning, **Bank of Nova Scotia** (TSX: BNS)(NYSE: BNS) and **Canadian Tire** (TSX: CTC.A) announced a partnership involving Canadian Tire Financial Services, consisting mainly of Tire's $4.4 billion in credit card receivables. Tire announced last year that it would be looking for a bank partner, and Bank of Nova Scotia was widely viewed as the leading candidate.

The deal sees Bank of Nova Scotia buying 20% of Canadian Tire Financial Services (CTFS), as well as committing up to $2.25 billion of financing tied to the credit cards. Bank of Nova Scotia and Tire will also collaborate on new products and promotions – for example, Bank of Nova Scotia will offer $500 in Canadian Tire Money to anyone who enrolls in a new five-year mortgage with the bank. The deal also includes options for both sides to sell stakes in CTFS over the next 10 years.

The agreement appears to be a match made in heaven. Below are the top reasons why.

1. Cost of funding

While Canadian Tire has a very impressive credit card portfolio, it does have one major disadvantage versus the banks: cost of funding. Banks can take money from customer deposits, which cost very little, allowing for very high returns when loaned out to credit card customers. To lower its cost of funding, Tire created a Special Purpose Entity, known as Glacier Credit Card Trust, and also offers GICs, but the interest rates Tire must pay are significantly higher than what Bank of Nova Scotia pays its depositors.

There is precedent for this type of transaction. In late 2012, **Target** (NYSE: TGT) sold its credit card portfolio to **TD Bank** (TSX: TD)(NYSE: TD) in the United States. TD paid a premium price of $5.9 billion because it has excess deposits south of the border. These deposits are lower cost than any money that Target could raise on its own.

2. Canadian growth

The timing of this agreement is perfect for Bank of Nova Scotia, less than a month after the bank hosted its investor day. And on that day, new CEO Brian Porter promised everyone that "you should expect to see meaningful growth in our Canadian credit card business over the next several years".

The problem with these kinds of statements is that credit card market share is very difficult to steal from competitors. Which means that the only way to meaningful grow a credit card business is through acquisitions. Tire's $4.4 billion portfolio, the eighth largest in Canada, was without doubt the best opportunity to make a meaningful impact.

3. Synergies

This isn't just a one-off transaction. There will be plenty of "significant opportunities for joint marketing to drive new business growth for retail and financial services businesses". In plain English, it means that Bank of Nova Scotia can use Canadian Tire products as part of its branch promotions. And Tire can market the bank's products in its stores.

One may remember back when Tire tried to offer other products through its financial services division, such as mortgages. It was a perfect example of a company losing focus of what it does best, which is why Tire eventually retreated. Now Tire can stick to its knitting while offering more financial services to its customers through Bank of Nova Scotia. This should be much more effective.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:TD (The Toronto-Dominion Bank)
3. NYSE:TGT (Target Corporation)
4. TSX:BNS (Bank Of Nova Scotia)
5. TSX:CTC.A (Canadian Tire Corporation, Limited)
6. TSX:TD (The Toronto-Dominion Bank)

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Date
2025/08/28
Date Created
2014/05/09
Author
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