Ignore the Headlines: Genworth MI Canada Inc. Is Doing Just Fine

Description

If the only thing you read of *The Globe and Mail's* August 1 article about the falling demand for mortgage insurance was the headline and a couple of paragraphs, you most likely sold your position in **Genworth MI Canada Inc.** (TSX:MIC).

Big mistake.

Its stock was up 3.5% August 2 in heavy trading. Sometimes, as iconic radio host Paul Harvey would say, it's important to know the rest of the story.

"Demand for mortgage insurance sinks after federal rule changes," read the August 1 *Globe and Mail* headline.

That sounds truly ominous.

"Genworth MI Canada Inc., which provides mortgage insurance for home buyers and financial institutions, reported Tuesday the total value of new insurance it wrote in the second quarter of 2017 was down 81% to $6.1 billion from $31.7 billion in the same period last year," wrote the *Globe and Mail's* Janet McFarland.

Not good, indeed.

However, in fairness to both McFarland and the newspaper, the author goes on to tell the rest of the story — one I'd say is still intact, despite all the changes the federal government has implemented in the last 12 months to calm rising housing prices.

Business isn't perfect

Before getting into what is and isn't working at the mortgage insurance company, it's important to distinguish between products.

Genworth sells transactional homeowner insurance, which involves both high-ratio and low-ratio mortgage borrowers. High-ratio borrowers make a downpayment of less than 20% of a home's purchase price; it's mandatory in Canada. Low-ratio borrowers make a downpayment of greater than

20%; this insurance is optional.

Genworth also sells portfolio insurance, which is bulk insurance for financial institutions to protect their portfolios of uninsured low-ratio mortgages.

As a result of the changes in the mortgage insurance rules implemented by the Department of Finance last November, all low-ratio loans (individual or bulk) are required to meet the same eligibility rules as high-ratio loans.

It's for this reason that new insurance written for portfolio insurance in the second quarter declined by almost $25 billion to just $1.1 billion, which translated into a 78% drop in premiums written.

The rule changes, as the *Globe and Mail* suggested, actually killed Genworth's portfolio business, but the transactional business should remain competitive once the real estate markets adjust to the changes.

What's good?

The key to any successful insurance company is sustainable underwriting profits. Thanks to Warren Buffett, you hear a lot about the use of his insurance float to grow **Berkshire Hathaway Inc.**
, but he'd be the first to tell you that you can't have growth in investment income without consistent underwriting profitability.

In Q2 2017, Genworth had a combined ratio of 22% on $170 million in premiums written compared to 40% in the same quarter a year earlier and 36% in the first quarter. Despite a 32% decline in premiums written, Genworth increased operating income by 28% year over year to $126 million.

The excellent performance is a combination of effective underwriting, a stronger economy resulting in lower claims, higher average premium rates, and higher investment income.

Imagine how it would have done if the rules hadn't changed? But that's water under the bridge.

A great dividend play

If you like dividend-paying stocks, Genworth is a good one yielding 4.7% at the moment, and it has a very respectable payout ratio of 36%.

Since the middle of 2013, Genworth's stock's only dropped below $30 on one occasion, so I'd buy some now and save some cash for when it next hits a bump in the road and slips below $30.

The rules might have changed, but it's still a quality stock.

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Date
2025/08/19
Date Created
2017/08/04
Author
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