

MANULIFE FINANCIAL CORP. (MFC-TSX-\$36.25)

Recommendation

Buy

Risk

Low

Target Price

\$43.00

Price

\$36.25

52-Week Range

\$44.23 - \$33.22

% Below High

-18.0%

% Above Low

9.1%

Shares O/S

1,495 million

Market Cap

\$54 billion

Average Daily Volume

20-day: 3,445,200

Year-End

December 31

C\$	EBITDA	Multi.
2007a	\$2.83	12.8x
2008e	\$2.75	13.2x
2009e	\$3.25	11.2x
Book Value	\$16.29	2.2x

	Amount	Yield
Dividend	\$1.04	2.9%

Analysts

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Data Source: www.BigCharts.com

SECOND-QUARTER RESULTS

HIGHLIGHTS

- Earnings Hurt By Weak Equity Markets
- Solid Performance for Underlying Operations
- Dividend Increased By 8%

CONCLUSION

BUY: 12-Month Target Lowered To \$43.00

Manulife Financial (MFC) reported EPS of \$0.66, down 7% Y/Y and about \$0.06 below our estimate. However, if a tax provision of \$0.02 per share and a currency hit of \$0.03 were to be excluded, the earnings would have been basically flat Y/Y. Earnings this quarter were also impacted by weak equity markets, resulting in lower security gains on available-for-sale (AFS) assets, unfavourable claims experience in reinsurance, and increased strain on higher insurance sales. The dividend per share was increased by 8%, from \$0.96 to \$1.04 annually, reflecting MFC's strong equity base.

Our 2008 EPS forecast has been lowered to \$2.75 from \$2.90, reflecting the weak equity markets and lower AUM growth expected this year. Our 2009 EPS estimate of \$3.30 has been lowered modestly to \$3.25. The strong Canadian dollar relative to the U.S. dollar has been a significant negative on earnings over the last 18 months; however, its recent weakness below par should prove to be a positive for EPS in the second half. Excess capital should allow MFC to take advantage of acquisition opportunities. We believe MFC's dividend will be increased over the next 12 months to at least the \$1.10-\$1.14 per share level, for an increase of 6%-9%.

We continue to recommend MFC as a BUY, based on the following: (1) no major credit-related issues; (2) earnings are extremely well diversified globally (50% U.S.) and well positioned in Asia; (3) we are very impressed with the growth in wealth management and believe MFC is pushing more in this direction; (4) Canada and the U.S. remain solid operationally; and (5) excess capital should support acquisitions, share repurchases and dividend increases, albeit less aggressively. Total 12-month expected return is 21.4%.

Valuation

We believe MFC has very strong fundamentals as discussed above, and continues to justify an 8% premium valuation to its peers. We have lowered our 12-month share price target modestly to \$43.00 from \$45.00, reflecting our lower EPS outlook.

Other Quarterly Highlights

- **MFC reported operating Q2/08 net income** of \$1,008 million, or \$0.66 per share, up from \$869 million last quarter but down 6% from \$1,070 million last year. Constant-currency net earnings were down 3% Y/Y.
- **Total Funds Under Management (FUM)** at quarter end were \$400 billion, down 3% Y/Y; again, however if the currency impact is removed, FUM was flat Y/Y.
- **Total U.S. Protection** reported Q2/08 net income of US\$221 million, up 23% Y/Y from US\$179 million. Of the total, JH Life's net income was US\$142 million, up 5% Y/Y. John Hancock Life sales were strong at US\$243 million, up 22% Y/Y, driven by solid sales across all product categories and market share gains. JH Long Term Care (LTC) net income was US\$79 million, up 80% Y/Y, driven by favourable claims experience offset in part by higher new business strain. LTC sales decreased 31%, as sales were exceptionally strong in the same quarter last year.
- **U.S. Wealth Management** reported Q2/08 net income of US\$268 million, up 14% from US\$235 million in the same period last year. Net income from variable annuities and pensions decreased Y/Y by 15%, driven by weak equity markets and slower sales of variable annuities and pension products. Total AUM decreased 4% Y/Y. Net income from fixed products increased to \$136 million, up 72%, reflecting strong investment gains.
- **The Canadian Division** reported record earnings, with net income in Q2/08 of \$302 million, up 2% Y/Y. Individual Insurance sales continued strong at \$84 million in the quarter, up 12% Y/Y, but net income declined 14% due to higher strain. Wealth management benefited from strong net flows of almost \$1.0 billion. Segregated fund sales increased over two-fold Y/Y, driven by the Income Plus product. Manulife Bank reported a 33% increase in loan growth Y/Y, driven by the ManulifeOne home-collateralized line of credit product.
- **Asia and Japan** reported earnings of US\$212 million, down 1% Y/Y. Sales in Japan doubled, driven by the launch of a new cancer product. Other Asia sales were up 22%, as a result of agency expansion and strong sales in Singapore and China.
- **Reinsurance** was the weak spot this quarter, reporting net income of \$45 million, down 27% Y/Y. The decrease was mainly due to unfavourable claims experience and weak equity markets.
- **Corporate** reported a loss of \$40 million in the quarter, a decline of \$97 million from the same quarter last year. The primary drivers were lower gains realized on AFS assets and private equity holdings, and a tax-related charge of \$33 million on leveraged lease investments.

- **Three tax-related contingencies** are outstanding. In Canada, tax changes could increase net income by \$169 million, whereas in the U.S. an appeals process could see benefits of \$107 million. However, issues related to the tax treatment of leveraged leases required an increase in MFC's tax provision by \$33 million, for a total provision of \$178 million to date. Should the tax attributes of MFC's leveraged leases be fully denied, the maximum after-tax exposure would be an additional \$382 million including interest.

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