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## **Exclusive: Buffett on how he struck the Home Capital deal**

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Globe and Mail Update

*Investing guru says short e-mail from Canadian banker sparked his interest in the troubled mortgage lender*

Legendary value investor Warren Buffett's interest in rescuing Home Capital Group Inc. was piqued by an e-mail from 82-year-old Don Johnson, a Canadian banker who sends his thoughts to the investing guru now and then.

"This one wasn't long, but it was to the point and that got my interest," Mr. Buffett, a fellow octogenarian at 86, told The Globe and Mail by telephone from his office in Omaha, Neb.

After that, a deal in which a subsidiary of Mr. Buffett's Berkshire Hathaway Inc. is poised to invest as much as \$400-million into troubled Canadian mortgage lender Home Capital came together at breakneck speed – from first contact to a handshake deal in three days flat. Berkshire arrived late on the scene, where an array of financial firms were circling, catching even sophisticated financial players tracking the process by surprise. Mr. Buffett said he's bullish on Canada in general, though he insists he has no fixed expansion plans for the country, and no particular insight into the direction of the Canadian housing market. Rather, he figured that by lending his firm's name to the struggling alternative mortgage provider, he could shore up faith in its stability and have a shot at healthy long-term returns, while collecting steady interest payments over the next year.

**David Berman: Why copycats can't follow Buffett's lead on Home Capital<sup>1</sup>**

**Andrew Willis: Why Warren Buffett is bullish on Canada<sup>2</sup>**

**Read more: The nuts and bolts behind Home Capital's deal with Berkshire Hathaway<sup>3</sup>**

"I really thought we could bring something to the party in addition to money in restoring confidence," Mr. Buffett said.

The chair of Home Capital's board, Brenda Eprile, hopes the investment "represents a turning point" for the company, which has been hammered by a crisis of market confidence and a run on deposits since it ran afoul of securities regulators over a failure to disclose concerns about mortgage fraud inside its business.

It soon became clear to directors that the company needed a reputable "sponsor" to burnish its battered reputation. Berkshire Hathaway is set to become Home Capital's largest shareholder through a two-stage agreement that could give it a 38-per-cent equity stake at a significant discount if investors give the green light at a September vote.

Berkshire also signed on to provide a new \$2-billion line of credit with slightly less onerous terms than the emergency loan from the Healthcare of Ontario Pension Plan (HOOPP) that has kept Home Capital afloat since April.

Eventually, Home Capital hopes to rebuild its portfolio of guaranteed investment certificates (GICs) as its core funding source. Home Capital's stock soared 27 per cent to \$19 a share on Thursday as shareholders embraced the news.

Berkshire must hold the Home Capital shares for at least four months. Mr. Buffett claims he didn't even know that – "it must have been something the lawyers stuck in," he said – and insists Berkshire is here to stay.

"I can tell you, we have no intention whatsoever of getting out in four months or eight months or 12 months," he said.

In fact, Mr. Buffett could move deeper into the market.

While he waits for his investment to mature, he will learn more about Home Capital's competitors and might explore opportunities for further acquisitions. "Six months from now or a year from now, as we see how this develops, you always think about that in any industry. But I have absolutely no grand plan for now," Mr. Buffett said.

He added: "I don't rule out anything in the future, either."

In the month since the worst of the panic subsided, Home Capital refreshed its board, bringing on director Alan Hibben to replace retiring founder Gerald Soloway.

The company also tapped financial advisers at RBC Dominion Securities Inc. and BMO Nesbitt Burns Inc. to evaluate its options.

Investment bankers worked the phones, approaching potential investors and processing non-disclosure agreements for more than 70 interested parties granted access to a confidential data room. The names of some private-equity firms eyeing the lender began to leak into the market, with Toronto-based Onex Corp. and Brookfield Business Partners LP among the potential bidders. But none of the offers that were tabled proved attractive.

Then came the investment pitch via e-mail from Mr. Johnson, a veteran at Bank of Montreal. He reminded Mr. Buffett of their meetings over the past few decades, attaching a photo to the e-mail from an encounter in Omaha, and passed along a colleague's contact information.

Mr. Buffett "did some thinking on it" with one of his lieutenants, Ted Weschler, and on June 12, they made their move. They sent a formal, no-conditions offer on June 13, and Mr. Weschler was dispatched to Toronto to discuss it. He reported back to Mr. Buffett that he was impressed with Home Capital's directors.

True to Berkshire's style, there wasn't much negotiating, though the two sides did have to tweak some specific terms to fit Canadian laws and regulations, which Mr. Buffett was studying on the fly. Mr. Weschler "went up and just explained what we would do. And then it was up to them," Mr. Buffett said.

By June 14, the two sides had agreed in principle.

"We've bought a lot of entire businesses here with what would look to a typical lawyer or investment banker as being a very peculiar way of doing due diligence," Mr. Buffett said. "But, essentially, we've got our own way of evaluating facts and sometimes we make mistakes. And hopefully our batting average is decent over time. It's not conventional."

There were good reasons to move quickly. Home Capital is still trying to narrow its shortlist and hire a full-time chief executive officer – a role it hopes to fill by July. Mr. Buffett hopes it will be easier "getting him or her to join the place" with "an anchor shareholder like Berkshire."

Home Capital also had concerns over staff morale. "It's very difficult if you're coming to work every day and you've got a bunch of guys chirping about your stock going to zero," Mr. Hibben said, referring to short-sellers betting against the company.

The deal was announced just after 11 p.m. on Wednesday night, and in Shanghai, where it was already late morning, Hugo Chan was in shock. Mr. Chan, whose investment firm Kingsferry Capital bought up Home Capital shares after the share price plunged in late April, was surprised Mr. Buffett's massive firm would get involved in such a relatively small investment. But he approves of the pact.

"In the short run, yeah, it's a big dilution. But at the same time, I think with the support of Berkshire, Home Capital will just have enormous potential to emerge into a more profitable business," he said.

The deal may seem like pocket change for Berkshire Hathaway, a financial juggernaut with nearly \$100-billion (U.S.) available to invest. But at its core, the strategy is simple.

"Guys like that like to make money and so I suspect that was part of their motivation," Mr. Hibben said.

Home Capital expects to seal further asset sales and deals in the near future and will use the Buffett name to woo depositors. At its peak, the company was collecting between \$25-million (Canadian) and \$35-million in deposits a day, before confidence in the firm evaporated and jittery investors began pulling their money.

Mr. Hibben hopes to return to accepting roughly \$30-million a day.

If they're successful, "it's not victory, but it is certainly going in the right direction," he said.

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### **More from The Globe and Mail's conversation with Warren Buffett**

Over a lifetime of savvy investing, Warren Buffett has earned the moniker "The Oracle of Omaha," after his home town in Nebraska. Here are some other nuggets of wisdom he offered, speaking to The Globe and Mail:

### **Why he's bullish on Canada:**

"I always have been, actually. My dad was, too, going way back to the 1940s. I just showed my tax return to somebody from when I was 13 years old and I think there was some Noranda mines. I had like four stocks when I was 13 and one of them was Noranda [Inc., a former mining company headquartered in Rouyn-Noranda, Que]. We used to talk about stocks and my dad always had some Canadian stocks. I wish we'd held onto them!"

### **On his confidence in Prime Minister Justin Trudeau:**

"It wasn't very long ago I actually was with your Prime Minister and Finance Minister [Bill Morneau] out in Seattle, and we had a long talk. I always have been enthusiastic on Canada generally, but I felt even more so after talking to them. Then I watched, on YouTube, your Prime Minister with that famous prize fight [a charity boxing match with Senator Patrick Brazeau in 2012], too. He looked pretty effective to me."

### **On lending to Home Capital's clients, who struggle to qualify for traditional bank loans, such as new immigrants or the self-employed:**

"I'm not sure whether I'd qualify very well on loans, when you get right down to it. ... If you look at my salary and everything, it might look like a fairly limited means. And if somebody didn't go down to my safe deposit box and find a bunch of bursar's certificates – a lot of people don't fit the cookie-cutter approach to borrowing that are perfectly decent credits. But you have to be able to distinguish them from the ones that aren't decent credits, and that takes some ability."

### **On Berkshire Hathaway's negotiating style:**

"We're sort of a limited-negotiation type of place. We really try to figure out a deal that makes sense for both parties. And if the other parties agree, we've got a deal, and if they don't agree, we don't have a deal and we're still friends."

### References

1. <https://www.theglobeandmail.com/globe-investor/inside-the-market/why-copycats-cant-follow-buffetts-lead-on-home-capital/article35438282>
2. <https://www.theglobeandmail.com/report-on-business/why-warren-buffett-is-bullish-on-canadian-real-estate/article35440579>
3. <https://www.theglobeandmail.com/report-on-business/the-nuts-and-bolts-behind-home-capitals-deal-with-berkshire-hathaway/article35438861>

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