2 Deep-Value Investment Opportunities for Dividend-Hungry Investors

Description

As a contrarian value investor, I seek out companies that have a significant disconnect between their share price and the intrinsic value of their underlying business. Typically, this disconnect arises because the market is not as efficient at valuing companies as some economists claim, with psychology, perception, and irrational exuberance driving many company valuations. This creates an opportunity for patient investors to invest in companies with solid underlying businesses but are undervalued by virtue of irrational market behavior.

Let’s take a closer look at two companies I believe meet that description. They offer significant potential upside over the long term while rewarding investors with sustainable and growing dividends.

Bank of Montreal

Bank of Montreal (TSX: BMO) (NYSE: BMO) is the most attractively priced of Canada’s six biggest banks, with an enterprise value of 10 times EBITDA, a price-to-book ratio of 1.8, and a forward P/E of 10.

Yet there appears to be no rational explanation for this attractive valuation, as the bank continues to report solid financial results and regularly hikes its dividend. It also has a strong balance sheet, with one of the lowest impaired loan ratios in the industry and is more than adequately capitalized.

While its bread-and-butter earnings come from its Canadian banking franchise, its U.S. commercial banking business offers significant growth prospects. There are signs this business is set to fire on all cylinders as the U.S. economy continues to surpass expectations coupled with a housing market rebound. This should see increased U.S. consumer confidence and growing demand for mortgages, consumer credit, and basic banking products, further boosting the bank’s earnings.

The strength of its underlying business is further highlighted by multiple dividend hikes made over recent years, giving it a sizable 3.8% dividend yield and a sustainable payout ratio of 48%.

This will see investors rewarded for their patience as they wait for the market to recognize the bank’s true value. Furthermore, if it successfully executes its U.S. growth strategy, there is potential for considerable earnings growth, which can only translate into more dividend hikes and ultimately a higher share price.

Manulife Financial Corp.

Despite weathering the global financial crisis better than most life insurers, **Manulife Financial Corp.** (TSX: MFC)(NYSE: MFC) still had to raise equity and slash its dividend in order to preserve capital and stabilize its balance sheet. This saw the market take a negative view of Manulife, which wasn't helped by the life insurance industry falling into disrepute, with a number of major life insurers teetering on the brink of collapse at the time.

It is the market's perception of risk which sees Manulife remain undervalued, trading with an EV of a mere 5 times EBITDA and a price of 1.4 times its book value. But this perception of risk is certainly overblown with Manulife's underlying business one of the strongest in the industry.

Not only is Manulife the dominant life insurer in Canada but it is the third-largest life insurer in the U.S. and the world's 30th-largest money manager, with operations spanning North America and Asia. This diversified global presence, along with its solid market share, endows Manulife with a wide economic moat protecting its competitive advantage and virtually guaranteeing future revenue growth.

Manulife's recent acquisition of **Standard Life Canada** has fortified this economic moat and significantly expanded its Canadian market share, creating greater potential for earnings growth. Its wealth management business is a virtual cash cow and with a massive $637 billion under management, imbues Manulife with a solid repeat revenue stream.

Management at Manulife is also feeling confident about the company's outlook hiking its dividend for the first time in five years at the end of the second quarter of 2014 by 19%. This gives it a yield of 2.9%, which, with a sustainable and conservative payout ratio of 29%, indicates there is sufficient room for additional dividend hikes.

These attributes clearly emphasize the strength of Manulife's business, flagging the disconnect between its market valuation and the growth potential of its business.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:BMO (Bank of Montreal)
2. NYSE:MFC (Manulife Financial Corporation)
3. TSX:BMO (Bank Of Montreal)
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Author
mattdsmith