Equities

17 May 2012 | 15 pages

Legg Mason Inc (LM)

Squeezing Up The Equity Value; Upgrade To Buy; Add To TPL!

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

- **Raising rating to Buy; Adding To TPL!** — From Neutral following the 5/16 capital plan including deleveraging + new buyback. Announcement comes following mixed C1Q post call update – see our 5/1 note, Off The Call – Flow Picture Improving But Is DTA "Trapped"? Lower Estimates/Target - and represents a clear positive development, we believe. Cognizant of the strong outperformance on 5/16 (up 7.5% vs. median 50 bps decline for Traditionals), we nonetheless see further follow through as investors digest the implications and accretion related to the news.
- **Raising C12-13 operating EPS & F13-15** – New C12-13 EPS are $1.88/$2.45 vs. $1.80/$2.18 prior to account for net lower interest expense, reduced share count, and lower tax rate, partially offset by May MTD NAV depreciation. New F13-15 operating EPS are $1.94, $2.63, and $3.26 versus $1.80, $2.32, and $2.83 prior.
- **Raising 12-month SOTP target** – $5 to $32.50 to reflect higher EPS + higher tax shield value per share. Target is 11x C13 operating EPS discounted six months + $7 p.s. NPV of goodwill/NOL tax shield. Believe C13 becomes focal point given step function in EPS power on full year interest savings + buyback compounding.
- **Despite 5/16 bounce stock still well cheap** — Ex ~$7 p.s. tax shield, LM is trading at 7x revised C13 EPS vs. traditional peers at ~12x. We expect the discount to ease given: 1) less gross debt + improving holding company strategic flexibility; 2) reduced risk premium; and, 3) new buyback will unlock tax shield given strong FCF and actionable/consistent repurchase + reduce risk of outsized deal. In essence, we see the buyback + modest debt reduction squeezing up the residual equity value, with potentially improving flow picture further working down the relative P/E discount.
- **Offensive/defensive play** — In a group lacking deep conviction, LM should outperform in up tape on the more transparent capital plan + repo + market leverage while proving defensive should markets ease as buyback + AUM mix temper EPS risks.
- **Capital plan actions** — 1) retire $1.25B convertible debt; 2) draw $250M on credit facility; 3) issue ~$650M new debt – collectively reducing gross debt by $350M; 4) accelerate remaining $155M buyback in F1Q13 (Jun); and, 5) launch new $1B buyback targeting 65% of CFO; likely over 2-3 year window (we note, prior $1B repo done in ~2 years). $155M + new $1B translates into 33% of 5/16 equity value.

Buy	**1**
from Neutral	
Price (16 May 12)	US$24.05
Target price	US$32.50
from US$27.50	
Expected share price return	35.1%
Expected dividend yield	1.8%
Expected total return	**37.0%**
Market Cap	US$3,360M

Price Performance
(RIC: LM.N, BB: LM US)

EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2012A	0.46A	0.34A	0.41A	0.49A	1.70A	1.54A
2013E	**0.44E**	**0.46E**	**0.49E**	**0.55E**	**1.94E**	**1.99E**
Previous	0.43E	0.43E	0.45E	0.49E	1.80E	na
2014E	**0.58E**	**0.64E**	**0.69E**	**0.73E**	**2.63E**	**2.30E**
Previous	0.52E	0.56E	0.60E	0.63E	2.32E	na
2015E	**na**	**na**	**na**	**na**	**3.26E**	**2.89E**
Previous	na	na	na	na	2.83E	na

Source: Company Reports and dataCentral, CIR. FC Cons: First Call Consensus.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2011	2012	2013E	2014E	2015E
Valuation Ratios					
P/E adjusted (x)	12.7	14.2	12.4	9.2	7.4
P/E reported (x)	14.6	15.6	14.1	9.2	7.4
P/BV (x)	0.6	0.6	0.5	0.5	0.4
P/Adjusted BV diluted (x)	na	na	na	na	na
Dividend yield (%)	0.8	1.5	1.8	2.0	2.2
Per Share Data (US$)					
EPS adjusted	1.89	1.70	1.94	2.63	3.26
EPS reported	1.65	1.54	1.71	2.63	3.26
BVPS	38.41	40.71	45.11	51.45	56.75
Tangible BVPS	3.87	3.65	5.22	7.89	8.70
Adjusted BVPS diluted	na	na	na	na	na
DPS	0.20	0.35	0.44	0.48	0.52
Profit & Loss (US$m)					
Net interest income	0	0	0	0	0
Fees and commissions	2,778	2,657	2,603	2,804	3,044
Other operating Income	6	5	5	6	7
Total operating income	**2,784**	**2,663**	**2,608**	**2,810**	**3,051**
Total operating expenses	-2,320	-2,231	-2,173	-2,301	-2,466
Oper. profit bef. provisions	**464**	**431**	**435**	**508**	**585**
Bad debt provisions	0	0	0	0	0
Non-operating/exceptionals	-99	-128	-106	-20	-20
Pre-tax profit	**365**	**303**	**329**	**488**	**565**
Tax	-119	-72	-95	-164	-189
Extraord./Min. Int./Pref. Div.	8	-10	-8	-8	-5
Attributable profit	**254**	**221**	**225**	**317**	**371**
Adjusted earnings	291	243	256	317	371
Growth Rates (%)					
EPS adjusted	19.3	-10.2	14.5	35.3	24.2
Oper. profit bef. prov.	34.9	-7.1	0.9	16.8	15.0
Balance Sheet (US$m)					
Total assets	**8,708**	**8,455**	**8,798**	**9,155**	**9,522**
Avg interest earning assets	na	na	na	na	na
Customer loans	na	na	na	na	na
Gross NPLs	na	na	na	na	na
Liab. & shar. funds	**8,708**	**8,455**	**8,798**	**9,155**	**9,522**
Total customer deposits	na	na	na	na	na
Reserve for loan losses	na	na	na	na	na
Shareholders' equity	**5,770**	**5,700**	**5,868**	**6,128**	**6,128**
Profitability/Solvency Ratios (%)					
ROE adjusted	5.0	4.2	4.4	5.3	6.0
Net interest margin	na	na	na	na	na
Cost/income ratio	83.3	83.8	83.3	81.9	80.8
Cash cost/average assets	26.8	26.0	25.2	25.6	26.4
NPLs/customer loans	na	na	na	na	na
Reserve for loan losses/NPLs	na	na	na	na	na
Bad debt prov./avg. cust. loans	na	na	na	na	na
Loans/deposit ratio	na	na	na	na	na
Tier 1 capital ratio	na	na	na	na	na
Total capital ratio	na	na	na	na	na

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Management Is Buying Back Nearly 33% of the Franchise

Investment Summary

We upgrade LM to Buy from Neutral, raise our 12-month SOTP target $5 to $32.50, and raise C12-13 operating and F13-15 EPS estimates following new capital plan and repurchase authorization announced intraday on 5/16 (see below for details). While we are cognizant of the strong outperformance on 5/16 (up 7.5% vs. median 50 bps decline for Traditionals), we nonetheless see further follow through as investors digest the implications and accretion related to the news – to be sure, we see shares offering 37% expected total return. The buyback + modest debt reduction should squeeze up the residual equity value, we believe, even as flows likely grind toward stabilization.

While the stock was beginning to screen inexpensively following a mixed C1Q post call update – see our 5/1 note, Off The Call – Flow Picture Improving But Is DTA "Trapped"? Lower Estimates/Target – the announcement represents a clear positive development, we believe, especially as we highlighted a more decisive capital management story would likely act as a catalyst for the stock – see our 5/10 note, April AUM: Long Term Flow Inflection Seems To Be Getter Closer. In turn, we add to TPL! given the improved risk/reward; LM and AMG now represent our top Traditional A/M selections.

We see a host of positives emerging from the actions. First, LM is de-levering the balance sheet modestly, while terming out the remaining debt, and thus reducing the risk of the balance sheet. Second, the repurchase will materially shrink the share count – to put the news in perspective, the accelerated $155M repurchase in C2Q plus new $1B authorization represents nearly 33% of LM's equity (and enterprise value). Third, the move will further improve the holding company's position, and likely help garner institutional volumes to some degree. Fourth, the actions are visibly accretive to EPS. Fifth, following a confusing post quarter capital management discussion, the news should crystallize management priorities, allowing for full(er) valuation for the sizeable tax shield, which accounts for about $7 per share, we estimate, sharply enhancing sum of the parts appeal. Six, deal risk seems to be lower, all else equal.

Raising SOTP Target On Accretion + Higher Tax Shield

We raise our 12-month SOTP target $5 to $32.50 to reflect higher operating EPS + higher tax shield valuation. As shown in Figure 1, our target reflects: 1) 11x target multiple on calendar 2013 EPS, or $27; plus, 2) $7 per share for the estimated net present value of LM's tax shield. Here, the aggregate $3.8B goodwill and NOL tax shield is expected to reduce future taxes by $1.5B – see Figure 2 for our updated NPV work. We previously discounted the tax shield valuation support given uncertainty around capital management priorities exiting F4Q12 (Mar) results.

We believe investors will look ahead to calendar 2013 given the full year impact from the debt refinancing plus cumulative impact from declining share count.

Figure 1. Boosting SOTP Price Target

C13 EPS	$2.45
x 11 P/E	$27.00
discounted 6 months @ 5%	$25.50
+ Tax shield	$7.00
Total	**$32.50**
FTM Dividend	$0.48
ETR	**37%**

Source: Citi Investment Research and Analysis

The 11x target P/E compares to Traditional asset managers currently trading at ~12x 2013E EPS. While the manager of manager structure warrants a discount to peers, a further improvement in either the balance sheet and/or LT flow recovery could further narrow the valuation gap, in our view. Though still outflowing, lead indicators are gradually improving, notably in FI and non-US distribution.

Figure 2. We Now Ascribe Full Value To LM's Tax Shield Given More Compelling Capital Repatriation Plan

Purchased Goodwill Shield					NOL Shield[1]						Total
Amtzn Yr	Year	Per Year	PV	NPV	Amtzn Yr	Year	Per Year	PV	NPV	Amtzn Yr	NPV
1	2012	102.0	90.7	90.7	1	2012	69.3	61.6	61.6	1	152.3
2	2013	136.0	107.5	198.1	2	2013	92.4	73.0	134.6	2	332.7
3	2014	136.0	95.5	293.6	3	2014	92.4	64.9	199.5	3	493.1
4	2015	136.0	84.9	378.5	4	2015	92.4	57.7	257.2	4	635.7
5	2016	136.0	75.5	454.0	5	2016	92.4	51.3	308.5	5	762.5
6	2017	136.0	67.1	521.1		2017	61.1	61.1	369.6	6	890.7
7	2018	136.0	59.6	580.7	*Cumulative*		***500.0***			7	950.3
8	2019	102.0	39.8	620.5						8	990.0
Cumulative		***1,020.0***									
			NPV/Share:	**$4.40**				**NPV/Share:**	**$2.60**	**Total:**	**$7.00**

Tax rate:	38.5%
Discount rate:	12.5%
Shares O/S (M):	140.0

Note: purchase goodwill shield refers to deferred taxes on indefinite-life intangible assets/goodwill that are not realized under GAAP.

Source: Company reports, Citi Investment Research and Analysis

Adding To TPL For Four Key Reasons

First, we expect further upward re-rating as EPS estimates work higher and investors work through positive implications of the moves. For instance, we raise our C13 estimate nearly 12% net of May MTD's market decline versus the 7.5% rise in the stock on 5/16.

Second, we now see outsized ETR versus peers, or 37% ETR vs. ~13% for Traditional A/Ms, respectively.

Third, we believe investors are desperately searching for an actionable name in the sector given mixed market and interest rate backdrop, with capital management a clear catalyst following recent sharp underperformance.

Fourth, as investors further appreciate the relative value discount and tax shield magnitude, we expect the valuation discount to narrow – today's news will be that catalyst, in our view.

Foibles And All, Just Well Too Cheap

Net, net, LM's stock price is still down moderately following disappointing C1Q conference call around incremental margins and capital management plans. However, even after 5/16 bounce, we believe LM is well too cheap, even after accounting for checkered (though improving) LT flow story and manager of manager model which tempers margin expansion to a large degree versus many peers.

Excluding the ~$7 per share net present value for the tax shield, LM is trading at 7x our revised C13 EPS estimate, or about a 5x P/E discount to peers (Figure 3). On an EV/EBITDA basis, and LM is trading at 6.1x C2013 EBITDA versus a 7.1x peer

median (Figure 4). Such a discount seems onerous to us. Apart from those Asset Managers where investors believe the strategic viability is under question (ART, for instance), Asset Managers tend to wash out around 10x FTM P/E. And, with clear(er) signs of flow stability as measured by quarter and recently monthly AUM trends, we would expect the multiple to recover to more competitive levels.

We also see LM as both an offensive and defensive play in a tough group at present. Broadly speaking, our global Asset Manager, Broker Dealer + Exchanges Coverage team are finding fresh ideas difficult to come by. In turn, we see LM outperforming into further down tape given its AUM mix tilted is toward bonds and money markets plus more consistent repurchase + dividend policy. Conversely, should markets rally, the compounding impact of declining share count and lower interest expense should drive competitive EPS leverage after several fits and starts over the past many quarters.

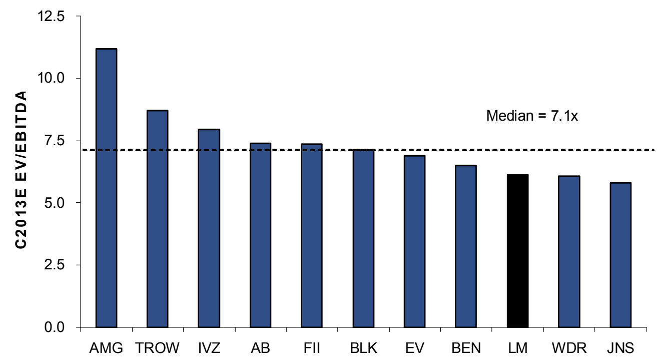
Figure 3. LM's ~7x C2013 P/E (Backing Out ~$7 P.S. Tax Shield)…

	P/E (x) 2012E	P/E (x) 2013E
AMG	14.1	11.7
AB	12.9	11.8
ART	49.3	N/A
BLK	13.2	11.8
EV	12.8	11.9
FII	12.2	11.0
BEN	11.8	10.6
IVZ	12.4	10.7
JNS	11.4	9.9
LM[1]	**9.0**	**6.9**
TROW	18.0	16.4
WDR	12.7	11.8
Median:	**12.7**	**11.7**

[1]LM price adjusted for estimated $7 p.s. tax shield NPV

Source: Company reports, Citi Investment Research and Analysis

Figure 4. …And 6x EV/EBITDA Multiple Is Well Too Cheap, In Our View



Source: Company reports, Citi Investment Research and Analysis

Raising EPS Estimates

We raise our C12-13 operating EPS estimates to $1.88 and $2.45 versus $1.80 and $2.18 previously to account for net lower interest (higher cash interest is more than offset by elimination of non-cash imputed), reduced share count, and lower tax rate, partially offset by NAV depreciation. New F13-15 EPS are $1.94, $2.63, and $3.26 versus $1.80, $2.32, and $2.83 prior.

Our operating estimates excluding an announced ~$75M charge related to prepayment of the $1.25B convertible note to KKR. We assume the $155M repurchase for C2Q is followed by using 65% FCF for repurchase rolling forward. Under our FCF projections, we would expect LM to exhaust the current authorization in approximately two to three years, or consistent with the prior $1B authorization announced in May 2010, assuming the stub repurchase is completed by 6/12, which seems likely based on our conversations with management.

Squeezing Up The Equity Value

We see a number of key positives:

1. **Delevering the balance sheet:** LM is de-levering the balance sheet modestly, while terming out the remaining debt, and thus reducing the risk of the balance sheet while likely improving its stance with credit rating agencies. The refinancing reduces gross debt by $350M as management uses cash on hand combined with $250M from the credit facility and $650M in new senior notes to fully retire the $1.25B 2.5% convertible notes (Figure 5). In turn, debt should decline from $1.5B at 3/31 to a pro forma $1.15B, keeping net debt at ~$100M;

2. **Repurchase will materially shrink share count…:** The repurchase will materially shrink the share count – to put the news in perspective, the accelerated $155M repurchase in C2Q plus new $1B authorization represents nearly 33% of LM's equity value. For the new authorization, management expects to use up to 65% of cash generated from operations beginning fiscal 2013. In Figure 6, we array the potential per year share count reduction at various levels of cash flow from operations;

3. **…While bolster EPS:** Given lower interest expense and reduced share count. As shown in Figure 7, we estimate $0.31 operating EPS accretion (12%) excluding any one-time debt extinguishment charges and $0.11 adjusted EPS accretion (3%), with the difference related to the non-cash imputed interest that is already excluded from adjusted net income. On the operating basis, the $0.31 EPS accretion factors $0.20 per annum for non-cash imputed interest + $0.17 for buyback partially offset $0.06 higher cash interest related to the higher interest rate (5.5%) on the new $650M senior notes;

4. **Improves holding company position:** The move will further improve the holding company's position, and likely helps to garner institutional volumes to some degree.

5. **Crystallizes management priorities:** The new capital plan sends a clearer message around FCF repatriation following a confusing post quarter capital management discussion and should crystallize management priorities, allowing for full(er) valuation for the sizeable tax shield, which accounts for about $7 per share, and sharply enhancing sum of the parts appeal. Additionally, it reinforces LM as one of the top FCF repatriators in the group as we estimate a pro forma 65% of net income will be returned (we assume dividend offsets stock-based compensation) – in Figure 8, we array the total capital returned to shareholders (calculated as dividend + buyback less stock-based compensation as a percentage of net income) for the group;

6. **Deal risk seems to be lower, all else equal**: As the capital plan likely reduces the probability of large(r) scale M&A and reduces potential execution risk – though focus on low(er) risk bolt-on and/or lift-out transactions are likely unchanged;

7. **Flows are beginning to stabilize**: While still early and we do not necessarily expect a linear recovery, there are early signs flows are beginning to stabilize. As shown in Figure 9, equities attrition has narrowed over the past four quarters while fixed income outflows have decelerated over the last three quarters. Additionally, based on our analysis of 4/30 AUM, data suggest a LT flow inflection seems to be getting closer – ex known low-fee sovereign mandate run-off, we estimate "core" FI flows were positive, for instance, while equities appear to have stabilized ex a $1B ClearBridge mandate loss – see our 5/10 note, April AUM: Long Term Flow Inflection Seems To Be Getter Closer.

Figure 5. Pro Forma Debt Is Reduced By $350M

(Figures in M except per share)

	3/31/12	Pro Forma
Price	$24.05	$24.05
Shares O/S	140.1	140.1
Equity	3,369	3,369
+ Gross Debt	1,500	1,150
- Cash	1,400	1,044
= Enterprise Value[1]	**3,469**	**3,475**

[1]Excluding NOL and goodwill tax shield

Source: Company reports, Citi Investment Research and Analysis

Figure 6. Repurchase Should Materially Shrink Share Count…

	Pro Forma Buyback Per Year			
CFO ($M)	**400**	**500**	**600**	**700**
buyback % CFO	65%	65%	65%	65%
Buyback ($M)	260	325	390	455
Share price	$24.05	$24.05	$24.05	$24.05
# Shares (M)	**10.8**	**13.5**	**16.2**	**18.9**
% 3/31 Shares O/S	**7.7%**	**9.6%**	**11.6%**	**13.5%**

Source: Company reports, Citi Investment Research and Analysis

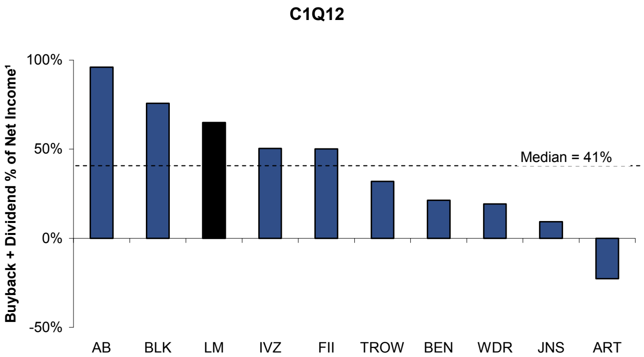
Figure 7. …While Bolster EPS…

	Pro Forma Accretion (C2013E)	
	Operating	**Adjusted**
Prior	2.18	3.61
Interest		
cash	-0.06	-0.06
imputed	0.20	0.00
buyback	0.17	0.17
Pro Forma	**2.49**	**3.72**
Accretion	**0.31**	**0.11**
% Accretion	**12%**	**3%**

[1]Note: interest accretion/dilution based on prior share count forecast

Source: Company reports, Citi Investment Research and Analysis

Figure 8. …And Capital Repatriation Focus

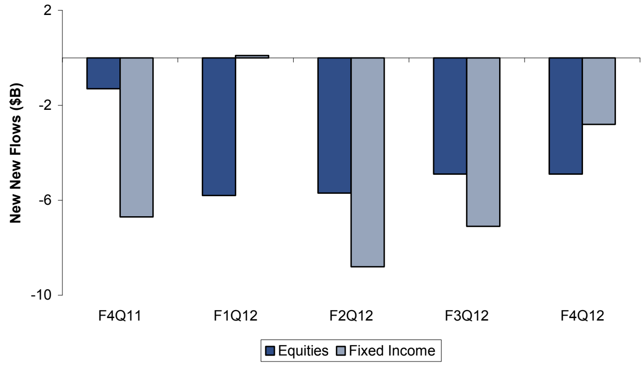


Note: For LM, we use pro forma 65% for buyback to account for new capital plan; we assume dividend offsets share-based compensation.

[1](buyback + dividend - stock based compensation) % net income

Source: Company reports, Citi Investment Research and Analysis

Figure 9. Flows Appear To Be Stabilizing



Source: Company reports, Citi Investment Research and Analysis

Best Ideas

Summary — We believe that the share price of LM will move Up in absolute terms in the next 1 Year based on the last closing price of US$24.05.

Rationale — We are incrementally bullish following the announcement of LM's new capital plan on 5/16.

Legg Mason Inc

(LM.N; US$24.05; 2)

Catalyst and Thesis — We see four catalysts: 1) we expect EPS estimates to work higher following positive implications of 5/16 capital plan; 2) we see outsized ETR versus peers; 3) we believe investors are desperately searching for an actionable name in the sector given mixed market and interest rate backdrop - with capital management a clear catalyst following recent underperformance; and, 4) we expect current P/E discount to narrow as investors further appreciate relative value to peers and tax shield magnitude.

Figure 10. Legg Mason Summary Model

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					Forecast:						Forecast:			% Change				
Revenues & Expenses	**F1Q12**	**F2Q12**	**F3Q12**	**F4Q12**	**F1Q13**	**F2Q13**	**F3Q13**	**F4Q13**	**F2011**	**F2012**	**F2013E**	**F2014E**	**F2015E**	**1QE/4Q**	**1QE/1Q**	**13E/12**	**14E/13E**	**15E/14E**
Investment Advisory Fees	623.6	582.8	545.2	564.7	560.4	556.6	564.7	578.0	2,398.9	2,316.4	2,259.6	2,439.3	2,652.1	(0.8)	(10.1)	(2.4)	7.9	8.7
Distribution and Service Fees	92.1	85.8	80.7	82.4	85.1	85.0	86.0	87.3	379.2	341.0	343.4	364.4	391.4	3.3	(7.6)	0.7	6.1	7.4
Other	1.5	1.3	1.0	1.5	1.3	1.3	1.3	1.3	6.2	5.3	5.2	6.0	7.0	(10.3)	(12.9)	(1.0)	15.4	16.7
Total Revenues	**717.1**	**669.9**	**627.0**	**648.6**	**646.8**	**642.9**	**652.0**	**666.6**	**2,784.3**	**2,662.6**	**2,608.2**	**2,809.6**	**3,050.5**	**(0.3)**	**(9.8)**	**(2.0)**	**7.7**	**8.6**
Compensation and Benefits	300.4	257.7	254.4	297.3	266.0	266.8	270.8	276.2	1,140.3	1,109.7	1,079.8	1,164.3	1,263.9	(10.5)	(11.4)	(2.7)	7.8	8.6
Distribution and Servicing	180.8	160.4	148.3	160.3	157.4	157.3	159.1	161.4	712.8	649.7	635.3	674.1	724.0	(1.8)	(12.9)	(2.2)	6.1	7.4
Communications and Technology	38.4	39.0	39.6	39.4	40.0	40.0	40.0	40.0	158.0	156.3	160.0	162.0	166.9	1.6	4.2	2.4	1.3	3.0
Occupancy	33.0	35.5	28.3	29.6	29.5	29.5	29.5	29.5	133.2	126.5	118.0	120.0	123.0	(0.4)	(10.7)	(6.7)	1.7	2.5
Amortization of Intangible Assets	5.6	5.5	4.9	3.6	3.6	3.6	3.6	3.6	22.9	19.6	14.4	14.4	14.4	(0.6)	(35.5)	(26.4)	0.0	0.0
Non-Recurring	13.7	15.1	42.3	1.9	75.0	0.0	0.0	0.0	54.4	73.1	75.0	0.0	0.0					
Other	44.9	49.9	49.9	44.3	45.0	45.0	45.0	45.0	175.8	189.0	180.0	180.9	188.1	1.6	0.2	(4.8)	0.5	4.0
Incremental Corporate Cost Saves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0					
Total Expenses	**616.7**	**563.0**	**567.7**	**576.4**	**616.5**	**542.2**	**548.0**	**555.7**	**2,397.5**	**2,323.8**	**2,262.4**	**2,315.7**	**2,480.4**	**7.0**	**(0.0)**	**(2.6)**	**2.4**	**7.1**
memo: expense ex transition costs	603.0	547.9	525.3	574.5	541.5	542.2	548.0	555.7										
Operating Income	**100.4**	**106.9**	**59.3**	**72.2**	**30.2**	**100.7**	**104.0**	**110.9**	**386.8**	**338.8**	**345.8**	**493.9**	**570.1**	**(58.1)**	**(69.9)**	**2.1**	**42.9**	**15.4**
Recurring Operating Income	114.1	122.0	101.6	74.1	105.2	100.7	104.0	110.9	441.2	411.8	420.8	493.9	570.1					
Total Other Income	-10.8	-51.1	-11.6	37.8	-9.6	-3.8	-2.0	-1.6	-21.6	-35.7	-17.1	-5.5	-5.4					
Continuing Operations Pre-Tax Income	89.6	55.8	47.7	110.0	20.7	96.9	101.9	109.2	365.2	303.1	328.7	488.4	564.7	(81.2)	(76.9)	8.5	48.6	15.6
Income Tax	27.9	-1.6	12.6	33.2	7.2	15.9	35.7	36.6	119.4	72.1	95.4	163.6	189.2	(78.2)	(74.0)	32.4	71.5	15.6
Net Income (loss) attributable to Non-controllin	1.7	0.7	7.0	0.7	2.0	2.0	2.0	2.0	-8.2	10.2	8.0	8.0	5.0					
Total Net Income	60.0	56.7	28.1	76.1	11.4	79.0	64.3	70.6	253.9	220.8	225.3	316.8	370.5	(85.0)	(80.9)	2.0	40.6	17.0
Adjusted Net Income	118.0	97.7	106.4	115.6	103.5	98.6	101.9	108.2	485.0	437.7	412.1	467.2	520.9	(10.5)	(12.3)	(5.8)	13.4	11.5
TOTAL OPERATING EPS	**$0.46**	**$0.34**	**$0.41**	**$0.49**	**$0.44**	**$0.46**	**$0.49**	**$0.55**	**$1.89**	**$1.70**	**$1.94**	**$2.63**	**$3.26**	(9.5)	(4.7)	14.5	35.3	24.2
ADJUSTED (CASH) EPS	**$0.79**	**$0.68**	**$0.76**	**$0.82**	**$0.76**	**$0.74**	**$0.78**	**$0.85**	**$3.15**	**$3.05**	**$3.13**	**$3.88**	**$4.59**	(8.5)	(4.4)	2.4	24.0	18.4
GAAP EPS	**$0.40**	**$0.39**	**$0.20**	**$0.54**	**$0.08**	**$0.59**	**$0.49**	**$0.55**	**$1.65**	**$1.54**	**$1.71**	**$2.63**	**$3.26**	(84.6)	(79.2)	10.9	53.8	24.2
CALENDARIZED OP EPS									**$1.74**	**$1.88**	**$2.45**	**$3.18**	**N/A**					
CALENDARIZED (ADJUSTED) CASH EPS									**$3.08**	**$3.11**	**$3.67**	**$4.49**	**N/A**					
Dividend Per Share	$0.06	$0.08	$0.08	$0.08	$0.11	$0.11	$0.11	$0.11	$0.20	$0.35	$0.44	$0.48	$0.52	37.5	83.3	25.7	9.1	8.3
Average Diluted Shares	149.3	143.9	140.1	140.1	137.0	132.7	130.1	127.5	153.9	143.3	131.8	120.5	113.5	(2.2)	(8.3)	(8.0)	(8.6)	(5.8)
Comp and Benefits to Revenues (%)	41.9%	38.5%	40.6%	45.8%	41.1%	41.5%	41.5%	41.4%	41.0%	41.7%	41.4%	41.4%	41.4%					
Operating Margin, GAAP	15.9%	18.2%	16.2%	11.4%	16.3%	15.7%	15.9%	16.6%	17.8%	18.2%	19.0%	17.6%	18.7%					
Adjusted Operating Margin (Net of Dist)	21.0%	21.3%	21.7%	21.2%	22.3%	22.1%	22.5%	23.3%	23.2%	21.3%	22.6%	24.5%	25.8%					
Equity AUM ($B)	**181.5**	**144.9**	**153.3**	**163.4**	**151.7**	**153.4**	**156.1**	**159.6**	**189.6**	**163.4**	**159.6**	**176.8**	**195.9**	(7.1)	(16.4)	(2.3)	10.8	10.8
Net Flows	-5.8	-5.7	-4.9	-4.9	-2.8	-1.0	0.0	0.8	-8.3	-21.3	-3.0	5.5	6.5					
Net Flows % Beg AUM	-3.1	-3.1	-3.4	-3.2	-1.7	-0.7	0.0	0.5	-4.8	-11.2	-1.8	3.4	3.7					
Fixed Income AUM ($B)	**365.4**	**355.5**	**352.6**	**356.1**	**361.1**	**364.7**	**368.4**	**373.6**	**356.6**	**356.1**	**373.6**	**394.9**	**418.3**	1.4	(1.2)	4.9	5.7	5.9
Net Flows	0.1	-8.8	-7.1	-2.8	-1.5	0.0	0.0	1.5	-37.0	-18.6	0.0	6.0	7.5					
Net Flows % Beg AUM	0.0	-2.4	-2.0	-0.8	-0.4	0.0	0.0	0.4	-10.2	-5.2	0.0	1.6	1.9					
Liquidity AUM ($B)	**115.6**	**111.4**	**121.1**	**123.8**	**117.3**	**114.3**	**114.3**	**116.1**	**131.4**	**123.8**	**116.1**	**123.3**	**131.3**	(5.3)	1.5	(6.2)	6.2	6.5
Net Flows	-16.1	-3.1	10.7	2.8	-6.5	-3.0	0.0	1.8	-15.9	-5.7	-7.7	7.2	8.0					
Net Flows % Beg AUM	-12.3	-2.7	9.6	2.3	-5.3	-2.6	0.0	1.6	-10.9	-4.3	-6.2	6.2	6.5					
Total AUM ($B)	**662.5**	**611.8**	**627.0**	**643.3**	**630.1**	**632.4**	**638.8**	**649.3**	**677.6**	**643.3**	**649.3**	**695.0**	**745.5**	(2.0)	(4.9)	0.9	7.0	7.3
Average AUM ($B)	**670.8**	**643.3**	**622.0**	**634.9**	**635.4**	**630.4**	**635.6**	**644.0**	**668.2**	**642.8**	**646.3**	**672.1**	**720.3**	0.1	(5.3)	0.5	4.0	7.2
Net Flows	-21.8	-17.6	-1.3	-4.9	-10.8	-4.0	0.0	4.1	-61.2	-45.6	-10.7	18.7	22.0	119.4	(50.7)	(76.5)	(274.8)	17.6
Net Flows % Beg AUM	-3.2	-2.7	-0.2	-0.8	-1.7	-0.6	0.0	0.6	-8.9	-6.7	-1.7	2.9	3.2					
Q/Q % Change	-2.2%	-7.7%	2.5%	2.6%	-2.0%	0.4%	1.0%	1.6%										
Annualized Organic Growth (Loss) Ra	-12.9%	-10.6%	-0.8%	-3.1%	-6.7%	-2.5%	0.0%	2.5%										
LT Flows ($B)	-5.7	-14.5	-12.0	-7.7	-4.3	-1.0	0.0	2.3	-45.3	-39.9	-3.0	11.5	14.0					
Annualized Organic Growth (Loss) Ra	-4.2%	-10.6%	-9.6%	-6.1%	-3.3%	-0.8%	0.0%	1.7%	-33.7%	-29.2%	-2.3%	8.6%	9.8%					
Revenue Yield (bps)	36.2	35.3	34.4	34.8	34.8	34.7	35.0	35.1	34.5	35.3	34.4	35.6	36.0	0.0	(3.7)	(2.5)	3.6	1.0
MISCELLANEOUS																		
EBITDA ($mm)	135	143	125	98	128	124	127	134	567	502	513	590	674	30.4	(5.2)	2.2	15.0	14.3
Free Cash Flow ($mm)	117	97	114	119	111	112	115	122	493	453	460	523	580	(6.6)	(4.6)	1.5	13.6	11.0
Net Debt (Cash) Per Share	$ 1.10	$ 1.97	$ 1.04	$ (0.09)	$ 1.31	$ 1.18	$ 1.05	$ 0.94	$ (0.20)	$ (0.09)	$ 0.73	$ 0.70	$ 0.44					

Source: Company reports, Citi Investment Research and Analysis

Companies mentioned:

AllianceBernstein Holding LP (AB.N; US$14.43; 2); Affiliated Managers Group (AMG.N; US$104.84; 1); Artio Global Investors Inc. (ART.N; US$2.90; 3H); Franklin Resources Inc (BEN.N; US$111.09; 2); BlackRock Inc (BLK.N; US$175.07; 2); Eaton Vance (EV.N; US$24.30; 3); Federated Investors, Inc (FII.N; US$20.70; 2); Invesco Ltd (IVZ.N; US$22.06; 1); Janus Capital Group (JNS.N; US$7.14; 2); Legg Mason Inc (LM.N; US$24.05; 2); T Rowe Price Group Inc (TROW.O; US$59.16; 3); Waddell & Reed Financial, Inc (WDR.N; US$28.67; 2)

Legg Mason Inc

Company description

Legg Mason is an investment management firm with $643 billion in assets under management as of 3/31/12. AUM mix is split roughly 25% equities, 55% fixed income and 20% money market assets. Approximately 70% of the assets are in the Americas division and 30% are in the International division. The firm distributes its products to both retail and institutional investors.

Investment strategy

We rate LM shares Buy reflecting: 1) clearer capital repatriation focus including outsized share purchase; 2) favorable risk/reward; 3) increased rating agency flexibility; and, 4) stabilizing flow story. We see LM outperforming should markets stay favorable given repurchase + market leverage while defensive should markets ease as buyback + AUM mix temper potential EPS risk(s).

Valuation

We value the shares of LM using a combination of Target P/E method and sum-of-the-parts. Our $32.50 12-month target price is derived by applying a 11x target P/E multiple to our calendarized 2013 EPS estimate (discounted back 6 months at 10% cost of capital) plus adding $7 per share related to the estimated NPV of the company's NOL and purchase goodwill tax shields. We believe a 11x target P/E multiple, below the company's 15x historical FTM P/E, is warranted given uneven organic growth prospects.

Risks

If the impact from any of the following factors proves to be greater than we expect, the stock price may have difficulty reaching our target price. If market conditions improve faster than anticipated, the stock price may outperform our target.

Financial market risk — Changes in markets have a direct impact on AUM and investment advisory and services fees.

Performance risk — An inability to meet relevant investment benchmarks could result in clients withdrawing assets and in prospective clients choosing to invest with competitors. This could also result in lower investment management fees, which could result in a decline in revenue.

Redemption risk — Investors can redeem their investments without notice. A significant increase in redemption rates could have a material adverse effect on revenues, financial condition, results of operations and business prospects.

Appendix A-1

Analyst Certification

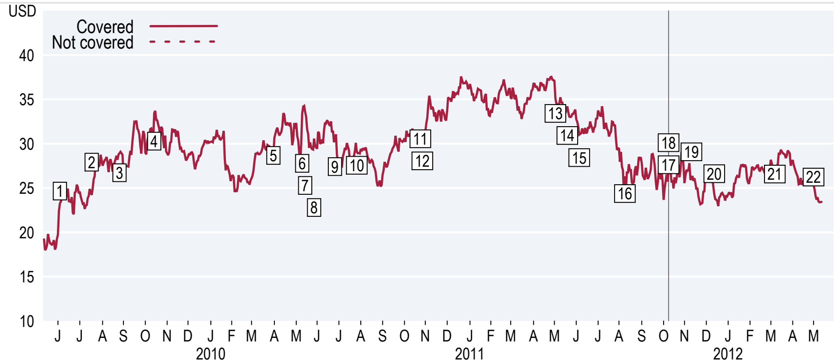
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Legg Mason Inc (LM)

Ratings and Target Price History
Fundamental Research

Analyst: William R Katz
Covered since March 31 2010



	Date	Rating	Target Price	Closing Price
1	3-Jun-09	*2H	*22.00	23.27
2	17-Jul-09	2H	*25.00	24.21
3	26-Aug-09	2H	*29.00	28.92
4	14-Oct-09	2H	*32.00	33.45
5	31-Mar-10	*2M	*29.50	28.67
6	11-May-10	2M	*33.50	33.38
7	14-May-10	*1M	*44.00	33.57
8	27-May-10	1M	*41.00	30.57

	Date	Rating	Target Price	Closing Price
9	25-Jun-10	1M	*42.00	30.70
10	27-Jul-10	1M	*44.00	29.07
11	25-Oct-10	1M	*45.00	30.96
12	27-Oct-10	1M	*46.00	30.58
13	3-May-11	1M	*41.00	35.13
14	19-May-11	1M	*40.00	34.20
15	6-Jun-11	1M	*38.00	31.01
16	9-Aug-11	1M	*34.00	26.30

	Date	Rating	Target Price	Closing Price
17	8-Oct-11	Stock rating system changed		
18	8-Oct-11	*1	34.00	25.72
19	10-Nov-11	1	*33.00	26.04
20	13-Dec-11	*2	*27.00	24.31
21	7-Mar-12	2	*29.00	26.69
22	1-May-12	2	*27.50	25.32

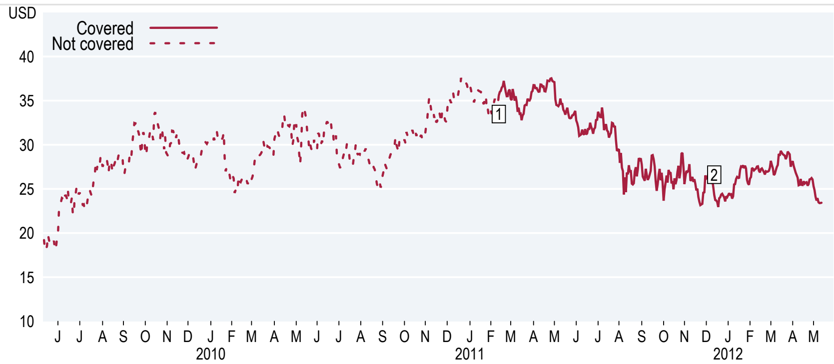
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Legg Mason Inc (LM)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: William R Katz
Covered since March 31 2010



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD MP	-	35.58

	Date	Rating	Target Price	Closing Price
2	13-Dec-11	*REM MP	-	24.31

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

BEST IDEAS UNIVERSE: The best ideas universe from which Eaton Vance (covered by William R Katz), Affiliated Managers Group (covered by William R Katz), AllianceBernstein Holding LP (covered by William R Katz), Invesco Ltd (covered by William R Katz), Franklin Resources Inc (covered by William R Katz), Legg Mason Inc (covered by William R Katz), T Rowe Price Group Inc (covered by William R Katz), Waddell & Reed Financial, Inc (covered by William R Katz) were chosen comprises: Och-Ziff Capital Management (OZM.N, US$7.84), Janus Capital Group (JNS.N, US$7.14), Artio Global Investors Inc. (ART.N, US$2.9), Eaton Vance (EV.N, US$24.3), Affiliated Managers Group (AMG.N, US$104.84), AllianceBernstein Holding LP (AB.N, US$14.43), Invesco Ltd (IVZ.N, US$22.06), Franklin Resources Inc (BEN.N, US$111.09), Legg Mason Inc (LM.N, US$24.05), T Rowe Price Group Inc (TROW.O, US$59.16), Federated Investors, Inc (FII.N, US$20.7), BlackRock Inc (BLK.N, US$175.07), Waddell & Reed Financial, Inc (WDR.N, US$28.67), KKR & Co. L.P. (KKR.N, US$12.06), LPL Investment Holdings (LPLA.O, US$31.27), Blackstone Group L.P. (BX.N, US$12.22), FXCM Inc (FXCM.N, US$9.99), WisdomTree Investments Inc (WETF.O, US$7.4), Apollo Global Management, LLC (APO.N, US$11.46), The Charles Schwab Corporation (SCHW.N, US$12.75) and TD Ameritrade Holding Corp (AMTD.N, US$17.24). All prices as of 16 May 2012.

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Citi Investment Research & Analysis Ratings Distribution

	12 Month Rating			Relative Rating		
Data current as of 31 Mar 2012	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	52%	37%	11%	10%	79%	10%
% of companies in each rating category that are investment banking clients	44%	42%	40%	47%	42%	43%

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Investment Ratings: CIRA's investment ratings are Buy, Neutral and Sell. Our ratings are a function of analyst expectations of expected total return ("ETR") and risk. ETR is the sum of the forecast price appreciation (or depreciation) plus the dividend yield for a stock within the next 12 months. The Investment rating definitions are: Buy (1) ETR of 15% or more or 25% or more for High risk stocks; and Sell (3) for negative ETR. Any covered stock not assigned a Buy or a Sell is a Neutral (2). For stocks rated Neutral (2), if an analyst believes that there are insufficient valuation drivers and/or investment catalysts to derive a positive or negative investment view, they may elect with the approval of CIRA management not to assign a target price and, thus, not derive an ETR. Analysts may place covered stocks "Under Review" in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and / or trading in the company's securities (e.g. trading suspension). As soon as practically possible, the analyst will publish a note re-establishing a rating and investment thesis. To satisfy regulatory requirements, we correspond Under Review and Neutral to Hold in our ratings distribution table for our 12-month fundamental rating system. However, we reiterate that we do not consider Under Review to be a recommendation.

Relative three-month ratings: CIRA may also assign a three-month relative call (or rating) to a stock to highlight expected out-performance (most preferred) or under-performance (least preferred) versus the geographic and industry sector over a 3 month period. The relative call may highlight a specific near-term catalyst or event impacting the company or the market that is anticipated to have a short-term price impact on the equity securities of the company. Absent any specific catalyst the analyst(s) will indicate the most and least preferred stocks in the universe of stocks under consideration, explaining the basis for this short-term view. This three-month view may be different from and does not affect a stock's fundamental equity rating, which reflects a longer-term total absolute return expectation. For purposes of NASD/NYSE ratings-distribution-disclosure rules, most preferred calls correspond to a buy recommendation and least preferred calls correspond to a sell recommendation. Any stock not assigned to a most preferred or least preferred call is considered non-relative-rated (NRR). For purposes of NASD/NYSE ratings-distribution-disclosure rules we correspond NRR to Hold in our ratings distribution table for our 3-month relative rating system. However, we reiterate that we do not consider NRR to be a recommendation.

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Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

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Citigroup Global Markets Inc	William R Katz; Neil Stratton, CFA

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