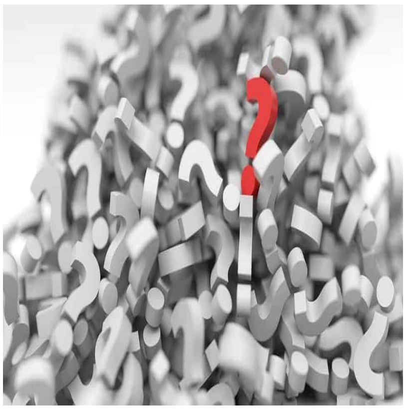

Home Capital Group Inc.: Are Shares a Buy Now That the Dust Has Settled?

Description

Shares of **Home Capital Group Inc.** (TSX:HCG) are now flat-lining after a bumpy downward spiral sparked by short attacks by Marc Cohodes, shady activities conducted by management, and liquidity issues which spooked not just Home Capital investors, but the entire industry. It really seemed like the sky was falling a few months ago — that was, until Warren Buffett and friends came to the rescue.

Great save by Buffett!

Sure, the Oracle of Omaha got a sweetheart deal, but I believe the initial deal was worth every penny for Home Capital Group.

Why?

The lifeline was a huge boost to investor confidence, which was desperately needed, especially since many pundits, including Marc Cohodes, thought the stock would be worth next to nothing in a matter of a few months. Home Capital Group was on the brink of collapse, and if it weren't for Buffett, I believe shares of Home Capital Group would be significantly lower today if he decided not to step in.

The $2 billion line of credit from Buffett was a breath of fresh air at the time, but the most remarkable part was that the full amount was repaid over a very short period of time. The management team sold assets in a hurry to raise as much cash as possible. Fast forward to today, and Home Capital's liquidity position doesn't look all that bad anymore. Investors were confident enough to take a pass on Buffett's second tranche offer!

Talk about a dramatic shift in stance over a period of just a few months. Now that the drama has settled down, Home Capital Group is on the road to recovery, but would you dare make a bet on the alternative lender? Or was the crisis earlier in the year too much for your stomach to handle?

Shares are cheap, the company's back on track: is this an opportunity?

Shares of Home Capital Group currently trade at a 8.6 forward price-to-earnings multiple, a 0.6 price-to-book multiple, and a 2.4 price-to-sales multiple, all of which are lower than the company's five-year historical average multiples of 9.3, two, and 4.7, respectively.

That's a ridiculously low price to pay for a business which has historically recorded a ROE in the 20s. Despite the dirt-cheap valuation, I still don't think the average investor should buy, even if shares become even cheaper. The risks involved with alternative lenders are way too high for the average investor.

Impressive key metrics … until they're not!

A few years ago, Home Capital Group had a ROE in the mid-20s. EPS and revenues were moving upward, and it seemed like the stock was a terrific long-term investment for value-conscious investors. Today, the ROE has dropped to 3.88% along with revenues and EPS.

Although these metrics had a long-term upward trend, it all came crashing down in a matter of a few months. While these metrics are useful in evaluating businesses, they don't tell the whole story. Home Capital Group had high ROEs and impressive EPS growth, but that's only because the business of alternative lending comes with greater risks. High risk, high reward, right? Well, with alternative lenders, I think it's more like extremely high risk, mediocre reward.

Home Capital Group investors are confident again, and shares could start to rebound over the next few months; however, I think there are many other rebound candidates on the market today with a lesser degree of risk and a higher potential reward.

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