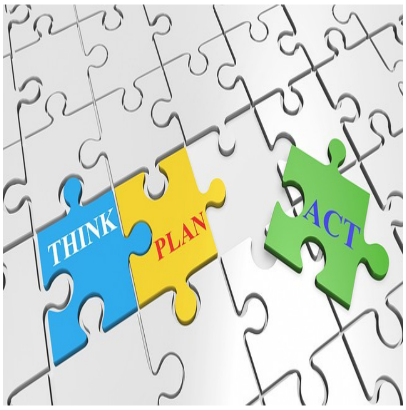

Home Capital Group Inc.: A Value Play or a Value Trap?

Description

With **Home Capital Group Inc.'s** (TSX:HCG) shares surging almost 10% today, it is a good time to look at the company again to try to determine what the future holds for the stock.

Are the shares a value play or a value trap?

Backdrop

Home Capital shares fell to lows of $5.99 back at the end of April 2017 from highs of almost $30 at the beginning of 2017.

This because of accusations of mortgage fraud that sent the company into a liquidity crisis, as shaken confidence, a run on deposits, and questions about Canada's housing market had investors running.

This is where Warren Buffett comes in, buying shares at approximately $10 and riding them higher thereafter.

Shares are now trading at almost $17 again, 82% higher than April 2017 lows, rendering April a blip on the screen that, with 20/20 hindsight, proved to be a major buying opportunity.

Is there still value?

It is clear with hindsight that the shares were attractively valued after this fall. But are they still?

The 2017 earnings per share numbers will be terrible — we all know that — with a reduction from earning more than $4 per share last year to a little more than half that.

But when all is said and done, the company is expected to return to earnings per share of more than $1.50 in 2018 for a P/E multiple of 11 times.

Solid future is shaping up

Home Capital faces the future with strong liquidity and a capital ratio that is much improved.

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

And with a capital ratio of over 21%, which is much improved from the 17% seen in the second quarter, and rising net interest margins that are now at 1.85%, we can feel confident in expecting increasing profitability.

Investor legal action

Since third-quarter results that were issued back in November, there have been a number of news items related to claims against the company.

In these claims, we have investors who are trying to get compensated for money lost due to purchasing Home Capital shares under false pretenses based on inaccurate information that the company was giving.

This comes after a class-action suit was settled where the company paid out $29.5 million to settle. These remaining few investors opted out of this suit and are filing separately.

While this is never a good thing, I think investors would be better served to focus on the fact that the company has so far come out of this scandal better and stronger.

And with rising interest rates expected to benefit the bottom line going forward, and a new CEO at the helm, I think the shares are still representing good value at these levels.

What we have here is a value play: attractive valuation accompanied by real, quantifiable improvements, which will continue to drive the stock higher.

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