



Should You Buy Home Capital Group Inc. Over Canada's Big Banks?

Description

Although the larger Canadian banks get most of the attention, there are a handful of other financial companies that deserve your attention. **Home Capital Group Inc.** ([TSX:HCG](#)), for example, offers deposits, mortgage lending, retail credit, and credit card issuing services across Canada.

While it sounds like the company would come into competition with Canada's big banks, it has found a niche by targeting populations that are underserved by its larger competitors. By offering loans to borrowers who do not meet big banks' lending criteria, Home Capital Group has figured out a way to grow quickly and profitably without running into direct competition with deep-pocketed rivals.

Should you consider Home Capital Group over some of Canada's other banks?

Impressive financial results

Earnings per share and dividends have been increasing consistently over the past decade, with both growing by at least 20% annually. Growth in both of these metrics have allowed dividends to only comprise an average 15% of earnings over the last 10 years.

These metrics are strong evidence that Home Capital Group is a growing company with an excellent business model.

Attractive valuation

Not many companies today have been able to grow earnings by double-digit rates over the past decade, while still trading at less than 10 times last year's EPS.

Bigger banks such as **Bank of Nova Scotia**, **Royal Bank of Canada**, **Toronto-Dominion Bank**, and **Canadian Imperial Bank of Commerce** all trade at higher valuations. This is despite Home Capital Group having higher profit margins, operating margins, returns on assets, and returns on equity than all these banks over the past five years.

High risk, high reward

Targeting consumers that aren't qualified enough to meet bigger banks' standards is largely what has allowed the company to more than double its share price over the past five years. Still, this type of lending does not come without additional risks.

Many financial experts believe that the Canadian real estate market is overvalued. In fact, there are a whole host of reasons why the Canadian economy looks to be in trouble. A correction in the real estate market would have a massive impact on Home Capital Group's revenues and earnings.

While the company has very low exposure to Canada's energy-producing provinces (about 3% of loans), mitigating the risk of lower commodity prices, a large chunk of revenues are tied up in Toronto's housing market. With housing in Toronto already nearing multi-year lows, returns may not be as rosy in the future for shareholders.

All is well when the real estate market is well

When comparing the financial results of Home Capital Group against Canada's larger banks over the past decade, the results are clear. Not only has Home Capital Group outperformed, but shares are also now trading at a cheaper valuation.

This lack of market respect, however, is largely predicated on the belief that the Canadian real estate market will slow down in the near future, something many investors have been anticipating for years. While it's tempting to buy the stock, there are other investment opportunities out there with similar return potential and immensely lower risk.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. TSX:HCG (Home Capital Group)

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