

# Finally, it's time to look at Manulife

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Insurer's valuation may be nearing bottom after years of record low interest rates and market volatility. Sun Life, on the other hand ...

The news has been bad for two of Canada's biggest insurers, Manulife Financial Corp. and Sun Life Financial Inc. Both companies' shares are down by a half to two-thirds from their levels before the financial crisis.

Does this constitute a buying opportunity? For Manulife, which has been wrestling with problems for nearly three years, the answer may finally be yes. Even a modestly negative scenario suggests its shares can hold their value, while positive surprises mean a chance for significant gains. Sun Life, however, has a more robust valuation, and seems to offer as much risk of decline as profit.

At risk of oversimplification, the problem for both insurers has been a combination of record-low interest rates and volatility in the stock market. These factors wreaked havoc on the assumptions that the two companies made about the long-term investment products they sold their customers. Losses ensued, as did painful hits to their capital.

Manulife, which traded at close to \$40 per share in mid-2008, is now under \$11. Sun Life, which topped \$50 in early 2008, is now around \$23.

What now? Well, for Manulife, a second-quarter loss that was not nearly as big as expected counts as good news. At long last, the company showed some success in managing the markets' impact on its bottom line.

There is now reason to be cautiously - very cautiously - optimistic. Analyst **Ohad Lederer** of **Veritas Investment Research**, who recently upgraded Manulife to a "buy," says "should [interest] rates hold, or even do the unthinkable and move up, we believe there are more positive than negative outcomes."

Here is **Mr. Lederer's** math: Assume Manulife increases its earnings just 2.5 per cent annually over the next three years, thereby missing its \$4-billion profit target by 2015 by nearly \$1.5-billion. The company will still earn \$8.7-billion, from which it would generate \$3.6-billion in dividends.

He assumes, also, that the company incurs more than \$5-billion in "headwinds," for changes to assumptions, extra money put into reserves against future losses, writedowns and other problems Manulife is likely to encounter. In that less than glowing scenario, **Mr. Lederer** pegs book value per share at \$12.57 at the end of 2015, roughly where it is today.

Annual earnings growth of 7.5 per cent, however, would bump up the book value, produce a return on equity of roughly 12 per cent, and should support higher price-to-book value multiples. In today's dollars, that should be worth from \$12.63 to \$14.49 - or 15 per cent to 30 per cent above current levels.

If interest rates get even lower, or equities fail to advance, the math for gains will not work, **Mr. Lederer** acknowledges. But what helps provide the floor for Manulife is its current valuation - the shares trade at a mere 0.9 times their book value. They are 1.1 times their tangible book value, a measure that strips out squishy intangible assets like acquisition-based goodwill and intellectual property.

Sun Life trades at 1.0 times its book value. On the other hand, it is one of the most expensive life insurers in North America on a price-to-tangible-book basis, at 1.5 times. (The median figure of a group of 17 companies is 0.7, according to Standard & Poor's Capital IQ.)

Some of its valuation may be the result of excitement over the company's MFS wealth-management business. Analyst Peter Routledge of National Bank Financial, who has a "sector perform" rating and \$24 target price, says the company is "a growth story on the wealth-management side."

Yet Sun Life's traditional insurance business faces many of the same challenges as Manulife, and it seems investors are still struggling to get a handle on the company's risk. The most recent Sun Life earnings announcement increased estimates for the amount of money going to reserves in 2012 and beyond. The company has also yet to quantify what its third-quarter review of its actuarial assumptions will bring.

All told, Sun Life's rocky road, combined with its above-average valuation, suggests investors may get surprised if they think they're buying at the absolute bottom. Manulife, beaten down for so long, may have already seen, and climbed past, its low point.

Manulife Financial (MFC)

Close: \$10.94, down 2¢

Sun Life Financial (SLF)

Close: \$22.75, down 39¢