



Why Home Capital (TSX:HCG) Stock Is a Sell

Description

Home Capital Group Inc. ([TSX:HCG](#))(NYSE:HCG) stock never really recovered from the hit it took in March. It continues to languish, with little in the way of catalysts and escalating risks. This pales in comparison to stock price recoveries that other more defensive stocks have made.

So, will a recovery continue to be elusive for Home Capital stock? Here's why I think Home Capital is not a good option for investor portfolios.

Home Capital stock falls on its increasing risk profile

Even in the best of times, Home Capital stock brings with it significant added risk. Many investors have been willing to take on this added risk for the potential of extra return. That is Investing 101. Today, it looks like this relationship is out of whack. This is because Home Capital's risk has increased to levels that have overwhelmed the merits of the investment.

This increased risk was on full display in Home Capital's first-quarter earnings results. In short, [these earnings came in significantly below expectations](#) due to rising credit loss provisions. The COVID-19 pandemic has led to some shocking and significant changes in assumptions. When calculating loan loss provisions, Home Capital includes assumptions on unemployment and home prices.

At this time, Home Capital is assuming that peak unemployment will hit in the second quarter. It is predicting that a recovery to pre-coronavirus levels will not happen until 2022. The average unemployment rate in its models is 11.6%. And it is modelling a 15.6% decline in home prices. These numbers would be devastating for most companies. They are even more so for a company like Home Capital, which primarily issues mortgages to higher risk lenders.

Home Capital stock losses will likely extend as provisions continue to mount

In the company's first-quarter conference call, a lot of the discussion centred on "deferred mortgages." While mortgages that are deferred during the crisis will not necessarily become credit-impaired, this risk is heightened. As of April 30, more than 15% of the company's total loans are under payment deferrals. So far, the provisions taken do not include anything for these deferrals.

Home Capital is one of those companies that will see a major deterioration in financials as a result of this crisis. Many of its mortgage holders will see a deterioration in credit worthiness. As a result, the company will have to continue recognizing huge losses in the near term. This will not be a pretty sight for Home Capital's stock price.

Home listings and home sales have deteriorated significantly in April. Home listings fell 40% in Vancouver and 60% in Toronto. Interestingly, Home Capital has seen a sharp increase in new loan originations, though, as re-financings have gone up.

Home Capital stock is reeling from the deterioration in the macro environment

Part of the appeal of Home Capital stock in recent times was management's focus on returning capital to shareholders. With the new crisis the company is facing, this focus has obviously gone. This is just another blow to the company as it deals with the toughest macro environment in history. And it is another reason that the demand for the stock will dry up and investor sentiment will remain negative.

Foolish bottom line

Home Capital was making good progress in its turnaround before the crisis hit. There is no easy way to say it, but now that the crisis has hit, this transformation has been stopped in its tracks. Visibility is non-existent and the risks are high. The company has too many things working against it, [the most important being credit deterioration. At this time, investors should be looking for companies that have more resilience and diversification.](#) Home Capital stock should therefore be avoided.

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