Canadian Western Bank Competitive Forecast

By Mark Sibthorpe

Based on historical financial data (see detailed charts pages 5-8), the oil based recession in Alberta, and comparison against two of its peers, my observation with respect to CWB's future performances is as follows:

1. Cost of funds and securitization to increase as a reflection of the increased risk in the Alberta and Canadian real-estate markets;
2. Expect return on assets to be reduced due to higher funding costs and additional expenses related to core banking conversion and also expansion into other markets;
3. Expect the trend for high loan and lease growth to decelerate as demand for loans decreases to reflect job losses and other economic stresses related to the recession in Alberta;
4. Expect credit card, car loan and mortgage delinquencies to increase.

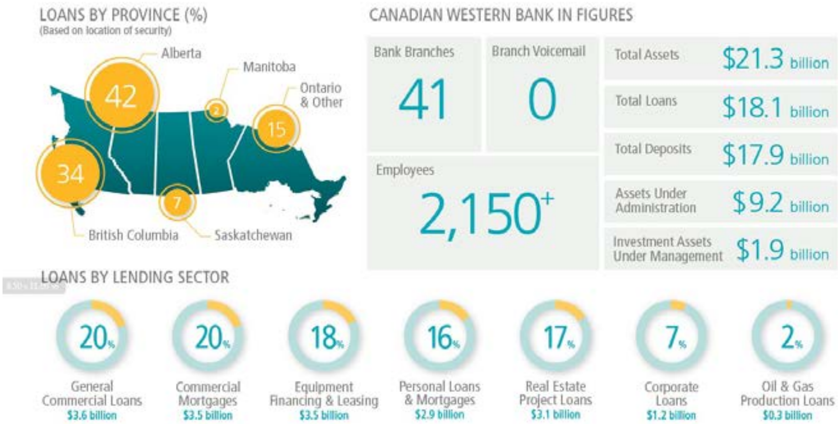
Recent filing

Despite a severe loss in share value (see chart 1), CWB's recent financial report project an upbeat and confident management. The numbers show growth and a jump in profit.

Chart 1 CWB share price

Fortunately for CWB it has insulated itself from short to medium-term risk as a consequence of its prudent mortgage securitization strategy. Unfortunately for CWB other risk may counter-balance its securitization strategy. These include: the timing of its expansion and core banking conversion, which will surely distract management and add operational risk; in addition to this, CWB will experience risks related to its predominant Alberta niche (see infographic 1).

The tables on page 2 represent the actual breakdown of CWB's mortgage portfolio (see infographic 1). This chart shows that the majority of its portfolio resides outside of Alberta. Charts 2 & 3 further demonstrate why this is a secondary risk, for the moment, as it demonstrates that the majority to of the portfolio insured.



Infographic 1, mortgage distribution CWB

	Securitized mortgages	Residential mortgages	Credit card loans	Total	% of portfolio
Alberta	$ 447,230	$ 135,203	$ 17,015	$ 599,448	**33.33%**
Ontario	383,797	141,548	21,692	547,037	**30.42%**
Atlantic provinces	236,828	89,933	7,253	334,014	**18.57%**
British Columbia	125,991	62,030	1,520	189,541	**10.54%**
Other	87,900	35,353	5,215	128,468	**7.14%**
	$1,281,746	$ 464,067	$ 52,695	$1,798,508	**100.00%**
As a % of portfolio	**71.27%**	**25.80%**	**2.93%**	**100.00%**	

c) Insured and uninsured portfolio

The Bank's total mortgage portfolio is represented by 91.39% or $1,596 billion in insured mortgages and 8.61% or $150 million in uninsured mortgages. Insured or high-ratio mortgages are mortgages with less than 20% down payment on the lesser value of either the purchase price of a home or the appraised value. Below that threshold the Bank Act requires that mortgage default insurance must be obtained for a fee by a mortgage loan insurance provider. Uninsured or conventional mortgages are mortgage loans that do not exceed 80% of the lesser value of either the purchase price of a home or the appraised value. The following chart provides a breakdown of the mortgage portfolio by province by insured and uninsured as of June 30, 2014:

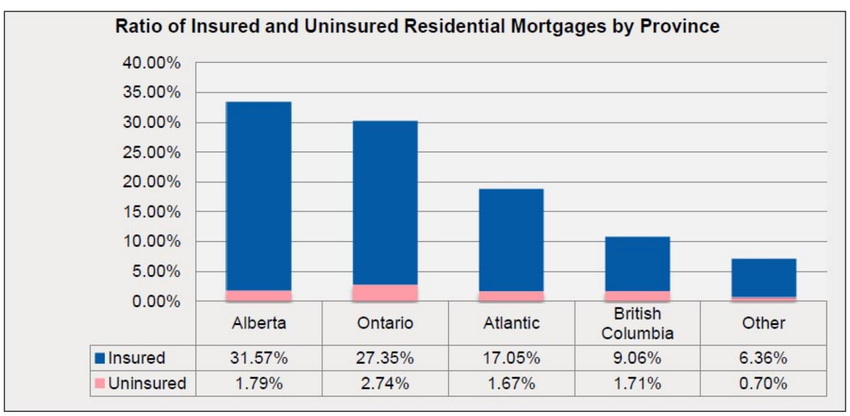


Chart 2 & 3, securitization of portfolio CWB

Of course 5% of CWB's loan portfolio is directly in oil related financing; and, with respect to this, although CWB denies the correlation of its recent insurance division sale[1] as a consequence of its oil exposure, the sale is certainly well timed to boost its capital ratios without having to resort to a fire sale.

[1] It recently sold its property and casualty insurance business for $197 million or 2.5 book value as of Oct 31.

After all, it is commonly understood that the effects of an oil shock often take 6 months or more before they register with the originating bank.

Another reason proceeds from this sale are beneficial is that they can support its ongoing initiatives to diversify into BC and also into the wealth management segments. The funds, which will boost revenue to outperform for 2015, will also help overcome CWB's poorly timed conversion of its core banking system to Temenos T24. This was initiated prior to the oil crash, never-the-less, conversions are well known to add to operational risk and to contribute to serious management distraction, even in the best of times.

Despite the evident risks, based on the recent quarterly report, management at CWB remain upbeat as shown by its March 4th dividend announcement. To illustrate this point further, compared to the same quarter last year, common shareholders' net income of $54.2 million was up 3%. Total revenues of $159.9 million were up 4%, primarily reflecting the positive impact of strong 12% loan growth (see chart 4), partially offset by lower net interest margin and non-interest income.

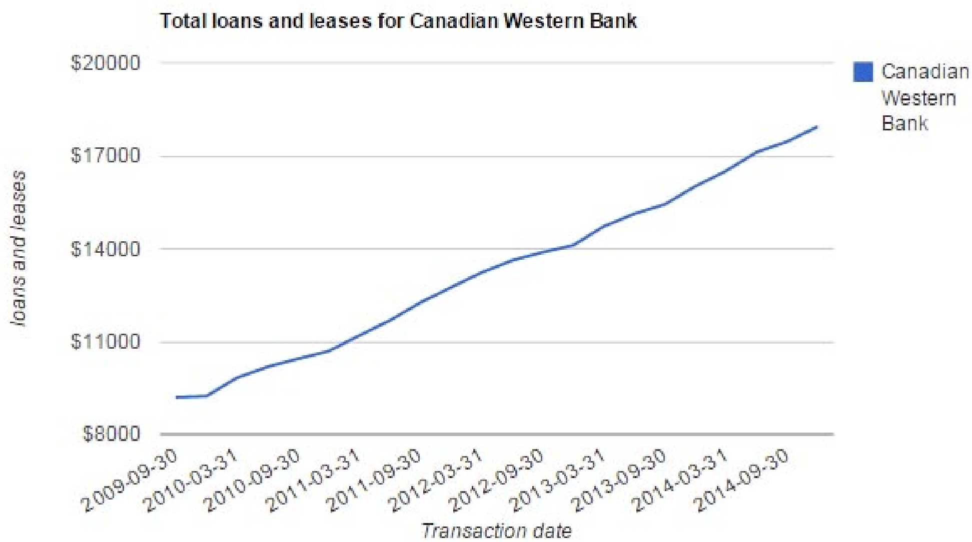


Chart 4, loan growth

In comparison to other FIs, such as, Canadian Tire Financial Services (CTFS), apart from CWB's strong equity capital (see chart 6), there is some room for improvement for CWB. Compared to CTFS which has experienced moderate growth versus CWB's high growth. Growth that may have contributed to lower returns on assets, which became evident in 2010 (see chart 5).

In comparison to another peer, Bridgewater Bank, CWB have expanded into new uncharted territory and the jury is out as to how this might translate in terms of risk and revenue. Bridgewater's also expanded its services in 2010 with the launch of its credit card. This appears to have proceeded year-on-year losses (see chart 7).

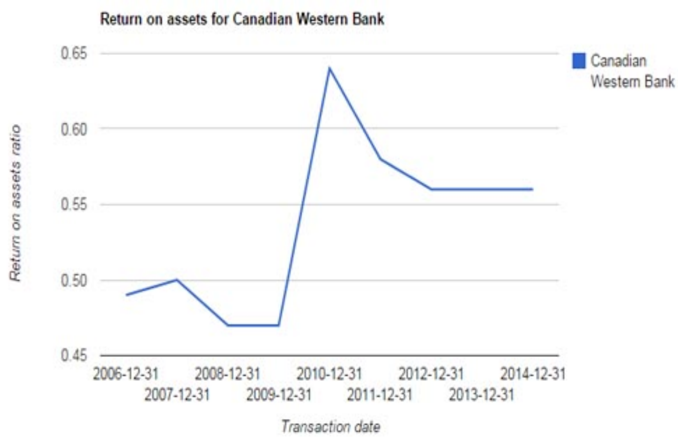


Chart 5, return on assets

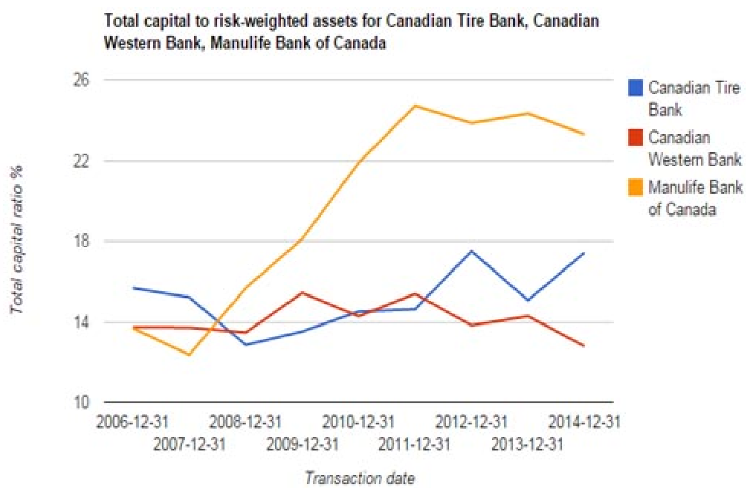


Chart 6, capital adequacy ratio

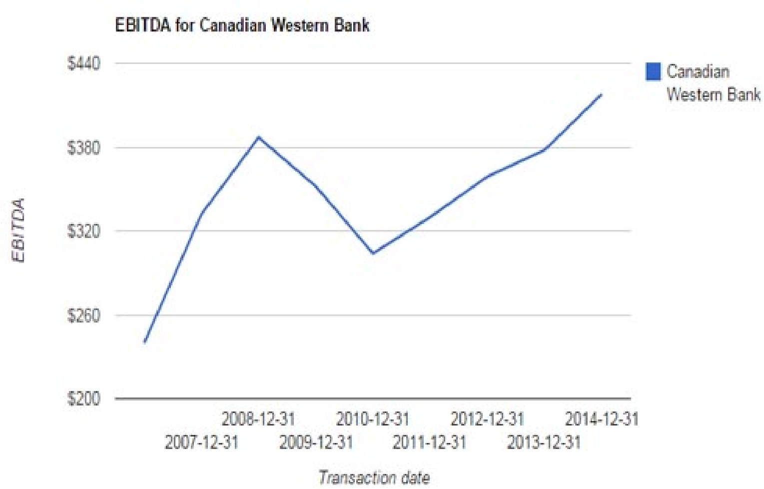


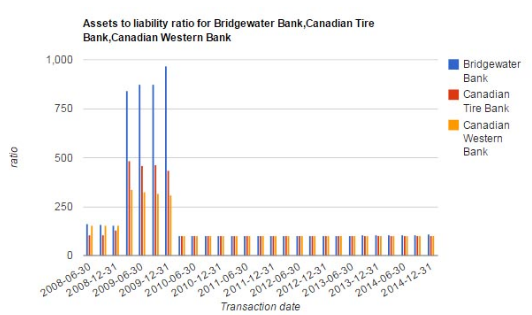
Chart 7, net income CWB

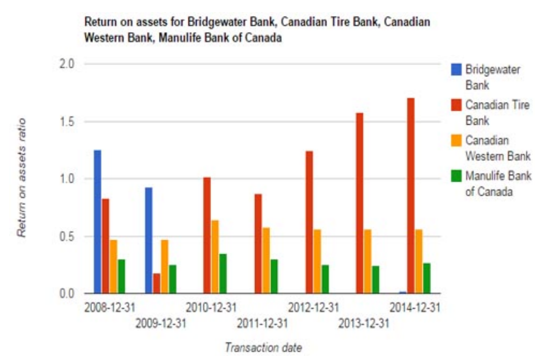
Summary

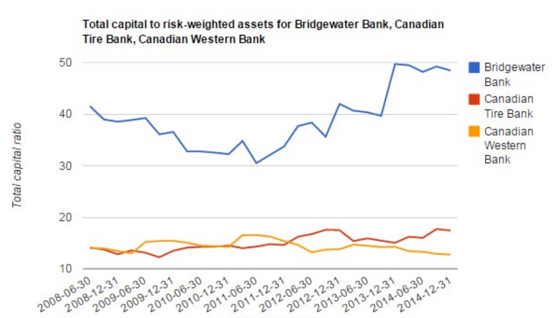
CWB has benefitted from years of growth, buoyed by the lucrative Alberta market: 12% loan growth shown in its last financial report. The concern is that CWB's growth appears unchecked, despite Alberta's altered circumstances. As the financial data show, CWB never experienced the credit crisis, and in comparison to its peers, whereas both CTFS and Bridgewater have been forced to weather unexpected challenges, CWB only knew growth. Going forward CWB may soon experience increased cost of funds as did CTFS in the past, it may also experience lower returns on assets, lower demand for loans and leases, and increased delinquencies. Given the sharp fall in its share price, perhaps these factors are already priced into the current share value. On the upside, its strong capital position will offer a safety net from a regulatory perspective, however, if circumstance change and more capital is required to meet OSFI standards, this might prompt costly decisions. This begs the question as to the soundness behind CWB's ongoing high growth expansionary strategy.

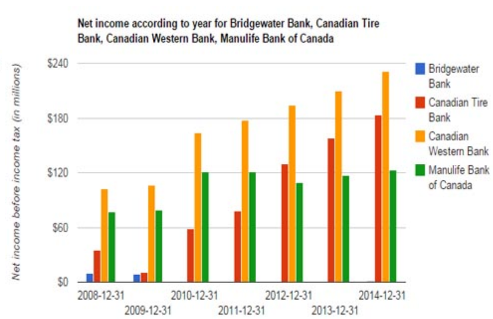
<u>Charts and data</u>: the following Charts and Data, available from BankNews.TV are intended to offer added insight into CWB's operations

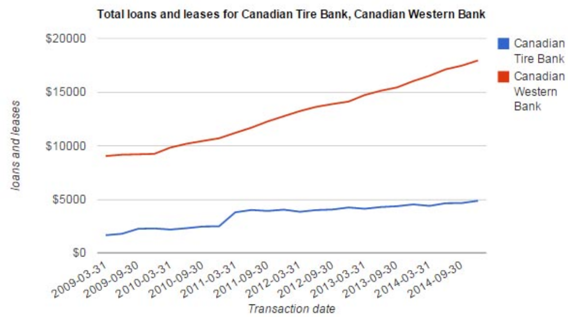
The charts on the following pages offer detailed financial insight and also provide contrast to other FIs by comparing CWB to Bridgewater Bank and Canadian Tire Financial (bank). In looking at the data, it should be noted that CDN Tire have a large credit card portfolio and Bridgewater bank began issuing a MasterCard in 2010. This explains the higher cost of funds and also is one explanation for Bridgewater's profit fall subsequent to issuing the card. It may also explain CDN Tire's higher cost of funds as both CWB securitize the majority of its mortgages while CDN Tire securitize the majority of its credit card receivables.

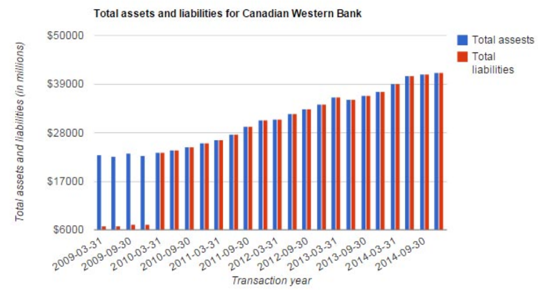


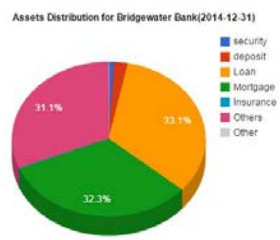




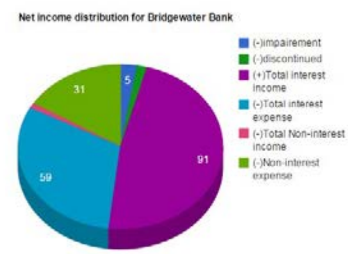




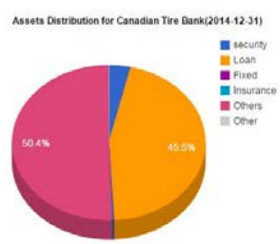




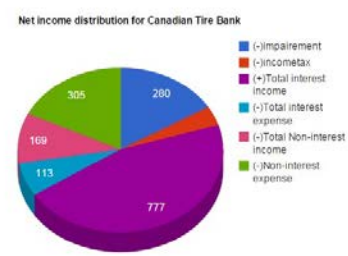
Total assets for Bridgewater Bank: $ 3,797.00



Net income for Bridgewater Bank: $-5



Total assets for Canadian Tire Bank: $ 10,698.00



Net income for Canadian Tire Bank: $183