Home Capital Group Inc.: Is Rally Driven by Warren Buffett Over?

Description

Shares of **Home Capital Group Inc.** (TSX:HCG) have lost about a quarter of their value since Warren Buffett's **Berkshire Hathaway Inc**. rescued this embattled mortgage lender after it faced a crisis of confidence.

Home Capital shares rallied about 30% in a single day after it secured up to $400 million in an equity investment from Buffett's Berkshire Hathaway**,** which also provided a $2 billion lifeline to stabilize the company's cash flows.

But after a roller-coaster ride in the past month, Home Capital Group's shares are back where they had started. It seems the rally fueled by the Buffett's support is fading away as speculative interest wanes and long-term investors look for signs of a solid turnaround.

One of the most important considerations for long-term investors is deciding if the time is right to look Home Capital Group again from a growth perspective or if they should stay on the sidelines.

To stabilize the Home Capital Group's share price, the new management needs to quickly show that it has a game plan which will not only allow the company to resume its dividend payments, but also bring back growth on a sustainable basis.

There are some early signs that the company has been able to restore some confidence and attract new deposits, which are key for its success.

In its latest liquidity update published on July 17, Home Capital Group said its aggregate liquidity and credit position has strengthened significantly since the last update on June 29.

"The company continues to source deposits through its deposit broker channel and Oaken, its direct to consumer channel, and has seen deposit inflows return to historical averages," it said in a statement.

In the two weeks to July 14, Home Capital attracted $125 million in net new deposits, most of them in its Guaranteed Investment Certificates program. By using proceeds from the sale of assets, the company was also able to reduce its outstanding balance to $900 million under the $2 billion line of credit it got from Berkshire Hathaway.

Though these are healthy developments for a company which was fighting for its survival a couple of months ago, long-term investors still would like to take their time before putting their faith back into the company, whose shares lost half of their value in the past year.

Apart from Home Capital Group’s financial health, there are some other factors keeping investors on the sidelines, despite the world’s most renowned investor’s backing.

First is the overall health of the Canadian housing market. The latest data show a disturbing picture for the country’s largest city Toronto, where sales in June plunged the most in seven years after the government’s intervention to halt growth in skyrocketing prices and stop speculation.

The second negative factor clouding the outlook for the whole housing sector is the prospects of higher borrowing costs for homeowners in days to come. As the Bank of Canada starts tightening its monetary policy, it’ll be tough for Home Capital Group to sell new mortgages and improve its bottom line.

At its current share price of $14.42, I see good upside potential for investors whose investment horizon is long term. But for short-term speculative investors, I think, the party is over for now!

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Date
2025/08/24
Date Created
2017/07/20
Author
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