



Can Home Capital Group Inc. Stop the Bleeding?

Description

In the latest chapter of a seemingly never-ending saga with Canada's once-largest alternative mortgage lender, **Home Capital Group Inc.'s** ([TSX:HCG](#)) subsidiary Home Trust has agreed to sell up to \$1.5 billion worth of mortgages to an unnamed buyer to help stem the recent run on the bank's deposits of late.

On Tuesday, Home Capital announced that it will sell off the equivalent of approximately 10% of its mortgage book to the unnamed buyer in the form of newly generated mortgages and soon-to-be-renewed mortgages, rather than selling mortgages the company is holding on its balance sheet.

This move is an attempt to bolster the bank's liquidity position after Home Capital announced it had drawn a significant portion down on its emergency credit line at an interest rate of 22% last month. With the company's current cost of capital exceedingly high, this move was greeted warmly by financial markets on Tuesday. The company's stock price closed nearly 30% higher, but it's still down more than 71% since January 1.

Long-term outlook for Home Capital

Many analysts have pointed to this move by Home Capital as a good one given the circumstances. The analysts note, however, that the long-term outlook for the Canadian lender appears to remain bleak. Jaeme Gloyn of **National Bank** said in a research note that Home Capital "solved a significant near-term liquidity risk, but acknowledged the current state of the business model is broken."

The lender confirmed that as of close of business Monday, Home Capital's high-interest savings account (HISA) deposits had shrunk from over \$2 billion in March to approximately \$142 million, and GIC deposits declined to \$12.6 billion. This continued run on the bank's deposits has required Home Capital to seek alternative sources of liquidity in addition to the emergency loan it received.

On that note, the company also announced that the loan it received from the Healthcare of Ontario Pension Plan has now been syndicated to a group of large global banks, including **Goldman Sachs Group Inc.**, **Credit Suisse Group AG**, and **Fortress Investment Group LLC** with another unnamed bank involved as well.

Bottom line

The issue moving forward with Home Capital's business model is that the lender will be attempting to stem losses and maintain its mortgage portfolio while, at the same time, tightening mortgage origination standards. Growth is largely out of the question for the time being with Home Capital, as the company has indicated it will be moving toward a "flipping" model, in which Home Capital or its subsidiaries originate the mortgages, and the bank turns around and sells these mortgages immediately for a significantly lower profit.

With Home Capital set to report earnings on Friday, I have a feeling this saga is far from over.

Stay Foolish, my friends.

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Author

chrismacdonald

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