



ANALYST QUICK NOTES

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Charles Schwab Corp. (NYSE: SCHW: BUY)

Target Price: \$46

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2/15/2017

Investment Thesis

- On Feb. 14, Schwab announced net new assets in January of \$11.1B, above average \$10.5B pace for 2016.
 - 10.2 million active brokerage accounts, up 4% from prior year.
- In early Feb., Schwab gave a winter business update:
 - Themes included client engagement efforts, a positively trending environment and disruptive advisory strategy.
- Broker and advisor metrics remained strong in 2016:
 - Added 1 million new brokerage accounts.
 - Daily average trades up 5% to 562,000.
 - New assets of \$126 billion, fifth year of > \$100 billion in annual new assets.
- As industry growth slows, a key component of Schwab's strategy is market share gains:
 - Low cost offerings (undercutting competition with low ETF expense ratios and trade prices).
 - Scale benefits from asset growth.
 - Expects RIA growth to be a bright spot as relationships and financial planning are more valued.
 - Schwab RIA assets have grown 9.7% CAGR vs. S&P 500's 4.7% since 2006.
 - Embraced recent trends with Robo-advisor offering, intelligent portfolios.
 - 401k plans growing more fee conscious.

- Schwab is best known as a discount broker, but we think a misunderstood part of the story is the bank.
 - In 2016, net interest revenue exceeded asset management and admin fees for the first time.
 - Schwab is rapidly sweeping money market assets into Schwab Bank (\$8 billion in 2016).
 - Every \$10B of sweep adds \$120 million in net interest revenue at current rates.
 - Schwab estimates half of its \$160 billion money market funds could be migrated, for a nearly \$1 billion revenue opportunity.
 - Every 25 bps increase in Fed funds rate adds \$200-\$300 million in revenues.

 - Corporate tax rate changes.
 - Schwab's net margin is expected to benefit more than most Financials.
 - Relatively high 37% tax rate in both 2016 and 2017.
 - A 15%-20% reduction in rates would add \$450 to \$600 million to after-tax profits, or 24% to 33%.

 - Management provided conservative base-line assumptions for 2017.
 - S&P rises 6.5%.
 - No Fed fund rate hikes and 10-year yields averaging 2.45%.
 - Daily average trades flat with 2016.
 - Low double-digit revenue growth.
 - Pretax margin of 41% vs. 40% in 2016 and 35.7% in 2015.

 - Argus estimate is \$1.64 for 2017 (\$1.58 consensus), \$2.05 for 2018 (\$1.95).
 - The 12% revenue growth is leveraged to 26% and 25% EPS growth, respectively.
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