Toronto-Dominion Bank Just Got a Little Bit Stronger

Description

If there was ever any doubt, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) still has a big appetite for credit cards. On Tuesday the bank announced it had acquired US$2.2 billion worth of credit card receivables from **Nordstrom Inc.** (NYSE:JWN). TD will also "become the exclusive U.S. issuer of Nordstrom-branded Visa and private label consumer credit cards to Nordstrom customers."

This is just one of many big credit card transactions TD has pulled off in recent years—since 2011 the bank has acquired roughly $20 billion worth of receivables.

So, what should shareholders think of this move towards credit cards? We take a look below.

Why retailers shouldn't own credit card portfolios

While credit cards can come with tempting profits, there's a big reason why retailers shouldn't own the receivables: it ties up capital.

Nordstrom is a perfect example. The company has a rule of thumb that 20% of its receivables should be funded using the company's own money, with the rest being funded by debt. In other words, Nordstrom had over US$400 million tied up by its receivables portfolio—money that could have been used to open new stores.

In the past Nordstrom was willing to tie up this capital and "earn a return that was noticeably lower than the rest of our business," as put by CFO Michael Koppel. But as more retailers started selling their credit card portfolios, Nordstrom bought into the idea. It announced its intention to find a bank buyer in May 2014.

Banks are better positioned

Banks are the perfect organizations to own credit card portfolios because they have a lower cost of funding. TD is once again a perfect example.

In the United States last year TD averaged nearly US$300 billion in deposits. And how much interest did the bank pay on this money? Just US$1.3 billion, which works out to a 0.47% interest rate.

Here’s the problem: TD averaged only US$123 billion in loans in the U.S. last year, less than half its deposits (by comparison, loans exceeded deposits in Canada). In other words, TD had more deposits than it needed. Much of that extra money went towards low-return securities, on which TD earned only 1.8% interest. So, it makes perfect sense for TD to fund credit card receivables instead.

It gets better. With Nordstrom’s credit card portfolio in hand, TD can widen its brand presence across the United States. And given TD’s experience with credit cards, it can apply its extensive risk management practices to this portfolio.

Bank analyst John Aiken at Barclays Capital has little doubt that this acquisition “will bear fruit over time,” even though exact terms weren’t disclosed. I’m inclined to agree. TD’s shareholders can rejoice.

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TICKERS GLOBAL

1. NYSE:JWN (Nordstrom)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:TD (The Toronto-Dominion Bank)

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