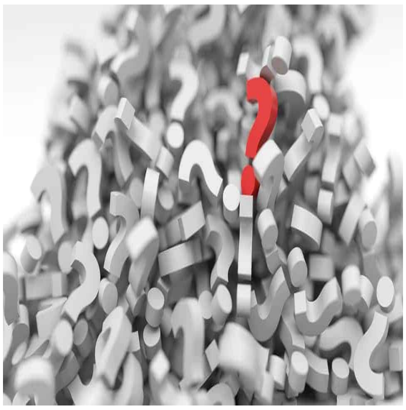

Contrarion Investors: Is Home Capital Group Inc. a Comeback Story in the Making?

Description

In the latest quarter, the third quarter of 2017, **Home Capital Group Inc.** (TSX:HCG) reported EPS that was significantly better than expectations. That's a good sign that expectations in general may be inaccurately low.

EPS was $0.37 compared to consensus expectations of $0.25 and compared to a loss of $1.73 last quarter and EPS of $1.01 last year, as Home Capital reported mortgage loan growth of -11%, weakening credit trends, but also an increase in funds coming into the company's GICs.

So, things are looking good, especially if we consider, and we must, that in April the company was in the midst of a liquidity crises after being accused of mortgage fraud.

The shares subsequently fell to lows of $5.99 from over $17 as a result of shaken confidence, a run of deposits, and questions about Canada's housing market.

And this is where Warren Buffett comes in. He swooped in at this moment, buying shares at approximately $10, and riding them higher thereafter. Shares are now trading at almost $17 again, rendering April a blip on the screen that, with 20/20 hindsight, proved to be a major buying opportunity.

With the implementation of B-20, the Office of the Superintendent of Financial Institutions's stress testing of uninsured mortgages, there will surely be a damper on mortgage originations, but Home Capital could be a beneficiary, as existing customers will find it harder to get approval elsewhere.

Home Capital faces the future with a capital ratio that is much improved. At over 21%, it is improved from the 17% seen last quarter, and while net interest margins are lower than before the liquidity event, they have risen from last quarter and are now at 1.85%.

The improvement in the capital ratio was as a result of the decline in the overall loan portfolio.

Current liquidity is more than good.

Home Capital currently has available liquidity and credit capacity of approximately $4.66 billion, including the undrawn $2 billion under the **Berkshire** credit facility.

In the aftermath of the crises, we have a firm that is intent on cleaning up shop. The company has overhauled its risk-governance procedures and renewed its board of directors, adding five new independent members, appointing new chairs, and appointing a new CEO, Mr. Yousry Bissada.

Mr. Bissada is a mortgage industry veteran who is now charged with being the lead in revamping the company's culture and taking the business to the next level, with risk management and compliance being top of mind, while also delivering on growth objectives.

That's not an easy balance to achieve, but with the stock trading below book value for a P/B multiple of 0.70 and earnings and ROE creeping up again under the new CEO/structure, it appears that, for investors who are looking for a value play in the financial services area, the shares are still not factoring much of an improvement, so they might be a good buy for those contrarian investors who have the patience and the stomach for it.

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