

## Equities

8 March 2012 | 12 pages

# Invesco Ltd (IVZ)

## Raising Target as Model Efficacy Climbs; Risks Dissipate

- Company Update
- Target Price Change
- Estimate Change

- **Maintain Buy; raise target \$3 to \$30; remains on TPL! as favored name** — Actions following bullish meeting with CEO, Mr. Martin Flanagan at Citi's 15<sup>th</sup> annual Financial Services Conference. Higher target reflects: 1) building flow traction; 2) improving FCF repatriation transparency; 3) declining deal risks – perceived or otherwise; and 4) seeming market share gains. Believe upcoming Feb AUM release on 3/9 and 1Q earnings to be announced in April will be key catalysts.
- **Building flow transaction** — Five key areas of incremental optimism: 1) risk premia inflows running \$500M/month in US, up from \$50M in August 10 – believe could be sizeable flow driver globally as product launches vintage; 2) Canada attrition stabilizing; 3) institutional traction building in income, real asset, IE and alternatives; 4) Europe stable; and 5) management spoke most favorably around equity flow traction vs. LM, BEN, TROW & WDR, we believe. To be fair, UK volumes seem lumpy.
- **Improving free cash flow transparency** — We expect management to unveil a more systemic cash usage plan, moving IVZ into phase III under CEO leadership – expense leverage, flow repositioning, and now more consistent repatriation. We look for healthy combination of repurchase + dividend growth to be main areas of absorption.
- **Putting to rest large scale deal risk** — Management categorically ruled out large deals though remains focused on niche/geographic extension transactions. Management noted they did not even look at Deutsche Bank's asset management platform sale despite media speculation and remains mostly focused on de novo expansion and further cutting operating risks, in our view.
- **Money markets malaise likely to persist** — Management echoed a building theme among those presenting at our conference: incremental reform is likely to prove nettlesome and likely to remain an overhang well into 2012. Such headwind should temper relative upside in sell rated FII, we believe.
- **Raising 2012-14 adjusted EPS** — To \$1.88/\$2.19/\$2.47 from \$1.86/\$2.16/\$2.45 previously. Revisions primarily reflect above trend markets.

<b>Buy</b>	<b>1</b>
Price (07 Mar 12)	US\$24.26
Target price	US\$30.00
	from US\$27.00
Expected share price return	23.7%
Expected dividend yield	0.5%
<b>Expected total return</b>	<b>24.2%</b>
Market Cap	US\$10,824M

### Price Performance (RIC: IVZ.N, BB: IVZ US)



EPS	Q1	Q2	Q3	Q4	FY	FC Cons
<b>2011A</b>	0.41A	0.44A	0.42A	0.42A	1.69A	1.68A
<b>2012E</b>	<b>0.44E</b>	<b>0.44E</b>	<b>0.47E</b>	<b>0.52E</b>	<b>1.88E</b>	<b>1.87E</b>
Previous	0.44E	0.44E	0.47E	0.52E	1.86E	na
<b>2013E</b>	<b>na</b>	<b>na</b>	<b>na</b>	<b>na</b>	<b>2.19E</b>	<b>2.19E</b>
Previous	na	na	na	na	2.16E	na
<b>2014E</b>	<b>na</b>	<b>na</b>	<b>na</b>	<b>na</b>	<b>2.47E</b>	<b>2.44E</b>
Previous	na	na	na	na	2.45E	na

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

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Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
<b>Valuation Ratios</b>					
P/E adjusted (x)	17.6	14.4	12.9	11.1	9.8
P/E reported (x)	24.1	15.4	13.6	11.2	9.9
P/BV (x)	1.4	1.4	1.3	1.2	1.1
P/Adjusted BV diluted (x)	na	na	na	na	na
Dividend yield (%)	1.8	2.0	2.2	2.6	2.9
<b>Per Share Data (US\$)</b>					
EPS adjusted	1.38	1.69	1.88	2.19	2.47
EPS reported	1.01	1.57	1.78	2.16	2.45
BVPS	17.52	17.08	18.35	20.19	22.19
Tangible BVPS	-0.11	-0.98	0.41	2.14	4.10
Adjusted BVPS diluted	na	na	na	na	na
DPS	0.43	0.49	0.54	0.62	0.70
<b>Profit &amp; Loss (US\$m)</b>					
Net interest income	0	0	0	0	0
Fees and commissions	3,488	4,092	4,357	4,772	5,190
Other operating Income	0	0	0	0	0
<b>Total operating income</b>	<b>3,488</b>	<b>4,092</b>	<b>4,357</b>	<b>4,772</b>	<b>5,190</b>
Total operating expenses	-2,898	-3,194	-3,275	-3,497	-3,767
<b>Oper. profit bef. provisions</b>	<b>590</b>	<b>898</b>	<b>1,082</b>	<b>1,276</b>	<b>1,423</b>
Bad debt provisions	0	0	0	0	0
Non-operating/exceptionals	244	10	13	28	31
<b>Pre-tax profit</b>	<b>834</b>	<b>908</b>	<b>1,095</b>	<b>1,303</b>	<b>1,454</b>
Tax	-197	-286	-285	-326	-363
Extraord./Min. Int./Pref. Div.	-171	108	0	0	0
<b>Attributable profit</b>	<b>466</b>	<b>730</b>	<b>810</b>	<b>977</b>	<b>1,090</b>
Adjusted earnings	583	725	829	977	1,090
<b>Growth Rates (%)</b>					
EPS adjusted	54.7	22.0	11.3	16.6	13.0
Oper. profit bef. prov.	21.8	52.2	20.5	17.9	11.5
<b>Balance Sheet (US\$m)</b>					
<b>Total assets</b>	<b>20,444</b>	<b>19,347</b>	<b>20,133</b>	<b>20,938</b>	<b>21,775</b>
Avg interest earning assets	na	na	na	na	na
Customer loans	na	na	na	na	na
Gross NPLs	na	na	na	na	na
<b>Liab. &amp; shar. funds</b>	<b>20,444</b>	<b>19,347</b>	<b>20,133</b>	<b>20,938</b>	<b>21,775</b>
Total customer deposits	na	na	na	na	na
Reserve for loan losses	na	na	na	na	na
Shareholders' equity	<b>8,265</b>	<b>7,785</b>	<b>8,348</b>	<b>9,045</b>	<b>9,824</b>
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	7.7	8.9	10.3	11.2	11.6
Net interest margin	na	na	na	na	na
Cost/income ratio	83.1	78.1	75.2	73.3	72.6
Cash cost/average assets	18.5	15.6	16.6	17.0	17.6
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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# Raising Target as Model Efficacy Rising

## Investment Summary

We affirm our Buy rating, raise our 12-month price target \$3 to \$30 and maintain IVZ on TPL! following our meeting with CEO, Mr. Marty Flanagan at Citi's Financial Services Conference on 3/7. We believe combination of improving flows plus declining risks should allow for further multiple expansion.

Four key themes: 1) flow traction is picking up, we believe; 2) after several fits/starts, we expect management to lay out more transparent FCF deployment strategy in concert with 1Q earnings likely to be announced in April; 3) management flat out ruled off large scale transactions, categorically debunking recent media speculation; and, 4) though a pick-up in flows in February/1QTD vs. a weak 4Q11 is a broad "Day 1" takeaway, we sensed outsized traction in Equities suggesting some market share gains.

Among first day traditional presenters/participants, IVZ's story seems most incrementally vibrant, in our view. We believe February AUM release expected on 3/9 and 1Q post quarter calls could be near term valuation catalysts.

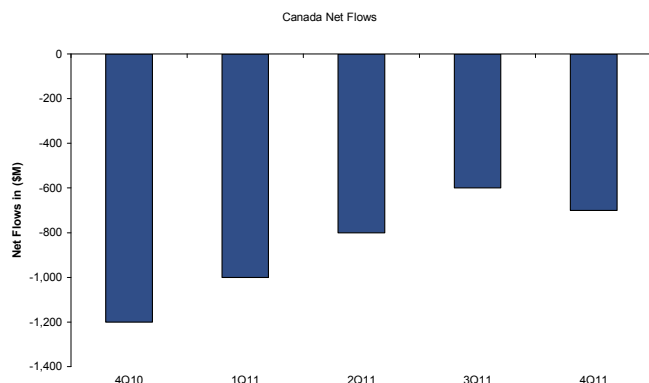
## Four Key Takeaways

**1) Flow traction appears to be picking up** – One of our key themes for IVZ reflects our belief that after several transition years, 2012 could begin to shift IVZ back into the "gatherers" camp, and today's meeting was positive.

In turn, management is meeting with strong success in its absolute return Risk Premia roll out, with monthly sales accelerating from \$50M/month in August 2011 to \$500M/month more recently. We see IVZ benefiting from good performance, market share gains, & distribution expansion. Management recently launched sister products in UK and is looking into Asia as well, which should help bolster volumes. No question, industry growth for this category is also strong, adding another tailwind for growth. Given WDR's A/S fund is ~\$24B in AUM and BLK's global allocation fund is ~\$51B, we see much room for growth.

Canada appears to be close to turning the corner – After several years of intense attrition (Figures 1-2), net outflows are stabilizing, with management now seeing a few days of positive net sales. Driving the turnaround reflects improving performance, broadening products and greater distribution. Favorably, Canada is among IVZ's most profitable geographies, such that a favorable inflection could bolster overall margins.

Figure 1. Canada appears to be turning the corner...



Source: Company Reports and CIRA Estimates

Figure 2. ...and is increasing its effect on flows

	Canada Flows as Percentage of Total				
	4Q10	1Q11	2Q11	3Q11	4Q11
Canada Net Inflow	-1,200	-1,000	-800	-600	-700
Total Net Inflow	-17,000	6,600	3,800	3,300	5,600
Canada as % of Total	7.1%	-15.2%	-21.1%	-18.2%	-12.5%

Source: Company Reports and CIRA Estimates

Institutional volumes are building – Though less specific, management mentioned seeing good traction with RE, credit, absolute return, international/EM equities and income oriented equity (including in the US).

Europe surprisingly sticky; UK a bit soft – Mr. Flanagan noted that Europe is surprisingly resilient despite intense macro headwinds, and certainly better than what we expected to hear. That said, management noted some softening in UK, likely also do to macro economic fatigue. Taken in sum, it would appear the net flow story is percolating.

2) Management bolstering the third stool of the valuation story – FCF repatriation – We expect management to unveil more systematic FCF deployment strategy in concert with 1Q EPS likely to be announced in April. Given no large scale deals and most products are built out, we expect both dividend hikes and repurchase to become more systematic uses of the FCF. Management affirmed that share count will not rise but we would expect more sustained reduction at the margin along with moderate dividend hike, the latter to allow for steady annual increases.

3) No distracting deals are likely – Management seemed particularly eager to dispel the notion that they are on the prowl for a large scale deal. In fact, management noted that they did not even get a pitch book for Deutsche Bank's asset management business currently being shopped (see also our note - [Invesco Ltd \(IVZ\) - When No News Is Good News; Remains A Top Pick](#)). Management offered that they remain open to bolt-on transactions but see no need for transformational deal. While careful 'never to say never', such discussion should rule out IVZ as the marginal bidder as other deals likely percolate, reducing operating risks, and assuaging some investor anxiety that a deal would complicate the flow inflection momentum that is building.

4) IVZ spoke a bit more constructively around equities flows leverage – Management did reiterate that L/C growth and L/C value activity remains slack. However, they are seeing momentum in passive (ETF) and active equity income funds, the latter both retail and institutional and seemingly a bit more optimistic than key peers.

## Money Market Reform – Playing the CBA Card

Management toed the ICI line around reform, indicating redemption restrictions and/or floating rate NAVs would be particularly harmful and that any changes offer significant public policy implications that will need to have cost benefit analysis. In turn, management does not see a decisive conclusion on this topic in 2012, keeping a relative headwind on sell rated FII, we believe given the latter's elevated exposure.

## Invesco Ltd

### Company description

Invesco is a leading independent global investment management company. IVZ provides services to retail, institutional and private wealth management clients. It manages separate client-focused equity, fixed income, balanced, money market, and real estate investment portfolios and mutual funds through AIM, Atlantic Trust, Invesco, Perpetual, PowerShares, Trimark and WL Ross. The company was founded in December 1935 and is based in Atlanta, Georgia.

### Investment strategy

We rate the shares of Invesco Buy. Our positive thesis is based on: 1) improving flow dynamics at a time of weak to flattening prospects among many traditional managers, and likely bolstering the case for IVZ to shift from the "Grinders" into the "Gatherers", and thus allow for solid if not moderate PE multiple expansion; 2) potential for solid performance fees into 2012 that may not be fully appreciated by investors; 3) solid FCF management driving buyback and further de-leveraging; and 4) following sharp underperformance, IVZ looks inexpensive, trading at the lowest FTM P/E multiple versus both history and 2008-09 trough levels among peers.

### Valuation

We value the shares of Invesco using the target P/E method. Our \$30 12-month price target is derived by applying a ~16x target P/E to our 2012 adjusted EPS estimate. The 16x target P/E is in-line with historical GAAP median of 16x but a premium to the sector.

### Risks

The three central risks to our 12-month price target reflect below average markets, outsized FX swings, and deal integration risks, the combination of which could reduce our EPS estimates and temper upward P/E multiple revaluation.

Additionally, 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.

**Integration risk** — The upcoming VanKampen integration could pose operating risks.

## Appendix A-1

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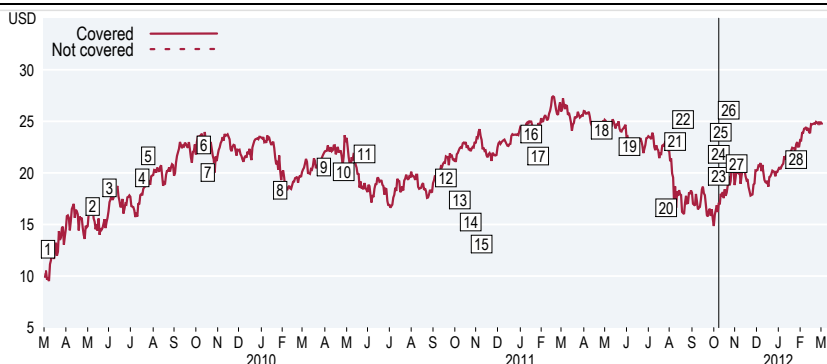
### IMPORTANT DISCLOSURES

#### Invesco Ltd (IVZ)

##### Ratings and Target Price History Fundamental Research

Analyst: William R Katz

Covered since March 31 2010



	Date	Rating	Target Price	Closing Price
1	4-Mar-09	*2H	*11.00	10.48
2	8-May-09	2H	*16.00	16.74
3	2-Jun-09	*1M	*20.00	17.17
4	17-Jul-09	1M	*21.00	17.82
5	27-Jul-09	1M	*22.00	19.28
6	13-Oct-09	1M	*27.00	22.71
7	19-Oct-09	1M	*30.00	23.12
8	28-Jan-10	1M	*27.00	20.21
9	31-Mar-10	1M	*26.00	21.91
10	28-Apr-10	1M	*27.00	21.61

\* Indicates change

	Date	Rating	Target Price	Closing Price
11	27-May-10	1M	*25.00	19.02
12	20-Sep-10	1M	*26.00	21.60
13	8-Oct-10	1M	*27.00	22.41
14	25-Oct-10	1M	*28.00	22.11
15	9-Nov-10	1M	*26.50	23.20
16	18-Jan-11	*2M	26.50	24.98
17	27-Jan-11	2M	*27.00	24.83
18	27-Apr-11	2M	*25.50	24.82
19	6-Jun-11	2M	*24.50	22.55
20	27-Jul-11	2M	*24.00	22.26

	Date	Rating	Target Price	Closing Price
21	9-Aug-11	2M	*18.50	18.69
22	19-Aug-11	2M	*17.00	16.11
23	8-Oct-11	Stock rating system changed		
24	8-Oct-11	*2	17.00	16.20
25	12-Oct-11	*1	*21.00	17.98
26	24-Oct-11	1	*23.00	19.67
27	3-Nov-11	1	*25.00	20.45
28	26-Jan-12	1	*27.00	22.78

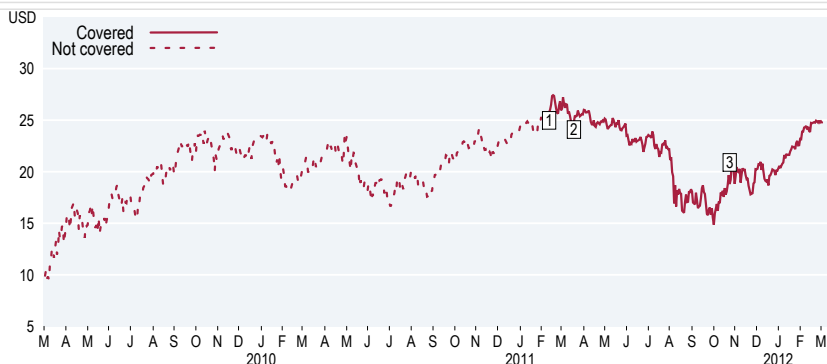
Rating/target price changes above reflect Eastern Standard Time

#### Invesco Ltd (IVZ)

##### 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	-	25.75

\* Indicates change

	Date	Rating	Target Price	Closing Price
2	18-Mar-11	*REM MP	-	24.85

	Date	Rating	Target Price	Closing Price
3	25-Oct-11	*ADD MP	-	18.80

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<i>Data current as of 31 Dec 2011</i>	<b>12 Month Rating</b>			<b>Relative Rating</b>		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Investment Research & Analysis Global Fundamental Coverage	57%	34%	9%	10%	79%	10%
% of companies in each rating category that are investment banking clients	45%	41%	40%	49%	43%	41%

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