

Why it's Time to Buy Home Capital Group Inc.

Description

In a previous [article](#), I wrote about **Home Capital Group Inc.** ([TSX:HCG](#)) as a long investment idea. The idea behind buying the shares was very clear: the security was trading at a price of approximately eight times earnings, and the dividend yield was approximately 3.5%. Although there have been certain developments since last week, there is still some very good news for long investors.

Last week, the Ontario Securities Commission (OSC) advised Home Capital Group of an investigation into its responsibilities to continuously supervise mortgage agents working with the company. Several months ago, an announcement was made regarding the termination of a number of relationships with mortgage agents, most of whom accounted for a small amount of the company's total volume. Clearly, Home Capital Group had very little alternative but to sever the relationships with these brokers as not everything was on the up and up.

Although the OSC investigation may have some merit, it is very difficult to believe the situation will be dire for the company. As investors, we've seen this story play out many times in the past. Remember **Wells Fargo & Co** ([NYSE:WFC](#))?

After an internal cover up, the company had a public debacle on their hands. The result was a temporary decline in the share price from approximately \$51 to under \$45 per share. Currently, shares are trading at close to \$58 per share. The question investors needed to answer at the time was, "Just how material is this to long-term profitability?"

In the case of Home Capital Group, this investigation is yet another chapter in the long line of PR challenges faced by management. Investors need to remember the competitive landscape. Since the introduction of new mortgage lending rules, the alternative lender space has shrunk drastically. Home Capital Group is a very important lender in this space; without its presence, competition among Canada's banks could quickly become lacking.

Moving on to the potential conclusion of the investigation, the reality is, the company has over \$1.2 billion in cash sitting on the balance sheet (as of December 31, 2016). With any luck, this investigation and conclusion will be quickly realized, and the stock price could rise once again.

As promised: the good news

What was trading at close to eight times its price-to-earnings (P/E) ratio last week is now trading at close to seven times its P/E. The dividend yield, which was close to 3.5% only one week ago, is now closer to 4%. The clear opportunity for investors with the appetite for risk is to long shares of Home Capital Group and be prepared for higher than usual volatility while expecting higher returns as well. Currently, new investors will be paid close to 4% to wait it out.

Investors looking for lower-risk, lower-return securities may look elsewhere.

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