How Raising Rates Will Save Home Capital Group Inc.

Description

Last week, shares of **Home Capital Group Inc.** (TSX:HCG) declined by slightly less than 2% as the alternative lender reported quarterly earnings. Although the company reported a loss and opened significantly lower on Thursday, shares recovered throughout the day to close up by a small amount.

While shares recovered from the initial shock, investors have more than one reason to invest in this company. Currently priced near the $14 mark, the company continues to report tangible book value of $21.63 per share as of the end of June. As a reminder, tangible book value is a proxy for what the company is worth after paying all outstanding liabilities. The non-cash assets are also subtracted before arriving at this number. Shares trade at a discount to tangible book value by more than 35%.

Given how much value is currently available, it is clear that investors continue to worry about the potential for continued losses. Given that the past quarterly loss per share was $1.73, the losses would have to continue at this rate for more than one year for shares to trade at tangible book value (assuming shares remained around the $14 mark). We can have a little more faith that the one-time fees incurred for the “lifeline” will not repeat. The expectation is that earnings will improve for the next quarter.

For investors wanting to benefit from rising interest rates, shares of Home Capital Group may just be the best possible investment available. Given the amount of variable mortgages outstanding, the company may be in position to see an increase in revenues as the amount of interest charged to many of these customers will be a little higher as we move forward.

Bringing closure to another challenge, the increase in rates has also led investors to seek out higher rates of return for their fixed-income investments. As Home Capital Group is eager to attract new money from investors (in order to fund mortgages), the company currently pays some of the best rates of interest rates available in the market. The money has started to flow into the company’s guaranteed investment certificates yet again.

As rates have increased, it is important to realize how investors will continue to make money from this investment. As more lending is done, the company’s balance sheet grows and grows. The opposite is also true. As rates increase and lending slows down, the company will experience a greater amount of runoff in regards to the mortgages outstanding. The result will be higher cash flows, which will either lead to a share buyback or the reintroduction of a dividend.

For investors seeking an investment that can benefit from higher rates of interest, shares of Home Capital Group may just be the diamond hiding in plain sight.

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