

Home Capital thrives on bad credit

Sub-prime lender targets clients banks don't want

BY JASON CHOW

Home Capital Inc. may be lending money to those with beat-up credit ratings, but its own balance sheet looks absolutely solid.

The numbers are impressive: Earnings have grown continually for the past 22 quarters and the company projects another 20% increase this year. Return on equity over the past year was 24.8% versus the banks' average of 17.6%.

All of this seems not to have gone unnoticed by the market. The stock has been on a continual upswing since August, adding more than 60% to its share value in the past eight months and boasts a 75% one-year total return. The stock (HCGb/TSE) closed at \$6.90 yesterday, unchanged.

"I think it's a real gem," said analyst Bob Leshchynshen of Northern Securities.

But it wasn't too long ago the Toronto-based company looked more like a lump of coal when small, independent commercial lenders were drowned in red ink during the recession of the early 1990s.

Home Capital decided to change and in 1990 began focusing exclusively on residential lending.

It didn't turn a profit again until 1995, but it's been plotting a steady course of earnings growth ever since.

Today, Home Capital and its wholly owned subsidiary, Home Trust Inc., specialize in providing mortgages to those who don't qualify for traditional bank loans — many who are self-employed or have once been bankrupt.

Since September, the company has begun issuing secured credit cards, also to bank rejects.

"They're fairly unique. Most of the banks are focused on their own criteria and when people slip through that, that's when Home Capital steps in," said Leigh Gardner, analyst at Spratt Securities.

Though the company lends to high-risk clients, it maintains a low level of delinquency on its loans with only one loan out of 5,000 ending in default. Its loan loss provision is only 0.33% of loans compared to the banks' average of 0.46%.

According to the analysts, the company does rigorous research on the properties it lends on and is diligent in collecting its payments.

"They collect like crazy. If you have a problem you get hit with a power of sale very quickly," said Mr. Leshchynshen.

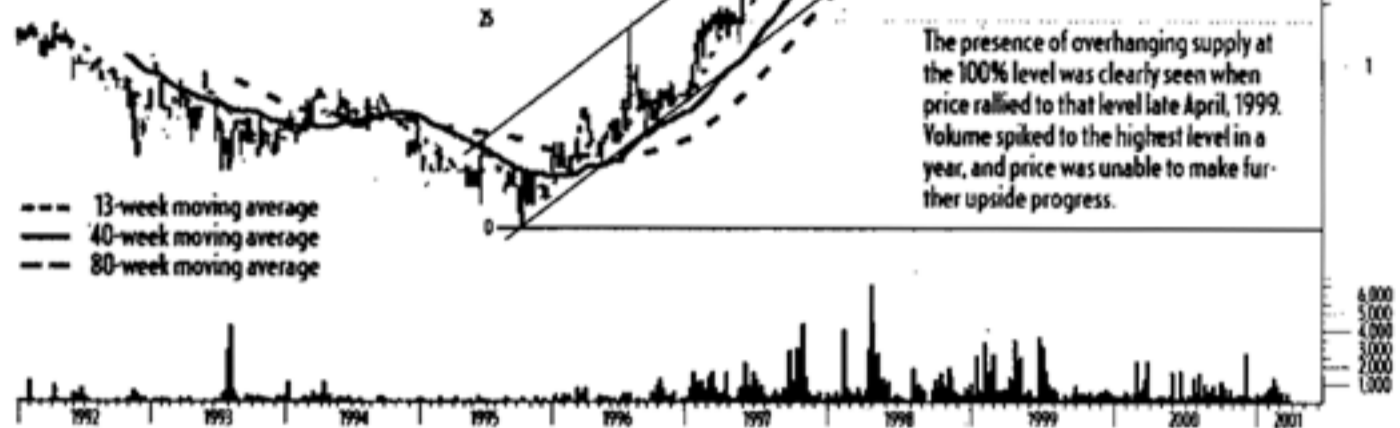
Look at its return on equity and you'll see what makes the analysts giddy — Home Capital's number is 41% higher than the

HOME CAPITAL GROUP INC. *Technical analysis by Roman Franko*

The MACD peaked mid-November, 1997, and made a lower high during May, 1998, a negative divergence with higher price highs during this period. This was a sign that buying pressure was waning and that a period of price weakness could be expected.

HCGb/TSE March 29: \$6.90, unch. Volume: 13,000

The Fibonacci levels as shown were set when this stock was examined mid-August, 1998. The 100% level identified supply throughout 1999 and April, 2000. When price finally broke that resistance, it went in a couple of steps to the 162% projection that was forecast over two years ago.



The presence of overhanging supply at the 100% level was clearly seen when price rallied to that level late April, 1999. Volume spiked to the highest level in a year, and price was unable to make further upside progress.

The Moving Average Convergence Divergence indicator consists of two moving averages revolving above and below a zero line. A buy signal occurs when the faster (solid) line crosses above the slower (broken) line; a sell is given when the converse occurs.

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Home Capital, after an initial selloff, began a bull run that peaked at \$4.45 the week ending May 15, 1998. A negative MACD-price divergence at that price peak warned of waning buying pressure and this was followed by a MACD sell signal late June. In mid-August, 1998, price had fallen through its 40-week moving average. However, the stock had congestion support, developed during the latter part of 1997, in the \$3 area. A fall below the 80-week moving average would leave the stock looking for support around \$2 before it could attempt another leg up. In fact, the stock plunged to precisely \$2 the week ending

Oct. 9, 1998. It then rallied to the 40-week moving average and then back the 100% zone at \$50 by early April, 1999. Price was finally able to overcome supply in that zone mid-August, 2000, and has now surged to the 162% Fibonacci projection at \$7. The weekly MACD suggests that the stock is overbought and may need to back and fill to its 40-week moving average in the \$6 range. Assuming that the stock can hold that rising support, it ought to be able to continue its uptrend.

Roman Franko is a technical analyst at Dundee Securities Corp. He may hold shares in companies mentioned here.

big banks' figure.

"These guys run a pretty lean operation and there are good margins in it," said Peter Schendel, a portfolio manager at Strathly Investment Management.

Lean, indeed: Home Capital's efficiency ratio — operating expenses as a percentage of revenue — is only 42%, much better than the banks' average ratio of 62%. In other words, the company is generating cash, keeps expenses low and isn't issuing any more shares to dilute the value.

But what if the current economic slowdown starts looking like 1990 again? Neither the company nor the analysts are very worried.

"We haven't seen much of a slowdown in the housing market," said Mr. Schendel.

Ms. Gardner said she's keeping her eye on unemployment numbers, especially in Ontario where most of Home Capital's business is located. She believes a rise in unemployment would hurt consumer confidence in the housing market.

"The first quarter looks good and we're confident it'll be a good

year," said chief executive Gerald Soloway.

All parties involved are predicting a stellar year for the company. Although the company did not release guidance, Mr. Soloway said he expects earnings to grow 20% to the range of 85¢ to 91¢ a share. Ms. Gardner has forecast 82¢ a share. Mr. Leshchynshen has predicted 84¢, but said he would likely revise his projections higher after the first-quarter results are released.

JUST ONE OUT OF 5,000 LOANS ENDS UP IN DEFAULT

Mr. Schendel sees much potential for the company's stock and expects the company to double earnings by 2004 — a figure Mr. Soloway said he is comfortable with.

"The stock is still cheap, incredibly cheap," said Mr. Schendel. "It's not a high flyer by any stretch — it carries a low multiple."

Some investors have been wary about putting their money into the company because of its class A multiple voting shares which are not publicly traded. Mr. Schendel believes if the company changed its ownership structure and dissolved the multiple voting shares, the company would attract more investors and the stock's value would increase by about 20%.

But Mr. Soloway said the company has no plans to change the ownership structure in the near future.

For all its successes, Home Capital remains small and quiet. Its market capitalization is only \$81.2-million. Its average daily volume is 12,715 shares and only two analysts cover the company.

According to Mr. Schendel, the company keeps a low profile, partly due to its own success.

"The stock doesn't trade a lot, so there's no commission dollars for brokers to be had off it. And there's no underwriting that needs to be done because they have more cash than they need."

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