Bet on Canadian Real Estate With This Massively Undervalued Stock

Description

Many investors are concerned about the Canadian real estate market.

They're convinced a 2008-style housing crash is about to send housing prices sharply lower. After all, millions of Canadians are out of work, and even though economies are opening across the country, a recovery doesn't look to be very swift.

But something funny is happening. Despite significant economic headwinds, the Canadian real estate market simply won't crash. Many cities are reporting sales that are way down, but prices haven't really budged. Patient homeowners realize today's weakness is just temporary, so they're holding out for an attractive price. And buyers with solid jobs that haven't been impacted by the pandemic still feel confident enough to buy.

Yet despite this, many of Canada's top real estate stocks haven't rallied at all. Many are still close to 52-week lows. I'd argue this is a massive buying opportunity. The worst of the market crash is behind us and it's obvious Canadian real estate isn't going to crash. Today is the time to buy.

Let's take a closer look at one real estate stock specifically — a wonderful company in a niche business that is so profitable, it basically prints money. And now shares are cheap, representing the best time to buy in years.

A high-quality business

Let's talk a little bit about mortgage default insurance, which has quietly been an excellent business.

Mortgage default insurance protects the lender in case a borrower defaults on their mortgage. It's mandatory on all Canadian mortgages with less than a 20% down payment. Premium rates start as low as 2.4% if you have a 15-19.99% down payment and go as high as 4% if you have a 5-9.99% down payment.

The premium is paid for by the borrower but is financed by the bank. It's simply added to the mortgage balance. Banks can also pay smaller premiums to insure loans with 65-80% loan-to-value ratios.

There are three sources of mortgage default insurance in Canada. The largest is CMHC, the arm of the federal government. It has a dominant market share. **Genworth MI Canada** (TSX:MIC) is solidly in second place. Canada Guaranty is also a player in the market, but it's a distant third place today. The mortgage default insurance sector is essentially a two-horse race.

Genworth has historically been an excellent business. It charges an average premium in the 2% range and has defaults under 0.25%. And remember, even though the bank finances the mortgage insurance premium, the insurer gets the cash immediately. That means it can be put to work in various investments. Most of the investment portfolio is in bonds, of course. But riskier assets like preferred shares are owned as well, helping to goose overall returns.

In 2019, Genworth generated a little more than $850 million in revenue from a combination of insurance premiums and investment income. Net profit was $426 million. That's right; this company was able to post profit margins of more than 50%. You don't find that very often.

The opportunity

Genworth is a fantastic business when times are good. But what about during recessions? Can it survive a Canadian real estate crash?

Even if the market turns sharply lower from here, Genworth is fine. The company has been putting cash aside for a rainy day for years now. It has more than $6 billion worth of investments on the balance sheet, mostly in high-quality bonds that can easily be tapped if liquidity is needed.

Shares are also trading at approximately 20% under book value, which has proven to be an excellent time to buy historically. And the stock trades at just six times trailing earnings, which is a dirt-cheap valuation.

Investors are also treated to an excellent dividend as they wait for the company to recover. The current yield is 6.9% and it's likely Genworth will resume issuing special dividends when it's clear the Canadian real estate market has returned to normal.

The bottom line

Genworth MI Canada is an excellent business that is temporarily beaten down, because investors are worried about the Canadian real estate market. Don't miss out on this opportunity to buy this long-term winner for your portfolio.

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