



Home Capital Group Inc.: Is This a Short-Term Blip or a Permanent Decline?

Description

Just a month ago, analysts were touting **Home Capital Group Inc.** ([TSX:HCG](#)) as a strong buy, citing it as one of the top mid-cap financial stocks on the Canadian stock market. All that changed last week when the alternative mortgage lender released its preliminary second-quarter results, revealing that single-family mortgage applications plunged 27% in the quarter despite rising home prices in major markets.

The stock fell 19% on Monday to a two-year low and has continued to decline, now down 25% over the past five trading sessions. The question is, can Home Capital recover or is this an early sign of a crisis in Canada's housing market?

In a statement, Home Capital tried to deflect the damage, stating that it was sticking to its mid-term targets target of 8-13% annual growth in diluted earnings per share, "reflecting the continued strength of the business and its diverse sources of growth. All other aspects of the business continue to deliver solid results and Home Capital expects to report Q2 diluted earnings per share of \$1.03, in line with diluted earnings per share of \$1.03 in Q1 2015 and down from diluted earnings per share of \$1.05 in Q2 2014."

"We are confident that the steps we have taken in the first half of 2015 were necessary to ensure the continued long-term profitability of our business, in spite of the short-term impact on originations," said Chief Executive Officer Gerald Soloway. "We have already seen a rebound in origination volumes towards the end of the second quarter, and our strong pipeline of mortgage originations gives us confidence that we will achieve our mid-term guidance."

Soloway's soothing words failed to convince analysts, with several cutting their ratings on the stock, while others reduced their price targets. "We expect the competitive prime mortgage environment, macro concerns and changes to its broker relationships to constrain total originations over the next six to 12 months," said Macquarie's Asim Imran, who cut his target share price 20% to \$44.

However, most analysts said Home Capital's losses won't necessarily lead to a widespread decline in housing prices. "We think this is an HCG-specific growth issue, not an early signal of rising losses or

broader housing stress,” wrote Royal Bank of Canada analyst Geoffrey Kwan.

Investors with a strong stomach may view Home Capital’s steep decline as a buying opportunity. That may be, but Foolish investors might be better off waiting until the dust settles, and make an investment decision after the company releases its full second-quarter results on July 29.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:HCG (Home Capital Group)

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Date

2025/08/19

Date Created

2015/07/15

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