

MANULIFE FINANCIAL CORP.

(MFC-TSX \$36.90)

Recommendation

Buy

Risk

Low

Target Price

\$45.00

Price

\$36.90

52-Week Range

\$33.77 – 44.23

% Below High

-16.6%

% Above Low

9.3%

Shares O/S

1,497million

Market Cap

\$55 billion

Average Daily Volume

20 day: 1,005,500

Year-End

December 31

C\$	EBITDA	Multi.
2007a	\$2.83	13.0x
2008e	\$2.90	12.7x
2009e	\$3.30	11.2x
Book Value	\$16.33	2.3x

	Amount	Yield
Dividend	\$0.96	2.6%

Analysts

Robin Cornwell B.A. (Economics),
MBA



Data Source: www.BigCharts.com

FIRST-QUARTER REVIEW

HIGHLIGHTS

- Q1/08 Earnings Hurt by Weak Equity Markets
- Underlying Earnings OK
- Up 14% Excluding Impact of Fair Value Accounting and Foreign Exchange
- D'Alessandro To Retire Next Year

CONCLUSION

BUY: 12-Month Target Lowered to \$45

Overall a very difficult quarter, with EPS about \$0.17 or 20% below our estimate. However, this shortfall was almost entirely due to the impact of lower equity markets and new accounting rules (commonly referred to as fair value accounting) which require the mark to market of securities at the end of each quarter. This new fair value rule, which did not exist last year, cost MFC \$265 million after-tax or \$0.18 per share this quarter. In addition, the currency impact of the stronger C\$ versus the US\$ impacted EPS by a further \$0.05.

As such, MFC reported EPS (fd) in Q1/08 of \$0.57 per share down 18% Y/Y. Reported ROE was 15.1%, down from 20.5% last quarter. On a constant currency basis, and excluding this fair value accounting, the underlying EPS at MFC increased by 14% (about \$0.79 per share).

To be clear, if the mark to market of securities had occurred at the end of April, \$150 million of this reserve would not have been required. Although there is logic behind the new fair value accounting rules as far as transparency is concerned, a new solution or variance would appear to be needed as life insurance companies are long-term investors and yet are now required to treat many securities as though they are to be liquidated at the end of each quarter.

Our 2008 EPS forecast has been lowered to \$2.90 from \$3.03, reflecting the market uncertainty and lower AUM growth expected this year. Our 2009 EPS estimate of \$3.35 has been lowered modestly to \$3.30. We expect that the stronger \$C relative to the \$US will continue to be a negative for the next quarter but, assuming it remains near par, we could see a positive impact on EPS in the second half. Excess capital of about \$3 billion should allow MFC to take advantage of acquisition opportunities, albeit not in the near-term until a new CEO is appointed. Although the dividend was not increased this quarter, which had been widely expected, we believe it will be increased over the next 12 months to at least the \$1.02 to \$1.04 per share level for an increase of 6% to 8%.

We continue to recommend MFC as a BUY based on the following: (1) earnings are extremely well diversified globally (50% U.S.) and well positioned in Asia; (2) we are very impressed with the growth in wealth management and believe MFC is pushing more in this direction; (3) Canada and the U.S. remain solid; and (4) excess capital should support acquisitions, share repurchases and dividend increases, albeit less aggressively. Total 12-month expected return is 24.7%.

Valuation

We believe MFC has very strong fundamentals as discussed above and continues to justify a 5% premium valuation to its peers even after a new CEO is appointed. We have lowered our 12-month share price target modestly to \$45.00 from \$46.00.

Equity Markets Hurt

The impact of volatile equity markets and new accounting rules (commonly referred to as fair value accounting), which require the mark to market of securities at the end of each quarter, was far greater than we had expected. This new fair value rule, which did not exist last year, cost MFC \$265 million after-tax or \$0.18 per share this quarter. Management noted that although the S&P/TSX and S&P 500 were off 3.5% and 9.9% respectively, the Hang Seng and Nikkei 225 were off significantly more at 17.8% and 18.2% respectively. As at the end of April, \$150 million of this reserve would not have been required.

Other Quarterly Highlights

- MFC reported EPS (fd) in Q1/08 of \$0.57 per share, down 18% Y/Y (excluding an accounting adjustment in Q1/07 of \$0.04 per share). MFC reported operating Q1/08 net income of \$869 million, down from \$1,144 million last quarter and \$986 million last year. Constant currency net earnings were down 5% Y/Y.
- Total FUM (funds under management) at quarter end were \$400 billion, down 6% Y/Y; however, again if the currency impact is removed, it was closer to a 2% increase Y/Y.
- Total U.S. Protection reported Q1/08 net income of US\$208 million, up 34% Y/Y from US\$155 million. Of the total, JH Life's net income was US\$143 million, up 25% Y/Y. John Hancock Life sales were strong at US\$209 million up 42% Y/Y, driven by solid sales across all product categories. JH Long Term Care (LTC) net income was US\$65 million, up 59% Y/Y driven by favourable investment gains.
- U.S. Wealth Management reported Q1/08 net income of US\$90 million, down from US\$154 million as asset-driven fee income declined and reserves were increased on segregated fund guarantees. Total AUM decreased 19% Y/Y.
- The Canadian division reported steady earnings, with net income in Q1/08 of \$254 million, up 6% Y/Y. Individual Insurance sales were strong at \$74 million in the quarter up 23% Y/Y. Wealth management suffered from lower equity markets as previously discussed. Segregated fund sales increased 32% Y/Y driven by the Income Plus product. Manulife Bank continued to experience strong loan growth up 21% Y/Y.

- Asia and Japan reported earnings of US\$186 million, a gain of 20% Y/Y. The earnings were driven by strong insurance sales in Japan, up 130% Y/Y, which is a significant change from stagnant sales over the last several years. Other Asia sales were up 22% as a result of agency expansion. Wealth Management had strong sales growth in pension products particularly in Hong Kong.
- During the quarter, MFC repurchased 4.8 million shares for \$180 million.

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