Genworth | 中泛控股 CHINA OCEANWIDE HOLDINGS

BROXTON CAPITAL ADVISORS

Genworth Holders Offered 25% Of Book Value For Insurance Company Or $5.43 Share

November 21, 2016

Genworth (GNW) is being purchased by Insurance Company China Oceanwide (CO). GNW may have been extensively shopped without attracting a buyer. The bid of $5.43 doesn't really work because the current net value is $8-12 per share, The holding company DCF value is $16.96 and the book value is $19.40. This is our report regarding subsidiary values, the long-term care (LTC) operations, share value analysis and alternatives for shareholders. The conclusion is below (bottom of page). If we had to characterize this deal, we would say it makes no sense and jeopardizes the company. An avalanche of 262 claims could be waiting if the deal is completed (Pg. 5). The shareholders are required to approve the deal, which we recommend they deny, but the holders are graciously being offered an extortion dilemma in order to quell the why factor. Sell now! Or the company will suffer something worse! As you will see, as we slowly draw back the curtains, the company is worth more, there is stability and strength at the LTC unit, additional liquidity if desired and there are indeed suitable additional choices available. All without selling for a discount. Here are the pertinent points:

- Long-term care is accreting reserves
- GNW book value as of 9/30/2016: $19.40 per share
- Current value $8-12 per share
- Holding company DCF value $16.96 per share
- GNW has no need for investment currently
- No secured debt or liquidity concerns at the Hold Co
- USMI can borrow $1-1.5 billion
- Experience at LTC does not support charge (Pg. 15)
- 2016 YTD long-term care OIBA -$22 mm after charge
- Shareholders can unlock GLAIC value without CO
- The post deal company could face up to $2 billion in appraisal lawsuits

Holding company senior notes	Amount
6.52% SNT due 2018	598 mm
7.70% SNT due 2020	397 mm
7.20% SNT due 2021	389 mm
7.63% SNT due 2021	724 mm
4.90% SNT due 2023	399 mm
4.80% SNT due 2024	400 mm
6.50% SNT due 2034	297 mm
6.15% Floating Rate Junior Notes, due 2066	598 mm
Holding company total	3,802 mm
Holding company stats	**9/30/2016**
Investment	**$ Value in mm**
Cash & liquid investments	1,200 mm
Investments	550 mm
GNW MTG INS Canada	1,250 mm
GNW MTG INS Australia	700 mm
U.S. MTG INS (USMI)	3,000 mm
GNW Life Ins.	1-2.4,000 mm
Runoff	300 mm
Hold co. value	8,000-9,400 mm
Hold co. debt	(3,500) mm
Inclusive of $300 mm discount for the 6.15% JSNs	
Hold co. net value	4,500-5,900 mm
GNW shares outstanding	498 mm
Current value GNW share	**$9.04-11.87**
Current book value / share	$19.40
Subsidiary dividend DCF	$16.96

Conclusion: This deal does not make sense and if completed, the holding company could become insolvent due to 262 claims. The current values are above the offering price and we do not consider China Oceanwide to be an actual buyer, because their bid is too low. Our analysis of the LTC Subsidiary shows it is not in trouble, mismanaged and annoying from a GAAP basis. GNW management has responsibility for not over reserving in the 2014 audit. In addition, we feel they are mismanaging investor expectations. GNW management now thinks the best idea is to sell the company at a 30-70% discount to its value. GNW shareholders should say nay, there are multiple better options available.

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Simplified Holding Company Structure

Value estimated for each subsidiary: runoff, GNW AU, GNW CDN and USMI, value not stated but estimated for GNW Life is 1-2.4 $ billion. Book value shown includes AOCI

Background

On October 24th 2016, Genworth announced the sale to insurance company, China Oceanwide for $5.43, a 20 cent premium to the recent closing price or roughly 25% of book value. The deal has a $100 mm breakup fee for GNW and a $200 mm breakup fee for CO.

GNW can be considered two companies; the life insurance subsidiary (GLIC) and the mortgage subsidiaries. The life insurance subsidiary contains the majority of GNWs book value ($8.5 billion) and includes long-term care and Genworth life and annuities (GLAIC). <u>The sale is contingent on CO removing and isolating GLAIC from GLIC.</u> Thus extracting value to the holding company from the life Insurance subsidiary. GLAIC has a book value of $2.4 billion or $5 per share. We estimate the value of GLIC to be $1-2.4 billion or $2-5 per share.

The low bid may be from the rapid rise in GNW securities. When CO began its' due diligence in January of 2016, the stock was hitting a low of $1.50 and the bonds were trading below 50 in some instances. Fast forward to November 2016 and most of the bonds are trading above 100 and the stock has recovered over 200% (before the announcement of this deal). Since the offer seems very small, shareholders are being incentivized with:

- Long-term care insurance (LTC) problems
- Holding Company Liquidity
- Possible Ratings agency downgrades

Current Enterprise, DCF and Book Value

Table one shows our estimate for each subsidiary. We have estimated between $1 and $2.4 billion for the entire life unit. Although the book value is over $8 billion. The value per share is the net value after subtracting the holding company debt. Table two shows the current value of shares using a subsidiary dividend DCF model for the mortgage insurance subsidiaries only. Table three shows the current value of shares using a subsidiary dividend DCF model for the mortgage subsidiaries and GLAIC.

Sum of the Parts Valuation

Subsidiary	$ Value in billions
GNW Canada MI	1.25 publicly traded
GNW AU MI	.70 publicly traded
USMI	3.0
Holding company	1.75 cash and investments
Other	.3
U.S. Life	1-2.4
Total value	8.00-9.4
Gross value per share	$16.50-20.50
Holding company debt	(3.5)
Shareholders value (net value)	4.75-6.25
Value per share/ 498 mm shares	$9.04-11.87

Subsidiary Dividend Discounted Cash Flow Model with the Mortgage Subsidiaries Only

GNW subsidiary dividend DCF Model	
GNW subsidiary dividends	$450 million year
10 year growth rate	7%
Next 20 year growth rate	6%
Discount rate	7%
Value	$ 12.7 billion
Cash & investments	$ 1.75 billion
Holding company debt	$ (3.5 billion)
Holding company operating expense	$ (2.4 billion)
Net value	$ 8.45 billion
Value per share (498 mm shares)	$ 16.96

Subsidiary Dividend Discounted Cash Flow Model With Mortgage Subsidiaries and GLAIC

GNW subsidiary dividend DCF Model	
GNW subsidiary dividends	$650 million year
10 year growth rate	7%
Next 20 year growth rate	6%
Discount rate	7%
Value	$ 18.3 billion
Cash & investments	$ 1.75 billion
Holding company debt	$ (3.5 billion)
Holding company operating expense	$ (2.4 billion)
Net value	$ 14.15 billion
Value per share (498 mm shares)	$ 28.41

Book Value 3rd Q 2016

Book Value	
Book value per common share	$ 29.84
Book value per common share, excluding AOCI	$ 19.40

AOCI: accumulated other comprehensive income. In general the gains on bonds that will never be recognized because they are held to maturity.

262 Claims

The litigation risk involved in a cash purchase of a company 75% or $7.5 billion below its' book value is daunting due to the increasing usage of Section 262 under Delaware law.

Section 262 under Delaware Corporate law allows shareholders who have followed the rules, a court appraisal hearing after a cash buyout is completed. If the court finds that the appraisal is more than the purchase price it awards the plaintiffs the difference. There are no additional criteria. 262 lawsuits are a relatively new and quickly growing development. Andrew Sorkin NYT article, More information More information, and here. Since the buyout is at such a huge discount to the values, we believe that the deal may face a large contingency of dissenters upon completion. This could create liability of over $2 billion dollars from 262 claims. If the deal passes with a simple majority, up to 240 million shares could dissent. These lawsuits could immediately cause a financial strain on the recently purchased company and invoke the attention and involvement of State regulators thus making the company less healthy than it would be absent the acquisition.

We do not think that this acquisition can be completed if the 262 claims go beyond a certain level. Although GNW will not know the extent of the claims until after the purchase is completed. We believe that the threat of appraisal lawsuits could lead to a negotiated outcome for the purchase at a higher level, if it reduces litigation significantly.

Holding Company

Doesn't Need Cash

As part of the purchase, we are told that CO will pay off the debts maturing in 2018.

"As part of the transaction, China Oceanwide has additionally committed to contribute to Genworth $600 million of cash to address the debt maturing in 2018, on or before its maturity."

Shareholders will receive no compensation for the holding company injection and it is unnecessary. The holding company has over $1.2 billion in cash and liquid investments and $1.7 billion including investments. From the 3rd quarter conference call:

"Moving to the holding company, we ended the quarter with approximately $1.2 billion of cash and liquid assets, which represents a buffer of approximately $720 million in excess of 1.5 times our annual debt service and restricted cash"

The holding company has sufficient liquidity through 2020. The 2018 maturity is a $600 million issue and the interest cost is $40 million annually. These notes are continuously callable at 100. After the redemption of the notes, holding company interest payments drop to $184 million annually and there are no maturities until 2020.

The 2018 notes should be called by GNW. (Holding Company Debt is on page 1). The holding company only needs $1.4 billion to address interest and maturities over the next four years. In addition, we expect at least $1.6 billion in dividends through the same period. So the contribution of capital to the Holding company of GNW by Ocean Wide is unnecessary.

Mortgage Insurance Subsidiaries

GNW's mortgage insurance subsidiaries are worth about $10.00 per share of GNW. There are three subsidiaries:

USMI

U.S. mortgage Insurance or USMI has 2016 operating income of $292 million dollars and a book value of $2.089 billion. We value the unit as being worth $3 billion or $6 per GNW share. Investors can view MTG and RDN as comparisons. GNW owns 100% of USMI.

GNW Australia

GNW Australia is publicly traded on the ASX, the symbol is GMA.AX. Genworth Holding Company owns 55% of the shares. We valued Genworth's net portion of the company at $700 mm. Genworth's portion of GNW Au has a book value of $687 million.

GNW Canada

GNW Canada is publicly traded on the Toronto Exchange. The symbol is MIC.TO. Genworth Holding Company owns 53% of the shares. We valued Genworth's net portion of the company at $1.25 billion. Genworth's portion of GNW CDN has a book value of $1.6 billion.

At this time the mortgage subsidiaries are the primary dividend payers to the holding company. Our projected dividends to the holding company are below. USMI is on a run rate to accomplish close to $400 mm in pretax income in 2016. Part of the reason for the improvement is the continuing decline in delinquencies since 2008.

GNW Mortgage Subsidiaries 2015 Annual Data in millions			
Subsidiary	**Revenues**	**Pretax Income**	**Dividend Capability to GNW**
USMI	$ 665 mm	$ 278 mm	$ 250 mm
GNW AU (55% owned by GNW)	$ 474 mm	$ 267 mm	$ 80 mm
GNW CDN (53% owned by GNW)	$ 564 mm	$ 348 mm	$ 120 mm
Totals	$ 1,703 mm	$ 893 mm	$ 450 mm

U.S. Life

*GNW life insurance or **GLIC** is the subsidiary that holds the long-term care insurance, life insurance and annuity subsidiaries. GNW life and annuity or **GLAIC** is currently part of GLIC.*

The group is responsible for 75% of GNW's revenues. The book value of the U.S. life subsidiary is $8.5 billion. In order to be conservative, we value the entire subsidiary at $1-2.4 billion.

GLAIC has an operating income run rate of roughly $300 million per year and a book value of $2.4 billion If GLAIC can be separated from long-term care they could be worth $2-3 billion or $4-6 per GNW share. The buyout is contingent on this. Book values for U.S. life subsidiaries without AOCI

GNW U.S. Life Subsidiary (GLIC)			
Subsidiary	GLAIC	2015 Revenues	3rd Quarter 2016 Book Value
Long-Term Care		$ 3.75 Billion	$ 5.97 Billion
Life Insurance	GLAIC	$ 1.9 Billion	$1.92 Billion
Fixed Annuities	GLAIC	$ .89 Billion	$ .700 Billion
Totals		$ 6.54 Billion	$ 8.6 Billion

We do not have any further analysis of the U.S. Life subsidiaries other than our opinion that the group is conservatively worth at least $1 billion and up to $2.4 billion. We do have an extensive analysis of the long-term care unit below in order to demonstrate that LTC is not in a position or trajectory to implode or financially harm the rest of the company.

Long-Term Care

The LTC Subsidiary shows it is not in trouble, mismanaged and annoying from a GAAP basis.

Introduction

The long-term care subsidiary provides in home hospice and nursing home insurance. As of 2014, GNW had 1.22 million insureds and close to 42,000 active claims or 3.4% of the insureds. As of 3rd quarter 2016, GNW had total reserves and surplus of $34.9 billion. GE through affiliate UFLIC (Union Fidelity Life Insurance Company) coinsures 25-30% of the liabilities.

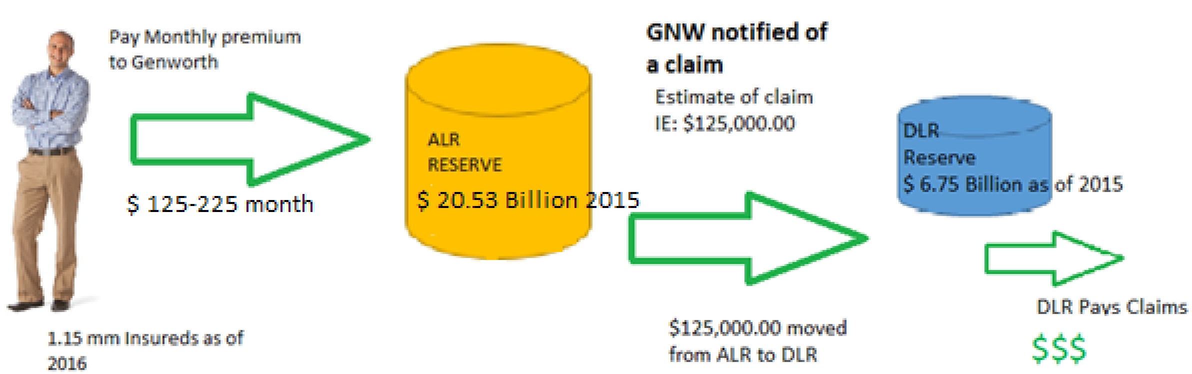
There is no way that LTC is going to have a cash payment problem in the next 25 years. To put it in perspective: If cash payments to beneficiaries tripled in 2017 to $5 billion and stayed there, and revenues stayed at $4 billion annually, LTC would not run out of money until 2046 or so. The main problem is the accounting annoyance from a GAAP basis. The GNW LTC reserve is about 15 X the market cap of GNW shares, or $30 billion, so a 2 or 3% increase in reserves causes a $1 billion dollar "flow through" loss for the shares. Importantly, Genworth shareholders are not required to add additional monies to the LTC sub and the holding company values are not dependent on LTC. If you want to see what an insurance company looks like when it "skips the rails" we recommend the Reliance Group Holdings 3rd quarter 2000 10Q.

Cash payments to beneficiaries in 2015 were $1.52 billion. We estimate 2016 Beneficiary payments to be $1.65 billion (an increase of 8.6%). <u>We estimate revenues for both years to come in at close to $7.8 billion. Reserve additions, after cash payments to beneficiaries, for both years is roughly $3.8 billion.</u> As you can see, the subsidiary is accreting reserves. The annual cash payments as a percentage of reserves and surplus are 4.7%. Cash payments as a percentage of revenue are 41%. Cash additions to the reserve are about $2 billion a year. In the next sections we review the subsidiary.

ALR & DLR

The $28.9 billion in reserves are divided into two buckets: The active life reserve (ALR) and the disabled life reserve (DLR). When a claim is made or an insured goes on claim, GNW allocates reserves from the ALR to the DLR. At this time an estimate is made for the claims impact on the DLR. For instance, a much lower reserve would be allocated for someone with an end of life terminal condition versus a younger person who is disabled due to a condition such as Alzheimer's disease.

SIMPLE DIAGRAM, dollar amounts are yearend 2015:



DLR Account: 2013 Through 3rd Quarter 2016

Factors effecting the DLR Claim estimate

- Severity: how long will person be on claim?
- How much of the available benefits will be utilized?

The following is the DLR gross and net of reinsurance for 2013 through 2015

GNW DLR (Amounts in millions)	2016 YTD	2015	2014	2013
Beginning balance as of January 1	6,749	6,216	4,999	4,655
Less reinsurance recoverables	-2,055	-1,926	-1,707	-1,574
Net balance as of January 1	4,694	4,290	3,292	3,081
Incurred related to insured events of:				
Current year	1,546	1,655	1,474	1,323
Prior years	378	39	726	3
Total incurred	1,924	1,694	2,200	1,326
Paid related to insured events of:				
Current year	-82	-151	-134	-131
Prior years	-1,160	-1,371	-1,263	-1,160
Total paid	-1,242	-1,522	-1,397	-1,291
Interest on liability for policy and contract claims	188	232	195	176
Net balance as of December 31	5,564	4,694	4,290	3,292
Add reinsurance recoverables	2,090	2,055	1,926	1,707
Ending balance as of December 31	7,654	6,749	6,216	4,999

Years with charges are highlighted in yellow. The correct actuarial projection, premium increases and investment income projection are the key to managing this subsidiary.

Genworth LTC Gross Profit

Gross profit: before operating expenses (Opex) and amortization of intangibles. Also included, OPEX and OIBA.

Period	2016 pre charge estimated	2016 post charge estimated	2015	2009-2016 pre charges	2009-2016 post charges
Gross Profit	$793	$368	$584	$5,486	$3,728
OPEX	$ 377	$ 377	415	$3,194	$3,194
OIBA	$416	$45 (w $54 tax refund)	$169	$2,292	$534

The 2014 Audit

In 2014 the company conducted an extensive actuarial audit and raised the reserves for the LTC unit. A limited amount of information has been distributed in the company filings since 2014. **2014** Company presentation

Walk-Through

As of December 31, 2015, GNW reported Total projected liabilities and reserves in the long-term care subsidiaries of $27.3 billion. In addition, the LTC subsidiaries have excess reserves of $5.9 billion. In 2015, gross profit was $584 million (OIBA+ operating expenses). Operating costs were about $415 million. Operating income before amortization (OIBA) was $169 million.

LTC reserves, costs & additions	2015	
Total reserves beginning	**25.5 B**	***Total reserves beginning***
Total revenues	3.75 B	
Beneficiary payments 2015	-1.52 B	***+ premiums and investment income (revenue)***
Operating expense	-.42 B	***-beneficiary payments***
Increase in reinsurance	.13 B	***- Operating expense***
Profit (OIBA)	-.17 B	***+ reinsurance***
Total reserves ending	**27.3 B**	***– OIBA***
2015 reserve additions	**1.8 B**	***2015 reserves ending***
Surplus	5.9 B	
LTC reserves + surplus	**33.3 B**	

LTC reserves, costs & additions	2016 YTD
Total reserves beginning	**27.3 B**
Total revenues	3.05 B
Beneficiary payments 2016	-1.24 B
Operating expense	-.28 B
Increase in reinsurance	.04 B
Profit (OIBA)	.02 B
Total reserves ending	**28.9 B**
2016 charge	**.425 B**
2016 Reserve additions	**1.2 B**
2016 Total reserve additions	**1.6 B**
Surplus	5.9 B
LTC reserves + surplus	**34.9 B**

As we can see in both tables: 2015-2016 YTD; LTC reserves have increased by $3.4 billion or "in a healthy manner."

Reserves increased by $1.6 billion in the first 9 months of 2016 including the addition of the $425 million charge.

Actual payments to beneficiaries are on a run rate of $1.65 billion for 2016, an increase of $130 million from 2015.

Gross profit for 2016 YTD is $207 million after the charge. Operating costs are $283 million. OIBA + tax refund is - $22 million for 2016 year to date.

Policy Groups

The policy groups (as of 2014) are shown below. GNW has indicated that the first four blocks or buckets are the most mispriced.

The chart below was provided as part of the 2014 review. As was shown in 2014, GNW had 1.22 million insureds and close to 42,000 active claims or 3.4% of the insureds. GNW has indicated that the amount of insureds activating claims has not increased as a percentage but the costs per claim has risen. In essence, GNW is seeing the rise in the cost of health care.

3rd Q 2014 LTC snapshot									**totals**
INS blocks or buckets	Pre PCS	PCS 1	PCS 2	Choice 1	Choice 2	PC Flex	MFMP	PC Flex 2	
Annual premiums (MM)	$81	$152	$383	$641	$872	$245	$102	$53	$2,529
Insureds (1,000)	70	68	187	315	415	98	45	22	1,220
Policies (1,000)	70	68	170	290	346	98	45	22	1,109
Avg. Age	85	82	76.1	68.7	64.9	59.7	63	58.7	
Unlimited coverage (Lifetime)	58.00%	36.00%	32.00%	32.00%	14.00%	4.00%	5.00%	0.00%	
Avg. premium (annual)	$1,191	$2,325	$2,228	$2,080	$2,108	$2,496	$2,259	$2,415	
Avg. daily max benefit	139	171	189	216	191	169	158	154	173.38
Avg. benefit period (years)	3.7	3.7	3.5	3.5	4	4	3.6	3.9	3.7375
Active claims	9,261	10,915	12,769	6,811	2,032	49	47	4	41,888
Amount in DLR ($ Billions) EST	$1.52	$1.80	$2.10	$1.12	$0.33	$0.008	$0.007	$.000	$6.910
% of bucket disabled	13.2%	16.1%	6.8%	2.2%	0.5%	0.1%	0.1%	0.0%	3.4%

Furthermore, we can see that in the insurance blocks (first highlighted line) Pre PCS, PCS 1 and PCS 2 have 75% of the disabled claims. Importantly in relation to severity, the unlimited coverage feature is prevalent in these blocks.

(GNW 2014 LTC review statement): Claim Durations 4+ Years increased ~10-13 percentage points. Expected length on claim established when a policyholder initially goes on claim moved from 2.2 years to 2.9 years primarily due to the changes observed in the later years of claim.

LTC Problems

First of all we reiterate that there is no way that the GNW LTC reserve will blow up or run dry in the next 25 years based on several extreme scenarios, such as the one contained at the end of this section. Also, the holding company is not required to add any additional monies to the unit. So, again the main problem is the accounting annoyance from a GAAP basis. The GNW LTC reserve is about 15X the market cap of GNW shares, or $30 billion, so a 2 or 3% increase in reserves causes a $1 billion dollar loss for the shares. This is not a threat to the LTC subsidiary. The 2016 charge took the unit to negative $22 million OIBA, and we expect that to return to positive in the 4th quarter. There is no threat to the holding company, outside of the massive "flow through" of accounting losses caused by the adjustments in LTC reserves. However, we would add that management does a poor job of explaining this.

There are three main problems with LTC: Its' hard to price, lower interest rates and management's ability to course correct by requesting timely and accurate premium increases. LTC insurance is priced once with increases allowed. This can cause more of a miss match over the 20 to 30 year period. According to GNW: "A Reserve is established when a policy is sold and then a reserve builds until death, lapse or claim. The Accounting practice locks In an ALR assumption at the time the policy is issued. The Locked-In Reserve Basis Can Result In Sufficient, Over Or Under Funding Of Future Claims." GNW 2015 review So LTC is not easy to price correctly. In addition, interest rates have generally been below the forecasted rate. If rates were 1% higher, Genworth's LTC unit would have had an additional $1 billion in revenue over the last 4 years. So there is no doubt that lower rates have had a primary impact. We do see a bright spot in the higher recent rates and the possibility for them to continue higher. The third problem is management not forecasting correctly and increasing premiums in a timely manner. This can be pretty subjective but management needs to over reserve if the unit is to remain profitable on a GAAP basis. This is not impossible:

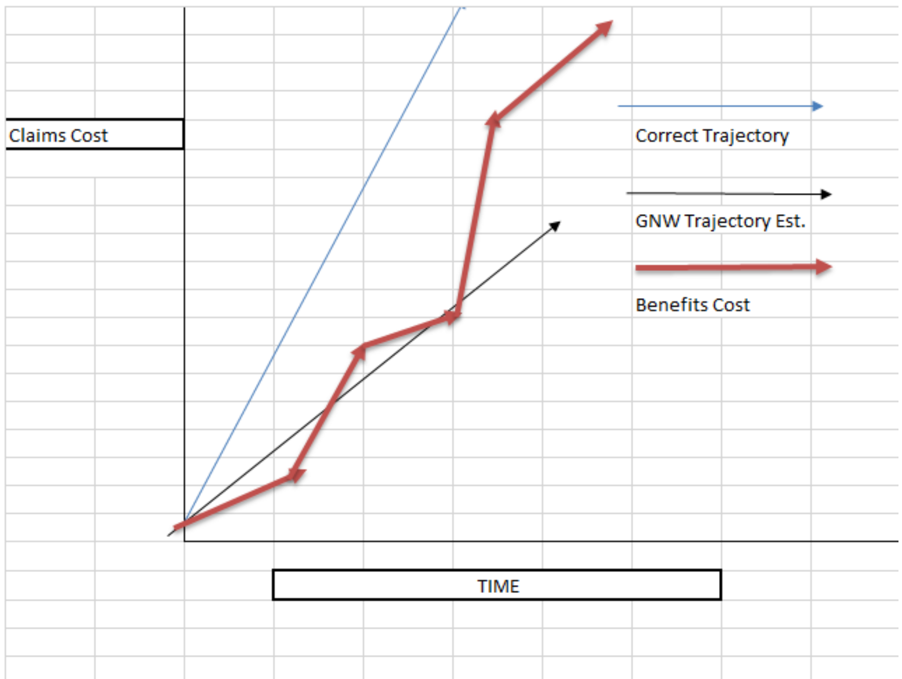
Aetna and Humana manage rising health care costs continuously and are able to generate profits.

The critical factor for GNW is requesting and receiving the premium increases for the different lines in the LTC subsidiary. State regulators allow premium increases for LTC insurance, based on actuarial changes, due to the rising cost of providing long-term care insurance. This is the key to maintaining the balance.

Genworth Management:

"Extensive discussions with our primary regulators indicate that they understand that LTC rate actions are the key to improving the financial position of GLIC and as I've said before, they understand why we need our life and annuity business to pay some level of dividends to the holding company to reduce our debt and strengthen the financial position of the holding company".

Chart Below: mismatched LTC cost trajectory example



GNW must estimate the correct growth rate in benefits and investment return and adjust the premiums in order to comfortably cover the benefits. GNW has not been able to do this. The reason cited is cost of claim due to increase in health care costs or length on claim. Basically GNW estimated the wrong trajectory on some of the blocks and interest rates are lower than projected. We suggest estimating a more aggressive growth rate in order to exceed the costs. Although, this is not too much of a problem. Cash costs have been around $700 million for the charges in 2014 and 2016. In the context of a $30 billion + dollar reserve and surplus we feel this is a big number to stock investors but not significant in the context of this insurance unit.

15 year hypothetical Armageddon Scenario snap shot for LTC

LTC	$ Billions
Current Reserves	28.9
reserves added assuming a 6% growth rate in premiums	51.85
Investment return at a rate 0f 5.5%	27.0
Benefits paid assuming 25% (288,000) of all “currently not on claim” insureds invoke coverage at a cost of $300,000.00 each+ current claims ($7.6 B)..New cash costs avg. $5.8 billion / year	(94.0)
Operating costs	(9.0)
Remaining + surplus	10.65

In the above chart, we show a hypothetical Armageddon projection for 15 years. Cash benefits paid increases by about 300% per year on average.

Why We Do Not Have Faith in the 2016 Charge

In October of 2016, GNW announced an additional charge to the LTC subsidiary of $425 million. We are not sure about this charge against the backdrop of actuarial missteps at GNW. Also the charge seems timely considering the current deal effort. We note that shareholders would not be likely to enter into a transaction 20 cents above the trading price and at 25% of book value without a problem. At the same time the due diligence for this deal began in January of 2016 when the stock was a lot lower and the bonds were below 50 in some instances.

The 2016 review seems to be a lot less comprehensive than the 2014 review and the 2016 review did not include external data or actuarial consultants as did the 2014 review. The 2016 reserve additions are not independently verified and confirmed. Also, we do not have any management explanations, presentations or strategies for addressing the new charge. Management has not produced the same kind of accountability for the 2016 charge. Source: GNW Financial Supplements

For the last three years, payments to beneficiaries have increased at a rate of 8.6%, in 2016 payments increased 8.7%. In 2016, premiums and investment income increased $173 million and payments increased $133 million. So revenue increases are staying ahead of benefit costs. We don't think it looks like there has been a change in the "experience" preceding the 2016 charge. In fact 2016 has improved over 2015. 2015 pretax income was $70 mm vs. 2016 projected pretax income of $149 mm (before the charge). We are within the actuarial channel for long-term care.

In addition, there is an anomaly in the premium recognition for 3rd quarter 2016. We find that in the third quarter of 2016 premium revenue drops 1.5% from the first quarter. GNW has not had a sequentially lower quarter intra year in premium recognition in the last five years we reviewed. This means that every quarter in the same year premium revenue increases sequentially. This is common in health care. The average increase for premium revenue in the 3rd quarter from the first quarter is 5% for the GNW LTC over the last five years. If we adjust the premium to 5% higher than 1st Q, we attain an additional $31 million in revenue and a more normal experience. This experience would be better than the 2015 average. Even without our adjustment the quarter is pretty normal. The GNW reported benefits and accruals as a percentage of revenue are at 86.9% and below 3rd quarter 2015. There is no explanation for 2016 3rd quarter drop in premium. There is no corresponding drop in insureds or prices. If the insured pool were to drop by 1.5% this would lead to a release of reserves in the ALR and a profit. Therefore, we are suspicious of the revenue drop.

Also, there is no corresponding increase in the reinsurance recoverables for 3rd quarter 2016. In 2014, reinsurance recoverables increased by 65% with the 2014 charge and dropped back to normal in 2015. In 2016, there is no increase in insurance recoverables commensurate with the claim.

The charge also equals almost exactly 100% of the units OIBA, or cash generation, for 2016. This is unlikely but, in the context of a spurious charge, it delivers the maximum effect to investors and tax benefit without causing any regulatory attention.

Without the charge, GNW's LTC unit is having its most profitable year (highest operating income) in the last six years. Since there is additional investment gain in this year, we subtracted the investment gains and we project that 2016 will be the third most profitable year for LTC in the last six years: 2016 projection: $149 mm, 2011 $146 mm, 2012 $150, 2013: $184, 2014 negative, 2015: $70 mm. By all measures 2016 is better than 2015.

A cynical person would say that the charge may not be legit. Or revenue recognition was slowed to show an experience that justifies the charge. We are not saying this, but we are aware of these details, facts and circumstances and as a result we do not have confidence in the charge. The backdrop are the actuarial missteps at Genworth and the need to get this deal done. In addition, the charge is the responsibility of management for not properly reserving or over reserving. Aetna and Humana manage rising costs and are able to generate profits. GNW needs to correctly asses these costs and if unsure, over estimate these costs.

Alternatives to Current Deal:

- Borrow from USMI pay the additional monies to the life unit and separate GLAIC into the holding company and retain the $5 per share in book value;
- Do a rights offering or a secondary with the current shareholders;
- Correctly asses the projections at LTC and return it to profitability;
- Continue to own the holding company. The discounted cash flow value is over $8 billion and the book value is over $19.00.

Conclusion: Holders Should Vote No, This Deal Makes No Sense

GNW shareholders are being enticed into a deal which makes no sense. The DCF value of the dividends of the mortgage subsidiaries to the holding company is over $16.00 per share. The current value is between $8 and 12 per share. The book value is $19.40 per share. Adding GLAIC to the DCF model gives us a value of over $28.00 per share. The company is worth at least $10.00 per share in all scenarios but why would someone sell the company here. If there is no buyer at the correct price, there is no buyer. We recommend that shareholders do not sell the company for $5.43 per share.

In order to get this deal done management has shown us holding company liquidity, long-term care problems and ratings actions.

LTC Not in Danger: There is no danger of the long-term care unit (LTC) blowing up the other valuable subsidiaries. LTC has increased reserves by over $5 billion from 2013 through 2015. GNW shareholders are not required to invest any additional monies in LTC. The subsidiary could also become massively profitable.

No Ratings Downgrades Coming: Furthermore, we do not believe there is a chance of risk jumping from one subsidiary to another and we do not believe that any of them are in danger of being downgraded due to LTC or GNW Life. Each sub we have reviewed is its own standalone rated company.

The Holding Company Does Not Need Cash: In addition to the buyout being as much as 59% below these values, we believe the completion will create an avalanche of 262 claims under Delaware law leaving the holding company insolvent.

Why is management and the board of directors doing this? Many times we find that there are bonuses and contractual salary raises on the other side of the deal. We don't know because we could not locate any disclosure but we believe that this is the case. As a special note, we see that almost all of the groups in the buyout have legal and banker representation except the shareholders. We urge shareholders to vote no.

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