Home Capital Group Inc.: Why I am a Confident Shareholder Going in to 2016

Description

The past year was not a pleasant one for **Home Capital Group Inc.** (TSX:HCG), as the company saw its share price decline by more than 40%. Many investors think the company is headed for more trouble. After all, the stock has been heavily shorted for years.

But as a shareholder myself, I am confident going in to 2016. Below are three reasons why.

1. A strong track record

Home Capital's shares have fallen mainly due to a big scandal back in July. It was discovered that some mortgage brokers had helped borrowers falsify income information on their mortgage applications. These brokers accounted for roughly $1 billion of Home Capital's mortgage originations back in 2014 and $2 billion of mortgages overall. The company immediately cut ties with these brokers.

Thus far, Home Capital's executives say there haven't been any major credit problems with these mortgages, but of course investors remain skeptical.

However, there's one reason to believe Home Capital: its track record. The company, led by Gerald Soloway, has done a tremendous job minimizing credit losses for well over a decade, creating tremendous value for shareholders in the process. And even though the company is facing scrutiny right now, I have little doubt that the management team can overcome these issues.

2. A lack of exposure to the worst markets

For Home Capital to suffer major credit losses, two things must happen. One, house prices must fall significantly. Two, borrowers must become unable to repay their mortgages.

There is certainly a threat of this in Alberta as well as other energy-producing regions, where the fall in oil prices is having severe ripple effects. Elsewhere though, the country is plodding along, and we're unlikely to see mass defaults (even though home prices seem very elevated).

Luckily for Home Capital, only 4.2% of its uninsured loans come from energy-producing provinces. And these loans are actually performing better than average.

Furthermore, condominiums represent only 9.0% of total mortgages, and these loans are also performing well. This is worth keeping an eye on, but so far it looks like there won't be any serious issues.

3. A severely depressed stock price

Home Capital Group is not without risks, but these are more than accounted for by its stock price. To illustrate, the company trades at just six times trailing earnings!

Clearly, investors are expecting some major loan losses. But when looking at the last quarter, even if loan losses had *tripled*, net income would have declined by only 6%.

Better yet, Home Capital has some significant growth opportunities (certainly more so than the big banks), and should also be able to lower its funding costs. At the end of the day, I believe this is a bet worth making.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:HCG (Home Capital Group)

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