Home Capital Group Inc.: Here We Go Again!

Description

Just this week, shares of **Home Capital Group Inc.** (TSX:HCG) have declined from last Friday's close of $17.31 to a current price of less than $16, signaling that investors who'd previously believed in the recovery of the alternative mortgage lender may be having second thoughts.

After a tumultuous 2017, the company has managed to put the criminal aspect of the alleged mortgage fraud in the past, as a number of senior level executives have left the company. Following these events, third-quarter earnings still came in on the positive side following a number of additional one-time costs, which ate into the bottom line.

What do we do from here?

At the current price, investors with a medium to high risk tolerance may want to reconsider investing in shares of this alternative lender, as there remains considerable upside. As of one year ago, the company held the biggest market capitalization of any alternative lender by almost a two-to-one ratio. The capacity to borrow, lend, and generate profits for shareholders has not diminished in the least.

As an alternative lender, many of the company's clientele needs their services much more than the company needs the clientele. Not only is the company in the business of providing mortgages to the country's B borrowers, but it also has many credit card customers who are rebuilding their credit through smaller variable credit products.

When we break down the company's cash flow statement for the past three fiscal quarters, the cash flow from operations was positive $67 million for the first quarter, negative $70 million for the second quarter, and an astonishing positive $681 million for the third quarter. Excluding the large change in working capital, the company has been net positive for the year with an increase of approximately $2 million. In spite of the worst calamity ever faced by the company, the cash flow from operations has remained even throughout the year!

Moving on to the balance sheet: the company continues to build tangible book value, as the dividend was eliminated throughout 2017, and shareholders' equity has continued to grow. In spite of a very lucrative investment made by Warren Buffett, which saw the company issue a greater number of shares, the company continues to carry tangible book value of more than $22 per share, which offers investors a 25% plus discount to tangible book value.

Why is there such as discount?

After dealing with the criminal aspects that faced the company, there are now civil matters to deal with. At least one firm has filed a lawsuit against Home Capital Group due to its actions (or lack of action) during the events which led to this major debacle. In spite of what could be a costly settlement, however, the company has proven that it is capable of turning a quarterly profit on an ongoing basis.

The biggest known risk at this time is just how much the company will earmark for the possibility of a settlement (or defence against these lawsuits). During the next quarterly earnings report, investors will hopefully receive more clarity.

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