Should Investors Bank On These 3 Non-Bank Financials?

Description

One of the criticisms of Canada's stock market is how focused it is on financials, specifically our big five banks. More than 20% of the TSX Composite Index consists of shares in **Royal Bank**, **Bank of Nova Scotia**, **CIBC**, **TD Bank**, and **Bank of Montreal**. Each of those stocks are among the 10 largest in Canada, and are constantly mentioned in the media. Most Canadian investors own at least one of the big banks.

Since those companies are so dominant, investors often miss out on some of Canada's lesser known financial companies. These companies often have growth potential better than larger financials, since they aren't so large. They serve profitable niches, often with little or no competition. And they often trade at a discount, since investors simply don't think of them.

Here are three that should be on your radar screen.

1. Carfinco

In today's tepid economic times, many people need a car but don't have the pristine credit needed to qualify for financing. Enter **Carfinco Financial** (TSX: CFN), Canada's biggest alternative vehicle financier. Carfinco works with independent dealers across the country, providing loans on used cars for borrowers who just don't qualify at the bank.

Borrowers pay well for the privilege of getting money from the company, often paying interest rates in excess of 20% annually. Rates are so high because write-offs are often excessive — to the tune of 10% a year — even during good times. The company has taken one important step to try and reduce write-offs, by installing tracking devices in all financed cars. If a borrower stops paying, at least the company can now locate the car and repossess it.

Carfinco is attractively valued, trading at just 12x trailing earnings. Its balance sheet remains solid, and it's grown to originate more than $1 billion in loans. The company currently pays a 4.8% dividend. It also has very little for competition, because it deals with borrowers who have often been rejected by other lenders.

2. TMX Group

Considering **TMX Group** (TSX: X) has a market cap of almost $3 billion and is a quasi-utility, the company gets very little attention.

Very simply, it's levered to Canadian growth. As the economy improves, so do trading volumes and new issuers on the exchange, the latter of which is the main revenue driver for the company. It also makes money settling trades in everything from stocks to fixed income to derivatives and commodities. With the company's recent announcement of plans to expand into the over-the-counter markets, TMX Group has pretty much cemented its status as the gatekeeper of capital markets.

When times are good, TMX Group is a cash flow machine. Free cash flow was $4.20 per share last year, easily covering the $1.60 annual dividend. 2014 looks good for new issuers, meaning the company will likely increase the 3% yield at some point this year.

First National Financial

Looking for a financial company with year-over-year revenue growth of 23.5%, earnings growth of 56%, and a 6.1% dividend yield? You won't find it with any of the big five banks.

First National Financial (TSX: FN) is Canada's sixth largest mortgage lender, working exclusively with mortgage brokers. Its mortgage rates are among the most attractive in the country, which the company manages to maintain because it has a skeleton staff and little in fixed expenses. And since First National deals exclusively with high quality borrowers, most of the mortgages on its books are insured against default.

Growth is expected to slow substantially in 2014, as the overall Canadian real estate market starts to slow. Still, the company only trades at 10 times expected 2014 earnings, and had a 48% return on equity in 2013. Even if the Canadian housing market suffers going forward, First National has a good presence with mortgage brokers, and is priced attractively without any growth.

Foolish bottom line

Since Canada has such strong banks, many investors don't pay any attention to other financial stocks that are cheaper, have better growth potential, and pay attractive dividends. They deserve consideration for your portfolio too.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:FN (First National Financial Corporation)
2. TSX:X (TMX Group)

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