

MANULIFE FINANCIAL CORP.

(MFC-TSX-\$25.25)

Recommendation

Buy

Risk

Low

Target Price

\$35.00

Price

\$25.25

52-Week Range

\$42.90 - \$21.17

% Below High

-41.1%

% Above Low

19.3%

Shares O/S

1,492 million

Market Cap

\$39 billion

Average Daily Volume

20-day: 5,900,000

Year-End

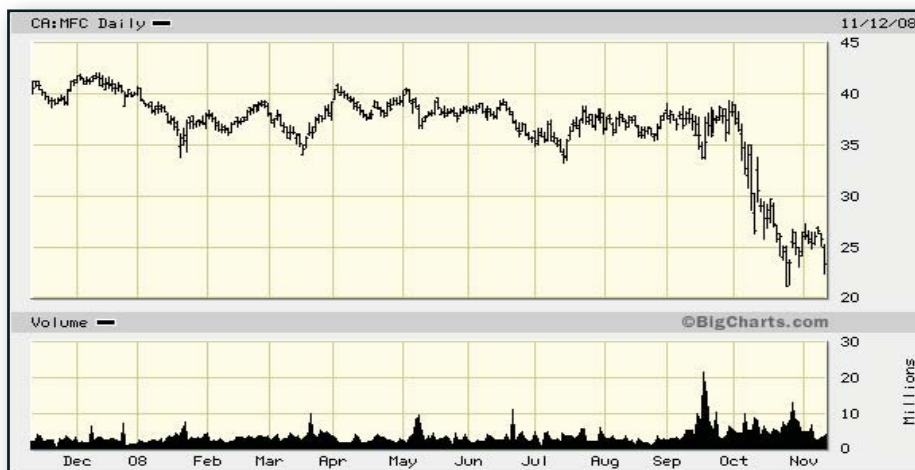
December 31

C\$	EBITDA	&Mult
2007a	\$2.83	8.9x
2008e	\$2.00	12.6x
2009e	\$2.90	8.7x
Book Value	\$16.41	1.6x

	Amount	Yield
Dividend	\$1.04	2.9%

Analysts

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Data Source: www.BigCharts.com

THIRD-QUARTER RESULTS

HIGHLIGHTS

- Q3/08 Earnings Hurt By Weak Equity Markets
- \$3 Billion Unsecured Loan Secured To Boost Capital
- Dividend Secure

CONCLUSION

BUY: 12-Month Target Lowered To \$35.00

Manulife Financial (MFC) reported EPS of \$0.33 down from \$0.70 in the same period last year and \$0.66 last quarter. This was in line with our revised EPS expectations as reflected in our report of October 15, 2008. Approximately \$574 million of the earnings shortfall was attributed to equity market declines with an additional \$253 million attributed to credit losses. Operating earnings excluding the latter remained relatively solid.

Management announced a \$3 billion bank financing to maintain strong capital ratios. The latter was somewhat of a surprise but nonetheless considered a prudent move by management as MFC's MCCR capital ratio will increase to about 225%, well above 193% as at the end of Q3/08 and the minimum required of 150%. Management was very clear that it had no intention of lowering the dividend and indicated that a further 25% decline in equity markets would still maintain the capital ratio within their targeted range of 180% to 200%. We highly endorse this action particularly given that it is not materially dilutive to shareholders.

Our prior 2008 EPS forecast of \$2.30 has been revised lower to \$2.00 as we expect volatile equity markets to persist for some time. Slower business volumes are expected for the wealth management sector and as well for the segregated fund

business. However underlying earnings remain solid and the \$C below US\$0.90 will be a plus in 2009. Our 2009 EPS estimate has been lowered to \$2.90 from \$3.10 (the latter was lowered on October 15, 2009 from \$3.25). We believe MFC's dividend will not be reduced but rather will be likely left unchanged over the next twelve months.

We continue to recommend MFC as a BUY based on (1) earnings are extremely well diversified globally (50% U.S.) and well positioned in Asia, (2) Canada & the U.S. remain solid operationally, and (3) dividend and capital base are solid. Total 12-month expected return is 41.0%.

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 to \$35.00 from \$40.00 reflecting our lower EPS outlook and lower valuations in the group.

Capital Adequacy Solid - Capital Rule Change & \$3 Billion Bank Loan

MFC's MCCR capital ratio stands at 225% currently up from 193% as at September 30, 2008. The increase resulted from three factors:

- (i) OSFI recently released revised capital rule guidelines for calculating minimum capital requirements for segregated funds and variable annuity guarantees. The most significant change to the rules is the relaxation of capital requirements on longer dated maturities over five years. MFC also reiterated that the bulk of the payments involving segregated funds and variable annuities "would be expected to occur between the next 7 to 30 years and that the amounts paid prior to that period would be immaterial",
- (ii) MFC announced that it has executed a binding agreement with the six major Canadian banks to provide it with a 5-year term loan of \$3 billion. The loan will be fully drawn by November 20, 2008 and be deployed, as necessary, to provide regulatory capital in various subsidiaries likely in the form of common equity. Management indicated that the loan will be paid back as quickly as possible with the interest rate on the loan at BA's plus 380 (about 6.3%).
- (iii) Management discontinued its share buyback program.

Credit Ratings – Moody's to Negative & S&P Unchanged

Moody's announced that it has changed the outlook for MFC to negative largely triggered by the additional debt taken on by MFC. If Moody's downgraded MFC by one level, MFC would still have a higher rating than most of its major competitors. S&P however reaffirmed its AAA rating.

Other Quarterly Highlights

- **MFC reported operating Q3/08 net income** of \$510 million or \$0.33 per share down from \$1,008 million last quarter and down 52% from \$1,070 million last year. The currency impact was minimal on a Y/Y basis. Approximately \$574 million was attributed to equity market declines with an additional \$253 million attributed to credit losses. There was some offset from interest rate reserve releases.
- **Total Funds Under Management (FUM)** at quarter end were \$385 billion down 4% Y/Y.
- **Total U.S. Protection** reported Q3/08 net income of US\$298 million up 49% Y/Y from US\$200 million. Of the total, JH Life's net income was US\$176 million up 18% Y/Y. John Hancock Life sales were strong at US\$211 million up 7% Y/Y driven by solid sales across all product categories. JH Long Term Care (LTC) net income was US\$122 million, over double on a Y/Y basis driven by favourable claims experience. LTC sales increased 9% Y/Y with group sales particularly strong.
- **U.S. Wealth Management** reported Q3/08 net income of US\$13 million down from US\$268

million last quarter and US\$270 million in the same period last year. The decrease was directly related to lower equity markets and lower fee income as FUM declined 4% Y/Y. Net income from variable annuities and pensions reported a loss of US\$23 million versus net income of US\$115 million a year ago driven by weak equity markets and higher segregated fund guarantee reserves. Net income from fixed products reported a loss of US\$9 million versus a profit of US\$104 million a year ago reflecting both credit losses and equity related losses.

- **Canadian Division** reported net income in the quarter of \$113 million or less than half of that reported in the same quarter last year. The quarter reflected higher segregated fund guarantees. Individual Insurance sales however were reasonably good in the quarter up 8% Y/Y but net income increased only 3% Y/Y. Wealth management net loss was \$100 million down from net income last year of \$91 million due to higher segregated fund reserves. Sales however remained strong with net flows of almost \$1.2 billion. Segregated fund sales increased over two-fold Y/Y driven by the Income Plus product. Manulife Bank reported strong loan growth Y/Y driven by the ManulifeOne home-collateralized line of credit product.
- **Asia and Japan** reported earnings of US\$208 million, down 4% Y/Y. Sales in Japan doubled driven by the launch of new products. Other Asia sales were up 3% as a result of agency expansion and strong sales in Singapore and China.
- **Reinsurance** reported net income of \$47 million up 12% Y/Y. The increase reflected better claims experience in P&C offset by the negative impact of weak equity markets.

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