



Reviewing May's Stock Pick: Home Capital Group Inc.

Description

Each month, writers of the Motley Fool are asked for their top stock pick for the month ahead. For May, I went out on a limb and chose a company which had been in the news quite a bit, and not always for the right reasons: **Home Capital Group Inc.** ([TSX:HCG](#)).

The fantastic news for investors who owned and held the shares throughout the month is that the profit (or recovery) has been extended to them. Shares of Home Capital Group closed April at \$8.04. After falling to a low of \$5.06 near the beginning of the month, shares rebounded to finish May at \$9.14 per share. The total gain for the month was no less than 13.7%.

While things have started to stabilize, investors may still need to be cautious with this name in spite of the potential of the company. Currently trading near \$9.14, the company still has tangible book value close to \$25 per share given the assets held on its balance sheet. Some have already figured this out in spite of the negative press which has become almost like background noise at this point.

While the company still has a number of challenges to face over the next few months, it is worth noting that the liquidity issues previously faced are no longer a concern. With the line of credit extended to Home Capital Group of \$2 billion, the value to be had by investors can either come from the ongoing cash inflows (the customers paying back their mortgages) or from the runoff values in the assets.

Although the original premise for this investment involved the ongoing profit from operations, the higher funding costs to maintain the company's mortgages may now be diminishing this profit. Investors may want to move on to Plan B.

With tangible book value near the \$25 mark, the company has sold off a number of mortgages in addition to handing renewals over to competitors in an effort to free up additional cash to maintain normal operations. Although the company's footprint may be shrinking, the upside for investors will be the realization of the value through the shrinking of the company.

The major risk

Although some investors worry about a U.S.-style housing collapse, it is important to note that this type

of event would not target any one company. In the event of a housing crash, almost all Canadian stocks would decline in value, Home Capital Group included. Let's not ignore this company based solely on the chance of a slump in the broader Canadian housing market.

While this investment is still not for the faint of heart, there may still be a lot of runway left for investors to reap large profits in the coming months.

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