

Equity Research

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Mark Palmer

(212) 588-6582
mpalmer@btig.com

Giuliano Bologna

(212) 588-6583
gbologna@btig.com

Financials

Genworth Financial, Inc.

GNW Exceeds Low Expectations with Strong 2Q16 Report Led by Robust U.S. Mortgage Insurance Results

Investors' severely low appraisal of Genworth Financial's (GNW) ability to execute an operational turnaround while simultaneously working to reshape the company was reflected in its extreme discount valuation heading into the release of its 2Q16 results yesterday after the market close. GNW exceeded that low expectations bar with a strong quarterly report highlighted by an earnings beat, strong performances from its U.S. and Canadian mortgage insurance units, and a display of steadiness from its troubled long term care (LTC) insurance unit.

GNW

\$2.75

12 month target

\$5.00

BUY

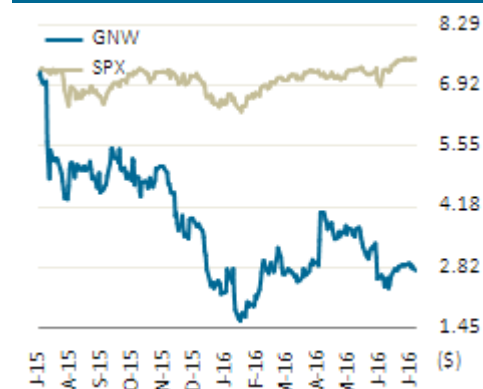
52 week range

\$1.61 - \$7.02

Market Cap (m)

\$1,370

Price Performance



Source: IDC

- As a consequence, we believe GNW likely moved a step closer to the re-establishment of the operational stability across its franchise that is a prerequisite for the successful restructuring of the company. GNW embarked on the first part of its restructuring on February 4 when it announced its plan to separate and isolate its LTC insurance business from its life insurance and annuity businesses. Ultimately, the company intends to split its mortgage insurance units from its life and LTC units, an action that would help to unlock the value of the mortgage insurance units, in our view.
- We are reiterating our Buy recommendation on GNW and price target of \$5** based on 0.25x its FY16E book value ex. accumulated other comprehensive income (AOCI) of \$20.60. While the company faces significant challenges, we believe their impact is already more than reflected in the company's stock price as the shares trade at just 0.14x its book value per share ex. AOCI as of June 30.
- GNW reported 2Q16 net operating income per share of \$0.25, exceeding the consensus estimate (and our estimate) of \$0.20. The beat was paced by a strong performance by the company's U.S. mortgage insurance unit, which posted new insurance written (NIW) of \$11.4bn, up 54% sequentially and 39% versus the prior year period.
- Valuation:** Our price target of \$5.00 is based on 0.25x our FY16E book value ex. AOCI per share of \$20.60.

Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 A	2Q16 A	3Q16 E	4Q16 E	FY16 E	FY17 E
Diluted EPS (Adj.)	0.31	(0.39)	(0.57)	(0.59)	(1.24)	0.11	0.34	0.22	0.22	0.89	0.96
BVPS (Ex-AOCI)	21.31	20.77	20.31	19.72	19.69	19.76	20.07	20.30	20.54	20.60	21.10
Operating Income	295	245	(351)	(203)	(14)	150	351	223	226	950	951

Source: BTIG Estimates and Company Documents (\$ in millions, except per share amount)

- ▶ GNW's U.S. mortgage insurance unit reported 2Q16 net operating income of \$61mm, flat with the prior quarter and up from \$49mm in 2Q15. The company's Canadian mortgage insurance unit also posted a solid quarter with net operating income of \$38mm, up from \$33mm in 1Q16 and \$37mm in the prior year period.
- ▶ Meanwhile, the LTC unit during 2Q16 reported \$37mm in net operating income, up from \$34mm in the prior quarter, in its best performance since its problems first became apparent in July 2014. The improvement was the result of stable claim experience, higher investment income and the benefit of management's efforts to achieve premium rate increases on LTC blocks from various state insurance commissions.
- ▶ GNW during 2Q16 met one of the goals of its operational turnaround as it reduced cash expenses by \$150mm on an annualized basis. The company also recaptured two blocks of life insurance business from its Bermuda-based affiliate Brookfield Life and Annuity Insurance Co. Ltd. (BLAIC) and filed for the regulatory approvals to repatriate the subsidiary, a process it hopes to complete in 4Q16.
- ▶ While some investors have pointed to GNW's holding company liquidity as a concern, it reported cash and liquid assets of \$934mm as of June 30, up from \$760mm at the end of the prior quarter. That amount represented a cushion of about \$510mm above one and a half times the company's annual debt service and restricted cash.

Income Statement

Genworth Financial Operating Model	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Dec-16	Dec-17
\$ millions	2013A	1Q14A	2Q14A	3Q14A	4Q14A	2014A	1Q15A	2Q15A	3Q15A	4Q15A	2015A	1Q16A	2Q16A	3Q16E	4Q16E	2016E	2017E
Premiums	5,148	1,307	1,343	1,395	1,386	5,431	1323	1134	1145	1157	4,759	794	1127	1104	1110	4,135	4,541
Net investment income	3,271	805	813	805	819	3,242	803	793	783	781	3,160	789	779	771	775	3,114	3,050
Net investment gains (losses)	(37)	(17)	34	(27)	(10)	(20)	-16	8	-51	-16	(75)	-19	30	0	0	11	-
Insurance and investment product fees and other	1,021	227	225	231	229	912	225	222	223	234	904	221	300	225	226	972	907
Total revenues	9,403	2,322	2,415	2,404	2,424	9,565	2,335	2,157	2,100	2,156	8,748	1,785	2,236	2,101	2,111	8,233	8,497
Benefits and other changes in policy reserves	4,895	1,194	1,256	1,986	2,184	6,620	1243	1232	1290	1435	5,200	860	1193	1163	1169	4,385	4,721
Interest credited	738	183	184	185	185	737	180	181	179	180	720	177	173	188	182	720	727
Acquisition and operating expenses, net of deferrals	1,659	378	404	398	405	1,585	380	295	314	433	1,422	394	327	338	346	1,405	1,356
Amortization of deferred acquisition costs and intangibles	569	134	138	143	156	571	121	101	563	207	992	99	112	109	108	428	422
Goodwill impairment	-	-	-	550	299	849	-	-	-	-	-	-	-	-	-	-	-
Legal Expense	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Interest expense	492	127	120	114	118	479	116	103	105	104	428	105	80	80	80	345	320
Total Benefits and Expenses	8,353	2,016	2,102	3,376	3,347	10,841	2,040	1,912	2,451	2,359	8,762	1,635	1,885	1,878	1,885	7,283	7,546
Income before income taxes	1,050	306	313	(972)	(923)	(1,276)	295	245	(351)	(203)	(14)	150	351	223	226	950	951
Provision for income taxes	324	87	85	(185)	(215)	(228)	91	70	(134)	(36)	(9)	23	110	62	63	259	266
Tax rate	30.9%	28.4%	27.2%	19.0%	23.3%	17.9%	30.8%	28.6%	38.2%	17.7%	64.3%	15.3%	31.3%	28.0%	28.0%	27.2%	28.0%
Net income (loss)	726	219	228	(787)	(708)	(1,048)	204	175	(217)	(167)	(5)	127	241	160	163	691	685
Income (loss) from discontinued operations	-	-	-	-	-	-	-	(314)	(21)	(73)	(408)	(19)	(21)	-	-	(40)	-
Less: net income attributable to noncontrolling interests	152	35	52	57	52	196	50	54	46	52	202	55	48	50	50	203	200
Net income (loss) available to common stockholders	574	184	176	(844)	(760)	(1,244)	154	(193)	(284)	(292)	(207)	53	172	110	113	488	485
Earnings per share - diluted	\$1.15	\$0.37	\$0.35	(\$1.70)	(\$1.53)	(\$2.51)	\$0.31	(\$0.39)	(\$0.57)	(\$0.59)	(\$1.24)	\$0.11	\$0.34	\$0.22	\$0.22	\$0.89	\$0.96
Net operating income per share - diluted	\$1.24	\$0.37	\$0.31	(\$0.65)	(\$0.83)	(\$0.80)	\$0.31	\$0.24	\$0.13	(\$0.17)	\$0.51	\$0.21	\$0.25	\$0.22	\$0.22	\$0.90	\$0.96
Total stockholders' equity, excluding AOCI	11,891	12,032	12,243	11,231	10,477	10,477	10,632	10,381	10,101	9,814	9,814	9,870	10,045	10,180	10,318	10,318	10,653
Total AOCI	2,542	3,483	4,215	3,934	4,446	4,546	4,692	3,309	3,478	3,010	3,110	4,185	5,088	5,063	5,038	5,138	5,288
Total stockholders' equity	14,812	15,515	16,458	15,165	14,923	14,923	15,324	13,690	13,579	12,824	12,824	14,055	15,133	15,243	15,356	15,356	15,841
Book value per share	\$29.55	\$31.27	\$32.68	\$30.54	\$30.04	\$30.04	\$30.72	\$27.39	\$27.30	\$25.77	\$25.73	\$28.14	\$30.24	\$30.40	\$30.57	\$30.66	\$31.37
Book value per share (excluding AOCI)	\$23.73	\$24.25	\$24.31	\$22.62	\$21.09	\$21.09	\$21.31	\$20.77	\$20.31	\$19.72	\$19.69	\$19.76	\$20.07	\$20.30	\$20.54	\$20.60	\$21.10
Weighted average diluted shares	501.2	502.7	503.6	496.6	496.7	499.9	498.9	499.9	497.4	497.6	498.5	499.4	500.4	501.4	502.4	500.9	504.9

Source: BTIG Estimates and Company Documents

Appendix: Analyst Certification and Other Important Disclosures

Analyst Certification

I, Mark Palmer, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

I, Giuliano Bologna, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

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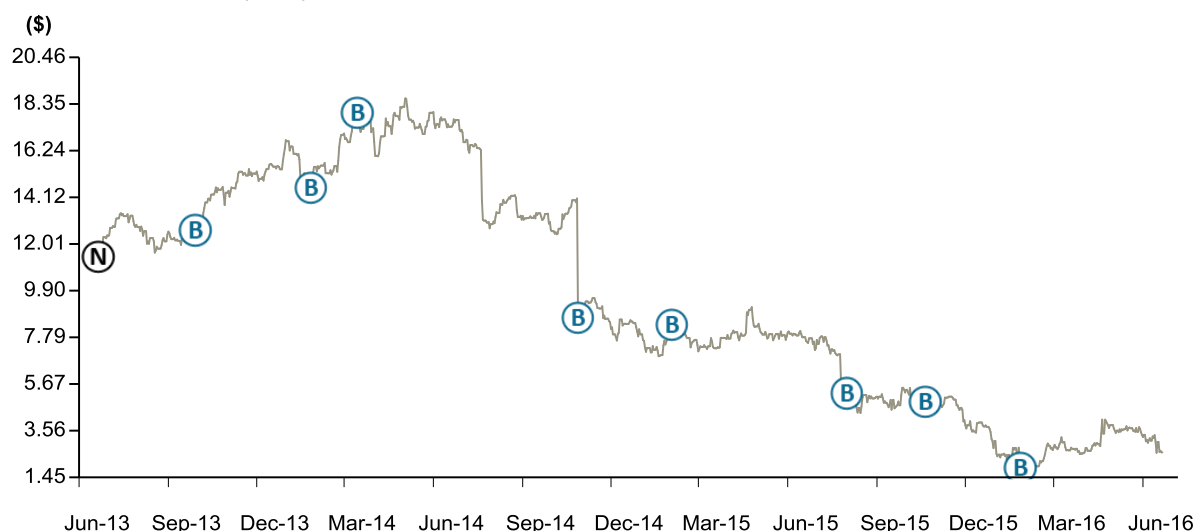
Company Valuation and Risk Disclosures

Genworth Financial, Inc. (GNW, Buy, \$5 PT)

Valuation: Our price target of \$5.00 is based on 0.25X our FY16E book value (ex-AOCI) per share of \$20.60

Risks: The primary risks to achieving our price target include an accelerated rate of deterioration within GNW's U.S. Mortgage Insurance portfolio, credit downgrades that could hamper new business generation in all segments, a slowdown in the Chinese economy that could negatively affect the company's mortgage insurance units in commodity-focussed Australia and Canada, tail risk associated with the company's Long-Term care exposures, and reinvestment risk given the current low interest rate environment.

Genworth Financial, Inc. (GNW)



Note: Closing Price and Target Price have been adjusted for corporate actions.

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
11-Apr-12	7.54	11	Mark Palmer	Buy
08-May-13	10.68		Mark Palmer	Neutral
08-Oct-13	12.62	17.50	Mark Palmer	Buy
04-Feb-14	14.53	18	Mark Palmer	Buy
24-Mar-14	17.93	22	Mark Palmer	Buy
06-Nov-14	8.66	16	Mark Palmer	Buy
11-Feb-15	8.33	15	Mark Palmer	Buy
10-Aug-15	5.24	13	Mark Palmer	Buy
30-Oct-15	4.87	10	Mark Palmer	Buy
05-Feb-16	1.86	5	Mark Palmer	Buy

Other Disclosures

Additional Information Available Upon Request

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