



Home Capital Group Inc.: The Astronomical Amount of Risk is Not Worth the Potential Reward

Description

Home Capital Group Inc. ([TSX:HCG](#)) has taken a nosedive lately as the stock is down over 45% YTD. Many Fool contributors have been saying that the company is “cheap” and could possibly be a value play, but I think the average investor should steer clear of this name. There’s a lot of negative momentum right now, with the stock getting “cheaper” by the day, but is the company really capable of turning things around?

To say Home Capital Group is cheap would be a vast understatement. The stock currently trades at a 5.2 price-to-earnings, a 0.8 price-to-book, a 2.2 price-to-sales, and a 2.3 price-to-cash flow. All of which are substantially lower than the company’s five-year historical average multiples of 9.3, two, 4.7, and 6.3 respectively. The stock also has an artificially high dividend yield of 5.2%, which is more than double the company’s usual dividend of around 2%.

The company’s ROE is also very impressive at 12.69%, which indicates that the company is efficient at turning its own investments into profit. But one thing that’s very misleading is the fact that the company takes on a lot of risk in order to get a higher ROE. I don’t believe the extra reward is worth this extra risk because, in the event of a housing collapse, alternative mortgage lenders like Home Capital Group will get crushed.

The company has received several notices from the Ontario Securities Commission. In one of the notices, it claimed that many senior management remarks were “materially misleading” to investors. The OSC also stated that Home Capital “failed to meet its continuous disclosure obligations” in previous years. With the sudden firing of ex-CEO Martin Reid, the management team is doing whatever it can to stop the stock from falling further into the abyss.

In a recent press release, the management team was trying to comfort investors by claiming the adjusted diluted earnings per share was up from the Q1 of last year. The management team assured investors that its core residential mortgage business was still doing well and that the company wasn’t doing as bad as the stock price would suggest. At this point, I would not trust anything that the management team says because the OSC has made it clear that Home Capital Group has a history of

providing misleading disclosures.

Sure, Home Capital Group may be cheap, and it could potentially rebound once the dust settles, but would you really want to own shares of a company whose managers act in such an immoral manner? The 6% dividend yield may seem attractive, but you're risking way too much for it. There are safer alternatives out there if a rebound and a high yield are what you're looking for.

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