Franklin Resources (BEN)

Updated May 3rd, 2020 by Eli Inkrot

Key Metrics

Current Price:	$18	**5 Year CAGR Estimate:**	15.0%	**Market Cap:**	$8.9 B
Fair Value Price:	$25	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date[1]:**	06/27/20
% Fair Value:	72%	**5 Year Valuation Multiple Estimate:**	6.8%	**Dividend Payment Date[1]:**	07/12/20
Dividend Yield:	5.8%	**5 Year Price Target**	$30	**Years Of Dividend Growth:**	40
Dividend Risk Score:	A	**Retirement Suitability Score:**	A	**Last Dividend Increase:**	3.8%

Overview & Current Events

Franklin Resources, founded in 1947 and headquartered in San Mateo, CA, is a global asset manager with a long and successful history. The company offers investment management (which makes up the bulk of fees the company collects) and related services to its customers, including sales, distribution, and shareholder servicing. As of March 31st, 2019, assets under management (AUM) totaled $580.3 billion for the $9 billion market cap company.

On February 18th, 2020 Franklin Resources announced that it had entered into a definitive agreement to acquire Legg Mason (ticker: "LM") for $4.5 billion of all-cash consideration, to go along with the assumption of $2 billion in debt. When announced the deal would create a combined $1.5 trillion asset manager. The transaction is expected to close by the third calendar quarter of 2020 subject to approval.

On April 30th, 2020 Franklin Resources reported Q2 fiscal year 2020 results for the period ending March 31st, 2020. Total assets under management equaled $580.3 billion, a -16.9% decline from the previous quarter, as -$25.4 billion in negative outflows was exacerbated by -$98.2 billion in negative market value change. Negative net flows are an item Franklin Resources has faced for several quarters in a row. For the quarter, Operating Revenue totaled $1.34 billion, a -5.3% decline, representing 0.20% of AUM or ~80 basis points on an annualized basis. Net income equaled $79.1 million or $0.16 per share compared to $350.5 million or $0.70 per share in the year ago quarter. However, market-to-market non-operating losses in the company's investment portfolio drove this result. On an adjusted basis, net income equaled $332.8 million or $0.66 per share, compared to $338.3 million or $0.67 per share in Q2 2019.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.12	$2.89	$2.99	$3.37	$3.79	$3.29	$2.94	$3.01	$3.38	$2.52	***$2.00***	***$3.04***
DPS	$0.29	$0.33	$0.36	$0.39	$0.46	$0.57	$0.69	$0.78	$0.89	$1.01	***$1.08***	***$1.27***
Shares[2]	672	653	637	631	623	604	570	555	519	499	***495***	***465***

During the 2007 - 2018 period, Franklin Resources grew earnings-per-share by a compound rate of 3.3% per annum. The biggest growth segment in the asset management industry is ETFs, which have much lower expense ratios than actively managed funds. Franklin's actively managed funds have performed well, which serves as an advantage versus other active asset managers; however, low-cost passive funds are the true competition. The rise of ETF investing will be a challenging headwind for the entire industry. The "race to the bottom" as it relates to fees, is good for investors but not asset managers. We expect assets under management to stabilize somewhat as higher asset prices are weighed against net outflows. However, if Franklin Resources has to keep lowering its management fees, stable AUM will still lead to declining net income, all else equal.

A counterpoint to this notion is that the Franklin Resources has an exceptional balance sheet, allowing the company to repurchase significant blocks of stock and work towards a solution in the changing asset management industry. Most recently this balance sheet flexibility was showcased with the proposed takeover of Legg Mason in an all-cash deal.

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[1] Estimate

[2] In millions.

Disclosure: This analyst is long the security discussed in this research report.

While this does not change the company's long-term problem, there are opportunities available in the way of synergies and complementary product offerings. We are forecasting lower earnings this year due to the COVID-19 crisis, but we are using $2.50 in underlying earnings power and a 4% growth rate for valuation and fair value estimate purposes.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	16.4	13.9	12.3	14.0	14.4	15.4	12.4	13.7	11.1	12.6	***7.2***	***10.0***
Avg. Yld.	0.8%	0.8%	1.0%	0.8%	0.8%	1.1%	1.9%	1.9%	2.4%	3.2%	***5.8%***	***4.2%***

Over the past decade shares of Franklin Resources have traded with an average P/E ratio of 13 to 14 times earnings. We are using 10 times earnings as our beginning baseline, as asset managers are facing substantial headwinds in the way of falling asset management fees. That being said, this multiple could be too conservative given Franklin's immense financial power. Still, with shares trading near 7 times earnings power, this implies the potential for a valuation tailwind.

The dividend is also worth mentioning. Not only is the 5.8% starting yield very well covered, Franklin Resources also has a tendency to periodically pay out a special dividend. While we have not included this in our forecast, investors could receive a yield in excess of the stated payout.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	14%	11%	12%	12%	12%	17%	23%	26%	26%	40%	***42%***	***42%***

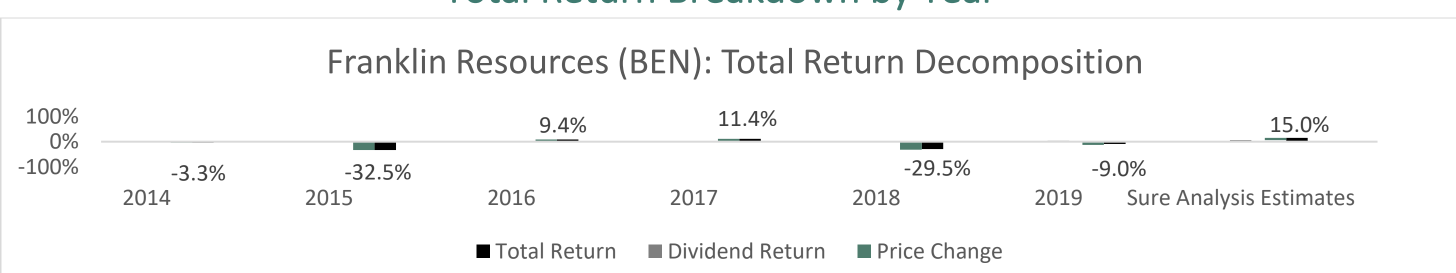
Franklin Resources' funds have performed well over the long-term, but we do not believe the company has a meaningful competitive advantage in its field. Indeed, Franklin Resources needs to adapt to the trend towards low-cost passive ETF's to remain competitive. Unless a novel solution is found, this could mean declining profits in the years to come.

The dividend payout ratio has never been especially high, which has allowed the company to retire a meaningful number of shares and pay the occasional special dividend. Lately the payout ratio has inched upward toward the 40% mark, but this payment is still very well covered. Franklin Resources has perhaps one of the best balance sheets in our coverage universe. Last quarter, the company held $5.8 billion in cash and $14.7 billion in total assets against total liabilities of $3.7 billion. The Legg Mason acquisition would dampen this financial might, but Franklin Resources will remain strong.

Final Thoughts & Recommendation

Shares are down -28% since our last report. Franklin Resources is a classic asset manager that has to battle the rise of low-cost ETF investing, which has been responsible for customers moving money from actively managed funds to ETFs. The company is in an interesting situation where the core business is declining, but the financial foundation – allowing for share repurchases, solid payouts and acquisitions – is exceptional. Total return potential comes in at 15.0% per annum, stemming from 4% growth, a 5.8% dividend yield and the possibility of a valuation tailwind. We acknowledge the challenges facing the business, but we are enthused by the company's financials. Shares earn a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	5853	7140	7101	7985	8491	7949	6618	6392	6319	5775
Gross Profit	3570	3196	3106	3558	3935	3733	3047	2928	2889	2370
Gross Margin	61.0%	44.8%	43.7%	44.6%	46.3%	47.0%	46.0%	45.8%	45.7%	41.0%
SG&A Exp.	1316	363	408	446	498	481	474	444	526	813
D&A Exp.	267	88	82	94	95	97	87	80	76	93
Operating Profit	2089	2660	2515	2921	3221	3028	2366	2264	2119	1557
Operating Margin	35.7%	37.3%	35.4%	36.6%	37.9%	38.1%	35.7%	35.4%	33.5%	27.0%
Net Profit	1446	1924	1931	2150	2384	2035	1727	1697	764	1196
Net Margin	24.7%	26.9%	27.2%	26.9%	28.1%	25.6%	26.1%	26.5%	12.1%	20.7%
Free Cash Flow	1594	1490	988	1974	2085	2183	1630	1061	2123	(32)
Income Tax	618	803	763	856	998	924	742	759	1473	442

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	10708	13776	14752	15390	16357	16336	16099	17534	14384	14532
Cash & Equivalents	3985	5199	4491	6323	7596	8368	8483	8750	6911	5958
Accounts Receivable	N/A	773	850	1039	950	838	794	1002	848	839
Goodwill & Int. Ass.	2007	2148	2142	2359	2326	2257	2211	2228	2333	
Total Liabilities	2958	4653	4991	4705	4145	3840	3571	4598	4176	2995
Accounts Payable	547	266	242	274	238	232	233	292	227	3908
Long-Term Debt	980	2201	2777	2295	2149	2155	2083	1098	729	304
Shareholder's Equity	7727	8525	9201	10073	11584	11841	11936	12620	9899	748
D/E Ratio	0.13	0.26	0.30	0.23	0.19	0.18	0.17	0.09	0.07	0.08

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	14.3%	15.7%	13.5%	14.3%	15.0%	12.5%	10.6%	10.1%	4.8%	8.3%
Return on Equity	18.8%	23.7%	21.8%	22.3%	22.0%	17.4%	14.5%	13.8%	6.8%	12.1%
ROIC	17.5%	19.2%	16.2%	16.9%	17.4%	14.0%	11.8%	11.8%	6.1%	10.7%
Shares Out.	672	653	637	631	623	604	570	555	522	499
Revenue/Share	8.58	10.72	11.04	12.59	13.58	12.93	11.34	11.43	11.75	11.45
FCF/Share	2.34	2.24	1.54	3.11	3.33	3.55	2.79	1.90	3.95	(0.06)

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