



Legg Mason Inc. (LM)

Updated May 1st, 2020 by Eli Inkrot

Key Metrics

Current Price:	\$49.86	5 Year CAGR Estimate:	-0.9%	Market Cap:	\$4.3 B
Fair Value Price:	\$30	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	06/15/20
% Fair Value:	166%	5 Year Valuation Multiple Estimate:	-9.7%	Dividend Payment Date:	07/13/20
Dividend Yield:	3.2%	5 Year Price Target	\$38	Years Of Dividend Growth:	10
Dividend Risk Score:	D	Retirement Suitability Score:	D	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 \$730.8 billion as of March 31st, 2019 (down from \$804 billion at the end of last quarter). Products by asset class include Fixed Income (58% of AUM), Equities (22%), Alternative Investments (10%) and Liquidity (10%). Geographically, 71% of Legg Mason's clients are domiciled in the U.S. The \$4.3 billion market cap company generated \$2.9 billion in annual revenue last year (~0.40% of assets).

On February 18th, 2020 Franklin Resources (ticker: BEN) announced that it had entered into a definitive agreement to acquire Legg Mason for \$50.00 per share. In addition, Franklin Resources will assume approximately \$2 billion of Legg Mason's outstanding debt. The transaction is subject to regulatory approvals and is expected to close no later than the third calendar quarter of 2020.

On April 29th, 2020 Legg Mason reported Q4 and fiscal 2020 results for the period ending March 31st, 2020. For the quarter the company reported \$730.8 billion in assets under management, reflecting -\$64.2 billion in negative market performance and -\$12.1 billion in long-term outflows. Revenue was up 3.9% to \$719.6 million. On an adjusted basis net income totaled \$93.2 million or \$1.02 per share, compared to \$59.8 million or \$0.67 per share in the year ago quarter. For the year Legg Mason generated \$2.922 billion in revenue, up 0.6% compared to last year. Adjusted net income totaled \$339 million or \$3.76 per share compared to \$288.6 million or \$3.26 per share previously.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.63	\$1.54	\$2.61	\$2.33	\$2.63	-\$0.25	\$2.18	\$3.72	\$3.26	\$3.76	\$2.50	\$3.83
DPS	\$0.20	\$0.32	\$0.44	\$0.52	\$0.64	\$0.80	\$0.88	\$1.12	\$1.36	\$1.54	\$1.60	\$2.04
Shares¹	150	140	125	117	111	107	96	85	86	87	87	80

Note that we are presenting the above figures closest to the actual calendar year. While Legg Mason has grown earnings-per-share by 11% per annum 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. 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 investments. 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 the ability to grow, especially on the equity side. Moreover, higher interest rates rise could negatively influence the company's fixed income business.

With that being said, the proposed acquisition by Franklin Resources adds an interesting storyline. While both company's face the same long-term problem, there is the possibility of synergies being created and complementary offerings helping to diversify the combined business if it comes to fruition.

¹ In millions.

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We expect reduced earnings this year on lower equity prices amid the COVID-19 crisis and we are using \$3 in underlying earnings power and 5% growth for valuation and fair value purposes.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	19.6	18.7	10.0	16.0	19.6	---	15.0	10.5	9.8	10.6	16.6	10.0
Avg. Yld.	0.6%	1.1%	1.7%	1.4%	1.2%	1.8%	2.7%	2.9%	4.3%	3.8%	3.2%	5.3%

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. Shares are trading over 16 times our earnings power estimate, implying a valuation headwind, however this is a result of the proposed \$50 per share acquisition price. If the deal goes through, with shares trading at \$49.86 at publication, there would be a slight share price increase. Meanwhile, the dividend should continue to add nicely, while share repurchases can aid in growth as well.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	12%	21%	17%	22%	24%	---	40%	30%	42%	41%	53%	53%

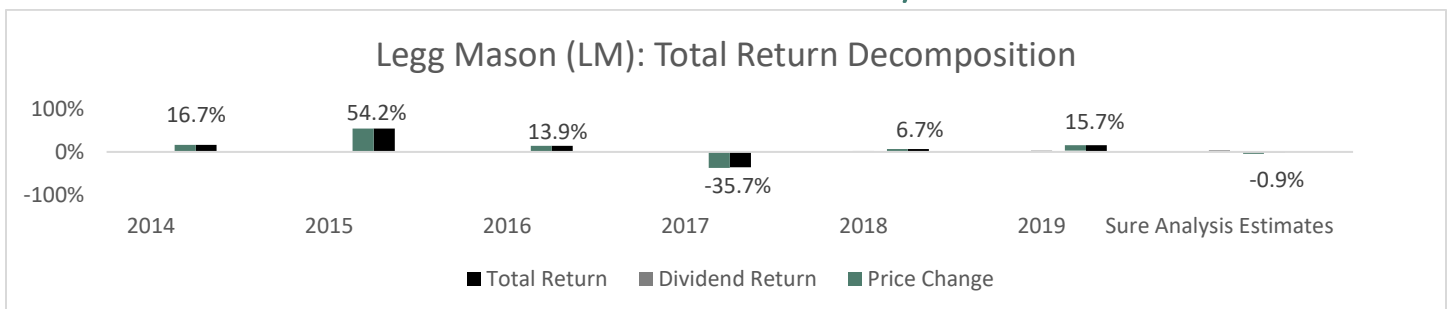
Asset managers enjoy small moats in the way of switching costs. Once set up with an asset manager it is a hassle to change and the benefits of switching are unknown. However, pricing power does not exist and indeed could be a key detrimental driver. Legg Mason's recession record is volatile. Back in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

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 around 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 28% since our last report amid the prospect of being taken over by Franklin Resources. Consolidation is a needed move as the industry faces long-term headwinds in the way of asset managers having to charge lower and lower fees to compete. Total return potential comes in at -0.9%, as 5% growth and a 3.2% dividend yield could be offset by a substantial valuation headwind. The outcome for Legg Mason is binary. If the deal goes through, shares will be bought out at a very small premium. If the deal does not go through, we see a lot of risk. As such, shares earn a selling 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	2784	2663	2613	2742	2819	2661	2887	3140	2,903	2903
Gross Profit	886	869	824	912	992	910	986	1142	1,065	1065
Gross Margin	31.8%	32.6%	31.5%	33.3%	35.2%	34.2%	34.2%	36.4%	36.7%	36.7%
SG&A Exp.	300	320	322	273	292	320	323	314	333	333
D&A Exp.	103	94	88	63	55	60	80	73	73	73
Operating Profit	387	339	300	431	498	388	418	522	469	469
Operating Margin	13.9%	12.7%	11.5%	15.7%	17.7%	14.6%	14.5%	16.6%	16.1%	16.1%
Net Profit	254	221	-353	285	237	-25	227	285	(29)	-29
Net Margin	9.1%	8.3%	-13.5%	10.4%	8.4%	-0.9%	7.9%	9.1%	-1.0%	-1.0%
Free Cash Flow	379	465	265	397	522	414	500	456	510	510
Income Tax	119	72	-151	138	125	8	84	-103	21	21

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	8708	8556	7270	7111	7065	7520	8290	8153	7,794	7794
Cash & Equivalents	1376	1408	980	914	672	1329	734	739	925	925
Accounts Receivable	367	334	351	349	368	335	433	476	425	425
Goodwill & Int. Ass.	5188	5132	4447	4412	4653	4626	5959	5730		5270
Total Liabilities	2901	2878	2451	2387	2580	3285	4279	4300	5,270	4105
Long-Term Debt	1730	1659	1353	1039	1049	1781	2222	2347	4,105	2222
Shareholder's Equity	5770	5677	4818	4725	4485	4214	3983	3824		3660
D/E Ratio	0.30	0.29	0.28	0.22	0.23	0.42	0.56	0.61	2,222	0.61

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.9%	2.6%	-4.5%	4.0%	3.3%	-0.3%	2.9%	3.5%	-0.4%	-0.4%
Return on Equity	4.4%	3.9%	-6.7%	6.0%	5.1%	-0.6%	5.5%	7.3%	-0.8%	-0.8%
ROIC	3.4%	3.0%	-5.2%	4.8%	4.2%	-0.4%	3.7%	4.6%	-0.5%	-0.5%
Shares Out.	150	140	125	117	111	107	96	85	86	87
Revenue/Share	17.91	18.57	19.61	22.40	24.89	24.77	28.64	34.44	33.99	33.99
FCF/Share	2.44	3.24	1.99	3.24	4.61	3.86	4.96	5.00	5.96	5.96

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

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