Why goeasy Stock Fell Over 11% in the 1st Week of April

Description

The interest rate hikes and warning of more hikes this year sent the tech stocks tumbling from their pandemic highs. Accompanying tech stocks was non-prime leasing and lending service provider **goeasy** (TSX:GSY), whose stock has tumbled 43% since September 2021. Its latest dip was over 11% in the first week of April, as the U.S. Fed released the minutes of its policy meeting. So, how is goeasy related to the Fed interest rate hike?

The indirect correlation between goeasy and federal interest rates

Like all other virus stocks, goeasy stock surged over 645% between March 20, 2020, and September 2021. This growth was driven by liquidity from the stimulus money and near-zero interest rates. Many Canadians used their stimulus checks to repay their non-prime loans. Some used loan insurance and borrowing assistance programs (extend the loan term). Although goeasy didn't see high loan originations in 2020, it reported a 46.4% EPS growth.

While customers repaid or extended loans, investors poured in the easy liquidity to buy goeasy stock and get a share in its rising EPS. I have been cautious about the stock since August 2021, as it achieved five-year growth in one year. At that time, I suggested adopting a wait-and-watch approach because of the stock's inflated price. A correction was likely as the government ended its stimulus package.

As expected, goeasy stock descended, as the government phased out the stimulus package. It fell further, as news floated that the Fed expects to increase the interest rate. In April, the Bank of Canada announced the first hike in a series of interest rate hikes to follow this year. This would reduce the liquidity in the economy. Hence, investors cashed out their pandemic stocks, bringing them to the pre-pandemic level.

This is an indirect relation between interest rates and goeasy stock. But there is a direct relation, too.

The direct correlation between goeasy and interest rates

goeasy has a credit facility with several banks on which it pays the prime rate plus a premium. The central bank interest rate influences the prime rate. An accelerated increase in interest rate might also increase the prime rate on goeasy's credit facility, thereby increasing its cost. Whether goeasy transfers this cost to consumers is yet to be seen.

In the meantime, the company took three steps to mitigate the rising interest rate impact:

- It reduced the credit facility from $310 million to $270 million.
- It extended maturity period to January 27, 2025.
- It reduced the interest rate payable on advances from the previous rate of Prime plus 200 bps to Prime plus 75 bps.

The company is also moving ahead with its plans to increase lower-cost funding. It has increased its Securitization Facility from $600 million to $900 million.

Should you buy the dip?

There are challenges ahead for goeasy, but it has a strong balance sheet and profit margin to withstand a crisis. The company even withstood the 2008 sub-prime crisis. The stock fell 60% at that time, and it took four years to return to growth in September 2012. Since then, the stock has grown steadily with shorter dips. This time, the company is better equipped to handle a crisis. It has a 33% secured loan and a 29.6% net profit margin.

The company is focusing on increasing revenue through new products like auto loans and new distribution channels like point-of-sale terminals. While increasing revenue, it aims to maintain its operating margin of around 35% by reducing the cost of funding.

goeasy has strong fundamentals and has been paying incremental dividends for seven consecutive years. The stock is currently trading at 11.6 times its forward price-to-earnings ratio, which is still high. There could be more downside, as the stock enters the oversold territory. But it is a small-cap stock that rewards its shareholders for taking risks.

This is a stock to buy the dip, but in phases. Invest 30% now and lock in a 2.9% dividend yield; invest 30% when it falls below $115; and invest the remainder if it falls below $110. You have to be patient with this stock and give it two to three years to give you a double-digit capital appreciation for the long term.

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