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In the Eye of the Storm

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The credit crisis is posing big challenges for financial services providers, for sure. But it's also opening up big opportunities

by Ryan Smith

Bill Graham maintains a confident and relaxed attitude in his tidy corner office on the top floor of the Scotiabank building in downtown Red Deer. He may seem far removed from the angry seas of the global economic storm, but the former high school teacher is right in the thick of it. He admits the situation has him navigating through "uncharted waters," but the founder, president and CEO of Rifco Inc. (that stands for Repair Industry Finance Corporation) remains buoyant.

"We're in the midst of a generational economic downturn, and I don't think you'll find any manager of a financial services company who doesn't wish the sailing was smoother than it is, but at the same time, if you're a true entrepreneur, you're probably enjoying the challenge," he says.

From bankers to stockbrokers to insurers, everyone in the finance business has been pulled into a money-sucking whirlpool, and what little cash lenders are now willing to part with is only available at premium prices. Nonetheless, Alberta has been on high economic ground for some time, and the current monetary drain is offering many locally based financial services companies a chance to come out of the crisis in better shape than before it started.

With strong growth in the recent past – Rifco ranked on Alberta Venture's Fast Growth 50 list as recently as 2008 – and a healthy outlook for the future, Graham's not worried his car loan company will sink anytime soon. In fact, the current global credit crisis is presenting opportunities along with the challenges, and his toughest decision is whether or not to proceed with caution or power full steam ahead. The dilemma is creating conflict in his company's boardroom, he allows. Rifco's growth-focused management team wants to increase market share and develop new customer relationships, while its external board members are inclined toward a more conservative course.

"There is some tension, but I think it's healthy and appropriate, and a balance is being met," he says.

As Graham describes it, Rifco is a small player in a big automotive finance market that is shrinking due to fewer auto sales, which is the result of diminished consumer confidence and more stringent requirements to qualify for loans. However, even as credit tightens and the market contracts, Rifco, which loaned nearly $40 million to car buyers last year, has an opportunity to increase its share of the market, mainly because some larger multinational players, including HSBC and Wells Fargo, are pulling up anchor and leaving Canada – along with hundreds of millions in business for others to haul in.

"We have more opportunity in the next 24 months than we could possibly take advantage of…. We're a niche player and our niche is getting bigger," Graham says. "For us, the limiting factor to growth is access to capital. We have good funding relationships, but no one is interested in backing unlimited growth rates right now."

Rifco supports about 25 employees and holds roughly 4,000 accounts with car buyers in eight provinces across Canada. Historically, the default rate on the company's loans has averaged just 4%, a sign of both good lending decisions and a good economic environment over the six years Rifco has been in business. Graham's major concern is that unemployment rates will rise along with effective interest rates – "Money is getting more expensive," he says – and then default rates will rise along with them.

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"Unemployment drives credit performance, and the marketplace has become less concerned about growth on the banking and credit side and more concerned about credit quality, so everyone is raising credit standards and raising rates in expectation of rougher times ahead. And we're in that group," he says.

"There is a thick swath of customers who would have qualified for auto financing at 0% or 2% for promotional rates or 7% or 8% at non-promotional rates last year, and now they'll likely see rates between 14% and 25%," Graham says. "Those customers will be in for a shock when they go to trade in their cars this year."

Graham believes his business in Alberta, where unemployment rates are the lowest in the country, will likely remain solid, though he is concerned lower oil and gas prices and tighter credit restrictions may choke the junior oil and gas explorers, resulting in fewer workers and an economy that is not as greased as it has been. "For now, we want to grow and continue to grant good loans and make sure we keep our delinquency rates under control," he says. "If we can do that, our business is well-protected. People always need to borrow money, in good times and bad."

Terry Kelly, who sits at the helm of Battle River Credit Union Ltd. in Camrose, echoes Graham's sentiments. His main concern, too, is unemployment rates, but he also keeps an eye on the prime rate to see how the government is "seeding his competitors," namely, banks. "For every quarter of a per cent the prime rate goes down, it costs us about $300,000 or $1.2 million a point in our prime-plus loans," says Kelly, Battle River's general manager. As a result, most lenders are now trying to avoid lending at prime-plus rates, and the cost of money and the requirements to get it are going up in spite of plummeting prime rates, Kelly says.

On the investment side, Battle River steered clear of asset-backed, subprime loans and, in an environment where cash is king, Alberta's fifth largest credit union has kept 12% – $55 million – of its $494 million in assets liquid. "As a general rule, the philosophy of credit unions as a whole has always been to be very conservative lenders, so I think we're in better standing than other financial institutions these days," Kelly says. As long as Battle River maintains a balanced portfolio of loans among commercial, mortgage, agriculture and personal loans, Kelly believes his business will continue to be a strong performer in a difficult economic environment.

"I'm glad we're in Alberta. We have the resources, and we're strong. If our biggest worry is that our [provincial] surplus is smaller than we expected it would be, then we're not doing too badly, at all," he says. "You ask people if they're worried, and they say, 'Yeah.' Then you ask if they are worried about their jobs, and they say, 'Well, not really.' So, I think we still have good strength in the underlying economy in Alberta."

Scott Tannas, president and CEO of High River-based Western Financial Group Inc., agrees with Kelly and takes the sentiment one step further. "We've been lucky in Alberta in terms of having a strong economy compared to the rest of the country, even the rest of the world, and right now that gulf has never been wider, in my view." Western Financial got its start as a chain of small-town insurance brokerages but has since expanded into commercial banking with its subsidiary Bank West.

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"In looking at the fundamentals of our business, the stock market really doesn't have a big impact on us – on car insurance and house insurance and so on – and our relationships with our customers as they relate to banking and insurance carries on as they always have," Tannas adds. He notes that if Alberta's economy slows down, house and car insurance are not elective and that part of Western Financial's business will not suffer, but commercial insurance does tend to shrink as businesses contract.

"The barometer for us is employment. That's the number we have to watch. It will tell us where things are headed," Tannas says.

Like all brokerage houses and investment banks, Acumen "took a hit" last fall, Laidlaw says. "But we've had some hedge products in place that mitigated some of the losses, and I think we've done better than most." Even national players have had to pare back – Canaccord Capital Corporation laid off 10% of its workforce – to make up the decline in revenue.

"I've only had one client who panicked and sold, and then, interestingly enough, a week later, he said, 'That's crazy' and bought back in with 50%, and we've been picking away with the rest," Laidlaw says.

In fact, Laidlaw says he has opened up more new accounts recently than he ever has, as new clients have come to him looking for investment bargains. Laidlaw likes to maintain balanced portfolios, but he sees some "screaming buys" in some homegrown Alberta companies in particular, such as WestJet and Suncor. "I think Alberta is still the best place to be in Canada. I'd rather be here than anywhere else in the country. We have the resources, and I think the best opportunities still lie here," he adds.

But how long will that last?

Joseph Doucet, the Enbridge Professor of Energy Policy at the University of Alberta, says he's cautiously optimistic for continued strength in Alberta's energy sector, even though the production of conventional oil and gas may slip as commodity prices remain low. "On the conventional [oil and gas] side of things, it's a traditional story: as commodity prices fall, drilling activity falls, and you have less employment and less subsidiary activities related to conventional production, and that's not different from any other downturn historically in Alberta.

"On the unconventional side, some projects have been delayed in the oilsands, of course, but the ongoing activities will continue and be profitable, and all of the spinoffs from that sector – employment and equipment rentals and such – will continue," he says. "Energy is not everything to Alberta's economy, but it's a whole lot, and I think the continued activity in the oilsands is going to continue to pump investment into the economy." Even if more projects get shelved or cancelled altogether, it's hard to miss what you didn't have to begin with; it can't be compared with the situation in Ontario, where automotive factories and other long-standing pillars of the economy are shutting down for good.

In the midst of these stormy economic times, executives in the financial sector are grappling with the decision Graham says is dividing Rifco's boardroom: whether to throttle forward or batten down the hatches. Either way, Graham thinks any business that can survive this economic tempest will be much stronger when the winds subside. "When we first started and things were going well, people would say, 'Yeah, but you haven't been tested by tough times, like a bad recession.' Well, they can't say that anymore."