Skip the Banks; Buy These 2 Stocks Instead

Description

One of the most common questions asked among Canadian investors is, “Which bank should I buy?” And while everyone seems to have a different opinion, rarely is the answer, “none of them.”

But there are two Canadian stocks in particular that have outperformed the banks over the past year. And these stocks still have plenty of room to run. Investors may want to consider them as bank substitutes in their portfolios.

Home Capital: Better returns, better growth, same price

Home Capital Group (TSX: HCG) specializes in providing mortgages to people who banks often turn down, such as entrepreneurs and immigrants. And the company does an outstanding job. Loan losses totaled only 0.09% of loans in 2013, and expenses were also lower than the Canadian banks. As a result, the company’s return on equity was 23.9% in 2013, well ahead of the average for the big banks.

Home Capital also has more room for growth than the big banks, due to its minuscule 3% market share. The company’s annual growth target is 10-15%, a range that is well above the Canadian banks’ growth rates. It company had no trouble meeting that target last year.

Best of all, Home Cap still trades at only 12 times earnings, about in line with the Canadian bank average.

Equitable Group: Still nice and cheap

Equitable Group (TSX:EQB) is another mortgage provider with plenty of room for growth. Since 2009, mortgages under management and earnings per share have both grown by 15% per year. And the company is much smaller than Home Cap, meaning it has even more opportunity to gain market share.

Equitable's return on equity has consistently been in the high teens over the past five years. Although this is respectable, it is not as good as Home Cap's, and as a result, its shares are cheaper. In fact, at barely 10 times earnings, Equitable's shares are cheaper than all the banks too. This does not make sense, given how much Equitable can grow its earnings.

A look at RBC

The banks simply do not offer as good a deal to investors, and **Royal Bank** (TSX:RY)(NYSE:RY) provides a perfect example. The bank does have opportunities to grow internationally, especially through businesses such as wealth management and capital markets. But the bank is expected to grow earnings by only 7% this year.

Yet RBC trades at 13 times earnings, higher than both Home Cap and Equitable. There is little reason for this, other than the fact that RBC is better known.

Foolish bottom line

Based on how cheap Home Cap and Equitable are, it would be natural to assume that their stocks have suffered. But actually the opposite is true. Home Cap and Equitable's shares have both gained 58% over the past year.

The good news is that with growth opportunities still high, and trading multiples still low, it's not too late to buy shares of these hidden gems.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:RY (Royal Bank of Canada)
2. TSX:HCG (Home Capital Group)
3. TSX:RY (Royal Bank of Canada)

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bensinclair