

Home Capital's shares soar on news of \$300-million share buyback

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PUBLISHED 3 HOURS AGO

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Shares of Home Capital Group Inc. jumped more than 20 per cent after the company announced it will repurchase up to \$300-million worth of its common shares, a move designed to boost the company's sagging stock price.

Home Capital announced plans Wednesday to launch a \$300-million substantial issuer bid, which will see the company repurchase \$300-million worth of common shares at a fixed price. The buyback's final terms will be set next week.

Home Capital's stock, which has sagged in 2018, surged on the news. Before the announcement, the company's shares had fallen 18.7 per cent since January, while the financial sub-sector of the S&P/TSX Composite had dropped 6.5 per cent. By late morning on Wednesday Home Capital's stock had jumped 18 per cent on the day.

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Home Capital's buyback plan was announced as part of its third quarter earnings. The company reported net income of \$33-million, up nine per cent from the same period a year prior. Mortgage originations continued to rebound, with \$1.4-billion of new loans issued last quarter, a rise of 17 per cent since the second quarter.

"The growth in originations suggests our lending market has begun to absorb the impact of the new mortgage rules and is adjusting to a higher interest rate environment," the company said in a statement.

Home Capital is in the midst of a turnaround after the mortgage lender, which specializes in loans to riskier "near-prime" borrowers, nearly collapsed in 2017. The troubles started when the Ontario Securities Commission issued an enforcement notice after finding some loan applications had been falsified, leading to the suspension of 45 Home Capital mortgage brokers. Shortly after, Home Capital terminated its chief executive officer.

The situation deteriorated quickly, and soon Home Capital was losing deposits that it relied on to fund its mortgages. In June, Warren Buffet's Berkshire Hathaway Inc. came to the rescue with a plan to invest as much as \$400-million into the troubled mortgage lender, as well as the promise of a \$2-billion line of credit.

Home Capital has taken major steps to turn itself around since, starting with the hire of a new CEO, Yousry Bissada, in July, 2017. However, the company is finding its footing again in a much different mortgage market. Today there is stiffer competition for clients, slower home sales in major urban housing markets -- and rising interest rates, which make it harder for prospective homeowners to afford house purchases.

Home Capital must also pay more for the money it borrows to fund its mortgages, which are mostly issued in southern Ontario. The company used to rely on cheap deposits, but regulators have warned against using such short-term sources of funding, considering investors can pull their money quickly -- which is what happened when Home Capital faced its crisis in 2017. To make its sources of funding more stable, Home Capital now issues five-year guaranteed investment certificates, which require Home Capital to pay a higher interest rate.

Amid this shift, it has been tough for investors to tell how profitable Home Capital can be, which has hurt the company's stock. At its peak in fiscal 2014, Home Capital earned nearly \$4.50 a share, according to Standard and Poor's Capital IQ. In the 12 months ended June 30, it earned \$1.55.

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Leading up to Wednesday's buyback announcement, some shareholders had argued that a share repurchase would help the company – especially considering it had excess capital on its balance sheet. Before the buyback, Home Capital's common equity Tier 1 (CET1) ratio – a key measure of a firm's financial buffer against bad loans – was 23.2 per cent, much higher than industry norms.

Seeing this excess capital, California-based Kingsferry Capital Management Group Ltd. released a public letter advocating for a \$60-million share buyback. On Wednesday, Home Capital announced a repurchase plan five times that size.

With files from James Bradshaw

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