Carfinco Financial Group Inc.
(TSX-CFN $11.08)

INITIATING COVERAGE

ALL GREEN FLAGS WITH U.S. EXPANSION

- The Business: Carfinco Financial Group provides financing on used car loans in Canada and the U.S. The Company purchases loans from a group of dealership partners and has carved out a niche by focusing on "D" credit quality clients.

- Investment Thesis: Given continued high debt levels of Canadian households combined with strong employment levels, there continues to be strong demand for financing needs from non-traditional sources in Canada.

  By charging an annual percentage rate ("APR") near 30% on most of its product offerings and securing funding at a cost of approximately 5% via a credit facility, CFN is able to earn very strong margins.

- Positioned for Strong Growth: Sustained strong loan originations domestically should continue to fuel domestic loan growth in the 15-20% range in 2014.

  Following an equity raise in April of 2013, CFN made an acquisition of Persian Acceptance Corp. (PAC) in September of 2013, a U.S. non-prime lender concentrated in the Northeast. Management is currently looking at other acquisitions to further the geographic expansion that could lead to upside from our current 2014 EPS forecasts.

- Catalysts: Near-term catalysts include the potential closing of a second U.S. subsidiary (Western Funding Inc.) in early 2014.

  Also, we expect an increase in the regular dividend in 2014, as payout ratios based on expected EPS should fall below 50%, historically a trigger for dividend increases.

Valuation Methodology

The target price is based on applying a 13.0x multiple to our 2014F diluted EPS estimate of $1.11.

Recommendation

We are initiating coverage on Carfinco Financial Group Inc. with a BUY recommendation with an average risk rating and 12-month target price of C$14.50 per share.
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Carfinco specializes in providing financing on used cars via a network of auto dealerships. The firm targets customers in the non-prime consumer segment generally considered to have a ‘D’ score. Increased unemployment in Canada and the U.S. would likely lead to higher loan loss ratios and reduced return levels. Funding is dependent on a syndicate of lenders backing the credit facility. Continued participation by the lenders in the syndicate is not guaranteed.

Interest Revenue $55.7 $66.2 $79.8 $100.7
Other Revenue $3.9 $5.6 $4.8 $5.0
Total Revenue $59.6 $71.8 $84.6 $105.7
Interest Expense $5.1 $5.9 $7.0 $8.0
Credit Provisions $19.5 $23.7 $30.6 $37.4
G&A Expense $11.5 $14.2 $19.1 $20.8
Other Expenses $0.4 $0.4 $0.2 $0.3
EBT $23.1 $27.6 $27.8 $39.2
Net Income $17.1 $20.6 $21.1 $29.4
Per Share
Diluted EPS $0.69 $0.84 $0.81 $1.11
P/LPS $1.42 $1.78 $2.60 $3.17
Profitability Metrics 2011A 2012A 2013F 2014F
Return on Assets 12.6% 12.6% 9.9% 10.9%
Return on Equity 52.7% 50.0% 34.3% 37.5%

The target price is based on applying a 13.0x multiple to our forecasted 2014 EPS estimate.

Company Profile
Carfinco Financial Group Inc. (TSX-CFN, FYE - Dec. 31) Analyst: Dylan Steuart, CFA
Recommendation: BUY 12-Month Target: $14.50 e-mail: dylan.steuart@jenningscapital.com
Risk Rating: AVERAGE Close: $11.08 Tel: (416) 304-2191

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Return on Assets 12.6% 12.6% 9.9% 10.9%
Return on Equity 52.7% 50.0% 34.3% 37.5%
INVESTMENT THESIS

Carfinco Financial Group Inc. ("Carfinco") provides financing on (generally used) vehicle purchases, and specializes in servicing customers who do not have access to traditional financing. The Company purchases loans from independent and franchise auto dealers across Canada and in select U.S. regions.

Management has carved out a niche market by targeting consumers across Canada (and recent expansion into the U.S. via acquisition) that are considered to have a ‘D’ credit score, meaning consumers with either no credit history or a poor credit score.

The Company is led by President and CEO, Tracy Graf, and Vice President and Chief Operating Officer, Troy Graf. See Appendix A for a summary of Management and the Board of Directors.

Carfinco’s strategy is to grow operations within Canada at an annual rate of 15-20%, while continuing its recent U.S. expansion via acquisition and organic growth.

We like Carfinco for the following reasons:

- Dominant position in its niche market allows the Company to generate very high margins in the auto finance industry.
- Historic, sustained growth in the domestic market with a management goal of strong continued loan growth (15-20%) within its core market.
- Recent collection initiatives should serve to mitigate credit losses in the event of economic turmoil.
- Recent U.S. acquisition will allow the Company to take advantage of a rebounding non-prime auto market south of the border.

What is required to unlock value for shareholders?

- Continued strong organic growth in the non-prime market within Canada
- Increase in the regular dividend, in line with expected earnings growth
- Credit losses coming in at or below average levels

We view the following as the major risks to our investment thesis:

- Credit quality of portfolio could deteriorate meaningfully in face of economic downturn given sub-prime nature of lending portfolio.
- Funding and future growth is dependent on a syndicate of lenders. No guarantee that the terms and current conditions of credit facility will be maintained.

Catalysts:

- Additional acquisitions within the U.S. subprime auto lending sector
- Increase of regular dividend would satisfy income hungry investors
**MARKET OVERVIEW**

**Summary**

Carfinco primarily focuses on providing financing for used auto loans in the non-prime sector, or specifically, clients who have a ‘D’ credit rating (no score, or a credit score below 619). Management has been able to carve out a niche within the ‘D’ paper space, as the domestic market has seen a considerable shake-out following the credit crisis (Figure 1).

*Figure 1  Competitive Summary*

![Graph showing competitive summary of car financing institutions.](image)

*Source: Company Reports*

The credit crisis spelled the exit from the Canadian non-prime auto market of three international players: HSBC, Wells Fargo, and AmeriCredit.

The two major players remaining are TD Bank (via an acquisition of VFC in 2006), and Bank of Nova Scotia (via an acquisition of Travelers Financial auto division), both of which currently do not venture as far down the credit spectrum as CFN does.

Similarly, a third player in the non-prime auto space, Rifco Inc. (TSXV-RFC), generally focuses its efforts on the ‘B’ and ‘C’ near prime segment, and is currently not a direct competitor of CFN’s main product offering.

We note that the high margin of the ‘D’ product space (the annual production rate (“APR”) on CFN’s main product offerings is 29.5%) remains very attractive and could attract additional competition in the future. More competition could impact pricing and squeeze margins from the current lofty levels.
Economic Conditions Fuel Underlying Growth

While exact data on the domestic non-prime auto lending market is not available, we can see that the domestic spending on new and used vehicles has rebounded very strongly.

Statistics Canada shows stable growth for both used and new car spending, and most importantly to CFN, stable and consistent growth of used car spend entering and coming out of, the credit crisis (Figure 2).

**Figure 2**  
**Used Car Sales Holding Steady ($ billion)**

![Used Car Sales Holding Steady](chart.png)

Source: CANSIM, JCI

Used car spending in Canada show CAGR of 3.3% from 2006 to LTM Q2/2013 ($25.5 billion), stronger than new car CAGR of 2.1% over the same time period, as used car sales held up much better in the economic downturn of the late 2000s.

Typically, approximately 60% of all used car purchases are financed via a loan (as opposed to lease, or cash purchase) indicating an approximate $15 billion annual market for used auto loans within Canada.

As of the most recent quarter end, Carfinco's gross loans on balance sheet were just over $240 million, a fraction of the total market. Looking at credit distributions for the Canadian population vis-a-vis CFN's portfolio highlights the niche the Company is targeting.
Figure 3  
Credit Score Distribution

Source: Company Reports

Figure 3 shows that CFN’s portfolio is concentrated (over 90%) in the ‘D’ paper category (a credit score under 619) and consumers with no credit score. These two categories only capture 16% of the population, a segment that, in general, would likely have a lesser relative share of car ownership than better credit quality clientele.

Figure 4  
High Debt Levels Combined With Low Employment Fuel Demand

Source: CANSIM, JCI

However, CFN has managed to grow its loan book by approximately 20% a year over the past three years, as it is the only significant lender concentrating on this niche. Two other factors have likely helped to fuel demand:

1. High consumer debt levels – The ratio of household debt to disposable income reached a new high of 163% in the second quarter of 2013, continuing the long-term run of ever increasing levels. Continued stressed levels should serve to increase demand for ‘non-traditional’ providers of credit (such as CFN) as larger institutions, such as the big banks, shy away from clients with damaged credit history.

2. Strong employment – On the flip side, unemployment levels continue to improve across Canada, an important metric, as while CFN’s client have a damaged or non-existent credit history, employment and an acceptable level
of disposable income to cover expected loan payments is required. Continued strong employment, particularly in Western Canada, will help to fuel ongoing demand and help to moderate future loan losses.

### Aggressively Branching out to Capture Future Growth

Carfinco currently has gross loan receivables of $240.9 million, for an annualized organic growth rate of 21% dating back to Q1/2010 (excluding acquisitions). Management has been able to achieve steady growth via ever increasing loan originations (Figure 5).

**Figure 5**  **Gross Loans and Originations ($000)**

[Graph showing gross loans and originations]

*Source: Company Reports, JCI*

Management has set a near-term loan growth target of 15-20% and is implementing a three-pronged strategy in order to continue growth.

#### A) Entering the U.S. Market

In April of 2013, CFN closed a secondary common share offering of $17.2 million with the proceeds to be used in order to pursue ‘future potential acquisitions’. The lack of available options domestically, combined with the rebound in the non-prime lending market in the U.S., led management to focus acquisition efforts south of the border.

On September 4, management announced the closing of the acquisition of Persian Acceptance Corp. (PAC). Total consideration was for $9.5 million, comprised of $9 million in cash, and $500K in common shares. PAC operates in five states located in the Northeast U.S. (Massachusetts, New Hampshire, Maine, Connecticut, and Vermont).

PAC’s main product offering is to similar ‘D’ clients, charging an average APR of 22-25%. After closing, a credit facility of $30 million backed by Wells Fargo was entered into at a rate of 4.45% plus LIBOR, which was subsequently reduced to 4.15% plus LIBOR, for an effective rate of 4.45%.

The lower APR than charged by CFN domestically is offset by the fact that the loans have full recourse back to the dealership from where they originate. This shifts the credit risk for PAC from the end-client to the dealership, greatly reducing realized losses.
Results for the first month after acquisition were positive, with annualized EPS contribution of $0.10, assuming zero growth.

**Figure 6**  
**PAC Results**

PAC Results (from Sept. 4th to September 30th)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Interest Revenue</td>
<td>1,200,682</td>
</tr>
<tr>
<td>Fee &amp; Servicing Income</td>
<td>29,359</td>
</tr>
<tr>
<td><strong>Total Revenue</strong></td>
<td><strong>1,230,041</strong></td>
</tr>
<tr>
<td>Interest Expense</td>
<td>138,460</td>
</tr>
<tr>
<td>Provision for Credit Losses</td>
<td>450,057</td>
</tr>
<tr>
<td>Depreciation of Equip.</td>
<td>6,486</td>
</tr>
<tr>
<td>Amort of Intangibles</td>
<td>5,646</td>
</tr>
<tr>
<td>G&amp;A Expenses</td>
<td>323,064</td>
</tr>
<tr>
<td><strong>Earnings before Taxes</strong></td>
<td><strong>306,328</strong></td>
</tr>
<tr>
<td>Taxes</td>
<td>121,000</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td><strong>185,328</strong></td>
</tr>
<tr>
<td>Diluted EPS Contribution</td>
<td>$0.01</td>
</tr>
<tr>
<td><strong>Annualized EPS</strong></td>
<td><strong>$0.10</strong></td>
</tr>
</tbody>
</table>

*Source: Company Reports, JCI*

The geographic diversification comes at a seemingly opportune time, as overall levels of non-prime auto loans are on the rebound, fully recovering from mid-2011 lows. Data from Experian Automotive shows that subprime auto loans south of the border totalled $143 billion as of Q2/2013, a Y/Y rebound of 11%.

**Figure 7**  
**U.S. Market Showing Signs of Rebounding**

*Source: Experian Automotive, JCI*
While Carfinco is currently adding technology infrastructure to PAC’s operations in order to fuel geographic and product expansion leading to organic growth in the back half of 2014, management is also currently looking for additional acquisitions.

To that end, management announced on November 1, 2013, that it had become the stalking horse bidder for the acquisition of the new equity ownership (following the emergence from bankruptcy) of Western Funding Incorporated (WFI), a non-prime lender based out of Las Vegas, but with branches from coast to coast in the Southern U.S.

**Figure 8**  
**WFI Loan Characteristics**

<table>
<thead>
<tr>
<th>Avg. Loan Terms</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>APR</td>
<td>23%</td>
</tr>
<tr>
<td>Vehicle Value</td>
<td>$4,000-$10,000</td>
</tr>
<tr>
<td>Down Payments</td>
<td>5-20%</td>
</tr>
<tr>
<td>Contract Terms</td>
<td>12-42 months</td>
</tr>
<tr>
<td>Purchase Discount</td>
<td>10-50%</td>
</tr>
</tbody>
</table>

*Source: Company Reports, JCI*

CFN has made a bid of 70% of net finance receivables (expected to be in excess of US$30 million at closing), which would make estimated total consideration over US$21 million.

Given the emergence from bankruptcy, estimating potential accretion of the acquisition is difficult at this time. If successful, the transaction should close in early 2014, at which time we will be able to adjust our estimates accordingly.

**B) Québec**

In 2011, CFN opened a servicing centre in Laval, Québec, related to the Company entering into a servicing agreement of loans owned by a U.S. entity. The servicing centre also allowed Carfinco to establish a beachhead to launch expansion into the Québec market.

Expansion to date has been slow, as cultural adaptation has taken time, leading to Québec still making up a minimal portion of the overall portfolio. However, we note that Québec is a large part of the Canadian auto marketplace (24% of new car sales in 2013 YTD) and remains a potential engine of growth.
C) Risk-Based Pricing – Moving up the Credit Spectrum

Also in 2011, management had indicated it was planning to expand its product offering domestically, by offering ‘risk-based’ pricing products; essentially offering loans to clients with improved credit, (i.e., a ‘B’ or ‘C’ credit rating), as compared to its established ‘niche’ market.

Looking at Figure 3, we see that a move to ‘B’ and ‘C’ clients opens up an additional 12% of the population to CFN, although likely a higher percentage of car owners.

CFN has introduced various tiers of products dependent on credit characteristics of the end user. While the main product offerings remain the GO Plan (a deep discount offering that allows the dealers to participate in good performance of the underlying portfolio while sharing the credit risk), and the standard Tier 2 product, the Tier 3 and 4 products attempt to capture higher credit quality clients.

<table>
<thead>
<tr>
<th>Product</th>
<th>APR</th>
<th>Discount/Reserve</th>
</tr>
</thead>
<tbody>
<tr>
<td>GO Plan</td>
<td>29.5%</td>
<td>20% average reserve</td>
</tr>
<tr>
<td>Tier 1</td>
<td>29.5%</td>
<td>8% discount</td>
</tr>
<tr>
<td>Tier 2</td>
<td>29.5%</td>
<td>4% discount</td>
</tr>
<tr>
<td>Tier 3</td>
<td>25.5%</td>
<td>0%</td>
</tr>
<tr>
<td>Tier 4</td>
<td>21.5%</td>
<td>0%</td>
</tr>
</tbody>
</table>

We note that CFN is entering a more competitive market with the introduction of its tiered offerings. This is a space in which large competitors, such as Scotiabank and TD Bank compete, alongside smaller player Rifco Inc. (TSXV-RFC). This will likely have a negative effect on margins given the competitive nature of the market, as the tiered products become a larger portion of the total loan receivable balance. However, improvement in credit losses via the higher credit quality clients should help mitigate margin compression.
Management secured an agreement in May, from the syndicate backing its credit facility, which allows CFN to offer loan terms of 72 months (6 years) for higher credit quality loans, up from 60 months previously. This will allow CFN to offer loans on terms comparable to that of its competitors.

**Financial Performance**

As discussed above (Figure 5), management has managed to show consistent and strong loan originations leading to growth of the loan book within the domestic market by targeting its niche market. Revenue growth of 19.8% (CAGR since Q4/2010) has been fuelled by the strong originations management has been able to source from an ever increasing dealer network.

*Figure 11 Revenue Growth ($ million)*

Despite the strong growth, management is still operating within a very high spread business. The main components leading to the spread are:

- **Gross yield** – CFN’s main product offerings charge a 29.5% APR. Management buys these loans at a discount from the dealer (average discount was 9.7% in the last quarter), raising the effective rate that accrues to CFN.

  While we expect this yield to decline in the future, given the increased focus on higher credit quality (and lower margin) clients, and the integration of lower yield U.S. subsidiaries, the Company posted a gross yield of 36.8% last quarter (excluding fees).

- **Funding costs** – Management has secured a main credit facility backed by a syndicate of four lenders (Bank of America, Bank of Montreal, Wells Fargo, and ATB Financial), with a limit of $205 million. CFN had drawn $134 million from the facility as of the most recent quarter. On November 1, the agreement was amended; lowering the borrowing cost to Banker’s Acceptance +2.75% (was 3.25%).

  Subsequent to the PAC acquisition, CFN entered into a $30 million credit facility with Wells Fargo to back the PAC loan book. The sum of
$22.3 million had been drawn as of Q3/13. The rate was also recently reduced to LIBOR + 4.15% (down from 4.45%).

CFN has $6 million in subordinated debentures carrying a 13% interest rate. **Overall, CFN’s total cost of funds was 5.0% in the recent quarter, down from 5.8% in Q1/2010**, offsetting margin pressure from lower realized gross yields.

- **Loan loss rates** – CFN had an annualized loan loss ratio (write-offs as a percentage of gross loans) of 13.9% in the last quarter, right on par with its average from the last 15 quarters.

Overall after credit cost margin spread was 18% last quarter, a bit of dip from recent highs of 20-24%, but still compares very well to a traditional financial institution. The Big Six Canadian banks average around 2-3% on this measure, highlighting just how profitable the non-prime auto business can be.

**Figure 12  A look at Spreads**

<table>
<thead>
<tr>
<th>Gross Yield (LHS)</th>
<th>Interest Cost (RHS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>34.0%</td>
<td>4.6%</td>
</tr>
<tr>
<td>35.0%</td>
<td>4.8%</td>
</tr>
<tr>
<td>36.0%</td>
<td>5.0%</td>
</tr>
<tr>
<td>37.0%</td>
<td>5.2%</td>
</tr>
<tr>
<td>38.0%</td>
<td>5.4%</td>
</tr>
<tr>
<td>39.0%</td>
<td>5.6%</td>
</tr>
<tr>
<td>40.0%</td>
<td>5.8%</td>
</tr>
<tr>
<td>41.0%</td>
<td>6.0%</td>
</tr>
</tbody>
</table>

**Source: Company Reports, JCI**

### Credit Metrics

Credit metrics are a key focus for investors, due to CFN lending exclusively to higher risk clients. While metrics have improved meaningfully since the height of the credit crisis, overall credit health of the loan portfolio is still a main indicator of present and future profitability outlook for the Company.

In general, credit metrics have improved since the crisis due to: 1) a general improvement in the overall domestic economic landscape, chiefly in employment levels; and 2) a general tightening in underwriting criteria and technology innovations that have improved collections and recoveries.

To this point, CFN now installs GPS starter interrupters on all new loan originations, which allows the Company to easily locate and interrupt the ignition on delinquent accounts, making repossession easier and adding incentive for the client to keep the loan current.
Figure 13 highlights the improvements CFN has made in three key credit metrics:

- **Loan loss rates** – Management has a policy of writing off loans after they are past due for more than 90 days (with the exception of U.S. loans). CFN had an annualized loan loss ratio (write-offs as % of gross loans) of 13.9% in the last quarter, below the five year average of 15.6%, and well below the ~20% levels during the credit crisis.

- **Delinquency ratios** – Loans that were delinquent, but not yet written off were 3.3% as of Q3/13, below the 3.6% average, but an increase from 2.5% in the prior quarter, mostly due to the inclusion of the U.S. loans that are written off on a later time frame. As a reminder, the U.S. loans are full recourse back to the dealer, which should result in fewer delinquent loans leading to actual write-offs.

- **Allowance levels as a percentage of gross receivables** – Credit provisions made against earnings build the allowance for credit losses account, which is held as a contra asset on the balance sheet. This balance is lowered by actual write-offs leading to the build of this account as an indicator of future credit loss coverage. Allowances as a percentage of gross receivables were 4.5% at quarter end, below long-term averages of 4.9%, due to the inclusion of the U.S. portfolio which should see lower relative write-offs. We expect this ratio to build over the near term.
FORECASTS AND VALUATION

CFN is currently trading at 13.6 times P/E on a 12-month trailing basis, a premium to its long-term average. We feel that the premium to near-term valuation is justified, as CFN enters 2014 looking to capitalize on its U.S. growth strategy and is positioned to increase the regular dividend payout to shareholders.

Figure 14  Price to Earnings Ratio Trading at Premium to Historical Averages

Source: Company Reports, JCI

We are forecasting strong Y/Y diluted EPS growth of 37%, as we estimate 2014 earnings per share at $1.11. The EPS growth is largely a reflection of management enjoying a full year of the PAC acquisition (and a cessation of related acquisition costs, $1.3 million in Q3/13, nearly $0.05 per share).

Figure 15  Financial Summary

<table>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Income</td>
<td>55,664</td>
<td>66,194</td>
<td>79,802</td>
<td>100,726</td>
<td>19%</td>
<td>21%</td>
<td>26%</td>
</tr>
<tr>
<td>Admin Fees</td>
<td>3,920</td>
<td>5,615</td>
<td>4,819</td>
<td>4,979</td>
<td>43%</td>
<td>-14%</td>
<td>3%</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>59,584</td>
<td>71,809</td>
<td>84,620</td>
<td>105,706</td>
<td>21%</td>
<td>18%</td>
<td>25%</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>5,053</td>
<td>5,917</td>
<td>6,995</td>
<td>8,048</td>
<td>17%</td>
<td>18%</td>
<td>15%</td>
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<tr>
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<td>$0.69</td>
<td>$0.84</td>
<td>$0.81</td>
<td>$1.11</td>
<td>20%</td>
<td>-3%</td>
<td>37%</td>
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<td>Dividend per Share</td>
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<td>$0.48</td>
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<td>Payout %</td>
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<td>ROE %</td>
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Source: Company Reports, JCI

The information contained in this report was obtained from sources we believe to be reliable. We do not represent that such information is accurate or complete and it should not be relied on as such. Any opinions expressed herein reflect our judgment at this date and are subject to change. Jennings Capital Inc. and/or employees from time to time may hold shares, options or warrants on any issue included in this report and may buy or sell such securities. This report is not to be construed as an offer to sell or solicitation to buy securities. Member – CIPF. Jennings Capital (USA) Inc. is a member of SIPC.
Our assumptions:

- We are forecasting minimal organic growth for the PAC U.S. subsidiary for 2014 as management attempts to improve infrastructure before ramping up the business. The possibility remains that we will see the unit grow meaningfully in the back half of 2014 adding upside to our estimates.

- Similarly, we are not factoring in any metrics for a possible closing of Western Funding Inc. (WFI) acquisition as the unknowns surrounding a successful bid are too plentiful to model, in our view. Again, an accretive acquisition of this company could lead to upside in our estimates.

- We are forecasting overall loan growth of 16% in 2014, in line with management's target of 15-20%.

- Loan loss ratios are forecasted to be in the 13-14% range through to the end of 2014 as we expect efforts to tighten up credit losses in Quebec and an increased shift to higher credit quality clients will bear fruit in 2014.

**Recommendation**

We are initiating coverage on Carfinco Financial Group Inc. with a **BUY** recommendation, **AVERAGE** risk rating and **12-month target price of C$14.50/share**.

Our target price is generating by applying a 13x multiple to our 2014 EPS estimate of $1.11. Our multiple is based on a slight premium to the near-term trading average of 12.6x of the group of auto lending peers in Canada and the U.S. (Rifco Inc. (TSXV-RFC), Nicholas Financial (NICK-US), and Credit Acceptance Corp. (CACC-US)).

The premium is justified, in our view, due to the near-term growth prospects following the implementation of the U.S. subsidiary, a healthy 4.3% dividend yield (with attractive payout ratios approaching 50% of EPS), and continued expected growth prospects of the domestic non-prime auto lending market in Canada.

**Figure 16**  
*Auto Lender Peer LTM P/E*

![Chart](chart.png)  
Source: Capital IQ, JCI

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INVESTMENT RISKS

Credit Risk: CFN provides financing primarily within the non-prime segment, to customers who would not be able to receive loans from traditional institutions due to poor, or non-existent, credit ratings. Given the nature of the end-client, CFN is exposed to the elevated risk of loan delinquencies and associated credit write-offs. Credit losses could elevate, impacting profitability, in the event of an economic downturn.

Funding Risk: The Company’s primary funding vehicle is composed of a credit facility provided by a syndicate of lenders. The facility expires in November 2014, and while CFN has long standing relationships with its lenders, there is no guarantee that the terms will remain as favourable, or that funds will be renewed upon expiration of the agreement.

Competition: Carfinco has 1,900+ dealer relationships across the country, and remains the only significant player in its niche ‘D’ paper market. However, barriers to entry are low in the industry, and the possibility remains that the attractive returns earned could draw entry into the market by much larger competitors, possibility impacting operations and profitability.

Furthermore, CFN is attempting to move up the credit spectrum (‘B’ and ‘C’ clients), bringing operations into direct competition with much larger players. There is no guarantee that the Company will be able to capture a meaningful share of this market, impacting future growth potential.

Regulatory: Given that Carfinco deals exclusively in the non-prime segment there is greater risk of future regulatory changes that may impact future operations as compared to the risk of a traditional lender. While CFN’s current operations are in line with all provincial and federal regulations, the possibility remains that future legislation may impact the non-prime industry in Canada or the U.S.

Interest Rate Risk: The Company currently underwrites contracts at a fixed rate, while it is funded by a credit facility that is tied to the prime rate of the lenders backing the syndicate, which is a floating rate. This exposes CFN to risk in the event of a rising interest rate environment. Carfinco mitigates this by entering into an interest rate swap agreement, but there is no guarantee that the hedging will be available in the future.

Technology Risk: CFN operations depend on the Company and its dealer partners having functioning data processing systems. Being able to quickly process loan applications through the proper approvals is key to being able to provide funding for each loan. Any interruption in the data system on either CFN’s or the dealer’s side would cause a distribution in operations and could potentially stall growth and profitability.
APPENDIX A – SENIOR MANAGEMENT AND BOARD OF DIRECTORS

Senior Management

Tracy Graf – President, CEO and Director

Mr. Tracy Graf was appointed President of the Carfinco Group in November 1998 and is now a Director and CEO of CFN. Prior to March 1997, Mr. Graf contributed significantly – both financially and conceptually – to the research and development of the Carfinco business concept. Mr. Graf has been a principal and founder of several successful small businesses in Alberta. Mr. Graf was the founder and past-President of Amigo Headwear Ltd., a North American clothing manufacturing company. From 1983 to 1994, Mr. Graf was General Manager of Graf Management and Cattle Co. Ltd.

Mr. Graf currently sits on the Board of Aurora Spine Corporation (TSX:ASG), a company formed to bring new and innovative solutions to spinal fusion surgery and on the Board of Lonestar West Inc. (TSXV:LSI), an oilfield services company. Mr. Graf also sits as a member of the Red Deer, Ronald McDonald House capital campaign.

Troy Graf, CA – Chief Operating Officer, Director

Mr. Troy Graf is responsible for all day-to-day operations of the Carfinco organization. He joined Carfinco at its inception in 1996, and has been a part of the entity’s development, first serving as Chief Financial Officer for 14 years, and then, in September 2011, being named Chief Operating Officer. Mr. Graf completed his Bachelor of Commerce at the University of British Columbia in 1993 and completed his qualifications as a Chartered Accountant in 1996. He articled with Grant Thornton LLP (formerly Doane Raymond), in Vancouver where he gained experience as an auditor for industrial firms, financial institutions (primarily credit unions) and numerous small business organizations.

Stephen Dykau, CA – Chief Financial Officer

Stephen Dykau is currently Chief Financial Officer at Carfinco Financial Group Inc., and is responsible for overseeing the Company’s financial operations and internal controls. He joined CFN in April 2009 and, prior to his appointment to CFO, held previous positions as Vice President of Finance and Controller within the Carfinco Group. Mr. Dykau completed his Bachelor of Management Degree at the University of Lethbridge in 2006, and completed his qualifications as a Chartered Accountant in 2007, after articling with Grant Thornton LLP in Edmonton, where he gained experience with large privately owned and public companies in numerous industries.
Board of Directors

Tracy Graf – President, CEO and Director – See Above

David Rosenkrantz – Chairman and Director

Mr. Rosenkrantz has been Chairman of the Board of Carfinco since 2009, and a Director since 2002. He is also a co-founder of Patica Corporation, a merchant bank specializing in the small-to-mid cap market, and he has served as a Chairman of Patica Corporation since 1993. Mr. Rosenkrantz has served as a Director of numerous public and private companies including: Medisystem Technologies Inc., Stellar Pharmaceuticals Inc., and Versent Corporation. Mr. Rosenkrantz is a graduate of Carleton University and obtained his MBA from York University.

Peter Miller – Director

Mr. Miller was named to the Board following the acquisition of Persian Acceptance Corporation (PAC) by Carfinco in 2013. Mr. Miller has more than 19 years of experience in the U.S. sub-prime automobile lending industry and was a co-founder of PAC in 1998. Prior to that, he spent 10 years as the General Manager of a family owned new car dealership. Mr. Miller earned a Bachelor of Arts in Economics from Duke University and a MBA at the Fuqua School of Business at Duke University.

David Prussky – Director

Mr. Prussky is a co-founder of Patica Corporation. He serves as President of Patica Corporation, He is also a director of Lonestar West Inc. (TSXV: LSI), Swisher Hygiene Inc. (TSX:SWI), Atrium Mortgage Investment Corporation, and Norrock Realty Finance. He has served on the boards of numerous public and private companies.

Maurice Kagan – Director

Mr. Kagan is currently President of Sparkle Solutions. In addition to his role as a Board member at Carfinco, he is the Chairman of Carfinco’s Audit Committee. Until June 2004, Maurice was CFO of Residential Equities Real Estate Investment Trust (ResREIT) and served as Vice President, Corporate at CapREIT until February 2006.

Simon E. Serruya – Director

A Director since 2002, Mr. Serruya is Chief Operating Officer of Yogen Früz International Inc., a foodservice firm with 1,300 locations in over 35 countries worldwide. He has been with the company since 1987, and was instrumental in the growth of Yogen Früz both domestically and internationally, taking the company public in 1994, and, in 2006, taking it private.

J. Daryl MacLellan – Director

Daryl is President of Desante Financial Services Inc., and Managing Director of Maxium Financial Services Inc. Prior to his current occupations, Daryl was President of CIT Canada and President of CIT Group Securities (Canada) Inc., units of CIT Group Inc. (NYSE:CIT), a leading global commercial and consumer finance company. A graduate of the University of Waterloo, Daryl is a Chartered Accountant and serves on the Board of Directors of the Canadian Financing Lease Association, as well as a number of other private companies.

Brent Channell – Director

Mr. Channell is Managing Director of Spartan Fund Management Inc., a specialist in alternative investment strategies. He has over 25 years of experience in alternative investments, structured finance, corporate finance and derivatives, primarily with the Royal Bank of Canada and Citibank Canada. He is a graduate of the University of British Columbia (BComm, Hons.) and Queens University (MBA).
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### APPENDIX B – FINANCIAL STATEMENTS

#### Balance Sheet ($ millions)

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<td><strong>Assets</strong></td>
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<td>250.4</td>
<td>250.4</td>
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<td>(9.7)</td>
<td>(10.5)</td>
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<td>(11.3)</td>
<td>(11.3)</td>
<td>(13.2)</td>
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<td>Goodwill</td>
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<td>187.6</td>
<td>239.1</td>
<td>246.6</td>
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<td>285.4</td>
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<td><strong>Liabilities</strong></td>
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<td>Bank credit facility</td>
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#### Income Statement ($ millions)

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<td>Interest income</td>
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<td>Provision for credit losses</td>
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<td>(0.1)</td>
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<td><strong>Net Earnings Before Taxes</strong></td>
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<td>Basic</td>
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<td>$0.20</td>
<td>$0.22</td>
<td>$0.16</td>
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<td>$1.11</td>
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<tr>
<td>Diluted</td>
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<td>$0.22</td>
<td>$0.16</td>
<td>$0.22</td>
<td>$0.81</td>
<td>$1.11</td>
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Source: Company Reports, JCI
APPENDIX C – COMPARABLE COMPANIES

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<td>$11.08 4.3%</td>
<td>$11.68 $8.05</td>
<td>$294</td>
<td>$2.50</td>
<td>$2.34</td>
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<td>37%</td>
<td>34.3%</td>
<td>37.5%</td>
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<td>TSX:RFC</td>
<td>RIFCO Inc.</td>
<td>$6.80 7.1%</td>
<td>$7.20 $2.76</td>
<td>$142</td>
<td>$0.69</td>
<td>$0.69</td>
<td>$0.27 $0.31</td>
<td>$0.49</td>
<td>39%</td>
<td>56%</td>
<td>57.1%</td>
<td>44.5%</td>
<td>43.0%</td>
<td>9.9X</td>
<td>21.9X</td>
<td>14.0X</td>
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<tr>
<td>NasdaqGS:CACC</td>
<td>Credit Acceptance Corp.</td>
<td>$124.45 0.4%</td>
<td>$129.99 $90.01</td>
<td>$2,955</td>
<td>$29.14 $29.14</td>
<td>$10.13</td>
<td>$10.43</td>
<td>$11.41</td>
<td>22%</td>
<td>9%</td>
<td>37.8%</td>
<td>37.6%</td>
<td>25.7%</td>
<td>4.3X</td>
<td>11.9X</td>
<td>10.9X</td>
<td></td>
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<tr>
<td>NasdaqGS:NICK</td>
<td>Nicholas Financial Inc.</td>
<td>$15.81 3.0%</td>
<td>$17.20 $11.71</td>
<td>$193</td>
<td>$1.05</td>
<td>$1.05</td>
<td>$1.58 na</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td></td>
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</tr>
<tr>
<td>TSX:CXS</td>
<td>Counsel Corporation</td>
<td>$2.19 21.9%</td>
<td>$3.00 $0.91</td>
<td>$216</td>
<td>$1.13</td>
<td>$0.82</td>
<td>$0.09 $0.16</td>
<td>$0.26</td>
<td>41%</td>
<td>70%</td>
<td>7.3%</td>
<td>8.8%</td>
<td>18.8%</td>
<td>1.9X</td>
<td>14.1X</td>
<td>8.3X</td>
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<tr>
<td>TSX:EQB</td>
<td>Equitable Group Inc.</td>
<td>$46.77 1.0%</td>
<td>$49.73 $31.80</td>
<td>$716</td>
<td>$33.77</td>
<td>$33.77</td>
<td>$5.43</td>
<td>$5.65</td>
<td>$6.31</td>
<td>11%</td>
<td>12%</td>
<td>17.5%</td>
<td>17.4%</td>
<td>16.6%</td>
<td>1.4X</td>
<td>8.3X</td>
<td>7.4X</td>
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<tr>
<td>TSX:HCG</td>
<td>Home Capital Group Inc.</td>
<td>$79.11 0.6%</td>
<td>$85.85 $49.65</td>
<td>$2,848</td>
<td>$32.27</td>
<td>$29.79</td>
<td>$7.07</td>
<td>$7.31</td>
<td>$8.34</td>
<td>14%</td>
<td>14%</td>
<td>25.5%</td>
<td>23.7%</td>
<td>22.2%</td>
<td>2.5X</td>
<td>10.8X</td>
<td>9.5X</td>
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</tr>
<tr>
<td>TSX:FN</td>
<td>First National Financial Corporation</td>
<td>$23.31 2.1%</td>
<td>$23.90 $15.15</td>
<td>$1,397</td>
<td>$4.81</td>
<td>$4.75</td>
<td>$2.63</td>
<td>$2.39</td>
<td>$2.25</td>
<td>36%</td>
<td>-6%</td>
<td>35.8%</td>
<td>50.5%</td>
<td>39.9%</td>
<td>4.8X</td>
<td>9.7X</td>
<td>10.4X</td>
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<tr>
<td>TSX:MKP</td>
<td>MCAN Mortgage Corp.</td>
<td>$12.92 3.7%</td>
<td>$15.25 $11.35</td>
<td>$264</td>
<td>$9.94</td>
<td>$9.94</td>
<td>$1.39</td>
<td>$1.41</td>
<td>$1.43</td>
<td>15%</td>
<td>1%</td>
<td>12.8%</td>
<td>14.9%</td>
<td>13.5%</td>
<td>1.3X</td>
<td>9.2X</td>
<td>9.1X</td>
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<tr>
<td>TSX:EFN</td>
<td>Element Financial Corporation</td>
<td>$14.64 3.3%</td>
<td>$14.84 $6.07</td>
<td>$2,275</td>
<td>$5.72</td>
<td>$4.66</td>
<td>-0.04</td>
<td>$0.36</td>
<td>$0.68</td>
<td>na</td>
<td>89%</td>
<td>na</td>
<td>-1.9%</td>
<td>6.8%</td>
<td>11.7%</td>
<td>2.6X</td>
<td>40.8X</td>
<td>21.6X</td>
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**Average**
- 22% 31% 25.7% 26.5% 25.4% 3.5% 15.6X 11.2X
- 41% 89% 57.1% 50.5% 43.0% 9.9X 40.8X 21.6X
- 41% 89% 57.1% 50.5% 43.0% 9.9X 40.8X 21.6X

**Adjusted Average**
- 23% 29% 25.2% 25.9% 24.9% 2.9X 13.1X 10.3X

Source: Company Reports, Capital IQ, Jennings Capital Inc.
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<tr>
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<th>RELEVANT DISCLOSURES</th>
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<td>Carfinco Financial Group Inc.</td>
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