TFSA Bargain Hunters: You've Got to Check Out This Cheap Stock

Description

One of the reasons why value investing is dying a slow death is because most value stocks deserve to be cheap.

A screen of Canada's cheapest value names reveals just a few sectors, industries that are well known for their terrible economics. Cheap energy and gold companies dominate the list. Retailers being disrupted by the internet are also present, and so are complex holding companies that investors have long given up on.

The holy grail of value investing is finding company that deserves a much better fate, which aren't easy to find, to say the least. And once you do find a high-quality business among all the trash, you'll then have to compete against other investors who are convinced it's a poor business. The vast majority of people aren't good at this contrarian thinking, so they pass on the opportunity.

One high-quality stock on this short list is **Genworth MI Canada Inc.** (TSX:MIC). Here's why this company deserves a permanent spot in your TFSA freedom fund.

A fantastic business

Genworth sells mortgage default insurance, a policy required by lenders when a borrower has less than a 20% down payment. The premium — which can be as high as 4.5% of the value of the property — is financed by the bank and slowly paid down by the borrower as they chip away at their mortgage. But make no mistake; the product is paid for by the borrower.

This is a fantastic deal for both the bank and the insurance company. The bank ensures that it won't take a loss on its riskiest loans, while the insurer gets paid an average premium in the 2-3% range on a loan that goes bad about 0.5% of the time. Plus, the premium gets invested, which generates additional earnings before any mortgage defaults.

To demonstrate just how good this business is, let's take a look at Genworth's 2018 results. The company generated $866 million in total revenue, which comes from both premiums generated and gains on its investment portfolio. Operating income came in at $475 million, which gives the company operating margins of 55%. You won't find many companies posting numbers better than that.

And remember, 2018 was a down year thanks to stricter mortgage regulations impacting the overall housing market.

These results translated into net income of $4.99 per share. The stock trades at just over $42 at writing, putting shares at just over 8 times earnings, which is far too low for a business this good.

What about the risks?

Genworth bears have long claimed that an imploding Canadian housing market will hurt the company in a big way. Perhaps such an event would even bankrupt Genworth.

These calls have been going on for years now, and nothing seems to happen. First it was Vancouver real estate that was going to cause problems. Then Toronto's overheated market was about to crash. Now economic weakness in Alberta is the big story, with naysayers claiming that a big wave of Calgary and Edmonton foreclosures will hit Genworth's bottom line.

Genworth's portfolio is well prepared to weather these risks. With an investment portfolio worth $6.4 billion, it can always tap if anything goes wrong. It would take housing meltdown as bad as the United States suffered in 2007-09 to do serious damage to Genworth. If you believe this was a fluke event, as I do, then you can sleep well at night owning Genworth shares.

Get paid to wait

Genworth offers one of Canada's best dividends, a terrific combination of current yield and dividend growth.

Let's talk about the dividend growth first. Genworth has hiked its payout each year since its 2009 IPO at an average rate of 8.7% annually. It has also paid several special dividends; the latest edition will give investors a $0.40 per share bonus on June 28.

Investors should also note that Genworth will likely announce another dividend increase in November.

Genworth's normal dividend comes in at $0.51 per share on a quarterly basis, which is good enough for a 4.8% yield today.

The bottom line

Where else can investors find a stock with this combination of yield right now, dividend growth potential going forward, an attractive valuation, and quality of underlying business? Genworth checks off all the boxes. That's why I own it in my portfolio. Perhaps you should too.

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