3 Financial Stocks I'd Buy Over Home Capital Group Inc.

Description

On November 4, **Home Capital Group Inc.** (TSX:HCG) released results for its third quarter, which ended on September 30.

On the surface, earnings didn't look too bad. Net income was down a hair compared with the same period last year, but still came in at a healthy $1.03 per share. Through the first nine months of the year, earnings were $3.09 per share, putting it on pace to earn $4.12 per share for the year. That's a very reasonable price-to-earnings valuation on a stock that currently trades at just over $33.

But for Home Capital bears, a troubling issue keeps rearing its ugly head. In July, the company said it was cutting ties with 45 mortgage brokers who had supplied it with $960 million in loans during 2014 on suspicions that these brokers used falsified income documents to get their clients approved.

Home Capital has been looking into the issue and management discovered the problem was much bigger than originally thought. The company has barely scratched the surface of its investigation into the matter, yet it has already discovered $1.72 billion in loans that look to be fraudulent.

That is a big number.

It's for that reason that I'm staying far away from Home Capital. When a company is a lender of last resort, it's going to have to deal with more fraud than a prime lender. It's just how the business works. And until management can identify the scope of the fraud, I have no interest in the stock.

Here are three financial services stocks that pique my interest far more than Home Capital.

Intact Financial

Intact Financial Corporation (TSX:IFC) is Canada's largest property and casualty insurer, owning brands like Grey Power, Belairdirect, and BrokerLink. In 2014 it wrote $7.6 billion in premiums, almost twice as many as its biggest competitor, Aviva.

Intact has two main things going for it. Firstly, it's the leader in a very fragmented market. Even though

Intact is almost twice as big as its nearest competitor, it still only commands 16.9% of the market share. There are dozens of smaller competitors out there for Intact to gobble up.

Intact is also a disciplined underwriter. This has led to combined and loss ratios that are far below the industry average. Better underwriting also leads to better returns. Intact posted a 16.8% return on equity in 2014, which was almost double the industry average.

Finally, Intact is a dividend-growth machine. The company has increased the dividend each year since 2009. Shares currently pay $0.52 each in quarterly dividends, good enough for a 2.4% yield.

Fairfax Financial

Everybody knows about Prem Watsa's ability as a value investor. The CEO of **Fairfax Financial Holdings Ltd.** (TSX:FFH) has used a value-investing philosophy to increase the company's book value by more than 20% annually for three decades.

But few people realize just how good Fairfax is at insurance. The company consistently posts terrific combined ratios from its five large insurance subsidiaries, which leads to good underwriting profits. Plenty of underwriting profits mean Watsa just has more capital each year to put into undervalued investments.

Investors are getting both Watsa's investing ability and the great insurance results at just a small premium to book value. And according to analyst projections for 2016, shares trade at just 10.9 expected earnings. Fairfax pays a 1.9% dividend.

National Bank

My thesis behind liking **National Bank of Canada** (TSX:NA) over the Big Five banks is simple. The stock is cheaper than its peers with a built-in catalyst.

Currently, National Bank shares trade hands at just 9.9 times trailing earnings, and at just 9.2 times projected 2016 earnings of $4.82 per share. It also has the highest dividend yield among its peers, paying out 4.7%. And with a payout ratio of right around 50% of earnings, the distribution looks to be pretty secure.

The built-in catalyst is when National's management finally decides to expand into the U.S. or another foreign market. The big reason why shares trade at such a low valuation to its peers is because there's much better growth potential in other countries besides Canada. Once National expands out of Canada, the valuation gap should narrow.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. TSX:FFH (Fairfax Financial Holdings Limited)
2. TSX:HCG (Home Capital Group)

3. TSX:IFC (Intact Financial Corporation)
4. TSX:NA (National Bank of Canada)

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