3 Reasons to Buy Home Capital Group

Description

In Canada, there are plenty of good reasons to buy shares of the major banks. There is relatively little competition, allowing for high returns. They are growing, at least modestly. And they are well-capitalized, especially compared to their American peers.

But there is another financial services company that scores even better on these metrics: **Home Capital Group** (TSX:HCG). The company specializes in providing mortgages to people typically turned down by the banks (such as entrepreneurs and immigrants), and has an excellent track record of doing so.

Home Cap's shares have done very well over the past year, increasing over 55%. But there are still plenty of reasons to buy the shares.

1. High returns

In 2013, Home Cap's return on equity came in at 23.9%, well ahead of the average for the large banks. In fact the company's return on equity has remained in the 20s for many years running. Even during the financial crisis, the company's ROE remained above 27% in both 2008 and 2009.

It is easy to see how the company is so profitable. Despite lending money to higher-risk borrowers, loan losses came in at only 0.09% of total loans. And the company's expense ratio was under 30%, easily lower than all of the big banks.

The high returns did not come from taking outsized risk. The Common Equity Tier 1 Capital Ratio was nearly 17%, far higher than any of the banks.

2. Room for growth

Most of Canada's big banks are struggling to find growth, partly because the biggest opportunities are in other countries, which come with lower returns. But Home Capital's addressable market in Canada is approximately $260 billion worth of mortgages. And despite being the market leader in its space, the company still only has a 3% market share. Home Cap also has opportunities to grow with its other services, such as commercial lending and its Equityline Visa product.

Home Cap's annual growth target is 10-15%, which it met last year.

3. Not too expensive

Home Capital's book value per common share is just shy of $17 (after a stock split), meaning that at $44.50 per share, the company trades at 2.6 times book value. But that still only represents 12 times earnings, a reasonable price. A comparison with **TD Bank** (TSX:TD) provides a perfect illustration.

TD's most recent results were generally well-received. The company grew earnings by 6%. The Common Equity Tier 1 Capital Ratio is 8.9%. Return on equity now stands at 13.3%. But these numbers are all easily eclipsed by Home Capital. Yet TD trades at 14 times earnings, while Home Cap only trades at 12 times earnings.

Foolish bottom line

The arguments against Home Capital are similar to those against the Canadian banks. Canada's housing sector appears overheated, and consumer debt levels are very high. But that does not answer the fundamental question: why buy shares of the Canadian banks when one could buy shares of Home Capital instead? The answer remains a mystery.

CATEGORY

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1. NYSE:TD (The Toronto-Dominion Bank)
2. TSX:HCG (Home Capital Group)
3. TSX:TD (The Toronto-Dominion Bank)

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