

Morgan Stanley (MS)

\$52.21 (As of 01/10/20)

Price Target (6-12 Months): **\$58.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/22/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: B

Momentum: B

Summary

Morgan Stanley's shares have outperformed the industry over the past year. The company has an impressive earnings surprise history. Its earnings surpassed the Zacks Consensus Estimate in three of the trailing four quarters. Notably, the acquisition of Solium Capital is in sync with the company's efforts to further strengthen its wealth management business. Moreover, steady loan growth, strong balance sheet position and the company's continued focus on its corporate lending business are expected to continue to aid profitability. However, weaknesses in investment banking and trading are expected to hinder fee income growth to some extent and hurt the company's top line. Moreover, given the decline in interest rates and a tough operating backdrop, the company's performance is expected to remain sluggish in the near term.

Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$52.47 - \$38.76
20 Day Average Volume (sh)	6,837,617
Market Cap	\$84.5 B
YTD Price Change	2.1%
Beta	1.39
Dividend / Div Yld	\$1.40 / 2.7%
Industry	Financial - Investment Bank
Zacks Industry Rank	Top 26% (65 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	10.0%
Last Sales Surprise	3.6%
EPS F1 Est- 4 week change	0.1%
Expected Report Date	01/16/2020
Earnings ESP	-2.9%
P/E TTM	11.6
P/E F1	10.1
PEG F1	1.1
P/S TTM	1.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	10,740 E	10,288 E	10,289 E	9,763 E	40,438 E
2019	10,286 A	10,244 A	10,032 A	9,479 E	39,965 E
2018	11,077 A	10,610 A	9,872 A	8,548 A	40,107 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.39 E	\$1.31 E	\$1.29 E	\$1.18 E	\$5.15 E
2019	\$1.33 A	\$1.23 A	\$1.21 A	\$1.00 E	\$4.87 E
2018	\$1.45 A	\$1.30 A	\$1.17 A	\$0.73 A	\$4.61 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/10/2020. The reports text is as of 01/13/2020.

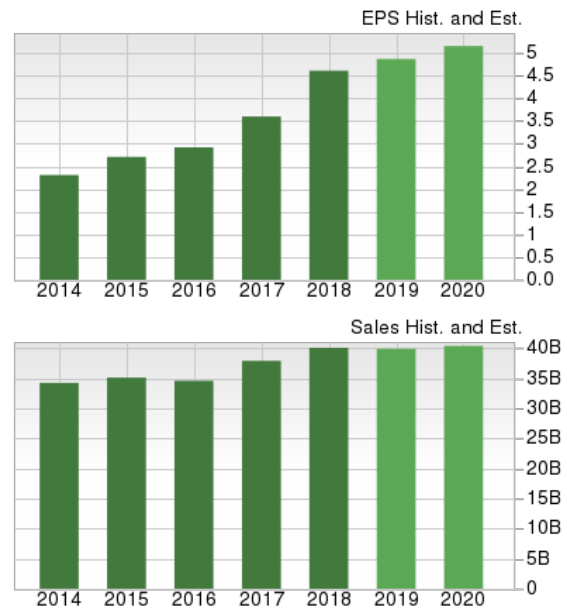
Overview

Founded in 1935 and incorporated under the laws of the State of Delaware in 1981, Morgan Stanley is the leading financial services holding company headquartered in New York. With 60,532 employees, the company serves a diversified group of clients and customers, including corporations, governments, financial institutions and individuals through more than 1,200 offices across 43 countries.

The company's businesses are divided into three segments:

- The **Institutional Securities (IS)** segment (51% of net revenues in 2018) includes capital raising; financial advisory services that include advices on mergers and acquisitions, restructurings, real estate and project finance; corporate lending; sales, trading, financing and market-making activities in equity and fixed income securities and related products, including foreign exchange and commodities; benchmark indices and risk management analytics; and investment activities.
- The **Wealth Management Group (WM)** segment (43%) provides brokerage and investment advisory services covering various investment alternatives; financial and wealth planning services; annuity and other insurance products; credit and other lending products; cash management services; retirement services; and trust and fiduciary services and engages in fixed income principal trading.
- The **Investment Management (IM)** segment (6%) provides global asset management products and services in equity, fixed income, alternative investments that include hedge funds and funds of funds, and merchant banking including real estate, private equity and infrastructure, to institutional and retail clients through proprietary and third-party distribution channels. The segment also engages in investment.

In May 2019, Morgan Stanley acquired Canada-based Solium Capital Inc.



Reasons To Buy:

- ▲ Over the past few years, Morgan Stanley undertook several initiatives to restructure its operations with a goal to lower balance-sheet risks and focus on segments — Wealth Management (“WM”) and Investment Management (“IM”) — that are less dependent on capital markets. Driven by the efforts, WM segment’s contribution to total net income increased from 34% in 2015 to 40% in 2018. Further, it had total client assets of \$2.6 trillion at the end of third-quarter 2019 and witnessed a three-year CAGR of 4.6% (till 2018). The acquisition of Solium will further strengthen the segment’s performance. Also, the company is leveraging its business mix and global client footprint to boost the IM segment. Its partnership with MUFG will also increase profitability.
- ▲ Morgan Stanley is focusing to strengthen its corporate banking unit, which is leading to steady rise in consolidated loans and lending commitments. These efforts, along with higher interest rates, resulted in an increase in net interest income (NII), which witnessed a five-year CAGR of 21.4% (2014-2018). The momentum continued in the first nine months of 2019 despite flattening/inversion of yield curve and two Fed rate cuts in the third quarter. While rising interest expenses and rate cuts are major near-term concerns, steady loan growth is likely to support the company’s NII growth.
- ▲ We remain encouraged by Morgan Stanley’s enhanced capital deployment activities. In June 2019, the company received the Fed’s approval for its 2019 capital plan, which includes a 16.7% quarterly dividend hike and a share repurchase authorization worth \$6 billion. As of Sep 30, 2019, nearly \$4.5 billion worth of shares were left to be repurchased. Given its solid liquidity position and earnings strength, the company will be able to sustain capital deployments and continue enhancing shareholder value going forward.
- ▲ Further, Morgan Stanley seems to be trading at a discount when compared with the broader industry as its current price-to-book and price-earnings (F1) ratios are lower than the respective industry averages. Also, the stock has a Value Score of B.

Morgan Stanley’s focus on wealth management operations and decent loan demand will support revenue growth going forward. Additionally, steady capital deployments reflect a strong balance sheet.

Reasons To Sell:

- ▼ Trading income, which is largely dependent on the overall performance of the capital markets, constitutes almost 35% of Morgan Stanley's net revenues. While solid client activity and significant market volatility aided trading revenues in 2018, the trend reversed in first nine months of 2019 (despite a strong performance in the third quarter). A similar trend is expected to continue in the near term as several geopolitical concerns, including trade war apprehensions, Brexit-related concerns and slowdown in global economy are expected to keep clients on the sidelines.
- ▼ A significant part of Morgan Stanley's revenues comes from investment banking, which is largely dependent on the overall performance of the capital markets. Though investment banking fees grew 10% in 2018 and 24% in 2017, the same witnessed dismal performance in the first nine months of 2019, declining 11% year over year. With lingering global concerns expected to weigh on the corporates' plans to raise fresh capital by issuing shares and/or debt as well as M&As and IPOs, performance of investment banking business is expected to remain muted in the near term.
- ▼ Despite Morgan Stanley's restructuring and streamlining efforts that resulted in achieving cost saving target of \$1 billion in 2017, operating expenses has been increasing. Though operating expenses decreased slightly in the first nine months of 2019, the same saw a three-year CAGR of 5.8% (till 2018). Notably, management expects efficiency ratio in 2019 to be lower than 72.6% in 2017. Nonetheless, expenses are likely to rise as the company continues to invest in franchise and revenues rise.
- ▼ Also, Morgan Stanley's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 10.86% compares unfavorably with ROE of 17.16% for the S&P 500. This reflects that it is less efficient in using shareholders' funds.
- ▼ Shares of Morgan Stanley have outperformed the industry over the past year. However, the company's current-year earnings estimates have remained unchanged over the past 30 days. So, given the concerns and no estimate revisions, the stock has limited upside potential.

Weak trading and investment banking performance will hamper Morgan Stanley's non-interest income. Also, elevated expenses are a key near-term concern, and will hurt the bottom line to an extent.

Last Earnings Report

Morgan Stanley Q3 Earnings Top on Bond Trading, Advisory

Better-than-expected capital markets performance drove Morgan Stanley's third-quarter 2019 adjusted earnings of \$1.21 per share, which outpaced the Zacks Consensus Estimate of \$1.10. Also, the figure increased 3% from the year-ago quarter. Results in the reported quarter excluded net discrete tax benefit.

Morgan Stanley recorded a rise in trading and investment banking revenues. Specifically, fixed income trading income jumped 21%, while equity trading income witnessed a fall of 1%. Overall trading revenues grew 10%.

Now coming to investment banking performance, advisory fees increased 8% and underwriting income was up 4%. Notably, improvement in underwriting income was driven by higher debt underwriting revenues (up 15%), partially offset by 9% fall in equity underwriting fees.

Further, higher net interest income, driven by rise in loan balance, supported the top line.

However, operating expenses witnessed a rise.

Net income applicable to Morgan Stanley was \$2.17 billion, up 3%.

Trading, Investment Banking Aid Revenues, Costs Rise

Net revenues amounted to \$10.03 billion, up 2% from the prior-year quarter. Also, the top line beat the Zacks Consensus Estimate of \$9.68 billion.

Net interest income was \$1.22 billion, up 30% from the year-ago quarter. This was largely due to a rise in interest income, partially offset by higher interest expenses.

Total non-interest revenues of \$8.81 billion dipped 1% year over year.

Total non-interest expenses were \$7.32 billion, up 4%.

Decent Segmental Performance

Institutional Securities: Pre-tax income from continuing operations was \$1.31 billion, decreasing 16% year over year. Net revenues were \$5.02 billion, up 2%. The rise was mainly driven by higher trading income and investment banking revenues, partially offset by significant decline in investment revenues.

Wealth Management: Pre-tax income from continuing operations totaled \$1.24 billion, up 4%. Net revenues were \$4.36 billion, down 1% year over year as decline in transactional revenues and lower net interest income were partially offset by higher asset management revenues.

Investment Management: Pre-tax income from continuing operations was \$165 million, surging 62% from the year-ago quarter. Net revenues were \$764 million, up 17%. The increase was mainly driven by rise in asset management fees and investment revenues.

As of Sep 30, 2019, total assets under management or supervision were \$507 billion, up 8% on a year-over-year basis.

Strong Capital Position

As of Sep 30, 2019, book value per share was \$45.49, up from \$40.67 as of Sep 30, 2018. Tangible book value per share was \$39.73, up from \$35.50.

Morgan Stanley's Tier 1 capital ratio was 18.4% compared with 19.0% in the year-ago quarter. Tier 1 common equity ratio was 16.2%, down from 16.7%.

Share Repurchase Update

During the reported quarter, Morgan Stanley repurchased shares worth \$1.5 billion. This was part of the company's 2019 capital plan.

Outlook

The company believes that "a low rate and a declining rate environment" is likely to adversely impact NII, partially offset by higher loan balances.

Management set an efficiency ratio target of less than 73% for 2019.

For the WM segment, NII growth is expected to be in line with the loan growth (which is projected to be mid-single-digits) in 2019. Also, the company expects margins of 26-28%.

The company expects 2019 effective tax rate to be relatively similar as 2018 level.

Over the medium-term, management targets a return on equity of 10-13% and return on tangible common equity ratio of 11.5-14.5%. The company looks to achieve 100% payout ratio going forward, subject to regulatory approval and any acquisition opportunities.

Quarter Ending **09/2019**

Report Date	Oct 17, 2019
Sales Surprise	3.60%
EPS Surprise	10.00%
Quarterly EPS	1.21
Annual EPS (TTM)	4.50

Recent News

Morgan Stanley's Ratings Affirmed by Moody's, Outlook Upgraded - Dec 11, 2019

Morgan Stanley's issuer as well as senior unsecured debt ratings has been affirmed at A3 by Moody's Investors Service, the rating arm of Moody's Corporation. The rating agency has also affirmed the ratings of all of Morgan Stanley's subsidiaries.

Further, the rating outlook for the firm and its subsidiaries has been upgraded to positive from stable.

Per Moody's, Morgan Stanley has been consistently adhering to strategic financial objectives and goals over the past several years, which has supported its strong credit profile.

The company has been able to maintain its competitive position among peers that lead the global capital markets. It has taken several initiatives to restructure its operations with a goal to lower balance-sheet risks and focus on segments — Wealth Management and Investment Management — that are less dependent on capital markets.

Driven by these efforts, the WM segment's contribution to total net income increased from 34% in 2015 to 40% in 2018. In fact, supported by these initiatives, the firm's total profitability has also improved.

Moody's also mentioned that with the help of solid structural and comprehensive liquidity management, Morgan Stanley has been able to offset the challenges that its heavy reliance on market funding poses.

Further, the firm also maintains a solid capital position in comparison with its peers. Also, since the financial crisis, Morgan Stanley has been continuously engaging in cost management. While expenses are expected to increase in the near term because of the company's continued investments in franchise, it achieved its cost saving target of \$1 billion in 2017 with the help of its restructuring and streamlining efforts.

Thus, the above-mentioned positives formed the basis behind the ratings affirmation by Moody's.

However, Moody's noted that Morgan Stanley has a complex legal structure, and its global footprint and extensive capital market activities increases management and governance challenges. In fact, the firm's baseline credit assessment ("BCA") rating incorporates one-notch of downward adjustment to reflect the credit risk that is associated with the opacity and complexity of its global operations.

Nevertheless, since the financial crisis, the firm's governance frameworks and related controls and processes have materially improved, per Moody's.

Notably, Moody's upgraded the ratings outlook to positive to reflect Morgan Stanley's strong financial performance, which includes the improvement in its profitability and its solid capital and liquidity positions.

What Can Lead to a Rating Upgrade?

Morgan Stanley's ratings could be upgraded if it is able to maintain its trend of improving the quality and stability of its profitability, along with maintaining a solid capital and liquidity position. Moreover, if the firm can demonstrate strong risk management controls in Institutional Securities' lending and improved results in regulatory stress testing, there is a possibility that its ratings could be upgraded.

What Can Trigger a Ratings Downgrade?

A rating downgrade can take place if there is significant deterioration in loan credit quality or loan underwriting standards, or if there is an increase in portfolio concentrations, and deterioration in Morgan Stanley's liquidity profile.

Dividend Update

On Oct 17, Morgan Stanley announced a quarterly cash dividend of 35 cents per share. The dividend was paid on Nov 15 to shareholders on record as of Oct 31.

Valuation

Morgan Stanley's shares are up 22.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 14.2% and 14.4%, respectively over the past year.

The S&P 500 index is up 25.6% in the past year.

The stock is currently trading at 10.11X forward 12 months earnings, which compares to 11.98X for the Zacks sub-industry, 14.88X for the Zacks sector and 18.88X for the S&P 500 index.

Over the past five years, the stock has traded as high as 15.94X and as low as 7.19X, with a 5-year median of 10.70X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$58 price target reflects 11.24X forward earnings.

The table below shows summary valuation data for MS

Valuation Multiples - MS					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	10.11	11.98	14.88	18.88
	5-Year High	15.94	15.3	16.21	19.34
	5-Year Low	7.19	6.05	12.01	15.17

P/TB TTM	5-Year Median	10.7	11.42	13.98	17.44
	Current	1.29	2.42	3.28	12.5
	5-Year High	1.72	3.33	3.98	12.53
	5-Year Low	0.71	1.6	2.44	6.03
	5-Year Median	1.24	2.39	3.46	9.07
P/S F12M	Current	2.09	3.63	6.53	3.5
	5-Year High	2.67	4.53	6.61	3.5
	5-Year Low	1.17	2.8	5.2	2.54
	5-Year Median	1.97	3.63	6.04	3

As of 01/10/2020

Industry Analysis Zacks Industry Rank: Top 26% (65 out of 254)



Top Peers

Bank of America Corporation (BAC)	Neutral
Evercore Inc (EVR)	Neutral
The Goldman Sachs Group, Inc. (GS)	Neutral
JPMorgan Chase & Co. (JPM)	Neutral
KeyCorp (KEY)	Neutral
Lazard Ltd (LAZ)	Neutral
Moelis & Company (MC)	Neutral
The PNC Financial Services Group, Inc (PNC)	Neutral

Industry Comparison Industry: Financial - Investment Bank				Industry Peers		
	MS Neutral	X Industry	S&P 500	BAC Neutral	GS Neutral	JPM Neutral
VGM Score	B	-	-	D	F	D
Market Cap	84.51 B	499.67 M	24.03 B	312.49 B	85.73 B	426.78 B
# of Analysts	7	3.5	13	7	7	6
Dividend Yield	2.68%	0.35%	1.78%	2.07%	2.07%	2.65%
Value Score	B	-	-	B	D	C
Cash/Price	3.69	0.38	0.04	2.23	4.55	2.33
EV/EBITDA	-1.43	4.61	14.04	-2.26	-4.27	-3.98
PEG Ratio	1.13	1.40	2.02	1.28	1.28	1.85
Price/Book (P/B)	1.15	1.93	3.32	1.28	1.06	1.81
Price/Cash Flow (P/CF)	8.65	8.66	13.52	10.64	7.64	11.24
P/E (F1)	10.14	10.30	18.82	11.49	10.16	12.95
Price/Sales (P/S)	1.62	1.59	2.63	2.72	1.78	3.01
Earnings Yield	9.86%	9.71%	5.31%	8.69%	9.84%	7.72%
Debt/Equity	2.58	0.41	0.72	0.99	2.68	1.26
Cash Flow (\$/share)	6.04	2.42	6.94	3.26	31.69	12.11
Growth Score	B	-	-	F	F	F
Hist. EPS Growth (3-5 yrs)	19.17%	11.59%	10.56%	30.95%	8.96%	15.31%
Proj. EPS Growth (F1/F0)	5.87%	10.47%	7.49%	12.05%	10.87%	1.51%
Curr. Cash Flow Growth	17.36%	32.67%	14.83%	25.85%	19.84%	23.43%
Hist. Cash Flow Growth (3-5 yrs)	12.40%	15.78%	9.00%	14.04%	4.71%	7.08%
Current Ratio	0.78	1.29	1.23	0.92	0.78	0.93
Debt/Capital	69.86%	28.79%	42.99%	47.56%	70.21%	54.37%
Net Margin	15.99%	4.69%	11.08%	24.16%	18.86%	24.70%
Return on Equity	10.86%	12.06%	17.16%	12.05%	11.41%	14.63%
Sales/Assets	0.06	0.22	0.55	0.05	0.05	0.05
Proj. Sales Growth (F1/F0)	1.18%	5.30%	4.20%	0.57%	3.12%	0.02%
Momentum Score	B	-	-	B	C	A
Daily Price Chg	0.29%	0.00%	-0.33%	-0.83%	-0.20%	-1.00%
1 Week Price Chg	0.22%	0.00%	-0.30%	-1.27%	0.40%	-0.57%
4 Week Price Chg	3.00%	0.01%	1.71%	0.17%	7.10%	-1.41%
12 Week Price Chg	20.19%	4.60%	6.05%	14.80%	17.27%	13.06%
52 Week Price Chg	25.32%	-2.85%	22.39%	35.02%	37.56%	35.54%
20 Day Average Volume	6,837,617	90,202	1,580,816	38,344,824	2,377,375	9,316,014
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.84%	0.00%	0.18%
(F1) EPS Est 4 week change	0.13%	0.00%	0.00%	1.03%	0.41%	0.58%
(F1) EPS Est 12 week change	-0.38%	-2.11%	-0.50%	1.66%	-3.17%	1.02%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	2.11%	0.86%	1.73%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	B
Momentum Score	B
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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