Avoid This TSX Stock if You Expect Canada's Housing Market to Crash

Description

The stock market fell off a cliff between February and March 2020. There was some sort of a rebound in April for most sectors. However, there were some businesses that have stayed put after the fall, because the bad news never stopped. Consumption for their products and services declined massively, and it is unlikely that business will resume, even after the lockdown restrictions lift.

Home Capital Group (TSX:HCG) is one such company. Its stock price fell from a 52-week high of $35.5 at the start of 2020 to less than $17 in March. It is now trading at $18.34, and it seems very unlikely that the mortgage lender's fortunes are going to improve if the grim situation persists.

Home Capital announced its results for the first quarter of 2020 in the first week of May. It reported a net income of $27.7 million in Q1 compared to $27.8 million a year earlier. Adjusted net income was $29.9 million, or $0.56 per share, in the March quarter, down 22.2% from $0.72 per share in Q4 of 2019. And from all accounts, it looks like the numbers are going to get much worse in the second quarter.

The company's loan-loss provisions zoomed up 674.4% sequentially in Q1. When compared to the first quarter of 2019, provisions surged 397.9%. You have to keep in mind that the impact of the pandemic became a lot clearer in the second half of March (i.e., the last 15 days of the quarter). If Home Capital has taken the impact of 15 days so seriously, the impact for the next 90 days could be devastating.

Home Capital has allowed deferrals of principal and interest payments to its customers. As of April 30, 2020, it had provided deferrals on 9,903 loans with a total value of $3.93 billion.

From bad to worse for this TSX housing giant

There is a catch to the number of deferrals. Just because a borrower has requested a deferral for six months doesn't mean that the borrower is included in the provision for credit loss. If the borrower's credit risk goes up after six months, then the borrower will be included in the provision and booked.This means there is potential for Home Capital's loan-loss provision to be much higher than actuallystated.

It isn't likely that the number of new loans is going to go up in the coming quarters. The number of sales in major cities has slowed down drastically. Home Capital says listings are down 65%. In cities like Toronto and Vancouver, the figure is around 40%.

This means mortgage originations or new loans stood at $1.62 billion in the first quarter for Home Capital compared with $1.62 billion in Q4 of 2019 and $1.22 billion in Q1 of 2019. Investors can expect a significant drop in new loans in the next two quarters.

During the analyst call, the company was asked when it would see a return to business as usual. This quote from Bradley William Kotush, CFO, sums it all up: "I can tell you the unemployment rates are assumed to peak in the second quarter … The models expect the rise in unemployment outweigh stimulus provided. And our model results in a decline in housing prices over the next 12 months. This is all from a third party. And so each of the scenarios show a significant spike in unemployment, GDP declines with varying degrees of recovery, and that the pre-COVID-19 recovery doesn't occur until 2022."

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