Why Warren Buffett's Home Capital Group May Be About to Fly Higher!

Description

This coming week, **Home Capital Group Inc.** (TSX:HCG) will report warnings, and investors will once again have the opportunity to witness the turning of a ship that was heading in the wrong direction.

The company came under attack over a year ago for knowingly extending mortgages based on fraudulent paperwork. In spite of this act not having any substantial impact on the day-to-day operations of the revenues and expenses of the company (as the monthly mortgage payments continued to be made), the share price declined substantially as many retail clients who had deposited money with the institution chose to withdraw it very quickly. Traditionally, this is what is known as a "run on the bank." As is sometimes the case, the snowball started at the top of a very large hill and became bigger and bigger as it picked up speed.

At a current price of under $14 per share, the company continues to trade at a substantial discount to tangible book value, which is currently more than $22 per share and has been steadily improving as the company has chosen to discontinue the dividend almost one year ago. Based on the normalized earnings, the price-to-earnings multiple is no more than 10 times its earnings (and potentially much less), as the company continues to move toward an optimal scale based on the current smaller amount of deposits and lending being undertaken currently.

For investors not wanting to undertake risk with Home Capital Group Inc., shares of competing **Equitable Group Inc.** (TSX:EQB) remain untarnished. At a current price of just under $57 per share, the dividend yield is close to 1.85% and trades at a smaller discount to tangible book value. As business continues to move forward as usual, investors can expect to receive their dividends on a quarterly basis for many years to come.

For income investors, **First National Financial Corp.** (TSX:FN) at a price of $27.50 per share offers a dividend yield of slightly less than 7%, which is paid on a monthly basis. The risk that investors need to be concerned with, however, is that many of the mortgages originated by this name are not retained on the balance sheet, which would drive tangible book value higher. With First National Financial, the share price is based much more on the dividend yield than it is on the amount of tangible book value found on the balance sheet.

Although investors have many options available to them in the alternative mortgage market, the same factors acting as a tailwind may also be acting as a headwind. As interest rates increase, variable mortgages will make more for the lender, but will also slow down the amount of new borrowing demanded by clients. Only time will tell how these factors net out.

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TICKERS GLOBAL

1. TSX:EQB (EQB)
2. TSX:FN (First National Financial Corporation)
3. TSX:HCG (Home Capital Group)

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