Dividend Investors: Which Insurance Company Is the Best Fit for Your Portfolio?

Description

Not unlike their banking counterparts, Canadian life insurance companies are widely viewed as being relatively safe to buy and hold for the long term. The life insurance industry is highly regulated in Canada which, historically, has meant less competition, greater pricing power, and greater sustained economic profits for the insurers.

Let's take a closer look at the Big Three Canadian life insurers: **Manulife Financial Corp.** (TSX:MFC)(NYSE:MFC), **Sun Life Financial Inc.** (TSX:SLF)(NYSE:SLF), and **Great-West Lifeco Inc.** (TSX:GWO) to see which is the right fit for your dividend-growth or income portfolio.

When evaluating a prospective dividend investment, the first thing most investors will do is review a company's current dividend yield. The current dividend yield tells us which company offers the best income stream if we were to assume a scenario of no growth for these companies going forward.

When comparing the current yields for the three companies, Great-West registers the highest current yield at 4.15% followed by Sun Life at 3.79% with Manulife trailing behind at 3.32%.

The dividend yield tells how much we as investors will receive this year, but it fails to account for each company's ability to raise their respective dividends for years to come and what the dividend will look like in five or even 10 years.

To incorporate this view for future dividend growth, we can estimate the potential for a company's pace of sustainable dividend increases by combining our outlook for that company's return on equity (ROE) with its retention ratio, or the percentage of earnings which are retained by the company for reinvestment purposes rather than being paid out as dividends.

Among the three, Great-West generates the highest ROE at 13.41%. Combine this with a retention ratio of 47%, and we can safely expect Great-West to grow its dividend by 6.27% annually so long as it can maintain this level of performance.

Sun Life registers a slightly lower ROE of 12.79%; however, it pays out only 41% of earnings in the form of dividends. By retaining the other 59%, the company should be expected to sustainably increase its payout by 7.4% going forward.

Manulife only generated ROE of 8.01% in 2016 and retained just 51% of those earnings, giving the company a sustainable growth rate of just 4.11%.

Interestingly, looking at how much these three companies actually raised their dividends for 2017 tells us a slightly different story. Manulife increased its payout by 10.8% this year, while Sun Life and Great-West were more in line with their sustainable growth rates with dividend increases of 7.5% and 6.1%, respectively.

Which should you buy?

Manulife appears to be the obvious laggard of the three, offering the lowest yield and lowest sustainable growth rate today. While the company raised its payout by the most of any of the three this year, its performance will have to improve materially if it expects to maintain the current pace of hikes going forward.

Sun Life and Great-West, however, appear to offer solid dividend investments for a conservative dividend-growth portfolio.

With both offering yields under 4.25%, it may be difficult to justify these investments for inclusion in an income portfolio, but with growth rates closing in each company's respective cost of capital, these two insurance companies would be a good fit for a long-term buy-and-hold dividend investor.

CATEGORY

1. Dividend Stocks
2. Investing

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

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Date
2025/08/26
Date Created
2017/06/01

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