Why Manulife Financial Corp. Is Undervalued and Poised for Upside

Description

Even after the recent sell-off, stocks are still pricey. The S&P/TSX is sitting at a price-to-earnings ratio of 16.7, the highest in almost five years, and many value oriented fund managers, including Warren Buffett, are sitting on high percentages of cash.

The reason is simple. For a value investor, the pricier markets as a whole and therefore stocks get, the lower possible return is attainable from them.

Fortunately the recent correction brought expensive companies down to more reasonable levels, and companies that were undervalued before the correction now look like bargains. One company that stand outs in this regard is **Manulife Financial Corp.** (TSX: MLF)(NYSE: MLF). Here's why it is undervalued and poised for upside.

Why Manulife is undervalued

The TSX has enjoyed an over 8% increase year to date, whereas Manulife has seen an approximately 2% increase year to date. Why has Manulife not participated in this year's gains? I think there are two basic reasons.

The first is that investors are wary of insurers, and especially Manulife, due to extremely poor performance during the financial crisis. Manulife shares dropped by almost 75%, due to the fact that the company had extremely high exposure to equity markets through its large variable annuity business. Investors have not forgotten this.

The second reason investors are reluctant to buy is due to Manulife's vulnerability to low interest rates.

Fortunately, the market has over-reacted to these concerns, and in doing so the stock is not reflecting the company's strong earnings potential. First, Manulife has strongly reduced its risk profile, making a repeat of the financial crash highly unlikely. With a Minimum Continuing Capital and Surplus Requirements (MCCSR) ratio of 243%, significantly above the target level of 150%, Manulife is very well capitalized.

Second, although Manulife is vulnerable to interest rates, it is well positioned to profit compared to peers when interest rates increase, has a rapidly growing wealth and asset management business, and enjoys a strong position in Asia that is being expanding aggressively. These prospects give Manulife an estimated 10% long term growth rate, and the company is expecting a very ambitious $4 billion in core earnings by 2016, almost double 2013’s core earnings.

The big question is, why does Manulife have a P/E ratio of 9.7, compared to 14.1 for **Sun Life Financial Inc.** and 12.9 for **Great-West Lifeco Inc.**, despite being in the same industry, with similar growth prospects? The answer is it shouldn’t, and the market is not recognizing Manulife’s great earnings potential.

The key to successful value investing is to find stocks that the market is overly pessimistic about, to the point where the share price no longer reflects the long-term growth potential of the company. With investors still negative on Manulife, this is an excellent time to buy before the market revalues it upwards.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:MFC (Manulife Financial Corporation)
2. TSX:GWO (Great-West Lifeco Inc.)
3. TSX:MFC (Manulife Financial Corporation)
4. TSX:SLF (Sun Life Financial Inc.)

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