ANALYST QUICK NOTES

New products, M&A announcements, management shakeups, earnings surprises. Whatever the news, you want to know what Argus thinks. Our Quick Notes fill this need by providing real-time analysis of current news about Argus-covered companies or other market-moving events. Please check back regularly for new Quick Notes. Important disclaimer information is on the last page of this document.

Charles Schwab Corp. (NYSE: SCHW: BUY)
Target Price: $46
Stephen Biggar
3/1/2017

Investment Thesis

- Trading price wars have heated up following a Feb. 28 announcement by Fidelity Investment that it was lowering online trading commissions on stocks and ETFs by 38% to $4.95 per trade (from $7.95):
  - Schwab immediately followed by matching the $4.95 offer, after recently dropping commissions to $6.95 from $8.95.
- Price wars are not new to the discount brokerage industry, although these recent price cuts are the largest we've seen from the main industry players since 2010:
  - We suspect rivals eTrade and TDAmeritrade will be hard pressed to not reduce commissions to maintain market share.
- Ongoing technology cost savings have helped to reduce trading costs, though we do not believe to the same extent as these 40% per-trade commission declines.
- The race to lower transaction and other costs has permeated other aspects in the investing world:
  - Schwab and Fidelity have also lowered expense ratios on popular, large-cap, index-based ETFs.
  - The asset management industry has been lowering fees as active management suffers from poor comparisons with returns on passive index funds.
  - Maintaining or growing market share has been a principle rationale for lowering fees.
- We would also highlight that the business models for discount brokerages have been changing over the past 5-10 years, with trading commissions lessened as a percentage of total revenues.
- At Schwab, trading revenues have been flat to lower and have not been part of the revenue growth story:
  - Trading revenues were 11% of total revenues in 2016, down from 14% in 2016, with lower commissions per trade partly responsible.

- The vast majority of Schwab's revenues are derived from asset management fees and net interest revenues, which have been benefiting from robust growth in asset values and higher interest rates.
- For its part, Schwab noted that its 2017 guidance issued earlier this year had assumed a flat interest-rate environment and a 6.5% equity market return for the full year.
    - With greater confidence in a higher-rate environment since that forecast, as well as an equity market that is running ahead of the full-year return assumptions, Schwab felt it could lower commissions while still meeting its revenue and profit projections.
- We maintain our BUY rating on Schwab to a target of $46 with the following assumptions:
    - The trading commission reduction will not cut into our 2017 revenue forecast for Schwab given offsetting favorable interest-rate and asset-management-growth assumptions.
    - Our broader Schwab investment thesis and revenue growth story revolves around market share gains from low-cost and innovative products, stronger asset-management fees, and benefits from shifting money market funds to Schwab's bank unit.

DISCLAIMER