Investors Can Receive a 50% Return With This Company!

Description

Last week, I wrote an article about **Home Capital Group Inc.** (TSX:HCG) and why Warren Buffett was right to take a position in the company. A few days after the article hit the wire, the company announced earnings which almost perfectly met expectations (and showed that the Oracle of Omaha got it right once again). In fact, the main difference between this quarter and the previous two was that earnings per share increased more than expected; earnings surpassed expectations and, unfortunately, only sent shares a little higher.

For investors who were long the stock, the good news is that there was an increase in price of approximately $0.65 per share to $14.50 in the day that followed the earnings announcement, yet the true value of this company has yet to be realized. In fact, we may be dealing with a situation where the market is pricing a security incorrectly due to the previous skeletons in the closet, which were on full display only one year ago.

This past quarter (Q1 2018), the company made a bottom-line profit of $0.43 per share, which is an increase of $0.05 from the previous quarter (Q4 2017). In addition to this increase, the increase from Q3 to Q4 2017 was $0.01. Clearly, things are moving in the right direction for the company, yet the message from company management has been inconsistent.

A reason the market is not offering an appropriate valuation could be due to what seems like a changing tune from company management. In the press release for Q4 earnings, it was noted that deposits had not moved upward, which is a sign that the company expected to undertake less borrowing over the near term; shares did not move substantially higher on the news.

In the current earnings report, the company indicated the expectation was that they were going to substantially benefit from many new renewals that were coming up in the months to follow. Essentially, mortgage originations would increase, and higher revenues would follow; shares increased a small amount on the news.

As many investors may be getting dizzy due to the short-term guidance, it may be the best time to take a step back and evaluate the company based on long-term fundamentals instead.

As earnings have increased from $0.37 to $0.38 to a current quarterly profit of $0.43 per share, the old saying, “the trend is your friend,” has never been more true. As the company is a consistent business (revenues and earnings across quarters) investors can easily take away that the expected annual profits should be $1.72 per share. At a very reasonable multiple of 10 times earnings, the share price should be no less than $17.

By basing the valuation on tangible book value instead, the number is no less than $23 per share (and is growing), as the company has ceased paying the dividend for close to one year. Should this change in the near future, the outcome of this security may be far above the $20 mark. Time will tell!

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