Here Is Why This Warren Buffett Stock Isn't a Buy After a 14% Plunge

Description

Home Capital Group Inc. (TSX:HCG), a Canadian mortgage lender rescued by Warren Buffett's **Berkshire Hathaway Inc**. last year, is still struggling to regain investors' confidence.

Though stock has gained more than three-fold since hitting the lowest point in April 2017, it's still not worth even half of the value it was trading just before the liquidity crisis hit, triggering a run on its deposits and forcing the management to seek a costly bailout from the world's most successful value investor, Warren Buffett.

Trading at $15.01, its stock price is down about 14% so far this year. So, what are the prospects for Home Capital going forward, and will it be able to regain its glory? I think this will largely depend on the Canadian housing market. Here is why.

Slowing mortgage demand

Home Capital Group's fortunes are directly linked with the health of Canada's housing market. After an almost decade-long boom, home sales and prices have remained depressed in the nation's largest cities, Toronto and Vancouver.

According to the Canadian Real Estate Association, sales in 2018 will decline 11% from 2017, after the banking regulator enforced stricter mortgage rules for borrowers, considerably slowing the mortgage demand.

These rules, which were imposed from January, have delayed the recovery in home sales and slowed the price increases. The benchmark home prices climbed 0.6% nationally in May compared with April. That advance was the slowest since September 2009 and reflected weakness in the Toronto area.

If this situation persists, the possibility for Home Capital shares to stage a comeback any time soon is very bleak. The company has lost significant market share to other lenders during its crisis, and it's unlikely that it will take a risky approach to increase its mortgage volume at a time when the market has become unsettled.

Home Capital's latest financial results suggest that the company is improving its bottom line, but the level of profitability is far below than what the company was making before the liquidity crisis.

For the first quarter, Home Capital reported a $34.6 million profit as well as a sharp increase in the volume of new mortgages it issued in the first three months of the year. These improving fundamentals also helped the company secure a $500 million line of credit from domestic lenders, replacing a costly arrangement the company had with the largest shareholder, Berkshire Hathaway.

The bottom line

There is no doubt that Home Capital Group is out of danger, and it's on a solid path to recovery. But that doesn't mean that its share price will go back to the pre-crisis level. Home Capital Group is a long-term bet for investors who are willing to hold on to this stock while it slowly regains its market position. The pace of this recovery will largely depend on the Canadian housing market, which doesn't seem to be supporting higher mortgage demand in the next two to three years.

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Date
2025/08/21
Date Created
2018/06/29
Author
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