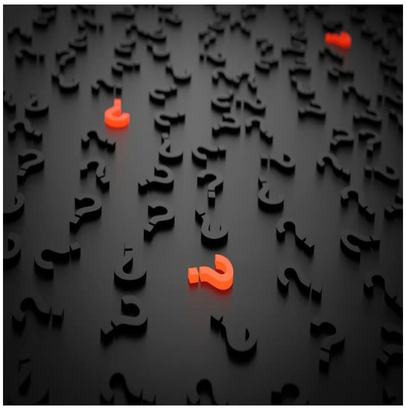

Is Home Capital Group (TSX:HCG) Stock Doomed After Warren Buffett Cuts Stake?

Description

Warren Buffett's **Berkshire Hathaway** announced yesterday it has mostly exited its investment in the Canadian **Home Capital Group** (TSX:HCG), about 18 months after his investment rescued this troubled mortgage lender from a deep liquidity crisis.

Home Capital said yesterday Berkshire's stake in the company will now decline below 10% upon completion of the company's $300 million buyback offer, which will reduce its shares outstanding by about 22.7%.

Warren Buffett's investment arm offered a crucial lifeline to Home Capital in June last year, as investors shunned this biggest alternative lender on concerns that it won't survive the liquidity crisis after the regulator found widespread irregularities in its broker network.

The deposit flight followed allegations from Canada's top securities regulator that the company and three top executives failed to disclose the full extent of mortgage-application fraud the lender reported in 2014.

Warren Buffett's cut of his exposure in Home Capital after more than doubling his initial investment, however, sent the wrong signal to the market and pushed the lender's shares down 15%. This sharp reaction suggests that some investors see much less value in the company with the world's most successful value investor out of the equation.

Negative stock reaction

Investors' negative reaction is also a reflection of Canada's overall housing market, which is still adjusting to new mortgage rules that have made it much tougher for borrowers to qualify for a home loan.

Home Capital, on its part, is trying to regain its market share and improve its profitability. In the third-quarter earnings announced last month, Toronto-based Home Capital showed an improvement in both profit and the origination of new mortgages.

The company reported net income of $32.6 million for the three months ended Sept. 30, up 8.7% from the same period a year prior. Mortgage origination continued to rebound, with $1.4 billion of new loans issued last quarter, a rise of 16.7% since the second quarter.

But that volume of mortgages is still far less than what the lender was originating during the peak of Canadian housing markets two year ago. Going forward, its profit outlook is still uncertain, and that's giving short-term investors a good reason to follow Buffett and reduce their holdings.

Bottom line

Trading around $14 at the time of writing, HCG stock isn't even worth half the price it was trading at when the 2017 crisis hit. The stock, however, is a good long-term bet on Canada's housing market. With rising population, immigrant inflow, and the lack of housing supply, Canada's housing fundamentals remain strong.

HCG stock has a good potential to offer hefty capital gains if you plan to remain invested for the next five years. The move by Buffett's investment firm shouldn't discourage you if you're a long-term investor.

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Date
2025/08/24
Date Created
2018/12/20
Author

hanwar