Value Investors: Don’t Try to Catch This Falling Knife!

Description

For value investors, a company like **Home Capital Group Inc.** (TSX:HCG) poses an interesting value proposition for those looking at picking up shares in a financials sector which has continued to ebb and flow over the past couple years.

Companies operating in the financial sector have seen momentum slow of late, as investors begin to worry about the negative impact of rising interest rates (at a point, higher benchmark interest rates hurt loan origination growth and loan quality). Of course, Home Capital’s woes in recent years have been much more serious than those of many of its peers outside of the alternative lending space Home Capital finds itself.

The potential upside, many say, is far greater with a company like Home Capital because of just how far the company’s stock price has fallen over the past two years.

After facing significant scrutiny from regulators over improper disclosures and falsified mortgage origination documents, investors in Home Capital have seen the equity value of their investment drop approximately 50% since the scandal broke. Shares have rebounded since mid-2017 lows, which arose due to a liquidity crisis that was solved in part by a substantial loan and investment from one of Warren Buffett’s subsidiaries.

Columbia Insurance, a wholly owned subsidiary of **Berkshire Hathaway Inc.** (NYSE:BRK.A)(NYSE: BRK.B), made what many confirmed was a vote of confidence in Home Capital in June 2017, offering Home Capital a $2 billion loan (at what appears to have been an exhorbitant rate, in hindsight), as well as an equity investment of 20% at the time with the option to buy another 20% at a later date. This option was voted down by shareholders, as it became clear the only winner in this transaction was Buffett and his companies.

The question many posed (myself included) at the time was just how solid of an investment was this? Would this really be one of Buffett’s “forever companies,” or was he in the game of getting a sweet deal and walking away before the stuff really hit the fan?

As it turns out, it appears the latter is most likely the case, with Buffett announcing in a news release that he will “continue to cheer from the sidelines from our friends at Home,” but went on to confirm that “Berkshire’s investment in Home is now not of a size to justify our ongoing involvement,” thereby indicating the company has substantially exited from its investment and is unlikely to have significant involvement moving forward.

Bottom line

Many of the key drivers behind the rebound in Home Capital’s share price since May 2017 lows have not truly materialized, as long-term catalysts for investors with an investment time horizon of any significant length. For value investors who are seeking great companies to pick up on the cheap, I would consider looking elsewhere at better companies with better long-term prospects.

Stay Foolish, my friends.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. TSX:HCG (Home Capital Group)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Bank Stocks
2. Investing

Date
2025/07/31
Date Created
2019/02/28
Author
chrismacdonald