Seeking Alpha α

# Genworth: Time For Plan B?

PRO Pick | Jan. 5, 2018 1:44 PM ET69 comments
by: Seven Corners Capital Management

**Summary**

- Genworth's acquisition by China Oceanwide for $5.43/share in cash is in doubt due to CFIUS concerns.
- Genworth's management stlll believes it can complete the merger.
- Even without the merger, Genworth's shares are worth at least $5.36 based on a sum-of-the-parts analysis.
- We examine how a "Plan B" scenario for Genworth might play out.


## Background Of Investment

We currently have a long position in Genworth Financial (NYSE:GNW), which in October 2016 signed an agreement to be acquired by China Oceanwide (OTC:HHRBF) for $5.43/share in cash (see merger PR here). In late January 2017, we posted on Seeking Alpha the following assessment regarding (1) GNW's then market valuation and (2) the likelihood of merger completion (see here for our full article):

> *We estimate that Genworth's current expected value (or EV) is $4.93/share, or 49% above the closing stock price of $3.30/share on January 30, 2017. Importantly, this estimate incorporates a 25% probability that the deal does not close, due to the risks we describe herein. However, even if one were to increase this to a 50% probability of not closing, our EV for Genworth would only fall to $4.43/share, still 34% above the most recent share price.*

Fast forward 11 months and one week (and a full 14 months after the deal was first announced), and, sadly for our long thesis, GNW still lacks the necessary regulatory approvals to complete the deal. Shares consequently have traded in the low $3s recently. On the plus side, however, because the stock had a significant margin of safety a year ago at $3.30 versus our assessment of expected value in the $4.43 to $4.93 range, despite all of the negative news, the mark-to-market damage has thus far not been too significant (shares now trade down just 5% since our original article appeared), as shown in the stock chart below:


The main sticking point for the GNW/Oceanwide merger has been the Committee on Foreign Investment in the United States (aka CFIUS), which under the Trump Administration has been reluctant to approve acquisitions of domestic companies by Chinese acquirers. Indeed, CFIUS just blocked MoneyGram's (MGI) acquisition by Ant Financial, leading some to conclude that the administration will block ***all*** pending Chinese acquisitions of U.S. companies (including GNW's acquisition by China Oceanwide) (source):

U.S. blocks MoneyGram sale to China's Ant Financial on national security concerns

Greg Roumeliotis    6 MIN READ

(Reuters) - Ant Financial's plan to acquire U.S. money transfer company MoneyGram International Inc (MGI.O) collapsed on Tuesday after a U.S. government panel rejected it over national security concerns, the most high-profile Chinese deal to be torpedoed under the administration of U.S. President Donald Trump.

Nevertheless, GNW and China Oceanwide just provided the following status update, claiming that they still believe that CFIUS approval and closing of the China Oceanwide merger is possible (source):

> ***Genworth and Oceanwide Provide Update on Efforts to Obtain CFIUS Clearance*** *- 01/04/18 - RICHMOND, Va., Jan. 4, 2018 /PRNewswire/ - Genworth Financial, Inc. and China Oceanwide Holdings Group Co. Ltd (Oceanwide) issued the following update on the status of their efforts to obtain clearance of their proposed transaction from CFIUS.*
>
> *Genworth and China Oceanwide remain committed to the transaction and have been working cooperatively with CFIUS since they first filed their original voluntary notice in January 2017. In October, the two parties withdrew their joint voluntary notice with the intent to refile the transaction with an additional mitigation approach to further protect the personal data of Genworth policyholders.*
>
> *"In the interim, we have been working with a leading U.S. third party data administrator to implement a mitigation approach that further protects our U.S. customers' personal private data," said Tom McInerney, president and CEO of Genworth Financial.* ***"We believe further protecting the personal information of our U.S. customers makes our overall mitigation plan more robust than our previous CFIUS filings and expect to file our new mitigation plan in the near term, as soon as the key terms of the additional mitigation approach are finalized."***
>
> *"We are encouraged by the progress we are making, which is one of the reasons we extended the merger agreement to April 1, 2018," McInerney said. "We continue to work hard with Oceanwide and with our regulators to successfully complete the transaction as soon as possible because we firmly believe this transaction will deliver the best possible outcome for all of our stakeholders."*
>
> *Said Lu Zhiqiang, chairman of Oceanwide, "We remain committed to our transaction with Genworth and look forward to building Genworth's businesses in the U.S. while at the same time bringing Genworth's expertise in long term care and mortgage insurance to China."*
>
> *There can be no assurances that CFIUS will ultimately agree to clear a transaction between Genworth and Oceanwide on terms acceptable to the parties or at all.*
>
> *In addition to clearance by CFIUS, the closing of the proposed transaction remains subject to the receipt of state-level regulatory approvals that are pending in Delaware and New York, as well as regulatory reviews in China and other international jurisdictions and other closing conditions.*

In addition, several days ago, the Delaware Department of Insurance posted the following statement regarding the pending merger on its website (source):

***Delaware Department of Insurance Updates Genworth Status***

*Date Posted: Tuesday, January 2nd, 2018. Dover, DE – On Tuesday, December 26, 2017, the Delaware Department of Insurance ("Department") issued the following status update in connection with the pending Form A and Form D applications submitted by China Oceanwide Holdings Group Co., Ltd.'s ("COH") and its Affiliates (together with COH, "China Oceanwide" or the "Applicant") to acquire Genworth Life Insurance Company ("GLIC"):*

*In addition to the approval of the Department, the entire Genworth/China Oceanwide transaction requires approval from several other international and domestic regulatory authorities, including approval by the Committee on Foreign Investment in the United States ("CFIUS"). Genworth and COH have not yet refiled their application for transaction approval by CFIUS. The parties filed and withdrew three previous applications with CFIUS, the last on October 2, 2017.*

*Genworth and COH have stated that they will continue to work with the Department to respond to its outstanding inquiries and information requests focused on Delaware's separate statutory and regulatory requirements, including assuring that any proposed transaction is fair to GLIC's policyholders and the public and that the surviving long-term care company is sufficiently solvent.*

*As the Department continues to work with the parties to determine the suitability of the transaction well beyond the parties' previously projected time frames,* ***the Department looks forward to the parties' continuing cooperation in providing the additional information necessary to complete the Department's evaluation****. The Department will continue to utilize its team of internal financial regulatory professionals and outside financial, actuarial, valuation, legal and other carefully selected experts to evaluate the information provided and respond in a timely fashion.* ***The most significant issue remaining is an agreement on the valuation of the remaining companies if the life insurance company is separated from the long-term care company, as is presently proposed.***

*At this point, no timeframe can be estimated as to whether and when the Department might make a final determination and, if appropriate, schedule a hearing. The Department is the primary United States insurance regulatory for GLIC.*

With respect to the reference by the Delaware regulator to "an agreement on the valuation of the remaining companies if the life insurance company is separated from the long-term care company", please note that this would (post-CFIUS sign off) likely be the key remaining regulatory issue for approval of the transaction (for more information on the Delaware and other regulatory hurdles, please see our January 2017 article).

## Ratings Agency Downgrades

Never shy about piling on vulnerable or stressed companies, rating agencies Moody's and Fitch have added insult to GNW's recent injuries by downgrading various of its holdco and insurance subsidiary (as applicable) credit ratings over the past few months:

***Fitch Downgrade*** *(source): DECEMBER 19, 2017 / 1:57 PM: Fitch Downgrades Genworth Life Insurance Co's IFS to 'B+', Outlook Negative. (The following statement was released by the rating agency) CHICAGO, December 19 (Fitch)* ***Fitch Ratings has downgraded the Insurer Financial Strength (IFS) ratings of Genworth Life Insurance Company (GLIC) and Genworth Life Insurance Company of New York (GLICNY) to 'B+' (Weak) from 'BB' (Moderately Weak) and removed them from Rating Watch Evolving. The Rating Outlook is Negative. Fitch has maintained the 'BB' (Moderately Weak) IFS ratings of Genworth Life and Annuity Insurance Company (GLAIC) on Rating Watch Evolving****.... The rating actions follow a second extension of the closing deadline of a proposed acquisition of the insurers' parent, Genworth Financial Inc., by China Oceanwide Holdings Group Co. Ltd. The transaction is subject to regulatory approval and was initially expected to close by mid-2017. Regulatory review continues and the close deadline has been extended a second time, to April 2018. Fitch believes the continued delay increases the uncertainty as to whether the proposed transaction will be approved. With less certainty that the merger will be completed, the ratings of GLIC and GLICNY were downgraded to reflect ongoing concerns regarding the adequacy of their recorded LTC reserves, which is highly dependent on assumptions regarding future rate increases.* ***GLAIC's rating remains on Rating Watch pending the completion of the acquisition by China Oceanwide****. The Evolving Watch reflects uncertainty as to whether the proposed transaction will be approved.* ***Fitch expects to resolve the Rating Watch status following regulators' approval or disapproval of the transaction****. China Oceanwide plans to contribute $600 million to GNW to address the 2018 debt maturity at or before the maturity date and $525 million to Genworth Life. If consummated, Fitch believes that the transaction addresses near-term concerns regarding upcoming debt maturities and potential capital impact tied to further long-term care reserve charges. However, underperformance of the LTC business continues to pressure Genworth Life's reserve margins and capital adequacy.*

***Moody's Downgrade*** *(source): Rating Action: Moody's downgrades Genworth ratings; remains under review for downgrade. Global Credit Research, New York, October 03, 2017 -* ***Moody's Investors Service downgraded the credit ratings of Genworth Holdings, Inc. (Holdings) senior unsecured debt to B2 from Ba3, the insurance financial strength (IFS) ratings of Genworth Life Insurance Company (GLIC) and Genworth Life Insurance Company of New York (GLICNY) to B2 from Ba3, and the IFS rating of Genworth Life and Annuity Insurance Company (GLAIC) to Ba1 from Baa2****. These actions follow the announcement by Genworth Financial (Unrated, Genworth), the ultimate parent of Genworth Holdings, on October 2, 2017 that it intends to refile its application with the Committee on Foreign Investment in the United States (CFIUS) and evaluate options to address its upcoming debt maturities in the event the transaction with China Oceanwide Holdings Group Co. Ltd. (COH; unrated) is not completed.* ***The ratings of Genworth's US and Australian mortgage insurance (MI) operations (Ba1 IFS rating, Positive; Baa1 IFS rating, stable, respectively) are not part of***

> ***this rating action**. This is due to the meaningful separation that exists between Genworth's life and mortgage insurance businesses which mitigates the weakened financial flexibility.*

For reference, below are the outstanding ratings for GNW and its various insurance companies as of January 3, 2018 (source); importantly, Genworth Mortgage Insurance Corporation still retains its "BB+" rating, so the "Company Ratings Event" clause in the China Oceanwide merger agreement (the occurrence of which could allow China Oceanwide to terminate the transaction) has not yet been tripped:

Ratings current as of 01/03/2018

**Industry ratings**

Our principal life insurance subsidiaries are rated by A.M. Best, Standard and Poor's, and Moody's as follows:

| Company | A.M. Best | Standard & Poor's | Moody's |
|---|---|---|---|
| Genworth Life Insurance Company | B | B+ | B2 |
| Genworth Life and Annuity Insurance Company | B++ | B+ | Ba1 |
| Genworth Life Insurance Company of New York | B | B+ | B2 |

Genworth Life and Annuity Insurance Company, Genworth Life Insurance Company and Genworth Life Insurance Company of New York ratings do not apply to the safety or performance of underlying portfolios of variable products, which will fluctuate and could lose value.

Our mortgage insurance subsidiaries are rated by Standard and Poor's and Moody's as follows:

| Company | Standard & Poor's | Moody's |
|---|---|---|
| Genworth Mortgage Insurance Corporation | BB+ | Ba1 |
| Genworth Financial Mortgage Insurance Pty Limited (Australia) | A+ | Baa1 |
| Genworth Financial Mortgage Insurance Company Canada (1) | A+ | N/A |

As a reminder, the definition of "Company Ratings Event" from Article X of the merger agreement is as follows (source):

> *"Company Ratings Event" means the change or the public announcement of a change in the financial strength rating assigned to Genworth Mortgage Insurance Corporation to below "BB (negative outlook)" by Standard & Poor's Corporation that is primarily and directly attributable to (1) the actions or inactions of the Company, its Affiliates or their respective Representatives that does not relate to an Excluded Effect, or (2) an adverse change in the condition (financial or otherwise) of Genworth Mortgage Insurance Corporation and its businesses not resulting from or arising out of an Excluded Effect.*

## The Rite Aid Precedent (Or What Not To Do)

In light of the challenging environment that currently faces the company, we believe that the overriding goal of those in GNW's C-suite should be to avoid (at all costs) ending up like Rite Aid (NYSE:RAD). Similar to GNW, RAD had a binding merger agreement with Walgreens (NASDAQ:WBA) to be acquired at $9/share in cash. Sadly for RAD's shareholders, management had no real backup plan in the event the WBA merger fell through, which of course happened in June 2017 as the FTC was poised to block the deal (see here for details). Without a viable Plan B, RAD's management had to improvise the following asset sale transaction with WBA (source here):

> **Rite Aid Enters Into an Agreement with Walgreens Boots Alliance to Sell 2,186 Rite Aid Stores and Related Assets for $5.175 Billion**
>
> **• Rite Aid and Walgreens Boots Alliance Mutually Agree to Terminate Previous Agreement Under Which Walgreens Boots Alliance Was to Acquire All Outstanding Shares of Rite Aid**
>
> **• Rite Aid to Receive $325 Million Termination Fee**
>
> **• Asset Sale Repositions Rite Aid as an Independent, Multi-Regional Drugstore Chain and Pharmacy Benefits Manager With Compelling Footprint in Key Markets and Strong Financial Position**
>
> **• Proceeds to Be Used to Significantly Reduce Debt and Strengthen Balance Sheet**
>
> **• Agreement Provides Rite Aid With 10-Year Pharmaceutical Purchase Option Through WBA Affiliate**
>
> **• Company Reports Fiscal 2018 First Quarter Results**
>
> CAMP HILL, Pa. (June 29, 2017) - Rite Aid Corporation (NYSE: RAD) today announced that it has entered into an asset purchase agreement with Walgreens Boots Alliance, Inc. (Nasdaq: WBA), whereby WBA will acquire 2,186 stores, related distribution assets and inventory from Rite Aid for an all-cash purchase price of $5.175 billion, on a cash-free, debt-free basis. Under the terms of the agreement, Rite Aid has the option to purchase generic drugs that are sourced through an affiliate of WBA at cost, substantially equivalent to Walgreens for a period of 10 years.
>
> The company also announced the immediate termination of the merger agreement, which was announced on October 27, 2015 and amended on January 29, 2017, under which WBA would have acquired all outstanding shares of Rite Aid. The decision to terminate the merger agreement follows feedback received from the Federal Trade Commission ("FTC") that led the company to believe that the parties would not have obtained FTC clearance to consummate the merger.

The new transaction clearly did not satisfy stampeding exiting arbs, who have sent RAD's shares down ~75% over the past year, when rumors that the FTC was opposed to the transaction first began circulating:


Clearly, the lesson from RAD is that the only way to succeed in negotiating is from a position of strength. Strength means having options. A viable Plan B allows one to simply walk away if Plan A proves unpalatable or infeasible (therefore a counterparty, such as WBA in RAD's case, cannot dictate the terms of a transaction). With respect to RAD, the company's massive debt burden meant that it had few attractive alternatives in the event the WBA acquisition fell apart.

## Genworth Management's Recent P.R. Meltdown

In GNW's case, the market has voted with its pocketbook and the spread between the market and merger prices for GNW shares has reached an astounding 40%. Why so large? Clearly, the CFIUS roadblock under the new presidential administration has been the major reason. In addition, though, the company management (and specifically the CEO) has totally failed to communicate to the market that GNW retains adequate options in the event the China Oceanwide merger were called off - and naturally the market thus leaps to the conclusion that therefore no such options exist.

Inexplicably, at the annual shareholder meeting on December 13, 2017, GNW's CEO McInerney even went to the extent of actively talking down the company's stock price (thus presumably undermining GNW's negotiating position) in the following exchange with a shareholder (source):

***David Robinson [shareholder]****: On the liquidation value, if life and long-term care was zero, do you not see, I mean you have done the calculations, is there not a liquidation value in the $5 to $6 range that we can go ahead and move forward on rather than trying to pursue this deal with Oceanwide? I mean, can you not just liquidate the mortgage insurance businesses $3.5 billion it looks like for USMI, which is not a rich premium relative to the market today. You see what the value is in Canada and Australia and you zero out long-term care and life and can you not liquidate and get more than $5.43?*

***Tom McInerney [CEO]****: Mr. Robinson, I think that's a difficult question to answer. I would say that I think the values that you have for USMI and I think that's at the high end of the range,* ***but in any event, there is no question that [while selling] the U.S. mortgage insurance business, the Canadian business and the Australian business would produce significant cash, almost all of that cash would be needed to pay off the debt, because to pay off the debt with that cash you would have to pay out the debt at premiums and therefore you would be left with very little cash left from selling all of those strong producing businesses****. Also the Canadian and Australian businesses, the Catch 22 in selling that is today we have debt service payments of over $200 million a year and those are the two entities that pay the debt service. So, that's also a challenge, because you had by selling all of those you would eliminate all of the cash paying, dividend paying capacity of the company. And so I think the shareholders will be left with very little cash at the end of that and the life and long-term care insurance businesses which are dependent as I said on $6 billion to $8 billion, $7 billion is our current estimate of future premium increases.*

*So, if we are able to achieve those premium increases, then perhaps the value of that businesses are zero, but if we are not able to achieve those premium increases, then the life in the LTC business probably has a negative value. And I think if you look at our stock price today, because I think the market itself is doing a similar analysis to what you are doing, Mr. Robinson.* ***And I think what their conclusion is this is the liquidation value of the MI subsidiaries, then you pay off of [the debt] and here is [what] you are left with. And I think the share price today at $3.40 or thereabouts and that has some value in it for the fact that the deal may close at $5.43. So, I do think...that [if] this deal doesn't close, even despite the other plans which would include selling some of the businesses, you would likely end up with a price lower than where the stock price is today****. So, I believe very strongly I think it's the view of the board based on the input of all of our outside advisors that $5.43 from Oceanwide still is the best deal for shareholders, because it provides a certain value or cash and eliminates the downside risk of our inability if that should occur of getting the future premium increases.*

***David Robinson [shareholder]****: The deficit of long-term care, I mean, we still don't go below zero, I mean, we are not going to owe, it can go bankrupt, but the shareholder is not going to go in rears just on that deficit. Is that not correct? I mean, can you not walk away and if you cashed out and I don't know how big a premium you are talking about on paying back to debt holders?*

> ***Tom McInerney [CEO]****: But again, I would say Mr. Robinson very difficult to answer that question. All of our businesses are highly regulated by state insurance departments as well as other entities. And so to the extent that there was a issue with our long-term care business and an insolvency of that business there* ***it is unclear from a legal perspective what all the regulators who control USMI – will regulate USMI, the Australian subsidiary, the Canadian subsidiary, our life and annuity subsidiary, which is the Virginia and our New York subsidiary – what they will do. So, it's very unclear that you could just walk away from the LTC business and that insolvency that's up to courts and all of that.*** *So again I think from a shareholders perspective to take the risk all of that is a lot more downside risk than the certainty of this deal at $5.43 per share.*

We fundamentally disagree with McInerney's assertions above. On the point regarding debt prepayment premiums, for example, there is no reason why GNW would need to prepay any debt (versus simply paying off debt as it becomes due and payable). If any equity stakes in the mortgage insurance subsidiaries were monetized, GNW could simply hold the proceeds in liquid investments at the holdco level until debt maturities naturally occur (so there would not be any call premiums). Furthermore, as we detail below in our Sum-of-the-Parts Analysis for GNW, we believe that CEO McInerney is dead wrong about GNW's stock valuation absent the China Oceanwide deal completion. In fact, we arrive at a SotP valuation of $5.36/share for GNW ***even assuming all life/LTC operations are valued at zero*** (which is illogical, since at a bare minimum these deserve an equity "option value", even if that amount is de minimis).

So why would the CEO go to such lengths to knock down the idea of a Plan B for GNW and claim that the company's shares would have little value on a standalone basis? Why does he try to (in our view) scare shareholders into believing that GNW could be torpedoed by its LTC liabilities, despite the fact that the holding company has no legal obligation to support the LTC insurance subsidiary (see our further discussion on this point below)? In short, why is he so apparently illogically insistent that the China Oceanwide deal is the one and only option that will save GNW shareholders from the abyss? Probably because he's incentivized to do so. First, please see below regarding the maximum payouts the CEO and other senior management could receive in the event the merger with China Oceanwide is completed, from page 98 of the definitive merger proxy (source):

***Information Regarding Golden Parachute Compensation***

In accordance with Item 402(t) of Regulation S-K, the tables below present the estimated amounts of compensation that each NEO could receive that are based on or otherwise relate to the merger. This compensation is referred to as "golden parachute" compensation by the applicable SEC disclosure rules, and in this section we use such term to describe the merger-related compensation payable to Genworth's NEOs. This merger-related compensation is subject to a non-binding advisory vote of Genworth's stockholders.

For purposes of illustration, the amounts set forth below have been calculated assuming that the merger is consummated on June 30, 2017, and further assuming that each NEO's employment is terminated by Genworth without cause or the NEO resigns for good reason (each of which we refer to as a "***qualifying termination***") on such date. The amounts indicated in the table below are estimates of amounts that would be payable to the NEOs, and the estimates are pre-tax amounts based on multiple assumptions that may or may not actually occur, including assumptions described in this proxy statement and in the footnotes to the table. Some of the assumptions are based on information not currently available, and as a result, the actual amounts, if any, to be received by an NEO may differ in material respects from the amounts set forth below. All dollar amounts set forth below have been rounded to the nearest whole number.

**Golden Parachute Compensation***

| Name | Cash(1) | Equity(2) | Pension/ NQDC(3) | Perquisites/ Benefits(4) | Other(5) | Total |
|---|---|---|---|---|---|---|
| Thomas J. McInerney *President and Chief Executive Officer* | $ 8,500,000 | $ 4,524,998 | $ 291,410 | $ 39,297 | $ — | $ 13,355,705 |
| Kelly L. Groh *Executive Vice President and Chief Financial Officer* | $ 2,475,000 | $ 1,257,653 | $ 1,004,516 | $ 22,606 | $ — | $ 4,759,775 |
| Kevin D. Schneider *Executive Vice President and Chief Operating Officer* | $ 4,168,750 | $ 2,932,195 | $ 3,755,869 | $ 44,686 | $ 1,000,000 | $ 11,901,500 |
| Michael S. Laming *Executive Vice President, Human Resources* | $ 2,000,000 | $ 515,850 | $ — | $ 17,477 | $ — | $ 2,533,327 |
| Daniel J. Sheehan IV *Executive Vice President and Chief Investment Officer* | $ 3,825,000 | $ 2,339,418 | $ 3,058,731 | $ 37,226 | $ 1,000,000 | $ 10,260,374 |

* Martin Klein resigned his position as Chief Financial Officer effective October 15, 2015, and is not entitled to receive any compensation or benefits that are based on or otherwise relate to the merger.

98

McInerney alone could potentially receive over $13 million and GNW's named executives as a group could be paid up to $43 million if the deal goes through as planned (note that in certain instances, however, certain of such payments are only triggered if the executives' employment is terminated upon consummation of the merger).

Second, McInerney and his key lieutenants are expected to have continuing executive roles at the company resulting from the China Oceanwide merger (note also that Oceanwide intends to expand the LTC business to the China market). The following is an excerpt from page 55 of the definitive merger proxy on this topic (source here):

> *[Prior to the signing of the merger agreement], representatives of Genworth had a telephone conference with representatives of China Oceanwide, during which representatives of Genworth and China Oceanwide discussed Genworth's policy that prohibited any discussion between Genworth executives and China Oceanwide concerning post-closing employment by China Oceanwide or the terms thereof unless expressly permitted by the Board.* ***The representatives of China Oceanwide indicated that China Oceanwide did not have operations in the U.S. and a key component of the proposed transaction with Genworth would be to have the ability to retain its current management team and leverage their expertise in the post-closing operations of Genworth. China Oceanwide therefore wanted to have some assurances that such management team will continue with Genworth post-closing****. In response, Mr. McInerney stated if China Oceanwide required further assurances in terms of post-closing commitments from employees, it should provide in the merger agreement for such arrangements to be negotiated between signing and closing, assuming the parties were able to come to terms on the definitive documents.*

In effect, not only will McInerney and crew receive millions of dollars directly as a result of the closing of the transaction, but they are also poised to help preside over the expanding international insurance empire which should take form post-merger (and one can only assume they will be compensated accordingly). So the Oceanwide deal is clearly a win-win scenario for Mr. McInerney and other top GNW executives, even if it is not necessarily the best option for GNW shareholders. No wonder the CEO appears (over)eager to talk down the idea of a Plan B!

## Genworth Sum-Of-The-Parts Analysis

GNW's stock closed at $3.15/share on January 4, 2018, in comparison with net book value (ex-AOCI) of $20.10/share as of September 30, 2017, indicative of the massive amount of value trapped below the LTC operations (Genworth trades at just 16% of book value). We believe that long-term downside is limited for GNW shares, because even if one assigns a zero valuation to its life and annuity businesses (assuming the China Oceanwide merger is terminated), the sum of the parts of the remaining businesses minus the holdco net debt equals $5.36/share, as per the following calculations (share percentages for GNW Canada and GNW Australia sourced from GNW's 2016 Form 10-K, pages 11 and 13, respectively; U.S. M.I. information sourced from GNW LTM earnings releases):

***Genworth Sum-of-the-Parts Valuation (ex-L&A businesses)*** = $2.68B, or $5.36/share based on 500 million GNW shares outstanding, 70% above the current market price, calculated as follows:

1. Value of GNW Canada equity @ 1/3/18 = 57.2% X C$3.84B X 0.80 f/x = $1.75B; plus

2. Value of GNW Australia equity @ 1/3/18 = 52.0% X A$1.47B X 0.78 f/x = $0.60B; plus

3. Value of U.S. M.I. @ 1/3/18 = 12X $298MM LTM Operating Income = $3.58B; minus

4. Estimated Net Holdco Debt @ 9/30/17 = $3.25B;

5. Equals Total of $2.68 billion.

GNW is therefore currently trading at a massive 41% discount to the SotP (ex-L&A), which seems extremely and unnecessarily pessimistic. Note that even this SotP valuation is punitively low, since GNW's life & annuity/LTC businesses would at a minimum still have option value for shareholders even in a runoff scenario (which would perhaps equal 5% of ex-AOCI book value attributable thereto, or around $0.75/share), or possibly more in a future de-stacking scenario.

Moreover, we believe that the full $5.36/share in SotP value is capable of being unlocked, since we do not believe (again, despite McInerney's prior statements) that GNW (either at the holdco level or the mortgage insurance level) has any legal obligation to inject money into, or provide other capital support to, the ailing LTC business. In this respect, we note that GNW's BLAIC capital maintenance agreement expired in October 2016, per the following excerpt from the Q3 2016 10-Q filing (source):

*BLAIC Repatriation*

In February 2016, as part of restructuring our U.S. life insurance businesses, we also announced an initiative to repatriate existing reinsured business from Brookfield Life and Annuity Insurance Company Limited ("BLAIC"), our primary Bermuda domiciled captive reinsurance subsidiary, to our U.S. life insurance subsidiaries in 2016. Effective April 1, 2016, we recaptured a block of universal life insurance from BLAIC to GLAIC. In addition, effective July 1, 2016, we recaptured a block of term life insurance from BLAIC to GLAIC and terminated a term life insurance excess of loss treaty with BLAIC. The repatriation was completed through the merger of BLAIC into GLIC in October 2016. As part of the repatriation, all parental support provided to BLAIC, including the capital maintenance agreement that previously existed between Genworth Financial International Holdings, LLC and BLAIC, was terminated. There will be no impact on our consolidated results of operations and financial condition prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") as the financial impact of these reinsurance transactions had been eliminated in consolidation. However, there is expected to be an adverse impact on GLIC's risk-based capital ratio of between five and ten points in the fourth quarter of 2016.

We also refer readers to the following exchange from GNW's Q3 2016 earnings conference call on the subject (source):

> **Sean Dargan**
>
> Okay. Thanks. And then I have one question for Kelly. I saw that the BLAIC repatriation was completed. Does that mean that the capital maintenance agreement between BLAIC and Genworth International Holdings is severed and should we think of that it as meaning that that's the final link that separates LTC from HoldCo as far as the bondholders are concerned?
>
> **Kelly Groh**
>
> Thanks, Sean, for the question. All of the capital maintenance agreements related to BLAIC have been severed, so there is no longer any parental support for any of that business.

In addition, we find it highly improbable that a sophisticated and well-advised (by insurance specialist Willis Securities) party such as China Oceanwide would have agreed to acquire GNW in 2016 if there were any remaining legal obligation that GNW provide continuing support to the LTC insurance business (other than China Oceanwide's agreement at the time to inject $525 million therein). Thus we conclude that monetization of the U.S. or foreign mortgage insurance subsidiaries should be available to pay down debt maturities at the holdco level as and when needed.

## Genworth "Plan B" Possibilities

Referring back to the Rite Aid discussion above, in our view GNW retains plenty of viable Plan B options in order to pay down its looming $600MM Note maturity in May 2018 if the China Oceanwide deal were to fall through due to regulatory roadblocks; the maturity appears to be the main overhang on the company's share price in the near term. Note that these options are in addition to simply employing available cash already at the holdco level for debt repayment (holding company cash and liquid assets stood at approximately $830 million as of the end of Q3 2017, per GNW's Q3 2017 earnings press release), as we assume GNW would want to maintain a permanent cash buffer at the holdco level out of prudence. Such Plan B options could include the following:

(1) ***Rights offering and/or China Oceanwide strategic investment in GNW equity*** - GNW could issue additional common equity. This could take the form of a rights offering, whereby current shareholders could subscribe for additional shares at or near the current stock price (rights offerings thus allow existing stockholders to avoid dilution in exchange for putting more capital into the business), and/or China Oceanwide could make a strategic investment in GNW equity (this could include a joint venture with GNW in China to create an LTC business there);

(2) ***IPO of the U.S. Mortgage Insurance business*** - GNW could conduct an IPO of perhaps 20% of the equity in its domestic mortgage insurance business. Over the past few years, peers such as Radian (RDN) and MGIC Investment Corp. (MTG) have seen their share prices increase significantly along with the continued recovery of the U.S. housing sector (shares of the former have more than tripled, and shares of the latter have nearly quintupled, respectively, since the beginning of 2013). Healthy investor demand in the sector implies that GNW's U.S. M.I. stake would likely receive an attractive valuation in a public offering; and

(3) ***Sale of Shares of the Canadian and/or Australian Mortgage Insurance businesses*** - GNW could further sell down its ownership stakes in Genworth Canada (OTCPK:GMICF) and/or Genworth Australia. As shown in the SotP calculations above, these equity holdings are currently worth $2.35 billion, or almost 4X the amount of debt coming due in May 2018.

In addition, on a longer-term basis, further options exist to unlock the value trapped in GNW's current corporate structure. One possibility would be to de-stack the company's life and LTC operations via a separate transaction involving a third party. China Oceanwide was (and, based on yesterday's press release, still is) obviously willing to inject $525 million into LTC in order to obtain the de-stacking, so clearly at such price China Oceanwide believes the benefit is worth the cost. If China Oceanwide believes this, it is reasonable to assume that another financial or strategic investor could be located to engage in a similar transaction (assuming such a transaction could obtain regulatory approval). Regulators and policyholders would be better off in the long run if a de-stacking is allowed, so long as this were to occur in connection with a capital infusion into LTC. If this is not possible, GNW could simply let these subsidiaries run off over time and shareholders would receive any residual value remaining once the claims are fully paid.

Another longer term option to consider would be the separation of GNW's U.S. M.I. business from its Life/LTC business via a spinoff of U.S. M.I. into a separately traded public company or the issuance of an M.I. tracking stock. In each case, the market would be forced to value GNW's various lines of business separately, i.e., based on the sum of the respective parts. Clearly this option would be complex (likely involving the approval of GNW's bondholders), but that does not mean it isn't doable.

## Conclusion

The GNW/China Oceanwide saga has indeed proven to be a long and winding road since we initially wrote about it in late January 2017. While the company management appears to believe that the deal can still be consummated prior to GNW's $600MM note maturity in May, serious obstacles remain. In contrast to GNW's CEO, McInerney, we believe that even without the merger, GNW's shares are worth at least $5.36 based on a sum-of-the-parts analysis. Moreover, we see multiple avenues available for the company to deal with both near-term (debt payment) and longer-term (de-stacking) challenges, which if properly implemented should unlock GNW's trapped value for shareholders. To be sure, if CFIUS and GNW's insurance regulators sign off on the China Oceanwide deal relatively expeditiously, we will accept the $5.43 merger consideration and walk away. However, GNW's management must make every effort in the meantime to prepare for Plan B, as strength lies not in a myopic focus on one outcome but rather in optionality.

**Disclosure:** I am/we are long GNW, RAD.

I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it. I have no business relationship with any company whose stock is mentioned in this article.

Editor's Note: This article discusses one or more securities that do not trade on a major U.S. exchange. Please be aware of the risks associated with these stocks.

## Comments (69)

**alpha08**
Where is Rick?

05 Jan 2018, 01:47 PM

**Rick39**
alpha 08

Here is the response you were waiting for. A past comment that Seven Corners posted in February is quoted below about a "no brainer". Think about it. Is the article above reflecting any more wisdom? You can decide for yourself.

quoting below:

//////////////

GNW shares have an intrinsic vale of $10 or higher today and this should increase over time - if deal gets blocked, shares would likely rise well above the 5.43 level within 2 years anyway IMO. Why do you think Oceanwide wants this deal so badly? They know they got a no-brainer at 5.43.
Feb 3, 2017. 05:21 PM

Link
Genworth: Is The China Oceanwide Deal Really At Risk? - Seven Corners Capital Management

05 Jan 2018, 03:10 PM

**Seven Corners Capital Management, Contributor**

Author’s reply » When you have nothing relevant to add to the conversation, throw rocks at the author (aka ad hominem attack) - brilliant!

05 Jan 2018, 03:22 PM

**HoopsAlpha**
Thats how he operates. Provides no real numbers or insight to his “analysis”. Im somewhat surprised he didnt mention conseco or 1.3 million policies in that post.

05 Jan 2018, 04:21 PM

**ocean 2026**
Trump will screw things up anyway he can. On the other hand, it seems the company is worth quite a bit more than the $5.43 anyway.. Its last quarter seemed sanguine for the future. I'll be interested in the 4th Qtr results-- the GNW may be better without the merger..

05 Jan 2018, 01:52 PM

**alpha08**
I agree with you. Interest rates going up. And mortgage industry is doing good

05 Jan 2018, 01:55 PM

**Trade In Mexico, Contributor**
Ocean, I am glad Trump has "screwed UP" and I MEAN UP, our stock market is up, our jobs growth is up, business and consumer confidence is UP, just about everything is UP that you would want, so thanks Trump! Everything is BETTER since Obama left office! Meanwhile, Trump has wiped out ISIS, which Obama created by prematurely and foolishly withdrawing from Iraq, and we finally have a President who is standing up to North Korea and Iran (both big messes that Obama punted on), and the UN members are finally paying their fair share of dues thanks to Trump....

The GNW buyout deal is not going to happen.

05 Jan 2018, 02:04 PM

**genoduffer**
T I M,
I agree with you 200%
Geno

05 Jan 2018, 02:37 PM

**ocean 2026**
If you knew so much, why are you hiding behind a fake screen name? my bio isn't emply.

05 Jan 2018, 04:00 PM

**ATX**
GNW is worth $20, if the buyout gets canceled, the stock will rise over time and get to its intrinsic value

05 Jan 2018, 01:55 PM

**alpha08**
$20 is too optimistic, you need treat LTC as negative value until premium hikes complete.

05 Jan 2018, 01:57 PM

**ATX**
Chinese don't overpay for stuff, if they offer $5, they know it's worth $10+

05 Jan 2018, 01:59 PM

**John Kass**
bingo

05 Jan 2018, 02:45 PM

**tom bernardi**
Chinese always overpay. Look at their golf moves in US

05 Jan 2018, 04:26 PM

**ATX**
then short all available shares

05 Jan 2018, 04:31 PM

**Brian Grad, Contributor**
Those were the Japanese in the late 80's

06 Jan 2018, 08:52 AM

**Castrese Tipaldi, Contributor**
Any plan B must necessarily start with the CEO and all the senior management (all the directors first) out and in the cold. They are an embarassment to the very concept of shame!

Provided that, in my humble opinion, just allowing the Long Term Care unit to run off smoothly in a decade or so would materialize around 10 $ of net value per share.

But again, for that you need men running the business, not BBIIIIPPPPP!
With men running the business, the options GNW has in case the shameful clearance sale to Oceanwide fails are limitless. The sense of urgency is fully fabricated here!

05 Jan 2018, 01:59 PM

**Oilworker2017**
This is why we play the game buying low price puts. My three favorites at this time, and guarantee at least one of them will triple:
GNW Jan 19 $3 puts at 14 cents. Expecting 50 cents and 42 cents is triple.
RH Jan 12 $90 puts at $2. Expecting $8, and $6 is a triple.
UVXY Mar 16 $10 calls at $2. Expecting $6, for a triple.

So what u do is put 1/3 of capital in each, ur guaranteed return of capital if just one triples. And with the bloat in GNW and merger dying soon, and RH overvalued stock, and VIX so low, it's a coming.

05 Jan 2018, 02:10 PM

**Oilworker2017**
RH from 92.50 down to 91.70 since post will be $82 in just 7 calendar days!

05 Jan 2018, 02:16 PM

**kenberth**
no! RH now $93! You're going to go broke!

05 Jan 2018, 08:37 PM

**RoHughes59**
"If this is not possible, GNW could simply let these subsidiaries run off over time and shareholders would receive any residual value remaining once the claims are fully paid."

You do realize that GLIC and GLAIC have LTC liabilities that will be running off over the next 50 or so years, right? So while your statement above might be "mathematically plausible", what investor would actually want to wait for that kind of an extended period to realize any potential upside?

05 Jan 2018, 02:12 PM

---

**Seven Corners Capital Management, Contributor**
Author’s reply » They would still have some value for shareholders - you would have to discount future expected proceeds to a present value. Not saying it would be worth much if de-stacking is permanently blocked, maybe $0.75/share in PV.

05 Jan 2018, 02:20 PM

---

**kenberth**
As claims come in and reserves are released, profit (and capital) can be dividended out to the holding company. Required capital goes down as the business shrinks.

05 Jan 2018, 03:28 PM

---

**Seven Corners Capital Management, Contributor**
Author’s reply » Yes, it all depends on whether regulators allow dividends though. One would have to assume that the LTC business will not be able to pay any divs to the holdco for quite a few years.

05 Jan 2018, 03:31 PM

---

**kenberth**
Why did the CEO say that if the rate increases are approved, the value is "possibly 0". The GAAP balance sheet has life+LTC worth 10B and that assumes (according to the CEO) 7B in rate increases. So how is that "possibly 0"?

"So, if we are able to achieve those premium increases, then perhaps the value of that businesses are zero,.."

05 Jan 2018, 02:16 PM

---

**Seven Corners Capital Management, Contributor**
Author’s reply » Assume he's referring only to LTC (not life)? Possible transcript is garbled also.

05 Jan 2018, 02:21 PM

---

**Oilworker2017**
see ya at RH $82 next week (11% drop) and GNW 2.50 in 2 weeks (18% drop). Market starting to ferret out these ones

05 Jan 2018, 02:28 PM

---

**John Kass**
Good Luck

05 Jan 2018, 02:46 PM

---

**kenberth**
GNW is trading at 3.20, a price you said yesterday that it would probably never see again. It's going up, not down!

05 Jan 2018, 03:29 PM

---

**241larry**
I'm confused. If the CEO thinks a zero value for LTC is a best case scenario why do they keep selling policies?

06 Jan 2018, 01:55 AM

---

**Barry Brewer**
Seven,

Rick, Josh and Scott have arrived at similar figures. You're in good company.

This is just an interminable nightmare. Death by a thousand cuts, or just boredom.

05 Jan 2018, 02:34 PM

---

**onec007**
Hey All:

New to this board, but can someone just summarize how the eff GNW went from $20 to $2 buck chuck in such a short-time? I remember my broker recommending GNW to me back at the $20 mark and I said "no thanks." I've since seen it appear on my tracker, but can't seem to find any info as to the complete meltdown of the s/p.

thanks

05 Jan 2018, 02:44 PM

---

**Financial Insights, Contributor**
Horrible management and execution. Doubling down on LTC market. Their Tnaigble book value alone is $20 a share, but market is saying that future earnings will continue to decline etc. I think if they had a decent CEO (mcInery is a dumb ass) this could be in the teens in a few years.

05 Jan 2018, 02:53 PM

---

**Seven Corners Capital Management, Contributor**
Author's reply » They need someone with a "can do" attitude, that's for sure, not one who tries to talk down the stock price.

05 Jan 2018, 03:14 PM

---

**onec007**
Book value might be worth $20 a share, but if management is willing to sell at just a fraction of that price you have to question how off is the book value. The s/p probably is worth significant more than its current s/p, but no where near the implied book value. Amazing how some management team can royally screw a company up yet go away with a golden parachute.

05 Jan 2018, 03:24 PM

---

**B Powell**
Did seem wierd how he said the equity was worthless considering the premium increases might not be secured ergo best to take the Chinese money.

05 Jan 2018, 03:36 PM

---

**Scott Molnar, CFA, Contributor**
It is a shame we cannot get shareholders to muster and dump the management. I would even be willing to do it for $1 plus options that only strike at $6. That gives Oceanwide deal price plus 10% before actually making anything. Best part would be just eliminating McInerney and saving his change of control payout.

05 Jan 2018, 04:08 PM

---

**onec007**
When you're the CEO who gets paid $13 mil if the company sells who cares if the s/p goes up or down. You gotta love golden parachutes for these CEOs 1. Michael Pearson at Valeant who got paid $9 mil for saddling the company with debt and almost bankrupted the company 2. Marissa Mayer at Yahoo who got a whopping $186 million by selling Asian assets and selling some operations to Verizon. She failed to revive Yahoo's fortune (clearly) and overpaid on acquisitions that didn't generate anything to the bottom-line. Lastly, RAD who kind of now reminds of GNW. John T. Standley, CEO of Rad got over $25 mil to sell out.

There is some value in GNW, but no where near $20 when you have poor management. When golden parachutes (compensation) are related to "merger-related" payments rather than stock performance investors can easily get screwd especially for those that bought high. We are definitely in an era of extreme greed!

“Fearful when others are greedy and greedy when others are fearful.” - W. Buffet

05 Jan 2018, 04:42 PM

**cmeek01@msn.com**
There's another reason why the CEO badmouthed the value of the company x the merger. It is an attempt to convince the regulators that policy holders could be in jeopardy. This is probably not a mere bluff, but a realistic concern for regulators.

05 Jan 2018, 02:49 PM

**Seven Corners Capital Management, Contributor**
Author’s reply » Interesting angle - although you presume regulators read Seeking Alpha transcripts!

05 Jan 2018, 03:13 PM

**17072452**
A powerful strategy indeed...too big to fail! Receivership is the last thing any regulator wants b/c they would actually have to work hard for a living.

05 Jan 2018, 04:11 PM

**Financial Insights, Contributor**
Excellent point about the C-Suite executives being incentivized to take this deal via golden parachutes, payouts, and continued "consultant" work at the new company if merger goes through. Total conflict of interest.

05 Jan 2018, 02:51 PM

**Seven Corners Capital Management, Contributor**
Author’s reply » The board of directors is supposed to look out for shareholders, but even they have been offered "continuing employment" by China Oceanwide after the deal closes. So basically only a deep-pocketed activist would be able to budge these people off of their current positions.

05 Jan 2018, 03:13 PM

**pogonific**
I am pretty confident (and there is good evidence to believe) CFIUS will not clear this deal - hence China Oceanwide is irrelevant.

On the SOTP analysis - it boils down to whether you believe regulators believe shareholder equity belongs to the LTC policy holders or not, in the event the doodoo hits the fan. LTC is an enormously difficult business to value - if you read the 10K, you'll see that a 25bps reduction in the discount rate applied to LTC liabilities is worth about $2bn, or to put it anouther way 25% more than the entire market cap today. Anyone that does SOTP analysis must be confident of the LTC liability discount rate to way better than 25bps, OR they believe the regulators will let the shareholders off the hook. Both of these seem doubtful to me.

And to be clear, I am not saying GNW is over or undervalued - I'm saying anyone who says confidently one or the other is doing so by making what to me seem questionable assumptions. Good luck to all.

05 Jan 2018, 03:13 PM

**Seven Corners Capital Management, Contributor**
Author’s reply » "OR they believe the regulators will let the shareholders off the hook"

This is the main issue and where we disagree with your premise - they don't actually appear to have shareholders on the hook (legally speaking), at least per what GNW management has previously disclosed (excerpted above: "there is no longer any parental support for [the LTC] business"). If there is indeed no longer any parental support, then the LTC regulators can't legally get at the MI assets. If you have evidence to the contrary, however, please provide.

05 Jan 2018, 03:20 PM

**kenberth**
He's stating that the LTC division can't be worth less than zero. GNW has other, legally separate divisions, some of which are publically traded which are worth 6 billion or so.

05 Jan 2018, 03:29 PM

---

**pogonific**
Honestly, I don't know the details well enough to claim to be an expert. But the excerpt you quote doesn't sit well with me for two reasons:
(a) if the regulators really can't block a liquidation which leaves them on the hook for any LTC hole while the shareholders pick off the other assets in the structure, I just can't believe they would have taken so long to not yet approve a transaction in which CO injects $600m (if memory servers right) towards that hole.

(b) If I start an insurance company from scratch, I'm pretty confident the regulator will insist shareholder equity belongs to the policy holders in the event of major loss, and they would prevent me making transactions which break this guarantee - the regulator is strongly incentivised to do so.

So not the evidence you asked for, but the best I can do.

05 Jan 2018, 03:30 PM

---

**Seven Corners Capital Management, Contributor**
Author's reply » Right - the SotP case is that LTC cannot be worth less than zero for shareholders (although it might indeed have a negative value viewed strictly from the policyholders' perspective) - in other words, the corporate veil separating the LTC business and the holdco cannot be pierced.

05 Jan 2018, 03:33 PM

---

**Seven Corners Capital Management, Contributor**
Author's reply » "I just can't believe they would have taken so long to not yet approve a transaction in which CO injects $600m"

It's 525MM, not 600MM. They would be approving a de-stacking of life and LTC. The article / SotP analysis assumes no de-stacking (so no regulatory approval is required in that scenario).

05 Jan 2018, 03:36 PM

---

**pogonific**
Thanks for clarifying - I understand it better now, well, I hope you're right. Good luck.

05 Jan 2018, 03:54 PM

---

**kenberth**
GNW and CO inject money into LTC, but they ALSO split the profitable life company away from LTC. The life company has an inherent worth that is now available to LTC, but wouldn't be in the future.

If you start an insurance company from scratch, the equity in the insurance company is available to policyholders. And it is in GNW's insurance company as well. GNW has other businesses besides the life/LTC business though. Those are distinct from the insurance company.

05 Jan 2018, 04:02 PM

---

**RoHughes59**
The key aspect of this you are missing is that the injection of capital is a quid pro quo for the unstacking.

The last time I checked, GLAIC had statutory capital in excess of $1.5 million.

So you are basically asking why the regulator hasn't approved a transaction where he will allow the transfer of a subsidiary theoretically worth $1.5 million for a $500 million capital contribution.

As the math above indicates, another equally plausible course of action here would just be to not approve the unstacking and keep the full value of GLAIC to support the LTC run-off.

There are many other non-financial factors to consider as well, but the point here is that the reason Delaware has been reviewing this transaction for so long is that this is no regulatory "lay-up".

05 Jan 2018, 04:19 PM

---

**9543151**
I sure want to know what the holding company cash level is on 12/31/2017. Also note that the Australian mortgage company has a $100M share repurchase plan in place. This would allow the holding company to sell approximately half as many shares and still maintain its respective ownership position. Another way to bring $50M to the holding company. They could do the same thing with Canada and let these foreign mortgage companies go into a sort of runoff to create liquidity.

05 Jan 2018, 04:00 PM

---

**26610243**
Can Shareholders oust the CEO in the next vote? Before, being the majority, the institutional holders were lazy and were betting on the easy BO route. But this time, they should show some responsibilities towards their shareholders.

05 Jan 2018, 04:17 PM

---

**Scott Molnar, CFA, Contributor**
9543151,

That actually is A$52mm which is about $40mm USD. Also, 45% of the buyback was already completed at the date of the last quarterly financials. At best, you are looking at an increase of $22m with the rest of the buyback. They also file daily buy-back notice when they buy shares with the ASX. The most recent one I saw was end of November which only put the buy-back at 50.5% complete. So, you will likely only see a few million more cash at 12/31 from the Australian buyback.

05 Jan 2018, 04:26 PM

---

**Jeremy Blum, Contributor**
The accountants are in now for the audit report. We will soon see if LTC takes another big hit. If it does, then it will be clear LTC has negative value.

I started my career working for the OTS a former bank regulator. The bank regulators almost always tried to force bank holding companies to inject money into their bank subs if capital was inadequate. The bank holding companies could fight back legally but they would likely eventually lose. I would be surprised if it wasn't the same case for insurance holding companies. GNW's only way off the hook is to get someone like the Chinese or other moneybags to inject money in return for no future liability. That appears to be the deal. If the deal falls through things get dicey.

05 Jan 2018, 05:21 PM

---

**Barry Brewer**
this is a great comment. do you think we'll see the results in Q1 earnings?

05 Jan 2018, 06:34 PM

---

**Scott Molnar, CFA, Contributor**
The cash flow testings happen in q4 so we should see them at the next earnings report. If there is not a major mark down, then the stock is even more massively undervalued since LTC/LI would have greater option value.

05 Jan 2018, 06:39 PM

---

**Seven Corners Capital Management, Contributor**
Author's reply » "I would be surprised if it wasn't the same case for insurance holding companies."

It doesn't seem to be the same case, actually, as GNW management previously clearly stated (before they were trying to talk down the stock). So unless you think the CFO doesn't understand insurance law, it would probably be prudent to go with their prior comments as valid.

05 Jan 2018, 06:42 PM

---

**Scott Molnar, CFA, Contributor**
Banking law is very different. Regulators can force HoldCos to support failing banks, because the FDIC can sieze all HoldCo bank subsidiaries in the event of failure. They usually cannot sieze non-bank assets at the HoldCo level. It basically means there is no point of having different legal entities for banks within the HoldCo, but that does happen thanks to M&A.

The FDIC also does not allow managers of failed banks from running a bank for a certain number of years. It prevents people who cause a failure from causing a second failure, but it makes it harder to bring in a turn around specalist potentially save the bank.

05 Jan 2018, 08:01 PM

---

**Barry Brewer**
A little of off topic on my behalf but I'll never forgive this. (Not you Scott, you'll see what I mean)

"Does not allow managers of failed banks..."

Except in the case of TBTF. LB, JD, VP (I think he was head of C then) BM.

I'll never forget.

05 Jan 2018, 08:35 PM

---

**Barry Brewer**
Thanks Scott, here's hoping. I think you may have mentioned that about 350 comments ago in another thread, but I wasn't sure.

05 Jan 2018, 08:39 PM

---

**Jeremy LaKosh, Contributor**
I'm glad you included the RAD case in your article. I think it's a great comparison. I got burned slightly with that trade. For GNW, instead of the equity, I've taken positions in three of the bonds maturing prior to 2022. They provide decent yield (better that most dividends). I'm not sure if you had a position on this.

05 Jan 2018, 05:38 PM

---

**consolidation**
Just saw this after my post. Bonds trading like they are money good and with a 7%+ annualized yield to boot. I am leaning on this toward the debt side as well.

06 Jan 2018, 12:39 AM

---

**diente**
as always good point of view seven

05 Jan 2018, 05:43 PM

---

**consolidation**
It is interesting that the 2018, 2020, and 2021 GNW bonds are trading at par. If the situation was dire price action would be telling a much different story. Whenever I consider taking an equity position regardless if its an investment or a binary event scenario, one of the first things I do is look at where debt traders have pinned the bonds since this is a most telling attribute for future prospects.

The bonds are saying that GNW will be fine in the short term regardless if this deal falls apart or not.

06 Jan 2018, 12:37 AM

---

**slodec**
Beyond Jan18, the highest open interest call volume is Jan20 5.5. What to make of that?

06 Jan 2018, 12:12 PM

---

**TallBob29**

Thanks for the read SCCM.

My interest is not as an investor but as a person with an elderly parent who holds one of those Long Term Care policies. (And whose annual premiums are on a steep climb.)
If I might ask, what effect might these various outcomes have on the LTC policy holders themselves? I see many comments above, written from the perspective of the parent company and/or shareholders. But I'm looking for a perspective from the policy holder's point of view.

Thanks in advance.

06 Jan 2018, 12:57 PM

---

**Scott Molnar, CFA, Contributor**
TallBob,

No matter what happens to Genworth, policy holders will continue to see rate hikes. There are options to help defease the rate hikes, but those will come with reductions in coverage. Even if Genworth fails, regulators will honor the policies but they could cut back coverage and raise rates further.

Hope that helps.

06 Jan 2018, 01:21 PM