Home Capital Group Inc.: Is This Stock a Good Buy?

Description

Any time you are able to find a stock that is not performing the way it should be, you have an opportunity for significant returns. One company that is currently trading at a significant discount to its book value is **Home Capital Group Inc.** (TSX:HCG). There's an opportunity here.

Home Capital's book value is approximately $22 per share. However, for a variety of reasons, the stock is trading under $14. That means that if you were to buy today and the market were to correct itself to the company's book value, you'd be sitting on a capital appreciation of 36.5%.

Not bad … but why is the company suffering at all?

Although there is no explicit near-term reason, my belief is that there are natural jitters about the company because of the problems it has dealt with in the past. In mid-2017, it was stuck dealing with a liquidity crunch due to a run on deposits — a phrase lenders never want to hear.

Effectively, lenders work by borrowing money from people (savers) and then lending it out to people (borrowers). At any given moment, there is not enough money being held in the bank that is lent out. So long as the savers don't need their cash, everything is fine. But when they all want to withdraw, and the bank doesn't have it because it lent it out, that's a real problem.

There were also problems with mortgage fraud at Home Capital Group, with the company having to pay tens of millions in fines to the Ontario Securities Commission. All of this created significant brand problems.

However, the company has turned around. It received a big investment from Warren Buffett. It is beginning to see depositors return, which is a good sign for a lender. And there are a few catalysts that should help the lender over the coming year.

One major catalyst is a rule put out by the Office of the Superintendent of Financial Institutions (OSFI). Potential borrowers will now have to show that they could pay back a mortgage to a bank, even if interest rates increase by 2%. That reduces how much money can be lent to otherwise great-quality borrowers.

Why is this good for Home Capital Group? It's not a bank. The above rule is targeted at traditional banks, not alternative lenders. So, if a traditional bank can't lend to a top-quality borrower, all the borrower has to do is go to Home Capital Group.

My thesis on Home Capital Group remains the same. I never advocate backing up the truck on a company that has dealt with significant problems systemically or brand-related. However, when investors have beaten a company down as much as Home Capital Group has been, there's opportunity.

I recommend buying shares of this stock. It shouldn't be a core piece to your portfolio, but if shares return to book value, it could be a great addition.

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jaycodon