

Seeking Alpha^α

Genworth: Additional Thoughts On Plan-B And Valuation

Jan. 12, 2018 8:28 AM ET72 comments
by: Seven Corners Capital Management

Summary

- This is a Follow-On Piece to Our Prior Article Regarding Genworth's Plan B Options if the China Oceanwide Merger is Blocked by Regulators.
- Required Approvals for Foreign Mortgage Insurer Equity Divestitures Appear Light; IPO of U.S. Mortgage Insurance Subsidiary Should Take Longer.
- We Demonstrate Why We Believe Genworth's Intrinsic Value Has Increased Over \$1 Billion (or \$2/Share) Since the China Oceanwide Merger Announcement.



This article is a follow-up to our previous Seeking Alpha article on Genworth Financial (GNW) published on January 5th, titled "Genworth: Time For Plan B?". There were a few loose ends from the prior article we felt needed tidying up, namely (1) what necessary regulatory approvals are required in order to monetize GNW's mortgage insurance, or M.I., equity stakes (both foreign and domestic) and (2) how does GNW's overall valuation compare to that which prevailed when China Oceanwide agreed to purchase the company in October 2016? We address each of these as follows:

1. Required M.I. Divestiture Approvals - With respect to the divestiture of equity stakes in GNW's M.I. lines of business, we believe that regulatory burdens are relatively light with respect to selling down the foreign M.I. holdings and more complicated for the domestic M.I. business. Below are (1) excerpts from news releases and GNW's SEC filings describing transactions wherein GNW either IPO'd or further sold down its equity stakes in its GNW Australia and GNW Canada mortgage insurers and (2) a discussion of possible timing and regulatory issues with respect to an IPO of a portion of GNW's U.S. M.I. holdings.

A. Sales of Shares of Genworth Australia:

In GNW's 2014 10-K filing ([link here](#)), page 16, we find the following disclosure regarding the IPO of GNW Australia:

On May 15, 2014, Genworth Mortgage Insurance Australia Limited ("Genworth Australia"), a holding company for Genworth's Australian mortgage insurance business, priced its IPO of 220,000,000 of its ordinary shares at an initial public offering price of AUD\$2.65 per ordinary share. The offering closed on May 21, 2014. Following completion of the offering, Genworth Financial beneficially owns 66.2% of the ordinary shares of Genworth Australia.

Although not stated in the 2014 10-K, we assume that GNW needed the approval of GNW's Australian mortgage regulators to do the IPO [note: a link to full GNW Australia IPO Prospectus is [here](#)].

In 2015, approximately one year following the IPO, GNW sold an additional 92 million shares in GNW Australia in a secondary offering. The press release announcing the sale contained no reference to needing any approvals for the sale, thus it appears to have been relatively straightforward to perform (source [here](#)):

Genworth Financial Announces Sale Of A Portion Of Its Interest In Genworth Mortgage Insurance Australia Limited

05/11/15

RICHMOND, Va., May 11, 2015 /PRNewswire/ -- Genworth Financial, Inc. (NYSE: [GNW](#)) today announced that its wholly owned subsidiaries Brookfield Life Assurance Company Limited and Genworth Financial International Holdings, Inc. (as partners) (together, the "Vendor") entered into an underwriting agreement for the sale of 92.3 million shares in Genworth Mortgage Insurance Australia Limited ("Genworth Australia") at A\$3.08 per share. The sale, which represents approximately 14.2% of Genworth Australia's share capital, is being conducted via a fully underwritten sell down to equity market investors and will leave the Vendor with an approximate 52.0% stake in Genworth Australia on completion.

"The sale today represents an important step toward the execution of our strategic initiative to increase the financial flexibility and strength of Genworth. This transaction advances Genworth's ability to support compliance with the Private Mortgage Insurer Eligibility Requirements and reduce debt levels," said Tom McInerney, President and CEO.

Note that, in addition to an underwritten secondary offering, GNW can also monetize its stake by tendering shares into any active repurchase program. In August 2017, GNW Australia announced an A\$100 million buyback program, of which A\$50 million had been completed as of the end of November 2017. GNW should benefit to the tune of A\$52 million (~US\$40 million at 0.78 f/x rate) from this repo program once fully completed, as it retains a 52% ownership stake in GNW Australia (source):

Genworth announces on-market share buy-back

(SYDNEY) 2 August 2017: Genworth Mortgage Insurance Australia Limited (Genworth or the Company) (ASX: GMA) today announced its intention to commence, with effect from 21 August 2017, an on-market share buy-back for shares up to a maximum aggregate value of \$100 million.

Based on Genworth's closing share price of \$3.02 on 1 August 2017, this would represent 6.5 per cent of the Company's issued share capital or around 33.1 million ordinary shares. The total number of shares to be purchased by Genworth under the on-market share buy-back will depend on business and market conditions, the prevailing share price, market volumes and other considerations.

The proposed on-market share buy-back is a continuation of the capital management actions that are designed to bring Genworth's solvency ratio more in line with the Board's target capital range of 1.32 to 1.44 times the Prescribed Capital Amount (PCA) on a Level 2 basis. The Company has received consent from its majority shareholder, Genworth Financial, Inc. (Genworth Financial), under the Shareholder Agreement, and the necessary regulatory approvals to commence the on-market share buy-back.

Total of all shares/units bought back, or in relation to which acceptances have been received, before, and on, previous day

	Before previous day	Previous day
3 Number of shares/units bought back or if buy-back is an equal access scheme, in relation to which acceptances have been received	16,889,647	124,021
4 Total consideration paid or payable for the shares/units	\$50,495,191.52	\$387,925.29

B. Sales of Shares of Genworth Canada:

In July 2009, GNW announced the closing of the IPO of 45 million shares of GNW Canada (source here):

Genworth Announces Closing of Canadian Initial Public Offering

07/07/09

RICHMOND, Va., July 7 /PRNewswire-FirstCall/ -- Genworth Financial, Inc. (NYSE: GNW) today announced the closing of the previously announced initial public offering of 44.7 million common shares of Genworth MI Canada Inc., priced at Cdn\$19.00 per share. The offering will generate net proceeds to Genworth Financial of approximately US\$635-730 million (net of underwriting commissions, taxes and other items), depending on whether an over-allotment option granted by Genworth to the underwriters is exercised.

Through the over-allotment option, exercisable by August 6, 2009, the underwriters may purchase up to 6.7 million additional common shares from Genworth Financial at a price of Cdn\$19.00 per share. If the option is exercised in full, Genworth Financial would have a 56 percent ownership interest in Genworth MI Canada.

"The IPO is an important component of our ongoing strategy to enhance our capital flexibility and strengthen our already sound financial foundation," said Michael D. Fraizer, chairman and chief executive officer of Genworth Financial. "We'll receive a meaningful level of capital through the transaction and continue to benefit from the earnings associated with our majority ownership position in Genworth MI Canada."

Although not stated in the above announcement, we assume that GNW needed the approval of GNW's Canadian mortgage regulators to do the IPO [note: a link to the full GNW Canada IPO Prospectus can be found here].

In GNW's 2012 10-K filing (link here), pages 14-15, we find the following disclosure regarding the IPO of GNW Canada, the subsequent share repurchase program and the contribution of GNW Canada shares to the U.S. M.I. insurance subsidiary (in order to increase its statutory capital):

In July 2009, Genworth MI Canada Inc. ("Genworth Canada"), our indirect subsidiary, completed the initial public offering (the "Offering") of its common shares. Following completion of the Offering, we beneficially owned 57.5% of the common shares of Genworth Canada. In August 2010, Genworth Canada repurchased 12.3 million common shares for CAD \$325 million through a substantial issuer bid. Brookfield Life Assurance Company Limited ("Brookfield"), our indirect wholly-owned subsidiary, participated in the issuer bid by making a proportionate tender and received \$187 million and Brookfield continued to hold approximately 57.5% of the outstanding common shares of Genworth Canada. In June 2011, Genworth Canada repurchased approximately 6.2 million common shares for CAD\$160 million through a substantial issuer bid. Brookfield participated in the issuer bid by making a proportionate tender and received CAD\$90 million and Brookfield continued to hold approximately 57.5% of the outstanding common shares of Genworth Canada in June 2011. In August 2011, we executed a non-cash intercompany transaction to increase the statutory capital in our U.S. mortgage insurance companies by contributing to those companies a portion of the common shares of Genworth Canada that were held by Brookfield outside of our U.S. mortgage insurance business, with an estimated market value of \$375 million. We continue to hold approximately 57.5% of the outstanding common shares of Genworth Canada on a consolidated basis. In addition, Brookfield has the right, exercisable at its discretion, to purchase for cash the common shares of Genworth Canada held by our U.S. mortgage insurance companies at the then-current market price. Brookfield also has a right of first refusal with respect to the transfer of these common shares of Genworth Canada by the U.S. mortgage insurance companies.

Similar to Australia M.I., GNW can monetize its Canadian M.I. stake by tendering shares into any active repurchase program. In May 2017, GNW Canada announced a 4.6 million share buyback program, to cost approximately C\$184 million assuming an average price paid of C\$40/share. GNW should benefit to the tune of C\$105 million (~US\$84 million at 0.80 f/x rate) from this repo program when fully implemented, as it retains a 57% ownership stake in GNW Canada. Below is from the Repurchase Announcement (source here; see full list of company PRs here):

Genworth MI Canada Inc. Announces Acceptance by TSX of Normal Course Issuer Bid

TORONTO, May 2, 2017 /CNW/ - Genworth MI Canada Inc. ("Genworth Canada", or the "Company") (TSX: MIC) announced today acceptance by the Toronto Stock Exchange (the "TSX") of the Company's Notice of Intention to Make a Normal Course Issuer Bid ("NCIB"). Pursuant to the NCIB, Genworth Canada may, if considered advisable, purchase through the facilities of the TSX or through other permitted means (including through other published markets), from time to time over the next 12 months, up to an aggregate of 4,597,385 of its issued and outstanding common shares (the "Common Shares"), being 5% of the Common Shares as of April 27, 2017.

Purchases may commence through the TSX on May 5, 2017 and will conclude on the earlier of the date on which purchases under the bid have been completed and May 4, 2018. Daily purchases under the NCIB will be limited to a maximum of 49,393 Common Shares, other than purchases made in compliance with the provisions of the block purchase exemption of the TSX rules and purchases from Genworth Financial, Inc., the Company's majority shareholder, and its affiliates (collectively, "Genworth Financial").

Genworth Financial will be permitted to sell its Common Shares to the Company in accordance with an exemption granted by the TSX pursuant to its rules, regulations and policies in connection with the NCIB in order to maintain its proportionate percentage ownership at approximately 57.2%. Genworth Financial has advised the Company that it intends to participate proportionately in the NCIB. The maximum number of Common Shares that may be purchased pursuant to the NCIB will also be reduced by the number of Common Shares purchased by the Company from Genworth Financial.

Note that since GNW U.S. M.I. currently owns 16.6% of GNW Canada's equity (worth around US\$500 million), sale of any portion of this position (and subsequent upstreaming to the holdco) would likely need additional regulatory approvals, since it would reduce U.S. M.I.'s statutory capital levels.

C. IPO of Shares of Genworth U.S. M.I. Business: Sales of the shares of U.S. M.I. would likely be a medium- to longer-term project, requiring the approvals of both the North Carolina Department of Insurance (U.S. M.I.'s principal insurance regulator) and the GSEs. In addition, it would take time to market the equity stake to institutional investors, therefore this option does not seem practicable prior to the \$600 million note maturity occurring in May 2018. By way of example, it took mortgage insurer Essent Group Ltd (ESNT) from the end of July 2013, when it first submitted its draft registration statement to the SEC, until the beginning of November 2013 to price its IPO (see company filings here and IPO Prospectus here).

2. GNW Valuation Delta Versus October 2016 - In order to determine how the valuation of GNW today on a standalone basis compares with that existing in October 2016 when China Oceanwide agreed to pay \$5.43/share in cash for GNW, we note the following (source: Google Finance and securities filings for GNW, GNW Canada and GNW Australia):

A. Genworth Canada Equity Stake: Shares of GNW Canada have appreciated nearly 50% since the merger announcement, as shown in the chart below. This equates to around C\$580 million (~US\$450 million, using the average CAD/USD exchange rate over the past year) in additional value attributable to GNW, based on ownership of 57.2% of the outstanding GNW Canada stock. In addition, GNW has received in the neighborhood of US\$80 million in dividends from its GNW Canada holdings since the merger announcement, for a total increase in value of approximately US\$530 million.

Market summary > Genworth MI Canada Inc

TSE: MIC - Jan 11, 4:00 PM EST



41.92 CAD +0.69 (1.62%)

1 day 5 day 1 month 3 month 1 year 5 year max

28.15 Nov 4, 2016



Open 42.60
High 42.77
Low 41.77

Mkt cap 3.81B
P/E ratio 7.2
Div yield 4.48%

B. Genworth Australia Equity Stake: Shares of GNW Australia have remained basically flat since the merger announcement, as shown in the chart below. However, GNW has received in the neighborhood of US\$50 million in dividends from its GNW Australia holdings since the merger announcement.



Thus, the value of GNW's foreign M.I. equity stakes alone (including dividends) have increased in value by US\$580 million, or \$1.16/share, since October 2016, an amount which nearly equals the total necessary to pay off GNW's 2018 Notes.

C. Genworth U.S. M.I. Business: In line with our previous GNW article, we value U.S. M.I. at 12X trailing adjusted operating earnings, which are \$298 million on an LTM basis. As of the date of the merger announcement, LTM earnings for U.S. M.I. were \$230 million, or \$68 million lower than currently. Thus, applying our 12X multiple, we conclude that the value of U.S. M.I. has increased by \$816 million since October 2016. When we look at U.S. M.I. peers, the aforementioned Essent, as well as Radian Group Inc (RDN) and MGIC Investment Corp (MGIC), we find that their respective stocks have appreciated quite significantly over the past year, in line with our view that the valuation of GNW's U.S. M.I. operations has also substantially increased:

Market summary > Essent Group Ltd

NYSE: ESNT - Jan 11, 4:55 PM EST

**47.84** USD **↑1.17 (2.51%)**

After-hours: 47.84 0.00 (0.00%)

1 day 5 day 1 month 3 month **1 year** 5 year max**32.04** Jan 12, 2017

Open 46.85

High 47.96

Mkt cap 4.71B

P/E ratio 16.04

Market summary > MGIC Investment Corp.

NYSE: MTG - Jan 11, 7:12 PM EST

**15.18** USD **↑0.44 (2.99%)**After-hours: 15.20 **↑0.13%**1 day 5 day 1 month 3 month **1 year** 5 year max**10.11** Jan 12, 2017

Open 14.80

High 15.18

Mkt cap 5.63B

P/E ratio 13.36

Market summary > Radian Group Inc

NYSE: RDN - Jan 11, 5:52 PM EST

22.41 USD ↑0.49 (2.24%)

After-hours: 22.41 0.00 (0.00%)



D. Genworth Life Insurance Valuation: Operating income for GNW's U.S. Life Operations on a LTM basis as of the end of Q3 2017 was negative \$63 million, which was actually a substantial improvement of \$133 million versus the negative \$196 million for U.S. Life on an LTM basis as of the merger announcement. However, since U.S. Life continues to lose money on an operating basis, we will assign no increase in value to these operations (and will actually assume they are \$63 million less valuable than they were a year ago).

E. Genworth Holdco Cash and Liquid Investments: These have declined by \$336 million since the date of the merger announcement, from \$1.165 billion to \$829 million at the end of Q3 2017. In addition, debt at the holdco level increased by \$8 million, bringing the decrease in value of GNW's corporate operations to \$344. We will offset this with the \$42 million in positive operating income attributable to GNW's runoff operations, so the total for this category is negative \$302 million.

F. Treasury Bond Rates On the Rise = Bullish for Insurers: One should also note that Treasury rates have begun to climb again recently, based on the potential for inflation to pick up and Asian buyers slackening their U.S. government debt purchases, which bodes well for an insurer such as GNW. Higher rates would make GNW's overall bond portfolio yield increase, which should translate into higher operating income going forward. Below is a chart showing that 10-year Treasuries have risen from 1.77% to 2.55% since the China Oceanwide merger was announced (source):

10 Year Treasury Rate Chart



In aggregate we believe that GNW's standalone equity value has increased by \$1.031 billion since October 2016 (\$580 million, plus \$816 million, minus \$63 million, minus \$302 million), or just over \$2/share. True, the 2018 Note maturity is much closer today than it was then, but as we discussed in our article from last week GNW appears to have ample resources available to pay off these notes, and the next maturity does not occur until 2020 (and this is just for \$400 million).

CONCLUSION

In the absence of a closing of the China Oceanwide merger, it appears that monetizing a portion of GNW's equity holdings in either or both of GNW Australia and GNW Canada would be fairly straightforward and timely (indeed, GNW already receives cash from these equity stakes through ongoing dividend and repurchase programs). While there is likely not enough time ahead of the \$600 million May 2018 note maturity to complete an IPO of GNW's U.S. M.I. business, GNW clearly could pursue such an option well before the \$400 million 2020 note maturity. On the valuation front, based on improved operating results in U.S. M.I., as well as a nearly 50% increase in GNW Canada's share price since the China Oceanwide deal was announced in October 2016, we find that the intrinsic value of GNW's equity has increased by over \$1 billion (or \$2/share) since the merger agreement was signed. Given that GNW's share price in the six months preceding the China Oceanwide merger announcement averaged around \$3.50/share, it is indeed strange that, given the foregoing, shares still remain below that level. In fact, we believe GNW should be trading close to \$5.50/share strictly on fundamentals, regardless of the fact that a \$5.43/share merger is pending (perhaps not coincidentally, both numbers are extremely close to our \$5.34/share Sum-of-the-Parts valuation derived for GNW in our January 5th article).

Disclosure: I am/we are long GNW.

Comments (72)

ATX

GNW intrinsic value is not \$2, it's \$20, Chinese are known for value buy, they don't overpay

12 Jan 2018, 08:53 AM

stockinvestor1956

"Chinese are known for value buyers, they don't overpay"

Really... you must not have been around several years ago when China sucked up lots of real-estate that went south for pennies on the dollar. I guess the younger generation today is smarter.

12 Jan 2018, 12:16 PM

Landlord Investor, Contributor

I'm surprised GNW Australia shares have been flat. The Australian stock market has moved up due to higher commodity prices. That translates into a more robust Aussie housing market which should benefit GNW Aus.

One thing that concerns me is lax underwriting in GNW Canada's MI. Seems like their loss ratio is too high compared to the delinquency rate. Any idea why that might be the case other than bad underwriting? Are there other hidden surprises in the underwriting that will only be discovered in a downturn?

I'm writing mainly from the perspective of the 2066 floating rate jr subordinated bonds.

12 Jan 2018, 09:26 AM

Seven Corners Capital Management, Contributor

Author's reply » Sorry, not an expert on Canadian or Australian housing markets, or GNW Canada's underwriting practices.

12 Jan 2018, 10:38 AM

Landlord Investor, Contributor

I'd estimate that the Canadian and Australian housing markets pose the biggest long term risk to GNW's solvency.

Anyway, there are clues indicating that GNW's underwriting is shoddy. Shoddy underwriting means there is hidden risk that could only be discovered later on. So, if that's true, you have to discount assets appropriately. Seems like the assets are trapped underneath shoddy management, so they have to be discounted.

I have a decent amount of experience buying into good assets with shoddy/shady management -- ie, NRF, RSO, AHT, RAS, TA, etc. In all of those cases, the best risk adjusted returns were always higher in the capital stack.

That said, I think the merger gets approved. I think the delay is largely related to the disorganized cluster at the top of all these agencies that have to coordinate the CFIUS decision. Most of those agencies don't even have appointments yet at key positions. They are sluggish and meandering on moving on a number of key issues. And, coordinating an intra-agency decision with big political ramifications is one of the most complicated things government is asked to do. But in the end, I think the merger gets approved.

12 Jan 2018, 11:03 AM

Seven Corners Capital Management, Contributor

Author's reply » "Shoddy underwriting means there is hidden risk that could only be discovered later on. So, if that's true, you have to discount assets appropriately."

If referring to the foreign M.I. entities, one would assume the market would do the discounting already in their share prices (unless there's MNPI out there).

12 Jan 2018, 11:54 AM

Landlord Investor, Contributor

"one would assume the market would do the discounting already in their share prices"

That's a good point about the foreign MI but the question is if the shoddy underwriting in the foreign MI is a one-off issue or something systemic in the organization. I suspect shoddy underwriting is systemic due because the overall management strikes me as shoddy, which means there will be future incidents of value destruction by management. Furthermore, shoddy underwriting only seems to be one aspect of this shoddy management. There's been accounting issues in the past and the CEO strikes me as trustworthy as a used car salesman in his communications. A great example is his ham-handed justification for why GNW isn't worth more than what OC will pay for it -- with the implication that shareholders shouldn't block the acquisition.

I'm telling you, I've been involved in a number of these sorts of names in the past. Ones where you do a SOTP valuation and it comes to X and you're scratching your head as to how the market could be valuing the company at some huge discount to X. The reason is the uncertain value destroying abilities of bad management. Plus people find it annoying to feel like they're getting screwed over by bad management even if the value destruction isn't that big in the grand scheme. As a matter of principle shareholders abandon ship.

Eventually, most of these names turn around when new management is brought in or they are acquired. Examples are when CIII took over management for RSO or when NRF was acquired by CLNS or when an activist takeover Commonwealth REIT. Someone will eventually takeover GNW whether it's the Chinese or someone else if the situation is what I think it is. However, don't expect the market to value GNW anywhere near the SOTP until a takeover occurs.

12 Jan 2018, 02:12 PM

Seven Corners Capital Management, Contributor

Author's reply » GNW management certainly has issues/conflicts, however they aren't in the same category as the Portnoys or the Cohens.

12 Jan 2018, 02:42 PM

smartinvestor

Thank you for these analyses. Just one question here. Are you sure you are not double-counting the dividends from the MI subsidiaries? If they went to HoldCo, you seem to be imputing extra value to the subs and also counting those dividends as part of HoldCo cash/investment standing.

12 Jan 2018, 09:36 AM

Seven Corners Capital Management, Contributor

Author's reply » Thanks - good point. About 30% of the GNW Canada divs would have actually gone into U.S. M.I. (since this entity owns about ~17% of GNW Canada equity, whereas the holdco owns ~40% of GNW Canada). So maybe you would deduct about \$0.20/share from the overall valuation.

12 Jan 2018, 10:35 AM

alpha08

Sevendcorners, what if regulators increase LTC reserve requirement. Than GNW has to pump at least another billion into reserves. Comment please..

12 Jan 2018, 10:10 AM

Scott Molnar, CFA, Contributor

Regulators cannot force them to inject money into any insurance subsidiary. While they can request an injection now or if they increase the reserve requirement, the company is not legally liable and can refuse. Of course, that would stop them sellin insurance and the subsidiary could be put into receivership or liquidation.

For the LTC specifically, the regulators could request more but there is no value that is worth any additional capital. Let them request and then take the subsidiary. The value is in the MI insurance subsidiaries.

12 Jan 2018, 11:28 AM

Seven Corners Capital Management, Contributor

Author's reply » LTC regulator doesn't want to see holdco overly stressed, b/c then chances of raising capital to inject into the insurance sub decrease substantially. It's in the regulators' own interests to see the holdco financially healthy (so it can raise new capital). If holdco goes kaput, then LTC could easily wind up burdening the states' guaranty funds down the road.

12 Jan 2018, 11:56 AM

Seven Corners Capital Management, Contributor

Author's reply » Note that if LTC regulators wanted to "raid" anything to help pay future LTC claims, they would be far better off raiding the life insurance sub - it has way more assets to take than the holdco. In addition, the LTC sub owns the life sub, so logically and legally speaking, you would think LTC sub has a stronger case to raid life rather than holdco. Of course, the life ins regulators could try to block this asset stripping - so you would have regulator v regulator (but in any event, as long as life has adequate RBC ratios, not clear why they shouldn't be allowed to send money upstream to the LTC sub).

The idea that somehow the LTC regulators can "grab assets" at will at the holdco level away from shareholders seems to have taken root in people's minds (fear fear fear!), but it's not very logical (in our opinion). If they *could* grab assets at the holdco (such as the equity stakes in the foreign MI cos), then why haven't they already done so (in other words, what are they waiting for)?

12 Jan 2018, 03:53 PM

diente

adding more gnw

12 Jan 2018, 10:39 AM

stockinvestor1956

As a spec play with a basket of other stocks seems SP is reason buy around \$3. Some think if the buyout fails then SP will retreat to low 2's then buy. I have no idea how low the stock may or may not go. That's why I bought stock in \$2 range and sold \$2.50 and \$3 puts to further reduce cost if stock is put to me or will keep premium and reduce my cost basis further. But if the sell occurs @\$5.43 then my June and Jan \$4 to \$4.50 calls should help to leverage my existing positions.

12 Jan 2018, 12:30 PM

pogonific

The key issue still remains - does negative equity at US life/LTC decrease equity at HoldCo or not. If not, then this is a reasonable analysis. If yes, then all your numbers are a rounding error on what management decide to put out for Q4 numbers. And I really mean decide, as reporting LTC with GAAP allows management to make assumptions which can make the numbers be anything they want them to be.

One other thing that isn't clear to me - bond yields going up will mean a material reduction in the value of the bond portfolio. So there may be paper losses coming in from that as well. Good luck to all.

13 Jan 2018, 10:03 AM

Seven Corners Capital Management, Contributor

Author's reply » "The key issue still remains - does negative equity at US life/LTC decrease equity at HoldCo or not"

Pretty much tried to answer this exhaustively already - if you are doubtful / unsure, then don't buy the stock.

"One other thing that isn't clear to me - bond yields going up will mean a material reduction in the value of the bond portfolio"

This is already captured in the "ex-AOCI" part of "Book Value ex-AOCI" - this metric excludes any unrealized appreciation on the bonds, so there are no "paper losses" (or paper gains, for that matter) in the future when using this number.

13 Jan 2018, 01:36 PM

909

Hello Seven Corners,

On the broadcast of the annual meeting, McInerney emphasized that the company needed \$7.3B more in premium increases to balance out LTC (and this is what the 2016 10K seems to say on page 105).

So I'm no actuary - but I wonder if you could straighten out my thinking on this matter. [BTW, for the record I am long GNW].

From the company's presentation, GNW has raised LTC premiums in the three-year 2015-17(e) period by about 28% on about \$2MM of in-force premiums. To my way of thinking, this is over a half-billion dollars in new premiums coming in (\$2MM times 28%). Now if you discount these new premiums by some smallish percentages for those who will drop their policies and for those who will go onto benefit status (I used - pulling these figures out of the air - a 5% drop in policies in the 1st year, and a 5% rate per year for those who would go on benefit), that still leaves - OVER A TEN YEAR PERIOD - \$4 billion+ in new premium income. This amount is more than half of the \$7.3B that the company says it needs -- and the company seems to be achieving more rate increases every year. So the conclusion here is that while the \$7.3B hole is massive, it seems as if it is getting filled.

OK. That's my math. It's fine if you tell me I am way off base with my thinking. And it's fine if you tell me to go read some actuary book as background.....

Any thoughts on this would be greatly appreciated.

14 Jan 2018, 10:20 AM

Oilworker2017

Well author seems to think this is worth \$7 if I read correctly. Then why a big March \$2.50 put trade at 15 cents? IMO GNW will hit \$2 before March 16, so the 2.50 put will hit at least 50 cents for 233% gain.

So I say it drops from current 3.20 to 2, which is decline of 37.5% in next 9 weeks, and then buy at 2 and ride back to 2.75. Let's see how it come out.

16 Jan 2018, 01:05 PM

stockinvestor1956

Oil, I believe you have until Friday for GNW to move down to 2.50 or you allegedly will loose a bundle. Now the target (strike/ex-date) has moved again out to March. But from your prior post to current post you've been a moving target like a politician running for office.

I don't think you have a clue what you're talking about. You would do much better throwing darts at a board that would be more accurate. No pun intended but you'e been all over the board with your post and would be broke if you had real money invested.

16 Jan 2018, 02:19 PM

ssstasss

You promised 100% secured 2.50\$ at Jan 18!

16 Jan 2018, 02:21 PM

stockinvestor1956

Its not Jan 18th yet but it appears he miss lead us mere pleasant not that anyone toke him serious. You could tell from his numerous post that he may have been missing a rung in the ladder but that's just an opinion could be wrong since I'm no shrink.

16 Jan 2018, 02:34 PM

Oilworker2017

2.50 by March 16, and most likely 2. Look at her sink even as market bouncing back. I think a spec buy at \$2. Author laid out a great case for how this is worth over \$5 but can't fight tape drops constantly does this stock.

16 Jan 2018, 03:09 PM

stockinvestor1956

You have a real habit of dodging the real issue that you previous stated?

Admit it you were wrong... it happens to us all. But your ego won;t let you. Since it blinded you with the constant repetitive post counting down the days before you cash in, don't remember?

16 Jan 2018, 03:17 PM

Oilworker2017

I was wrong about timing not direction. I think you and I are on same page we know this is going to 2.50, only question is timing. I thought would happen by end of this week but now, I am thinking we need something else like bad earnings or the merger being killed- so I am pushing out to March expiration for 2.50. Cheers.

When do you think it will fall below 2.50, January Feb or March?

16 Jan 2018, 08:42 PM

stockinvestor1956

Oil, I don't make short term guesses its a suckers game for those who think they know more than they actually do. The timing issue certainly will be reflected in you having lower acct balance. Long term if the buy out does not happen this stock could gravitate to \$7-\$8.

17 Jan 2018, 12:55 PM

Tommy Carstensen

It's at \$3.25 now. Please comment.

18 Jan 2018, 07:13 AM

pogonific

Well, I'm not 7SCCM, but they've been very patient with my questions, so I'll try to have a stab at this as a help.

The 7SCCM investment thesis behind GNW assumes LTC goes bust - i.e. your math may well be true but is irrelevant. The assumption rests on the fact that when you buy GNW you buy stock in a holding company that owns the LTC equity. Just as you as a shareholder are not directly liable for the LTC hole, neither is GNW HoldCo. If you believe that, then the thesis is that all the other bits of GNW HoldCo are worth significantly in excess of

1/21/2018 Genworth: Additional Thoughts On Plan-B And Valuation - Genworth Financial, Inc. (NYSE:GNW) | Seeking Alpha

today's market cap. What happens to LTC? Well, it's the regulators' / policyholders' problem -GNW HoldCo just values it at 0. I don't know enough to tell you what to believe, but that at least is the thesis, so your question is somewhat irrelevant though important.

As far as your math is concerned, it seems OK to me - but the thing to add which you may well know is that the current GNW book value assumes those \$7bn of rises are already there on the BS - if it didn't, the company would be well in negative equity and the regulators will have had to seize it already. It's pretty adventurous accounting if you ask me, but the whole LTC business model strains the GAAP accounting approach to its limit - GAAP just isn't designed for such long dated assets/liabilities requiring plenty of assumptions to be valued.

14 Jan 2018, 10:51 AM

909

Hi Pogonific,

Terrific thoughts - thanks so much.

I hadn't put all the pieces together before your posting. But, ok, let me play with your ideas.

Your big point is the \$7B of LTC rate increases that ALREADY are on the BS. Yes - booking these increases before they happen seems questionable. But - if my previous math is anywhere near correct - the LTC rate increases are about halfway accomplished (when one projects them over the next ten years). So booking the entire plug amount of \$7B now - while still questionable - has more substance behind it than it did at the start of 2015.

So if this reasoning is going in the right direction, then why does the CEO still quote the \$7B figure without any qualification describing the effect of the rate increases already enacted and in-force, and why doesn't the market begin to recognize the rate improvement with a higher stock price? Am I missing something or have I made a big mistake in assumptions somewhere along the line?

Again - a pleasure to "talk" with you about this interesting stock situation...

14 Jan 2018, 04:08 PM

Landlord Investor, Contributor

"why doesn't the market begin to recognize the rate improvement with a higher stock price?"

It's the market penalty for a CEO who puts \$7B on the BS based on hoped for rate increases

17 Jan 2018, 02:04 PM

Landlord Investor, Contributor

Sorry, hit post accidentally on my phone.

I was saying there's a penalty/discount for CEOs the market perceives as dishonest. Maybe he's not as slimy as the Cohens or Portnoys but a CEO mistrust penalty is the only logical answer for why this stock trades at a discount. I have yet to see a more convincing answer. "The market is stupid and inefficient" isn't particularly convincing to me.

17 Jan 2018, 02:08 PM

pogonific

I last looked at the 10K a few months back, so memory is not that fresh. If I recall, the balance sheet contains an asset which is something like "price increases we think we'll get, but haven't yet" and it is that asset which is about \$7bn as of the last 10K. If what you say is true, then it sounds like the hole was even bigger than \$7bn as of 2015.

In any event, the CEO is not credible on this topic - he seems to be behaving in a far from value creating manner, and the hypothesis on these boards is that he's after scaring everyone into believing the CO offer is a really good deal and the world will end if GNW doesn't take it (and get him his double digit exit bonus whilst continuing to be CEO).

14 Jan 2018, 05:01 PM

Pgnyagny

Can they pay the notes maturing in May 2018?

15 Jan 2018, 12:45 PM

stockinvestor1956

They have enough cash per last cc on hand may require some shuttling but IMHO, yes.

15 Jan 2018, 01:26 PM

freeport123

The bond market says YES!

15 Jan 2018, 10:26 PM

Seven Corners Capital Management, Contributor

Author's reply » Bonds all trade near par, correct.

15 Jan 2018, 10:34 PM

5914011

If memory serves me well, I believe Mr McInerney plans on having a lucrative long term contract with CO if this deal goes through. Perhaps his incentive, at the expense of the stockholders....

15 Jan 2018, 06:23 PM

stockinvestor1956

Agreed to his greed... at stock holders expense. If its possible he will push the deal at all cost.

15 Jan 2018, 06:34 PM

Seven Corners Capital Management, Contributor

Author's reply » Technically it is the board of directors, not necessarily the people in the C-suite, that is supposed to look out for shareholders. That's why you normally don't want the CEO to be the board chairman - they represent conflicting interests (and when a conflict occurs, CEO will usually favor him/herself over shareholders).

15 Jan 2018, 10:35 PM

stockinvestor1956

I think in this case we all know what's going on from history. Who rewards a CEO for poor performance. You got it a board that dances to his beat nothing but straw men.

16 Jan 2018, 10:51 AM

stockinvestor1956

I would bet if its possible to get approval of the CFIUS board. That Mr. McInerney will make it happen before 18 bond is due. He has lots personally riding on sell so I expect he will do whatever they ask. Since shareholder have always been the least of his concerns.

16 Jan 2018, 11:00 AM

Oilworker2017

Seven Corners,

Any idea why this stock seems to never ever move higher? I'm serious- would like to get your thoughts.

I am feeling more constructive on it today, so I am updating my forecast for March 16 close to 2.52. I think it will touch significantly lower before that time, but I do feel stock is worth about 2.50 even with no merger. however it could pull a RAD and go to 1.75, then 2.50.

If you don't like buying puts then short sell March \$3 calls if you desire position. Right now they are 40 cent by 53 cent on bid and ask, so probably you can get filled at 47 cents, and watch that ask go from 53 cents down to 1 cent and u can cover there. This stock broken, holding 3.18 right now but once it closes under 3 it gonna flush.

This is all assuming stock market keeps going higher- if we wee to get 5% drop in S&P 500 I could see GNW dropping 50% from here

17 Jan 2018, 11:07 AM

B Powell

GE has just taken a 15bn charge on LTC in run off since 2006.

16 Jan 2018, 09:19 AM

alpha08

Yes, it shows how LTC can ruin gnw

16 Jan 2018, 10:32 AM

alpha08

But looks like gnw LTC reserve is adequate

16 Jan 2018, 10:33 AM

haschultz

Agree that GNW is mostly up to date with LTC reserves. The news sounds to be like GE was not keeping up to date with their LTC reserves and should have been following GNW actions over the past few years.

So, I see the GE news as not relevant to GNW as it is just catch-up to what GNW has been doing annually by re-evaluating LTC and adding reserves as neededd.

16 Jan 2018, 10:38 AM

alpha08

It can be a positive news for gnw. As regulators will understand the risk and allow more premium increase

16 Jan 2018, 10:43 AM

Oilworker2017

Has anything ever been taken as a positive for GNW? 3.17 now- as the stock market is rocketing to the moon today- looks like people selling their dogs- certainly would not pay over 2.50 for it, I think March 16 close is \$2.52 after a dip much lower- let's see- 58 days is a long time at the current pace stock would drop under \$1 but don't think it can keep this up forever.

So I was wrong probably won't hit 2.50 this week but once bad earnings/LTC reserve news and merger death come out we can see big declines. Make no mistake I still feel this is worth \$2.50 or more but it can go a lot lower first.

17 Jan 2018, 11:21 AM

dragontigerdou

GE's reinsurance write-off is more a reflection of whats already known in GNW's LTC legacy products. It is more a lagging indicator.

16 Jan 2018, 10:46 AM

Oilworker2017

I tend to think the stock is worth at least \$2.50 even if no merge but I think big over reaction could happen when merge dies so maybe \$2 stock or even \$1.50 good luck 2 u, would think at \$2 it is buy for rebound to 2.60-2.75.

16 Jan 2018, 11:47 PM

Oilworker2017

No upside in this stock, shorts loving the action. To be honest, based on market action I think if Dow went to 40K this year GNW at best is \$3.30. Still think it's MAYBE an OK buy at 2.50, but not sure.

17 Jan 2018, 12:05 PM

haschultz

Oilworker,

Gosh, you sound like a broken record with your constant posting of the same thing.

See here where shorts have been covering in GNW.....down 6% in last 2 week reporting period as per:

<http://bit.ly/2ES2bOP;submit=Short+Quote>™

Why couldn't you have done this research before claiming "shorts loving this action"? They love it so much they are covering and no longer favor the up/down risk/reward yet you are predicting another 20% drop in price (from \$3.19 to \$2.50).

You might also look at the analyst expectations for GNW as they are making money and have made much since the offer was first made by Oceanwide.....so an argument can be made it is now worth more than \$5.43. See the analyst expectations at: <https://yhoo.it/2FNINoM>

The analysts see GNW earning ~\$1/share in 2017 and again in 2018. And, with nearly 500 million shares, that is \$500 million per year profit.

17 Jan 2018, 12:52 PM

stockinvestor1956

Its called attention seeker... but I'm not a shrink.

17 Jan 2018, 01:00 PM

Oilworker2017

So why is the stock down almost every single day?

Why is it going to 2.50 before 3.50?

Why is it the case that if the Dow hit 100 million GNW wouldn't hit 3.75? Serious questions.

17 Jan 2018, 01:27 PM

Oilworker2017

So on paper, it looks like a buy at 3.17 right? \$1 EPS? They ain't play the game on paper. This is going under 2.50 by end of March, whether the Dow goes to 30K by then or not.

Every penny down is met with additional selling, we ain't seen a close under 3 yet but once that happens it's quick down to 2.50 and then 2 but I still expect it will close at 2.52 on March 16, 2018, good luck all. People are selling their dog stocks that never move up and trading for stocks that go up.

I agree with most of u that fundamental value of GNW is 2.50 per share or maybe tad higher but market doesn't care people selling this dog.

17 Jan 2018, 01:58 PM

stockinvestor1956

Oil, this is my last post... since its really hard to take anything you say seriously. Especially, since you have been continually wrong on all your calls. Along with the repetitive count down post on put pricing or have you forgotten?

Anyone willing to hold this stock IMHO will do one of two things:

1. You will receive \$5.43 if sell is approved.
2. If no sell then the stock IMHO should gravitate to \$7 to \$8 in 2 to 5-years.

What happens in the short term no ones really knows, it could pull back or could go up. I don't invest based on short term outcomes as I've stated its a suckers game and not good for your financial health.

17 Jan 2018, 02:20 PM

Oilworker2017

OK we'll see. S&P 500 is 2807 right now and GNW is 3.18. I say in a year S&P is 3300 and GNW is \$2.25. We will see who is closer.

If we got S&P to go to a higher number, say 100 million or so, GNW could go to 3.50 or even 3.75.

The merger will not be approved and IMO stock will drop 50% when that is announced. So if announced right now would be 1.59. TY.

17 Jan 2018, 03:10 PM

Oilworker2017

OK I will selling March \$2.5 puts, get assigned long and look to sell at \$8. Thanks then. Doing it in 45 hours, watch March 2.5 puts on Friday.

17 Jan 2018, 05:58 PM

ssstasss

Ohhhh.... it's 18 of January now :(

Where is you 100% safe 2.5\$ you little scam?

18 Jan 2018, 02:27 PM

CarthageCapital

Thanks for the analysis. I think the risk with the deal is if the Trump administration wants the Chinese to have access to the personal information of policy holders (some government workers). This could be a big security risk. Your analysis showed me a lot about the value of the separate pieces. But oh wow the LTC piece scares me a lot.

19 Jan 2018, 12:02 PM

stockinvestor1956

Those that have followed the CFIUS board and GNW's 3rd app includes a third party administrator, which will eliminate any security risk. But that still may not mean they will approve sale due to political ramifications.

19 Jan 2018, 12:13 PM

OskeeWowWow

Somebody knows something. Strong upward breakout today from a small symmetrical triangle at the base of a larger descending triangle. From a technical analysis standpoint, this is a particularly potent combination. Expect big news next week.

20 Jan 2018, 12:30 AM

smartinvestor

GNW has not yet resubmitted a CFIUS application with a third-party administrator.

Price breakout Friday may have been simply related to options expiration.

20 Jan 2018, 10:03 AM

stockinvestor1956

No one said they did I said it would be a 3rd app with administrator:

<http://bit.ly/2FZ2aKk>

20 Jan 2018, 10:51 AM

obiwan48

Just a few thoughts going forward with GNW:

- *. They have poor management that is self serving their own interests- big negative
- *. Interest rate environment rising-Postive for GNW
- *. IMHO the various States (and their Regulators) that have a large number GNW LTC policies will be cooperative in allowing rate increases by GNW (at least to a fair point) in the future. They absolutely, have no desire to have to deal with a large LTC firm in receivership in their respective States. Talk about an expense and pain in the a—.

- *. Large Short positions in the stock- any really positive catalyst, could easily start a short squeeze. If so, a sharp, large percentage move in price via a multi day rally.
- *. I don't think the merger is going to happen- mainly due to the political situation now. The 3rd party oversight is positive, but I'm not sure if that is still good enough for the security concerns to be overcome. If it happens, it happens. If not, GNW stock has already pulled back, because of the delays. If it doesn't go through, GNW should survive, and move back above \$5 overtime- quicker if management is changed (Pretty Please).
- *. One of the reasons GNW hasn't rallied (besides all the over hanging issues)with the rest of the market, is that it's been too easy to make money with any number of well managed, profitable, non- troubled companies. However, valuations are now very rich on many of these. Going forward from a percentage move upward, GNW could offer a better return. I feel a better and a more positive visibility will return to GNW, based upon improving financials, regulatory liency (regarding rates), interest rates, and larger investors seeing a momentum value play when a short squeeze occurs via positive news.
- *. My sense is GNW heads back toward 4.50-5.00 in 2018.
- *. Wish someone out there could dump the CEO and much of his Board.

Long GNW

20 Jan 2018, 09:52 AM

larry700

Good article however I disagree on management. I do recognize the conflict. BLACKROCK LLC acquired 4 to 5 million more shares in the last quarter. They now own more than 10%. This is very positive in my opinion. A lot of implications.

20 Jan 2018, 10:35 AM

haschultz

Best positives are:

- + Rising interest rates helps GNW profitability & metrics
- + Blackrock high and increased position supports share price
- + Most selling should have occurred in late 2017 for tax write-offs
- + GNW LTC unit finances justify rate increases which have been approved with others working their way through to approval
- + LTC reserves have been added to several times.....so more large needs to add to reserves are probably lower

20 Jan 2018, 11:13 AM

stockinvestor1956

How could anyone not agree that management has not run this company in the stock holders best interest. Excluding all the screw up with their lack of actuarial pricing of LTC products along with life ins. While I'm long this company in spite of an inept management GNW is worth more in its parts than whole \$7-\$8.

20 Jan 2018, 10:58 AM

Seven Corners Capital Management, Contributor

Author's reply » Main problem is the BoD - if the stock price tanks, they simply turn around and hand themselves a boatload of free shares (courtesy of us, the shareholders). So it's a no lose situation for them - stock goes up, great, the shares they've already given themselves are worth more - stock goes down, no problem, they just grant themselves hundreds of thousand of new shares. Not to mention the cash payments they receive for their BoD (part-time) work.

BoD Chairman Riepe received \$242K in cash in 2016 - most people would be thrilled to make this much at a full-time job! Riepe has been on GNW's BoD since 2006 collecting fat director checks/share grants - meanwhile the stock price has gone DOWN 90% during his tenure - yet no large shareholder steps up publicly to ask Mr Riepe to move aside and let somebody else steer the ship.

Other directors got between \$127K and \$161K in cash in 2016. But wait, there's more - the company (meaning, us, the shareholders) matches directors charitable gifts up to \$10K as well(!) In what kind of bizarro world do you get paid more than handsomely for part-time work (including

matching charitable payments) at a company while the actual owners LOSE MONEY year after year since the mid-2000s??? So that's the real problem: Nobody on the BoD ever suffers financially, no matter how bad GNW's financial performance is = no accountability.

20 Jan 2018, 01:17 PM

Seven Corners Capital Management, Contributor

Author's reply » Also note that anytime a BoD member gets sued, we the shareholders pick up the tab (via the D&O insurance premiums we pay on on their behalf on a regular basis). Note that Berkshire Hathaway has NO D&O insurance at all - maybe BoD members at a company (not just GNW, any public company) would pay a bit more attention to what management is up to if they actually had some downside risk for corporate malfeasance and/or incompetence. But when you literally suffer zero consequences, why bother?

20 Jan 2018, 01:22 PM

Seven Corners Capital Management, Contributor

Author's reply » Here are the top holders as of 9/30/17 - wish they would speak up publicly and demand results and accountability for poor performance:

Holder Shares Held Market Value

GE FINANCIAL ASSURANCE HOLDINGS INC 86,216,559 \$325,036,427
 BLACKROCK INC. 54,184,349 \$168,513,325
 VANGUARD GROUP INC 42,117,165 \$162,151,000
 STATE STREET CORP 20,566,929 \$79,184,000
 MILLER VALUE PARTNERS, LLC 18,839,885 \$72,534,000
 FMR LLC 16,849,716 \$64,871,000
 DIMENSIONAL FUND ADVISORS LP 11,720,614 \$45,125,000
 NORTHERN TRUST CORP 8,101,907 \$31,193,000
 CNH PARTNERS LLC 7,796,296 \$30,016,000
 MARSHALL WACE NORTH AMERICA L.P. 7,063,193 \$28,253,000
 PRUDENTIAL FINANCIAL INC 6,637,723 \$25,555,000
 OXFORD ASSET MANAGEMENT LLP 6,491,815 \$25,018,000
 SHAH CAPITAL MANAGEMENT 6,072,889 \$23,380,000
 BANK OF NEW YORK MELLON CORP 5,931,041 \$22,834,000
 CALIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM 4,496,028 \$17,310,000
 STATE OF NEW JERSEY COMMON PENSION FUND D 4,400,000 \$16,940,000
 MORGAN STANLEY 4,115,334 \$15,844,000
 GEODE CAPITAL MANAGEMENT, LLC 4,095,748 \$15,768,000
 PZENA INVESTMENT MANAGEMENT LLC 3,966,700 \$15,272,000
 PARAMETRIC PORTFOLIO ASSOCIATES LLC 3,642,723 \$14,024,000
 SABA CAPITAL MANAGEMENT, L.P. 3,571,234 \$13,749,000
 LITESPEED MANAGEMENT, L.L.C. 3,435,094 \$13,225,000
 GOLDMAN SACHS GROUP INC 3,170,039 \$12,205,000
 OMERS ADMINISTRATION CORP 3,038,500 \$11,698,000
 LSV ASSET MANAGEMENT 3,016,413 \$11,613,000

20 Jan 2018, 01:43 PM