

# INVESTING



CEO Gerald Soloway  
is big on common sense

## Hope for the homeless

Home Capital profits from giving mortgages to risky clients

**A**t a time when the Big Five banks are taking it on the chin for questionable loans, Gerald Soloway's business plan for Home Capital Group Inc. might leave you scratching your head. After all, Home Capital (TSE: HCC.B), through its wholly owned Home Trust Co. subsidiary, offers residential first mortgages to people who normally cause bankers to scrunch up their noses. Its clients typically have

one of three strikes against them: they've got crummy credit due to a past personal bankruptcy, they're self-employed and can't easily prove their net income, or they're immigrants with no work history in Canada. Whatever the reason, the big banks turn down one-in-five mortgage applicants. Doesn't sound like an appealing bunch to lend to though, does it? Soloway begs to differ. "The big banks'

lending is predominantly based on a computer scoring system whereby you either pass or fail; there aren't a lot of maybes in there," says Home Capital's president and CEO. "Our whole business is made up of the maybes." And a good dose of common sense, he adds.

Soloway's track record at Home Capital is impressive. The company recently logged its 26th consecutive quarter of profit growth, with fourth quarter net income jumping nearly 38% to \$4.1 million from last year, on revenue of \$24.9 million. What's more,

Home Capital's return on equity for 2001 clocked in at 23.8%. That's nearly twice the figure at most Canadian financial institutions. Clearly, Soloway is doing something right. Now he's taking his know-how in another direction: offering secured Visa credit cards with large limits and low rates to homeowners, using their houses as collateral.

The company began life in the 1980s as a junior oil explorer, which Soloway guided into the lending business during the decade's real estate boom. When the commercial market collapsed, the company nearly went under. It endured five painful years of cleaning up its books before turning a profit in 1995. In the past year, Home Capital stock returned 105%, recently topping \$13.50 a share. Today, just 1.5% of Home Capital's portfolio is in non-residential properties, down from 35% in 1990. Especially risky second mortgages, which once accounted for 17% of its business, stand at just 0.1%.

Home Capital has gradually developed an expertise in weeding out the truly horrific borrowers from the merely dubious ones. First, the lender only mortgages homes that will be easy to sell in a bear market. That means no 20-acre farmhouses or townhouses modified with indoor bowling alleys. The firm will lend only up to 75% of the market value of the home, so that in a crunch it can sell the property and get back its investment. Then there's the uncanny ability Home Capital underwriters have for lending to the right people. Soloway has developed

an intricate database of statistics to help select clients. The most reliable? Those in the service industry like waiters and plumbers. The worst? "I'm a lawyer by profession, but the most problematic area we've had is lending to lawyers," says Soloway. "If there's a problem, their first attitude is to fight rather than pay."

Andy MacDonald, a broker with MortgageBroker Inc., says Home Capital's method of dealing with delinquent accounts also keeps them profitable. "If a payment is missed, banks tend to send two or three letters out over 90 days reminding you to pay," says MacDonald, who directs about 5% of his clients to the company. "Home Capital is more on the ball. They call up right away to find out why the payment was missed." Home Capital's delinquent loans in 2001 stood at just 0.52%, which is in-line with or even lower than the banks.

The company has a very small following in the institutional community, but those analysts who do cover it like what they see. "You try to avoid dealing in stereotypes, but Soloway calls a spade a spade and seems to know where his bread is buttered," says Jason Donville, president and director of research at Lightyear Capital Inc., who, along with an analyst at Sprout Securities, maintains a 12-month target price of more than \$18.

While Home Capital has plenty of room to grow in the alternative lending business—it serves just 5% of those mortgage seekers who are turned away by the banks, a business worth about \$70 billion—Soloway is pursuing other revenue streams. One is packaging mortgages as securities and selling them to Bay Street. In the past quarter alone, the sale of mortgage-backed securities

added nearly \$1 million to Home Capital's top line. But it's the secured credit card business where Soloway sees real growth. The idea behind his Home Trust Visa, launched in February, is that homeowners can use their houses as collateral to obtain credit in the \$10,000 to \$50,000 range, with no fees (other than a one-time set-up cost of \$570) and an annual rate of 11.99%. Soloway believes it is the only card of its kind in Canada.



As the economy continues to tread water, however, Soloway will have to be cautious. So far, the housing market shows no signs of softening, fueled as it is by low interest rates and high demand. But that could change if unemployment figures rise and consumer confidence wanes, especially among Home Capital's credit-challenged customers. The near collapse of the sub-prime lending industry in the US shows what awaits Soloway if he starts taking on overly risky clients to fuel growth. As of September 2001, delinquent sub-prime mortgages in the US totaled 7.11% of all home loans, up from 5.53% a year earlier. "You can't really compare us to the sub-prime market in the US because they lend to people we never would," argues Soloway. "They operate on a completely different model." Investors will be watching closely to make sure it's a model Soloway doesn't adopt.

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