Why I Believe Manulife Financial Corp. Is Undervalued and Possesses Solid Growth Potential

Description

Finding value in Canada's financial services sector is becoming increasingly difficult, with ever-improving financial performances and regular dividend hikes, particularly among the banks, garnering investor interest and driving share prices higher.

One company that stands out for all the right reasons yet remains unfairly valued by the market is Canada's largest life insurer, **Manulife Financial Inc.** (TSX: MFC)(NYSE: MFC). Like many life insurers and wealth managers, it incurred big losses during the global financial crisis, but it pulled through better than many of its peers because of conservative management.

Let's take a closer look at why Manulife should be a core long-term holding in every investor's portfolio.

Wide moat equals competitive edge

By virtue of its size, dominant market position across a range of global insurance and wealth management markets, and the high barriers of entry associated with the asset management life insurance industries, Manulife possesses a wide, multifaceted economic moat. This allows it to retain its competitive advantage over the long term, protecting future revenues and almost guaranteeing further growth.

Recently, Manulife completed its first acquisition in 10 years, paying $4 billion for **Standard Life Canada**, which further strengthened its economic moat. The acquisition also saw Manulife acquire 1.5 million customers and boost its presence in Quebec, where it has historically been underrepresented.

All of this not only further protects its competitive advantage but also significantly boosts its long-term growth prospects.

Wealth management continues to perform strongly

While life insurance may be Manulife's bread and butter, it is wealth management that holds the greatest margins and growth opportunities, particularly in the U.S. and China, which have exceptionally large financial services markets.

Earlier this year, Manulife Asset Management, the funds management arm of Manulife, was ranked the 30th largest money manager globally and now has $300 billion under management. The strength of its asset management operations can be seen in its second-quarter 2014 results, where its U.S. funds management business reported record quarterly sales as well as record funds under management.

This gives Manulife massive total funds under management of $637 billion, which at the end of the second quarter of 2014 was a 0.5% increase compared to the first quarter and an impressive 12% increase over the second quarter 2013. This will continue to boost revenues and ultimately the company's bottom line, particularly if stocks markets keep performing strongly.

Impressive financial results

The strength of the company's position in the life insurance and wealth management industries continues to translate into solid earnings. Second-quarter 2014 earnings were up a healthy 14% quarter over quarter and a massive 2.6 times year over year. The key drivers of this strong performance were significantly higher fee income from increased assets under management, a stronger U.S. dollar, and lower hedging costs.

As a result of this solid performance, Manulife hiked its dividend for the first time since the GFC, by an impressive 19% to $0.155 per share quarterly, or an annual dividend of $0.62 per share. Manulife's dividend yield of 2.9%, coupled with a very conservative payout ratio of 29%, indicates that not only is the dividend sustainable, but that there is plenty of room to hike it further if the outlook continues to remain positive.

Undervalued and attractively priced

Despite Manulife's solid market position in life insurance and funds management industries, in addition to strong financial performances, the company remains unfairly valued by the market. Currently, Manulife trades with an enterprise value of a mere five times EBITDA and a forward price-to-earnings ratio of 11, which can be attributed to the market's overblown perception of risk related to life insurers, particularly post GFC.

However, Manulife has a history of conservative management, which is how it avoided many of the excesses that affected other fund managers and life insurers during the GFC. It has also focused on shoring up its existing business and reducing risk since — hence the reticence to acquire other life insurance businesses until recently.

The company's conservative approach to risk continues, with it maintaining a minimum continuing capital and surplus requirements ratio of 243%, well in excess of the minimum. While its financial leverage ratio remains low at 28.2%, which is a 2.6% improvement quarter over quarter and 4.5% year over year.

Manulife retains a conservative approach to risk management and its business as whole. When coupled with all of these other factors, it is clear Manulife is a cornerstone dividend growth stock for every portfolio.

CATEGORY

1. Investing

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1. NYSE:MFC (Manulife Financial Corporation)
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