

POWER FINANCIAL CORP. (PWF-TSX \$36.10)

Recommendation

Buy

Risk

Low

Target Price

\$45.00

Price

\$36.10

52-Week Range

\$30.74 - \$42.69

% Below High

-15.4%

% Above Low

17.4%

Shares O/S

705 million

Market Cap

\$25 billion

Average Daily Volume

20 day: 534,600

Year-End

December 31

C\$	EPS	Multi.
2007a	\$2.84	12.7x
2008e	\$3.00	12.0x
2009e	\$3.30	10.9x
NAV	\$38.30	-5.7%

	Amount	Yield
Dividend	\$1.34	3.7%

Analysts

Robin Cornwell B.A. (Economics),
MBA



Data Source: www.BigCharts.com

A TOP CHOICE IN THE FINANCIAL SECTOR

HIGHLIGHTS

- Q1/08 Earnings Slightly Lower Than Expected
- Dividend Increased by 7%
- Robert Gratton Retires

CONCLUSION

BUY: 12-Month Target Lowered to \$45

Power Financial reported Q1/08 adjusted operating EPS (fd) of \$0.67. The earnings were up 2% Y/Y, but were \$0.02 per share lower than expected. The results saw lower-than-expected earnings from both IGM Financial (IGM) and Great-West Lifeco (GWO), but Pargesa's earnings were in line. These results exclude non-operating earnings of \$95 million or \$0.13 per share from gains at GWO and Pargesa. Reported earnings were \$0.80 per share. The stronger C\$ vs US\$ had a negative impact of an estimated \$0.03 per PWF share. ROE was 16.2%, down from 17.3% last quarter. The dividend was increased to \$1.34 per share annually, up 7%.

We are lowering our 2008 EPS estimate for PWF to \$3.00 from \$3.15 and modestly reducing our 2009 EPS estimate to \$3.30 from \$3.35. Our 12-month share price target for PWF has been lowered to \$45.00 from \$46.00 to reflect the lower target prices set for GWO and IGM. We continue to rate the shares as a BUY and believe PWF continues to be one of the best positioned financial service companies in Canada, particularly in the wealth management sector.

PWF Trades at a 5.7% Discount to Net Asset Value

PWF had a book value of \$16.81 per share as at March 31, 2008, however this is not representative of the current market value of its subsidiaries. Actual Net Asset Value (NAV) for PWF is about \$38.30 per share which more appropriately reflects the current public market value of all investments. PWF at present trades a discount of 5.7% to this current NAV. Our 12-month projected NAV is \$47.50 per PWF share, based on our 12-month revised share price targets of \$57.00 for IGM (previously \$58.00) and \$39.00 target for GWO (previously \$40.00).

Valuation: PWF Should Support A Share Price Closer To NAV

We expect PWF's share price to trade closer to its forward NAV and therefore we have lowered our 12-month share price target to \$45.00 which implies a discount of closer to 5% to our 12-month target NAV of \$47.50 per share. If financial service sector consolidation becomes a possibility, then we would expect the discount to disappear and see PWF's share price trade closer to its targeted NAV and possibly support a premium.

Management and Board of Directors Changes

Robert Gratton, Chairman of the Board, announced that he is retiring. The Board of Directors approved the appointment of Andre Desmarais and Paul Desmarais Jr. as Co-Chairmen of the Board of Directors. Raymond McFeetors, Chairman of the Board of Great-West Lifeco, has been appointed to the Board of Directors and also appointed Vice-Chairman.

Great-West Lifeco: BUY: 12-Month Target Lowered To \$39.00

We have lowered our 12-month target share price for GWO to \$39.00 from \$40.00, based on the modestly slower earnings outlook. We believe GWO represents a solid, low-risk, global growth opportunity using an "add-on" acquisition strategy focused on the wealth management sector. In addition to the Putnam transaction, GWO has made five other add-on acquisitions which, collectively, we expect to be significantly accretive to 2009 EPS. More significant is our expectation that GWO may make several more of these add-on acquisitions over the next 12 months and further enhance EPS in both 2008 and 2009. We continue to highly endorse this strategy. Our valuation also recognizes the good constant currency underlying earnings growth at GWO and the significantly higher yield of 3.7%. Our total expected return over the next 12 months for GWO is 27.5%.

- **Great-West Lifeco (GWO)** reported adjusted Q1/08 EPS (fd) of \$0.60, (up 4% Y/Y and \$0.03 below our expectations. These earnings exclude an after-tax net gain of \$118 million (\$0.13 per share) in connection with several non-recurring items. The currency impact was significant, such that on a constant-currency basis EPS would have been \$0.65, up 13% Y/Y. Putnam's earnings were lower than expected, declining by \$0.03 per GWO share as assets under management (AUM) declined by 10% Y/Y and net redemptions of long-term funds increased. Adjusted ROE decreased modestly to 21.1% in the quarter, down from 21.9% last quarter.
- **Earnings Outlook** - We are lowering our 2008 EPS estimate for GWO to \$2.60 from \$2.70, due to weaker equity markets, our lower expected AUM forecast and the impact of the stronger \$C currency. To err on the side of caution, we have lowered our 2009 estimate modestly to \$2.90 from \$2.95, as we expect better results at Putnam and wider spreads (see quarterly highlights below) on the roll-over of the annuity book in the U.K. Our 2009 EPS estimate represents a 12% increase over 2008. ROE is expected to remain strong at near 20%.
- **Dividend Outlook** - We expect a trailing dividend payout ratio of 47% to 50%, which would suggest a more modest dividend increase over the next 12 months to the \$1.25 to \$1.30 level, for an increase of 7% to 11%. However, based on next year's EPS outlook, we expect the dividend could increase by 10% to 15% in fiscal 2009.

- **Putnam Update** - Putnam had a very difficult quarter and contributed net earnings of US\$3 million or nil per GWO share, down from US\$27 million last quarter or \$0.03 per GWO share, well below our estimate of US\$22 million. On a stand-alone basis excluding restructuring charges, Putnam reported net income of US\$24 million (after-tax and non-controlling interest), down from US\$50 million last quarter. The gross margin in the quarter was 14.2% down from 25.4% last quarter. Management suggested that the 14.2% margin would normalize to 19.2% if non-recurring items are removed from the quarter. Management reiterated that more administrative expenses can be eliminated and that growth in the institutional book of business looks very promising. Margins are very sensitive to AUM performance and we expect that, longer term, margins will improve closer to the 28% to 30% level. The retail turnaround will take longer than we expected, but further acquisitions should not be ruled out. As at the end of the quarter, total AUM decreased by 10% Q/Q and Y/Y to US\$168 billion, from US\$186 billion at the end of the previous quarter. Net flows accounted for the loss of US\$3.7 billion while market performance accounted for the loss of US\$13.9 billion of AUM. Money Market saw net inflows of \$0.3 billion.
- **Canada** - Q1/08 net income was \$245 million up 11% Y/Y. Operating expenses were up 1% Y/Y, providing positive operating leverage.
- **U.S. Division** - Q1/08 was weaker than expected, with a 4% decrease in \$US net income excluding Putnam (see discussion above). The weaker results reflected a 13% decline Y/Y in Health Care, which has now been sold. Excluding Health Care, US\$ net income was down 1% Y/Y.
- **Europe** - A stronger Q1/08 was reported, with net income of \$175 million up 19% Y/Y. On a constant currency basis net income rose 36%. Sales in Ireland/Germany were down 29% Y/Y, due in part to the introduction of a new contract law in Germany, which affected the timing of how sales are reported. The acquisition of the Standard Life annuity payout block should be a positive in 2008, as will the rolling over of the Equitable Life block. We expect significant spread improvement as the payout annuity blocks of business are reinvested under a yield enhancement strategy initiated by management. Although reinvestment is happening at a slower rate than expected, the good news is that the recent credit problems seem to be widening potential spreads going forward by over 50%.
- **Management Changes** - Robert Gratton steps down as Chairman of the Board of Great-West Lifeco and its major subsidiaries and is replaced by Raymond McFeetors, formerly President and CEO of Great-West Lifeco and its major subsidiaries. Allan Loney replaces Raymond McFeetors as CEO of Great-West Lifeco and its major subsidiaries. Allan Loney was formerly Executive Vice-President, Chief Actuary/Capital Management.

IGM Financial – BUY - Conclusion: BUY - 12 Month Target Lowered To \$57.00

We consider IGM as the premier asset management company in Canada and well positioned in its distribution channels with Investors Group (strong and growing captive sales force) and Mackenzie (independent sales channel). We believe IGM is deserving of a premium EBITDA multiple based on its superior positioning and good profit margins (impressive expense controls). Although we expect AUM growth to be muted in 2008, we expect better growth in fiscal 2009. We have lowered our 12-month target price for IGM slightly to \$57.00 from \$58.00, which represents a multiple of 8.0x our 2009 EBITDA forecast, a premium to AGF at 7.2 times but lower than CIX at 8.5 times (CIX yields 8.2% versus about 4.0% for IGM and AGF).

- **Q1/08 Results Weaker than Expected** - EBITDA per share decreased by 4% Y/Y and sequentially to \$1.50, about \$0.06 lower than expected. EPS (fd) were reported at \$0.79 down from \$0.82 last quarter and flat Y/Y. ROE was marginally lower at 19.5%. The Y/Y decrease in EBITDA was largely due to a decline in average mutual fund AUM of 4%. Total AUM as at the end of the quarter amounted to \$119 billion but subsequently increased to \$122 billion by the end of April.

- **Earnings Outlook** - We expect this volatility to continue for some time, and we have lowered our AUM growth expectations for fiscal 2008. Accordingly, we have lowered our 2008 EBITDA per share estimate to \$6.50 from \$6.70, and have lowered our 2009 EBITDA per share estimate to \$7.15 from \$7.25. Our EPS estimate for 2008 has been lowered to \$3.38 from \$3.45, and our 2009 EPS estimate has been lowered to \$3.65 from \$3.70. This forecast assumes a modest share repurchase program in each year. ROE for 2008 is expected to decline to the 20.0% level, down from 21.5% in fiscal 2007.
- **Dividend Outlook** - We expect a dividend payout ratio closer to 60% of EPS in 2008, which would imply a dividend in 12 months time of about \$2.03 to \$2.05 per share or an increase of 4% to 6%. We expect a 12-month total return of 25%.
- **Q1/08 Results** - Cash operating earnings of \$211 million or \$0.79 per share, flat Y/Y. Revenues decreased Y/Y by 1% with management fees decreasing 4%. Expenses increased 6%, producing a negative operating leverage of 1% this quarter. However, about \$6 million of the increase was the result of higher fund absorption costs resulting from IGM moving to a fixed-rate fee structure (which requires IGM to absorb more expenses if AUM declines).
- **EBITDA** - EBITDA in Q1/08 was \$1.50 per share, a 4% Y/Y decline. EBITDA continues to be our preferred measure of performance for mutual fund companies, as it excludes the amortization of commissions which can be erratic, particularly in periods of strong sales. EBITDA margin of 58% in Q1/08 was unchanged from the same period last year.
- **Lower AUM Growth** - Total AUM at quarter end was reported at \$119 billion, a Y/Y decrease of 4%. Total mutual fund AUM for IGM as at the end the quarter was \$105 billion, down marginally from \$107 billion as at the end of last quarter and down 5% Y/Y. Gross mutual fund sales in the quarter were \$4.1 billion, with net sales of \$262 million.
- **April AUM Increase Driven by Market Performance** - Total mutual funds as at the end of April increased to \$108 billion, down 3% Y/Y but up 2% over quarter end as market performance accounted for an increase of \$2.6 billion in April. AUM level now equals that of Q1/08.
- **IG** - Reported gross long-term fund sales of \$1.6 billion in Q1/08 with net sales of \$352 million, a relatively good quarter considering the market environment. Total mutual fund gross sales were \$1.9 billion, with net sales of \$514 million. Total mutual fund AUM as at the end of the quarter was \$58.6 billion down 3% Y/Y.
- **Mackenzie** - Reported gross long-term fund sales of \$1.5 billion in the quarter, with net long-term redemptions of \$375 million. Total mutual fund gross sales were \$2.0 billion with net sales of \$254 million. Total mutual fund AUM as at quarter end was \$44.5 billion, down 7% Y/Y. Total AUM including institutional AUM and the Cundill AUM decreased 5% to \$61.0 billion Y/Y.
- **Counsel Fund Management** - Reported net sales of \$3 million (gross sales of \$84 million) in Q1/08, a decent quarter given the market volatility. AUM decreased by 5% Y/Y to \$2.2 billion.
- **Redemption Rates Remain Low** - IG redemption rates remained near record lows of 7.4%, down from over 8.0% last year and well below the industry average of 15.4%. Mackenzie's redemption rate on long-term assets was stable at 14.4% and slightly below the IFIC industry average (ex Mackenzie) of 14.7%.
- **IG Consultants Increase** - The number of IG consultants increased 357 over last year or 9% Y/Y, to 4,342 and are at the highest level in IG history.

Parjointco-Pargesa

- Pargesa (through Parjointco, the holding company owning the interest in Pargesa) contributed \$17 million to net income in Q1/08 (excluding non-operating earnings of \$9 million), down from \$18 million in the prior quarter and the same quarter last year.

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