



Is Now the Time to Buy Home Capital Group Inc.?

Description

Alternative mortgage lender **Home Capital Group Inc.** ([TSX:HCG](#)) recently reported its first results since the crisis that took the company to the brink of collapse. Those results were worse than expected with the lender reporting a larger-than-forecast loss. There are signs, however, that the storm is over and Home Capital is capable of flourishing.

Now what?

For the second quarter 2017, Home Capital reported a loss of \$111 million compared to a net profit of \$58 million for the previous quarter and \$66 million a year earlier. That loss was almost double the \$66 million predicted by analysts.

The primary reason for the sharp decline in net earnings was a marked uptick in costs incurred primarily because of the run on deposits and ensuing liquidity crunch that occurred earlier this year and almost caused the lender to fail. To stabilize the company, management obtained a costly emergency credit facility that had an effective interest rate of over 22%. That line of credit cost Home Capital almost \$131 million in interest and fees.

The liquidity event also saw Home Capital incur a further \$73 million loss on the portfolio of mortgages, which was sold to raise much-needed capital so business could continue to operate.

Because of this bad news, Home Capital's stock fell by just over 2% over the last week.

There was, however, considerable good news as well.

The alternative lender could stabilize its funding platform after the **Berkshire Hathaway Inc.** deal was announced in late June. Since then, net daily average inflows of deposits have exceeded \$15 million, and Home Capital had deposits totaling almost \$13 billion at the end of July.

More importantly, the quality of Home Capital's loan book remains high.

Gross impaired loans as a percentage of total loans come to a modest 0.26%, which is far lower than

Canada's major banks. The quality of its mortgage portfolio is further underscored by the fact that only 0.22% of its total loans are over 90 days past due. That means there would need to be a significant uptick in impaired loans to have any impact on Home Capital's balance sheet. An average loan-to-value ratio of 59% for its uninsured mortgages means that there is plenty of wiggle room to renegotiate those loans should Canada's notoriously indebted households be impacted by economic shocks such as higher interest rates.

Home Capital has also been able to raise \$1.4 billion through the sale of a tranche of its commercial and residential mortgage assets, and that allowed it to repay the amount outstanding under the credit facility from Berkshire Hathaway.

Nevertheless, the company still retains access to that facility and the ability to draw upon that \$2 billion if required, giving it total aggregate available of just under \$4 billion at the end of July. This provides Home Capital with considerable financial flexibility.

So what?

Home Capital survived its brush with corporate death, but the liquidity crisis is certainly now over. The alternative lender has righted the ship, steadying its business, growing deposits, and boosting its liquidity. This leaves it well positioned to benefit from the growing demand for alternative mortgages and higher interest rates. The recent decision by the Bank of Canada to hike the headlines rate to 0.7% has been a boon for banks and non-bank lenders alike. Higher rates make lenders more profitable by boosting earnings and expanding margins.

Each of the factors discussed combined with Home Capital trading at a 36% discount to its book value per share means that it is now a risky but attractively priced investment.

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