



## Home Capital Group Inc.: Watch Out Below!

### Description

**Home Capital Group Inc.** ([TSX:HCG](#)) announced March 27 that CEO Martin Reid's employment with the company had been terminated effective immediately. No reasons were given for Reid's dismissal; board member Bonita Then is the interim CEO until a replacement can be found.

The news sent Home Capital Group stock spiraling downward by more than 7% as investors speculated if the company faced bigger problems than an ineffective CEO.

In February I [suggested](#) value investors with an aggressive bent consider Home Capital Group's stock; with so much uncertainty surrounding the company right now, I'm not even sure aggressive investors want to catch this falling knife.

Discretion, as they say, is the better part of valour. Here's why.

### A tipping point

Home Capital Group's stock hasn't traded in the mid-\$20s on a consistent basis since 2013. The next low, should it test \$20 in the weeks ahead, would be \$10 — a level it hasn't seen since the 2008 market correction.

Unless you've got a massive appetite for risk, there are so many TSX stocks that would make better investment alternatives at this point, because even if Home Capital Group is able to find a competent replacement for Reid, the speculation it's facing and increased scrutiny from regulators will continue to act as significant headwinds to its stock price. The risk you would be taking far outweighs the reward.

### What's changed?

When I wrote about Home Capital Group in February, I suggested that regulator troubles along with tightening mortgage rules were two things plaguing Home Capital Group stock. Both of those issues have clearly not gone away.

While it's unknown how much regulator troubles played into Reid's firing, analysts wonder — where

there's smoke, there's fire.

“Geoffrey Kwan, an analyst at RBC Dominion Securities Inc., questioned Home Capital's ‘unexpected’ decision to dismiss Mr. Reid without having a permanent successor in place,” wrote the *Globe and Mail*'s Christina Pellegrini March 28. “He also said it was ‘interesting’ that neither Mr. Soloway nor former chief financial officer Robert Blowes were not named interim CEO. Both former executives sit on the company's board.”

### **The big short**

Former U.S. hedge fund manager Mark Cohodes, whose bread and butter, until he retired in 2008 when his fund got hit with major losses, is shorting stocks. He's been short Home Capital Group since November 2014 when it was trading around \$50 — much higher than where it currently trades.

But if his March 28 appearance on BNN is anything to go by, he's ready to ride Home Capital Group stock right into the ground, making a handsome profit in the process.

“It's time for the adults in Canada who regulate and oversee this company to take action,” he said on BNN. “[Home Capital will be serious] when they hire outside legal counsel to do a full internal investigation of what's really going on there.”

Cahodes has a prickly reputation, something that's not unusual when you make a living shorting stocks, but it doesn't mean he isn't right. In time, we'll get the truth behind Reid's dismissal.

### **Bottom line**

The quality of mortgages underwritten by Home Capital Group appear to be first rate; it was a big reason why I changed my opinion about the company.

However, as analyst Geoffrey Kwan points out, it is odd that neither Gerald Soloway nor Robert Blowes took the job as interim CEO despite being on the board. It's possible they wanted to separate themselves in an impartial manner from the proceedings to hire a new chief executive; it's also possible that they were unable to because regulators prohibited them from doing so.

There are too many questions and not enough answers. Until this is resolved, investors should expect its stock to keep falling.

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