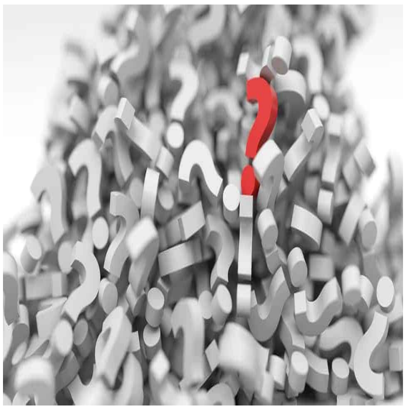

How Should Home Capital Group Inc. Proceed With its Upcoming Vote?

Description

On September 12, shareholders of **Home Capital Group Inc.** (TSX:HCG) will vote on whether or not to approve a second investment tranche for Warren Buffett's **Berkshire Hathaway Inc.** (NYSE:BRK.A)(NYSE:BRK.B). The vote is a relatively simple one, in which shareholders will be asked if they agree to add an additional 23.955 million common shares and sell those shares to Berkshire for $10.30 per share, representing a discount of more than 20% to the company's share price as of August 24.

The 23.955 million shares which are expected to be issued will hand over an additional 19.99% of the company to Berkshire in addition to the first tranche, which saw the company receive a 19.99% equity stake in the Canadian alternative lender for an even steeper discount; Berkshire paid only $9.55 per share for a little more than 16 million shares the first time around.

One thing investors will notice here is that the company needs to issue substantially more shares to give Mr. Buffett an additional 20% of the business; the reality that all shareholders, including Mr. Buffett, will be diluted by the second tranche, should the vote go through in the affirmative, is a harsh one to accept for some, and will likely make the vote a contentious one.

Shareholders have generally been sitting on the fence with respect to the vote — a vote which will require a simple majority to pass. One the one hand, an additional investment from Mr. Buffett would inexorably tie the fate of the Canadian alternative lender to Berkshire's financial returns — something Mr. Buffett cares deeply about. The prestige and perceived safety of having Warren Buffett more fully invested in Home Capital is a situation some investors prefer.

This view is supported by a fairness opinion conducted by three firms (which is slightly unusual; typically, only one firm is consulted). The fairness opinion came back supporting the equity issuance, even though the price the shares would be issued at is currently below the shares' intrinsic value. The analysis took into consideration a "what if" analysis, comparing the price of Home Capital's shares with and without Berkshire's investment; it concluded that shareholders would ultimately be better off with the investment.

Bottom line

In general, dilution is a very bad thing for investors when considering the impacts dilution has on some key aspects of the equity portion of the business (dilution affects everything from return on equity to earnings per share). While the cash raised through this issuance should, in theory, provide the alternative lender with another capital infusion, increasing the company's margin of safety with respect to its liquidity position, this capital does not come without costs for shareholders. Home Capital's shareholders will need to decide for themselves, and it will be interesting to watch from the sidelines and see how this situation plays out.

Stay Foolish, my friends.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:BRK.B (Berkshire Hathaway Inc.)
2. NYSE:BRKA (Berkshire Hathaway Inc.)
3. TSX:HCG (Home Capital Group)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Bank Stocks
2. Investing

Date
2025/08/02
Date Created
2017/08/30
Author
chrismacdonald