

Morgan Stanley (MS)

\$49.68 (As of 02/24/20)

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

Long Term: 6-12 Months

Zacks Recommendation: **Outperform**

(Since: 01/20/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: B

Growth: B

Momentum: A

Summary

Morgan Stanley's shares have outperformed the industry over the past year. The company has an impressive earnings surprise history, having outpaced the Zacks Consensus Estimate in each of the trailing four quarters. The company's planned acquisition of E*Trade Financial for \$13 billion will further support Wealth Management business. Improving economy and focus on corporate lending operation are expected to continue supporting profitability. Although dependence on capital markets to generate trading and investment banking revenues, lower rates and continuously rising operating expenses are major near-term concerns, initiatives to further strengthen investment management operation are likely to support top-line growth. Also, enhanced capital deployment activities reflect a strong balance sheet position and will enhance shareholder value.

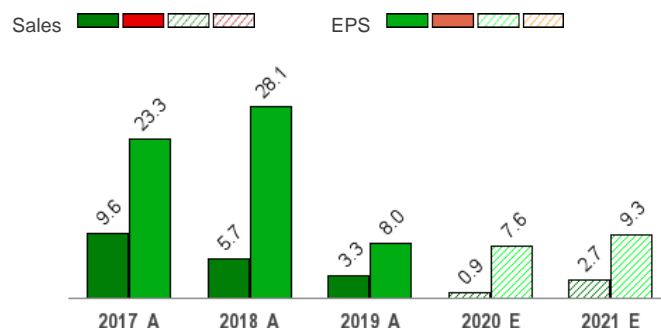
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$57.57 - \$38.76
20 Day Average Volume (sh)	11,908,253
Market Cap	\$80.4 B
YTD Price Change	-2.8%
Beta	1.34
Dividend / Div Yld	\$1.40 / 2.8%
Industry	Financial - Investment Bank
Zacks Industry Rank	Top 36% (92 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	22.5%
Last Sales Surprise	14.1%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	04/15/2020
Earnings ESP	0.0%
P/E TTM	10.0
P/E F1	9.3
PEG F1	1.0
P/S TTM	1.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	11,256 E	10,966 E	10,424 E	10,638 E	42,920 E
2020	10,864 E	10,525 E	10,245 E	10,244 E	41,803 E
2019	10,286 A	10,244 A	10,032 A	10,857 A	41,419 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.61 E	\$1.50 E	\$1.45 E	\$1.43 E	\$5.86 E
2020	\$1.49 E	\$1.33 E	\$1.29 E	\$1.22 E	\$5.36 E
2019	\$1.33 A	\$1.23 A	\$1.21 A	\$1.20 A	\$4.98 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 02/24/2020. The reports text is as of 02/25/2020.

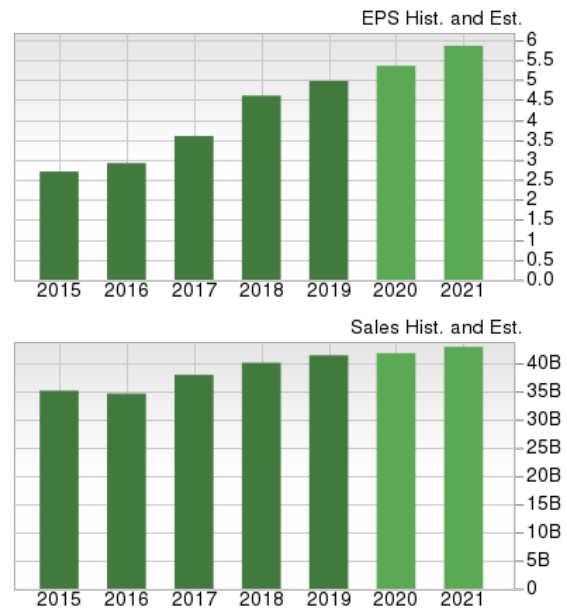
Overview

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 60,431 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 (49% of net revenues in 2019) 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 (8%) 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 2019, the company acquired Canada-based Solium Capital Inc and renamed it as Shareworks by Morgan Stanley.



Reasons To Buy:

▲ Morgan Stanley is undertaking several initiatives to restructure its operations with a goal to increase reliable revenue sources and focus on segments — Wealth Management (“WM”) and Investment Management (“IM”) — that are less dependent on capital markets. Driven by these efforts, both the segment’s aggregate contribution to net revenues jumped from 26% in 2010 to 51% in 2019. Further, WM’s total client assets witnessed a three-year CAGR of 6.7% (2017-2019). The planned acquisition of E*Trade and Shareworks deal are expected to further strengthened the segment’s performance. Also, the company is leveraging its business mix and global client footprint to boost IM’s performance, with assets balance recording a five-year CAGR of 8% (ended 2019). The company’s partnership with MUFG will also support profitability.

Morgan Stanley’s focus on less capital markets dependent operations and decent loan demand will support revenue growth. Also, steady capital deployments reflect a strong balance sheet position.

▲ Morgan Stanley is focused on strengthening its corporate banking unit, which is leading to steady rise in consolidated loans and lending commitments. The same witnessed a three-year CAGR of 9.8% (2017-2019). These efforts also resulted in an increase in net interest income (NII), which witnessed a four-year CAGR of 8.3% (2016-2019). Despite flattening/inversion of yield curve and three interest rate cuts in 2019, NII is expected to get support from steady loan growth and improving economy.

▲ We remain encouraged by Morgan Stanley’s enhanced capital deployment activities. In June 2019, the company received the Fed’s approval for its capital plan, which includes a 16.7% quarterly dividend hike and a share repurchase authorization worth \$6 billion. As of Dec 31, 2019, nearly \$3 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.

▲ Shares of Morgan Stanley have outperformed the industry over the past six months. Also, the company’s 2020 earnings estimates have moved 4.1% upward over the past 60 days. Further, the stock 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. So, given the strong fundamentals and positive estimate revisions, the stock has upside potential.

Risks

- Morgan Stanley's Institutional Securities ("IS") segment (mainly constituting trading and investment banking) depends on the overall performance of the capital markets. The segment witnessed dismal top-line performance in 2019 as challenging operating environment depicting trade-war and Brexit-related uncertainty, and other geopolitical matters led to volatile client-activities, and muted equity/debt issuances and M&As. Thus, the future performance of the segment depends on market developments and client volumes.
 - Despite Morgan Stanley's restructuring and streamlining efforts that resulted in achieving cost saving target of \$1 billion in 2017, expenses have been increasing. Operating expenses recorded a four-year CAGR of 5.3% (till 2019). Expenses are likely to continue rising on steadily increasing revenues (leading to higher compensation costs) and the company's investment in franchise.
 - Also, Morgan Stanley's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 11.70% compares unfavorably with ROE of 17.21% for the S&P 500. This reflects that it is less efficient in using shareholders' funds.
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Last Earnings Report

Morgan Stanley Q4 Earnings Top on Trading, Underwriting

Better-than-expected capital markets performance drove Morgan Stanley's fourth-quarter 2019 adjusted earnings of \$1.20 per share, which outpaced the Zacks Consensus Estimate of 98 cents. Also, the figure jumped 64% from the year-ago quarter. Results for the reported quarter include severance costs of \$172 million and exclude net discrete tax benefit.

Morgan Stanley recorded a rise in both trading and investment banking revenues. Specifically, fixed income trading revenues surged 126%, while equity trading income was relatively stable. Overall trading revenues grew 28%.

Now coming to investment banking performance, underwriting income was up 35%. The improvement was driven by a rise in both equity and fixed income underwriting revenues, which were up 31% and 39%, respectively. On the other hand, as expected, advisory fees declined 11%.

Further, higher net interest income, driven by rise in loan balance (up 11%) and lower interest expenses, supported the top line.

However, operating expenses witnessed a rise, mainly due to higher compensation costs (up 38%).

Net income applicable to common shareholders was \$2.09 billion, increasing 53%.

For 2019, adjusted earnings of \$4.98 per share grew 8% year over year and outpaced the Zacks Consensus Estimate of \$4.86. Net income applicable to common shareholders was \$8.51 billion, up 4%.

Trading, Investment Banking Aid Revenues, Costs Rise

Net revenues for the quarter were \$10.86 billion, up 27% from the prior-year quarter. Also, the top line beat the Zacks Consensus Estimate of \$9.52 billion.

For 2019, net revenues grew 3% to \$41.42 billion. It also surpassed the consensus estimate of \$40.08 billion.

Net interest income was \$1.43 billion, jumping 45% from the year-ago quarter. This was largely due to a 19% fall in interest expenses.

Total non-interest revenues of \$9.42 billion jumped 25% year over year.

Total non-interest expenses were \$8.12 billion, up 21%.

Impressive Quarterly Segment Performance

Institutional Securities: Pre-tax income from continuing operations was \$1.13 billion, increasing 44% year over year. Net revenues were \$5.05 billion, up 32%. The rise was mainly driven by higher trading income, investment banking revenues and investment revenues.

Wealth Management: Pre-tax income from continuing operations totaled \$1.16 billion, up 15%. Net revenues were \$4.58 billion, up 11% year over year as rise in transactional revenues and asset management revenues were partially offset by lower net interest income.

Investment Management: Pre-tax income from continuing operations was \$447 million, surging substantially from \$74 million in the year-ago quarter. Net revenues were \$1.36 billion, soaring 98%. The increase was mainly driven by rise in asset management fees and investment revenues.

As of Dec 31, 2019, total assets under management or supervision were \$552 billion, up 19% on a year-over-year basis.

Strong Capital Position

As of Dec 31, 2019, book value per share was \$45.82, up from \$42.20 as of Dec 31, 2018. Tangible book value per share was \$40.01, up from \$36.99.

Morgan Stanley's Tier 1 capital ratio was 18.6% compared with 19.2% in the year-ago quarter. Tier 1 common equity ratio was 16.4%, down from 16.9%.

Share Repurchase Update

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

Two-Year Outlook

Management projects efficiency ratio to be in the range of 70-72% in 2021, below 72.7% in 2019.

For the WM segment, the company expects pre-tax margin to be 28-30% in 2021.

Loan growth is projected to be in mid-single-digits range in 2020. Further, NII is likely to be stable as the full impact of 2019 three rate cuts, the realization of the forward curve and the continued diversification of deposits will be offset by lending growth.

The company expects 2020 effective tax rate to be slightly higher or roughly 22-23%. It is likely to report some quarterly volatility.

Quarter Ending 12/2019

Report Date	Jan 16, 2020
Sales Surprise	14.07%
EPS Surprise	22.45%
Quarterly EPS	1.20
Annual EPS (TTM)	4.97

Management expects to fully convert all of the existing corporate clients to the Morgan Stanley work model by the end of 2021.

Return on tangible common equity (ROTCE) ratio of 13-15% in 2021.

Long-Term Targets

Management targets ROTCE ratio to be 15-17% and efficiency ratio to be less than 70%.

For the WM segment, the company expects pre-tax margin to be more 30%.

Recent News

Morgan Stanley to Acquire E*TRADE for \$13 Billion - Feb 20, 2020

Morgan Stanley has entered into an all-stock acquisition deal with Arlington, VA-based E*TRADE Financial, per which the former will acquire the latter for \$13 billion. Post completion, Morgan Stanley will be well positioned as a leader in the Wealth Management industry across all channels and wealth segments, with significant increase in the scale and breadth of its franchise.

E*TRADE's more-than 5.2-million client accounts and \$360 billion of retail client assets will augment Morgan Stanley's current 3-million client relationships and \$2.7 trillion of client assets. Thus, the combined entity will have client assets worth \$3.1 trillion, 8.2 million retail client relationships and accounts, and 4.6 million stock-plan participants.

Morgan Stanley will be able to serve clients with superior products and services catering the advisor-driven model, combined with E*TRADE's direct-to-consumer and digital processes. Therefore, Morgan Stanley will be transitioned to a more balance-sheet light business mix, with strong and diversified revenue sources.

"E*TRADE represents an extraordinary growth opportunity for our Wealth Management business and a leap forward in our Wealth Management strategy. The combination adds an iconic brand in the direct-to-consumer channel to our leading advisor-driven model, while also creating a premier Workplace Wealth provider for corporations and their employees. E*TRADE's products, innovation in technology, and established brand will help position Morgan Stanley as a top player across all three channels: Financial Advisory, Self-Directed, and Workplace," said James Gorman, chairman and CEO of Morgan Stanley. "In addition, this continues the decade-long transition of our Firm to a more balance sheet light business mix, emphasizing more durable sources of revenue," Gorman further noted on this.

However, the deal awaits certain regulatory approvals and customary approvals by shareholders of E*TRADE. The transaction is anticipated to close in the final quarter of 2020.

Besides, Moody's has placed Morgan Stanley's ratings under review for upgrade.

Terms of the Deal

Per terms of the deal, each common shareholder of E*TRADE will get stock equivalent to 1.0432 of Morgan Stanley shares for every E*TRADE share held. This represents per share value of \$58.74 based on the closing price of Morgan Stanley common stock as on Feb 19, 2020.

Strategically, the combined entity will enhance through advanced technologies, innovative products and create a competitive edge with financial stability. Remarkably, on completion of the acquisition, online brokerage and digital banking services will enhance clients' experience.

Mike Pizzi, CEO of E*TRADE, will join Morgan Stanley, looking after the E*TRADE business within Morgan Stanley and head the ongoing integration process. Moreover, one of E*TRADE's independent directors is likely to join Morgan Stanley's board.

Financial Benefits

Catering huge funding benefits to Morgan Stanley, the deal comes with around \$56 billion of low-cost deposits. The acquisition move follows the bank's efforts to record revenues from balance-sheet light and more lasting sources of revenues. Notably, post integration, the combined wealth and investment management businesses are likely to contribute about 57% of the bank's pre-tax profits, excluding potential synergies, above the 26% recorded in 2010.

Post combination, significant cost savings worth \$400 million is expected with optimization of technology infrastructure and shared corporate services, along with funding synergies of \$150 million from E*TRADE's around \$56 billion of deposits. In addition, \$7.3 trillion of combined current customer assets is likely to generate significant revenue opportunities.

Per Morgan Stanley, the acquisition is likely to be accretive once fully phased-in estimated cost and funding synergies are realized. Furthermore, the bank's common equity tier 1 ratio is estimated to expand by more than 30 basis points (bps) on closure and augment the bank's return on tangible common equity by more than 100 bps, with fully phased-in cost and funding synergies. Apart from this, Wealth Management's pre-tax profit margin is expected to be up more than 30%.

Dividend Update

On Jan 16, Morgan Stanley announced a quarterly cash dividend of 35 cents per share. The dividend was paid out on Feb 14 to shareholders on record as of Jan 31.

Valuation

Morgan Stanley's shares are up 17.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are up 3% and 4.8%, respectively over the past year.

The S&P 500 index is up 14.5% in the past year.

The stock is currently trading at 9.13X forward 12 months earnings, which compares to 11.03X for the Zacks sub-industry, 14.45X for the Zacks sector and 18.44X 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 10.49X. Our Outperform recommendation indicates that the stock will perform better than the market. Our \$58 price target reflects 10.74X 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	9.13	11.03	14.45	18.44
	5-Year High	15.94	15.3	16.21	19.34
	5-Year Low	7.19	6.05	12.01	15.18
	5-Year Median	10.49	11.35	14.15	17.47
P/B TTM	Current	1.07	2.16	2.75	4.66
	5-Year High	1.51	3	2.89	4.9
	5-Year Low	0.61	1.47	1.83	2.85
	5-Year Median	1.09	2.21	2.52	3.62
P/S F12M	Current	1.92	3.95	6.55	3.39
	5-Year High	2.67	4.53	6.65	3.43
	5-Year Low	1.17	2.8	5.39	2.54
	5-Year Median	1.99	3.63	6.04	3

As of 02/21/2020

Industry Analysis Zacks Industry Rank: Top 36% (92 out of 255)



Top Peers

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

Industry Comparison Industry: Financial - Investment Bank				Industry Peers		
	MS Outperform	X Industry	S&P 500	BAC Neutral	GS Neutral	JPM Outperform
VGM Score	A	-	-	B	D	F
Market Cap	80.41 B	629.01 M	24.03 B	285.68 B	77.62 B	414.52 B
# of Analysts	8	2.5	13	10	8	10
Dividend Yield	2.82%	0.00%	1.76%	2.20%	2.23%	2.72%
Value Score	B	-	-	B	C	D
Cash/Price	3.60	0.37	0.04	2.24	4.35	2.17
EV/EBITDA	-1.75	5.02	14.08	-2.38	-4.29	-2.94
PEG Ratio	1.03	1.09	2.08	1.19	1.05	2.47
Price/Book (P/B)	1.09	1.97	3.29	1.22	0.88	1.77
Price/Cash Flow (P/CF)	8.23	9.52	13.42	8.92	7.82	10.91
P/E (F1)	9.27	11.21	19.00	10.72	9.13	12.34
Price/Sales (P/S)	1.49	1.50	2.64	2.52	1.44	2.90
Earnings Yield	10.79%	8.94%	5.26%	9.32%	10.95%	8.10%
Debt/Equity	2.58	0.40	0.70	1.00	2.30	1.24
Cash Flow (\$/share)	6.04	3.02	7.03	3.67	28.72	12.11
Growth Score	B	-	-	C	F	F
Hist. EPS Growth (3-5 yrs)	19.85%	14.18%	10.84%	26.87%	8.49%	16.24%
Proj. EPS Growth (F1/F0)	7.56%	15.23%	7.09%	11.02%	16.95%	-0.06%
Curr. Cash Flow Growth	17.36%	15.37%	6.72%	3.02%	-13.72%	23.43%
Hist. Cash Flow Growth (3-5 yrs)	12.40%	14.85%	8.25%	27.50%	0.72%	7.08%
Current Ratio	0.78	1.33	1.22	0.91	1.28	0.92
Debt/Capital	69.86%	28.05%	42.37%	47.63%	69.70%	54.21%
Net Margin	16.80%	11.13%	11.56%	24.15%	15.70%	25.49%
Return on Equity	11.70%	11.77%	16.80%	11.95%	10.27%	15.19%
Sales/Assets	0.06	0.22	0.55	0.05	0.06	0.05
Proj. Sales Growth (F1/F0)	0.93%	3.93%	3.90%	0.82%	2.59%	1.67%
Momentum Score	A	-	-	B	B	D
Daily Price Chg	-5.23%	-2.17%	-0.83%	-4.74%	-2.64%	-2.69%
1 Week Price Chg	-6.12%	0.00%	1.65%	-1.41%	-2.72%	-1.20%
4 Week Price Chg	-6.46%	0.00%	-0.37%	-0.37%	-5.71%	0.10%
12 Week Price Chg	1.22%	0.37%	3.74%	-2.09%	3.17%	0.52%
52 Week Price Chg	17.75%	-4.80%	14.14%	11.82%	13.03%	24.56%
20 Day Average Volume	11,908,253	54,624	1,992,841	39,535,352	2,660,305	8,518,845
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	-0.02%	0.16%	-0.54%	0.00%
(F1) EPS Est 12 week change	4.07%	1.47%	-0.17%	1.54%	3.80%	2.87%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	-0.48%	0.58%	0.23%	0.00%

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	A
VGM Score	A

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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