



## Should Brookfield Asset Management Inc. Buy Home Capital Group Inc.?

### Description

**Brookfield Asset Management Inc.** (TSX:BAM.A)([NYSE:BAM](#)), Canada's largest alternative asset manager, had its annual meeting June 16.

CEO Bruce Flatt fielded questions after the meeting; one of them was whether or not Brookfield would consider buying **Home Capital Group Inc.** ([TSX:HCG](#)), the troubled mortgaged lender that came within a whisker of permanently shutting down.

"Everything that is in the market, we look at. If there's a transaction that made sense on a risk/reward that we could get involved in, we'd be pleased to be involved," Flatt said. "Whether that happens or not, we'll see."

That sounds like a polite way of saying "I doubt it," but let's assume that Brookfield does have a serious interest in Home Capital. What would the risk/reward argument look like for a company that manages and invests in more than \$250 billion in infrastructure assets?

### Home Capital's current situation

Since Home Capital's board of directors was seriously remade in early May, a lot of water has passed under the bridge.

Most recently, it announced that it's reached a deal to sell a \$1.2 billion portfolio of commercial mortgages to KingSett Capital, a Toronto-based private equity firm specializing in real estate.

The move allows Home Capital to reduce the balance on its \$2 billion line of credit, which charges 10% on the outstanding balance of \$1.65 billion, 2.5% on the \$350 million that's undrawn, and a \$100 million non-refundable commitment fee.

An interest rate of 13.7% for a mortgage lender is pretty steep, but when you're facing closure, it's hard to drive a bargain. This asset sale relieves a good deal of the financial pressure it was facing due to diminishing customer deposits.

The other recent piece of news was a big boost to Home Capital's share price. On June 15, the company announced it had reached a settlement agreement, along with that of three of its former executives (founder Gerald Soloway included), with the Ontario Securities Commission (OSC) over improper disclosures made by management regarding 45 independent mortgage brokers who submitted false income claims for client mortgage applications in 2015.

While the settlement agreement gets the OSC off Home Capital's back, it's still to be determined what, if any, permanent damage has occurred as a result of its improper communication of the facts and the realization that its quality control is less than adequate.

### **How might a real estate pro view this?**

Flatt's people might turn to portfolio manager Dave Taylor, who's made more than \$25 million, or 93%, for his clients since first investing in Home Capital in May.

He's holding his position, confident that Home Capital Group is worth more than \$15 a share.

"The most important thing I found out was that the old Home Capital Group is gone. Gerry [Soloway] is gone. [Martin] Reid is gone," Taylor told *Bloomberg*. "There's a new board. We're definitely not going to exit our position."

Home Capital had a market cap of \$3.4 billion at the end of 2014 before its business began to unravel. Today, it's about \$1 billion; at the end of April, it was as low as \$385 million.

My uneducated guess is that Flatt wouldn't pay more than \$1.7 billion, or half its value at its height, but that's probably being too generous.

Despite having approximately 13% of the \$1.3 trillion Canadian residential mortgage market, its high-interest savings account deposits have declined dramatically from \$528 million at the end of April to \$112 million as of June 20.

Any buyer would have to recapitalize Home Capital's business, and there's no guarantee that it will get back any of the deposits lost.

That's quite a bit of risk.

### **Bottom line**

If a company of Brookfield's stature were to buy Home Capital, I believe customers would return. That, in turn, would strengthen Home Capital's share price.

Should Brookfield buy Home Capital? I believe it should.

Will it buy Home Capital? As Flatt said, it's all about the price. At this point, I'd say the likelihood is less than 50/50.

### **CATEGORY**

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