



Legg Mason Inc. (LM)

Updated February 1st, 2020 by Eli Inkrot

Key Metrics

Current Price:	\$39	5 Year CAGR Estimate:	6.2%	Market Cap:	\$3.4B
Fair Value Price:	\$36	5 Year Growth Estimate:	4.0%	Ex-Dividend Date¹:	03/25/20
% Fair Value:	109%	5 Year Valuation Multiple Estimate:	-1.7%	Dividend Payment Date:	04/29/20
Dividend Yield:	4.1%	5 Year Price Target	\$44	Years Of Dividend Growth:	9
Dividend Risk Score:	C	Retirement Suitability Score:	B	Last Dividend Increase:	17.6%

Overview & Current Events

Founded in 1899, Maryland-based asset manager Legg Mason (LM), employs about 3,300 people and had assets under management (AUM) of \$804 billion as of December 31st, 2019 (up from \$782 billion at the end of last quarter). Products by asset class include Fixed Income (56% of AUM), Equities (27%), Alternative Investments (9%) and Liquidity (8%). Geographically, 71% of Legg Mason's clients are domiciled in the U.S. The \$3.4 billion market cap company generates about \$3 billion in annual revenue (~0.37% of assets).

On January 29th, 2020 Legg Mason reported Q3 fiscal 2020 results for the period ending December 31st, 2019. (Legg Mason's fiscal year ends March 31st.) For the quarter the company reported \$803.5 billion in assets under management, primarily driven by \$20.9 billion in positive market performance, partially offset by net outflows. Operating revenues came in at \$753.9 million in Q3, representing a 7.0% increase compared to the year ago period. On an adjusted basis net income totaled \$93.2 million or \$1.03 per share, compared to \$76.3 million or \$0.86 in Q3 2019.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.32	\$1.63	\$1.54	\$2.61	\$2.33	\$2.63	-\$0.25	\$2.18	\$3.72	\$3.26	\$3.60	\$4.38
DPS	\$0.12	\$0.20	\$0.32	\$0.44	\$0.52	\$0.64	\$0.80	\$0.88	\$1.12	\$1.36	\$1.60	\$1.94
Shares²	164	150	140	125	117	111	107	96	85	86	87	80

While Legg Mason has grown earnings-per-share by nearly 10% over the last decade, we caution that this is coming off a recession low. Indeed, the company still has not eclipsed its pre-recession high mark of earning \$4.48 per share back in 2006. Moving forward we are forecasting 4% annual earnings growth, as we believe this incorporates a "normal," if not positive, environment without the impact of the recession or the substantial, but unlikely to repeated recent performance.

Legg Mason is not immune from the problem that plagues nearly all asset managers; specifically, the move away from high-fee options and toward low-cost, passive investment vehicles. This shows up in revenues collected, as asset managers must either reduce the fees they charge or risk losing customers. The good news is that the bulk of Legg Mason's assets under management are already in low cost options including Fixed Income and Liquidity. The bad news is that this trend does not appear to be going away and will weigh heavily on asset managers' ability to grow, especially on the equity side. Moreover, should interest rates rise substantially this could negatively influence the company's fixed income business.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	20.1	19.6	18.7	10.0	16.0	19.6	---	15.0	10.5	9.8	10.9	10.0
Avg. Yld.	0.5%	0.6%	1.1%	1.7%	1.4%	1.2%	1.8%	2.7%	2.9%	4.3%	4.1%	4.4%

¹ Estimate

² In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Legg Mason’s valuation history has been quite volatile over the past decade, trading between 9- and 20-times earnings. We believe a multiple near 10 times earnings is reasonable, more or less in-line with what we expect from the company’s peers. This reflects a lot of the uncertainty with asset managers in general and with the business performance should we see a substantial downturn in the years to come. The current valuation near 11 times expected earnings implies a small valuation headwind possibility.

Meanwhile, the dividend – now sitting at 4.1% - should add nicely from this point, while share repurchases can aid in growth given the lower valuation of the security.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	9%	12%	21%	17%	22%	24%	---	40%	30%	42%	44%	44%

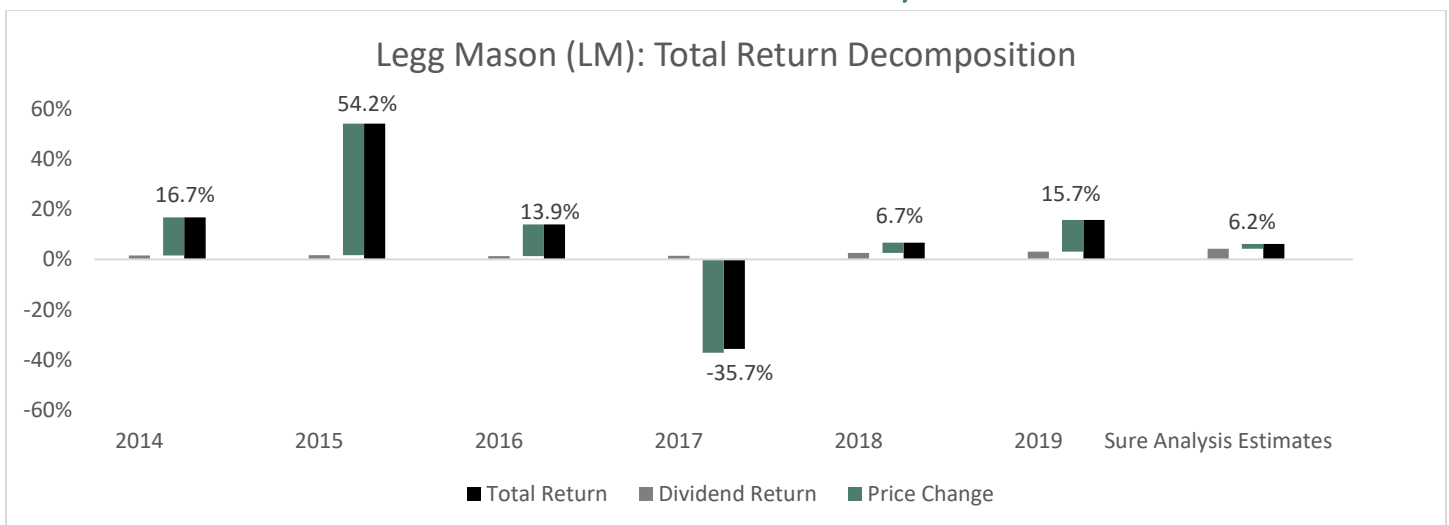
Asset managers enjoy small moats in the way of switching costs. Once you are set up with an asset manager it is a hassle to change and the benefits of switching are unknown. However, pricing power does not exist and indeed could be a key detrimental driver in the years ahead. Legg Mason’s recession record is volatile. Back in 2006 the company was earning \$4.48 per share and paying out a healthy dividend. When the financial recession came, the company lost -\$13.85 per share and slashed its dividend from \$0.96 down to \$0.12. In turn, the share price fell dramatically from \$130 in 2006 all the way down to a low of \$10 in 2009.

Since that time the company has got back on its feet, incrementally improving with the dividend finally hitting its pre-recession mark, but earnings-per-share are still lagging. Legg Mason is likely to perform poorly during the next recession. The payout ratio is reasonable, coming in at under half of expected profits. In the last few years this mark has been much lower, allowing for a number of shares to be retired in the interim.

Final Thoughts & Recommendation

Shares are up 5% since our last report. While Legg Mason has posted reasonable results, we believe the company has an elevated amount of risk. In particular, the industry faces long-term headwinds in the way of asset managers having to charge lower and lower fees to compete. Also, Legg Mason is likely to suffer in a market downturn. We are forecasting 6.2% total return potential stemming from 4% growth and a 4.1% starting dividend yield offset by a valuation headwind, acknowledging a fair amount of intermediate and long-term business risk. We continue to rate Legg Mason as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	2635	2784	2663	2613	2742	2819	2661	2887	3140	2,903
Gross Profit	N/A	886	869	824	912	992	910	986	1142	1,065
Gross Margin	N/A	31.8%	32.6%	31.5%	33.3%	35.2%	34.2%	34.2%	36.4%	36.7%
SG&A Exp.	2123	300	320	322	273	292	320	323	314	333
D&A Exp.	114	103	94	88	63	55	60	80	73	73
Operating Profit	321	387	339	300	431	498	388	418	522	469
Operating Margin	12.2%	13.9%	12.7%	11.5%	15.7%	17.7%	14.6%	14.5%	16.6%	16.1%
Net Profit	204	254	221	-353	285	237	-25	227	285	(29)
Net Margin	7.8%	9.1%	8.3%	-13.5%	10.4%	8.4%	-0.9%	7.9%	9.1%	-1.0%
Free Cash Flow	1329	379	465	265	397	522	414	500	456	510
Income Tax	119	119	72	-151	138	125	8	84	-103	21

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	8623	8708	8556	7270	7111	7065	7520	8290	8153	7,794
Cash & Equivalents	1466	1376	1408	980	914	672	1329	734	739	925
Accounts Receivable	349	367	334	351	349	368	335	433	476	425
Goodwill & Int. Ass.	5218	5188	5132	4447	4412	4653	4626	5959	5730	
Total Liabilities	2751	2901	2878	2451	2387	2580	3285	4279	4300	5,270
Long-Term Debt	1420	1730	1659	1353	1039	1049	1781	2222	2347	4,105
Shareholder's Equity	5842	5770	5677	4818	4725	4485	4214	3983	3824	
D/E Ratio	0.24	0.30	0.29	0.28	0.22	0.23	0.42	0.56	0.61	2,222

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.3%	2.9%	2.6%	-4.5%	4.0%	3.3%	-0.3%	2.9%	3.5%	-0.4%
Return on Equity	3.9%	4.4%	3.9%	-6.7%	6.0%	5.1%	-0.6%	5.5%	7.3%	-0.8%
ROIC	2.7%	3.4%	3.0%	-5.2%	4.8%	4.2%	-0.4%	3.7%	4.6%	-0.5%
Shares Out.	164	150	140	125	117	111	107	96	85	86
Revenue/Share	16.96	17.91	18.57	19.61	22.40	24.89	24.77	28.64	34.44	33.99
FCF/Share	8.55	2.44	3.24	1.99	3.24	4.61	3.86	4.96	5.00	5.96

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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