

Federated Investors, Inc (FII)

SEC Discourse Waters Down Bear Thesis

■ Company Update

- **Maintain contrarian Buy recommendation** — Notwithstanding 8/31 NY Times article calling for esoteric changes to money markets, we believe the bear thesis on FII is increasingly less valid, and thus setting up for a major 'short squeeze'. Two factors pace our thinking: 1) believe probability around severe reform is diluted; and, 2) timing of reform is extended. We believe "lower for longer" rate backdrop is already priced into the shares, leaving radical reform as the only negative argument on the shares. We believe such a view is extreme. We believe recent SEC discourse further complicates the bear thesis.
- **SEC discourse waters down bear thesis** — On 8/28 SEC Commissioners Gallagher + Paredes released a joint statement on money market fund regulation. Following our review of the letter – and when taken into consideration with the 8/23 statement released by Commissioner Aguilar – we believe: a) either radical reform by the SEC; or, b) more radical changes by the FSOC are not the most likely course(s) of action.
- **What did Gallagher + Paredes say?** — In a short but cogent rejoinder to Chairman Schapiro, we believe, the commissioners: 1) argued against radical reforms, citing lack of data that such deep reforms would stem redemption risks and/or raise unintended consequences; 2) offered more measured changes; and 3) were not "abdicating" oversight responsibility. In our view, such a letter will make it increasingly difficult for more extreme measures by other regulators – namely the FSOC or the FRB. While logic does not always rule the day, we believe the discourse will force the FSOC to remand the discussion back to the SEC, likely post 2012 election – meaning no earlier than late 1Q13 and suggesting no likely outcome even next year. While such timing could be an overhang, it does make it costly for the bears, particularly as likelihood for structural change that will significantly dilute FII's LT EPS power seems to be increasingly less visible.
- **What did Gallagher + Paredes counter with?** — 1) Greater study of 2010 rule 2a-7 changes; 2) offered board-driven "gating" during periods of extreme industry stress (akin to 2008 when FII absorbed problematic money market fund from Putnam without enhanced risks, we believe); and, 3) greater disclosures.

Buy	1
Price (31 Aug 12)	US\$21.22
Target price	US\$25.00
Expected share price return	17.8%
Expected dividend yield	5.1%
Expected total return	22.9%
Market Cap	US\$2,209M

Price Performance (RIC: FII.N, BB: FII US)



EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2011A	0.42A	0.41A	0.37A	0.36A	1.55A	1.45A
2012E	0.41A	0.39A	0.39E	0.42E	1.61E	1.63E
Previous	0.41A	0.39A	0.39E	0.42E	1.61E	na
2013E	na	na	na	na	1.72E	1.76E
Previous	na	na	na	na	1.72E	na
2014E	na	na	na	na	2.04E	1.90E
Previous	na	na	na	na	2.04E	na

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

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	13.0	13.7	13.2	12.3	10.4
P/E reported (x)	12.4	14.6	13.2	12.3	10.4
P/BV (x)	4.5	4.1	3.6	3.3	3.0
P/Adjusted BV diluted (x)	na	na	na	na	na
Dividend yield (%)	10.5	4.5	4.9	5.1	5.3
Per Share Data (US\$)					
EPS adjusted	1.64	1.55	1.61	1.72	2.04
EPS reported	1.71	1.45	1.61	1.72	2.04
BVPS	4.76	5.24	5.90	6.38	6.99
Tangible BVPS	-2.19	-1.71	-1.02	-0.58	-0.03
Adjusted BVPS diluted	na	na	na	na	na
DPS	2.22	0.96	1.05	1.09	1.12
Profit & Loss (US\$m)					
Net interest income	0	0	0	0	0
Fees and commissions	949	892	936	1,009	1,168
Other operating Income	3	3	3	4	4
Total operating income	952	895	939	1,012	1,172
Total operating expenses	-620	-630	-653	-705	-814
Oper. profit bef. provisions	332	265	287	307	358
Bad debt provisions	0	0	0	0	0
Non-operating/exceptionals	-31	-19	-7	-6	-2
Pre-tax profit	301	246	279	302	355
Tax	-112	-91	-102	-112	-131
Extraord./Min. Int./Pref. Div.	-19	-9	-16	-18	-21
Attributable profit	171	146	161	172	203
Adjusted earnings	164	156	161	172	203
Growth Rates (%)					
EPS adjusted	-20.2	-5.4	3.8	7.2	18.5
Oper. profit bef. prov.	-8.2	-20.1	8.0	7.3	16.4
Balance Sheet (US\$m)					
Total assets	1,154	1,151	1,186	1,233	1,283
Avg interest earning assets	na	na	na	na	na
Customer loans	na	na	na	na	na
Gross NPLs	na	na	na	na	na
Liab. & shar. funds	1,154	1,151	1,186	1,233	1,283
Total customer deposits	na	na	na	na	na
Reserve for loan losses	na	na	na	na	na
Shareholders' equity	494	543	614	660	716
Profitability/Solvency Ratios (%)					
ROE adjusted	32.0	30.1	27.6	27.1	29.5
Net interest margin	na	na	na	na	na
Cost/income ratio	65.1	70.4	69.5	69.6	69.5
Cash cost/average assets	60.0	54.7	56.1	58.2	64.7
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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Investment Summary

We maintain our recently formed but well out of consensus Buy recommendation and \$25 12-month price target. Our thesis is straightforward. We see a short squeeze brewing as the singular bear thesis around radical money market reform seems either less likely and/or well pushed out – both of which seem to raise the cost of being short the shares. The sell side is categorically neutral to negative on the shares while the buy side is heavily short the shares. Yet, recent developments seem to be watering down such a negative strident view, we believe.

When we upgraded the shares, we met with stiff resistance (see also 8/24 note – [Money Market Reform Risk\(s\) Evaporate\(s\) - Upgrade FII To Buy; Also Raise Targets On SCHW, IVZ, LM + BLK](#)) that the FSOC and/or FRB would look to “leapfrog” the SEC’s inability to promulgate further changes. The general thinking is that the FSOC and/or FRB would exact more radical changes that would: a) question the efficacy of the money market business; and, b) therefore radically harm FII’s LT EPS power (and/or create a one-time dilutive capital raising event). Shortly thereafter, the NY Times ran an article arguing for such an outcome.

Yet, more practically, we believe the joint statement released on 8/28 by SEC Commissioners Gallagher and Paredes (following and perhaps adding on a separate statement by SEC Commissioner Aguilar) waters down the bear thesis.

Why So?

Tough to Use A Blunt Force Tool Blindly

While we believe the letters from Aguilar and Gallagher + Paredes seek to de-politicize the reform discussion and remove the hyperbole – we also found three cogent arguments that water down the bearish argument. We note:

1. **Radical reform seems extreme** – Here, the commissioners argued: a) not clear that floating rate NAVs, capital buffers, and/or redemption restrictions – particularly when linked with capital buffers – would stem redemptions and/or without; b) adding unintended consequences; and c) felt such reforms were not grounded in evidence demanding such radical reform;
2. **Not all or nothing** – These commissioners were not stonewalling reform, but did offer other, more measured changes; and
3. **Have not “abdicated” oversight of money markets** – Setting up tense debate and perhaps legal risk from industry participants should either the FSOC or FRB seek to move to more radical alterations without further considering consensus with these specific commissioners for further study and/or alternative outcomes.

What Was the Counter?

While the statement offers a more comprehensive discussion, we summarize the three key counter proposals by Commissioners Gallagher + Paredes:

1. **Better study 2010 Rule 2A-7 changes around liquidity, disclosure, concentration, and risk taking, among others.** Here, the commissioners seem to focus on efficacy of such changes holding up well despite recent series of global economic stresses and needing greater

analysis around the cost/benefits of these initial changes around further changes; and

2. **Indicated board-driven selective gating as alternative to help stem redemption risks.** Perhaps drawing on events that unfolded in the industry in 2007-2008 during the GFC, these commissioners believe allowing the funds to selectively gate redemptions could address either fund-specific or industry at large redemption runs, and by extension, reduce embedded social costs (the very issue the regulators are ultimately concerned with); and
3. **Greater disclosure.**

Where Do We Go From Here?

In terms of next steps, we note:

1. **Any material movement on money market reform is not likely to occur prior to the election in November, which means that reform is not likely to get addressed until at least 1Q13** – and likely to remain a working discussion throughout much of the year, if not slipping into 2014, we surmise;
2. **Based on the statements by Aguilar, and Gallagher + Paredes, we are hard-pressed to see how the FSOC and FRB would move stridently now.** We believe changes that either the FSOC and/or FRB would seek are increasingly more complex, may not have strong political consensus, and likely raise meaningful legal risks along the way (based on our discussions with industry executives and their interpretations of both the scope and intentions of Dodd Frank).
3. **We would expect FSOC to likely remand back to the SEC further analysis for reform, which implies more measured change ultimately and thus less likely to disenfranchise money market funds overall** and/or radically shift volumes out of the more (currently) lucrative (given lower fee waivers) Prime-based vehicles.

What Do We Think Will Occur?

Ultimately, we see more measured changes and not radical reform. We see less likelihood that Prime-based funds will be regulated away, particularly with nominal differences between management fee rates and operating expense ratios between Prime funds and Treasury/Government money funds (see Figure 1). That said, we believe money market business – following rule 2Q-7 changes in particular - will remain a scale driven game, and favorable for larger players, such as FII, among others. We believe the “discretionary gating construct” counter-offered by the SEC follows on such successful examples in 2008 and would further drive share to the larger, more liquid managers.

Figure 1. Prime-based Funds Are Less Likely To Be Regulated Away, In Our View, Especially When Considering Nominal Differences Between Management Fees + OERs Across Prime And Treasury/Government Money Funds

Company	Prime			Treasury/Gov't			Difference (Prime - Treasury/Gov't)	
	AUM (\$M)	Avg Total Exp (prospectus)	Avg Mgmt Fee (prospectus)	AUM (\$M)	Avg Total Exp (prospectus)	Avg Mgmt Fee (prospectus)	Avg Total Exp (prospectus)	Avg Mgmt Fee (prospectus)
BlackRock	107,509	0.29	0.15	23,382	0.32	0.15	-0.03	0.00
Federated	109,708	0.52	0.27	94,723	0.56	0.32	-0.04	-0.06
Invesco	30,048	0.52	0.21	24,228	0.42	0.15	0.10	0.06
Legg Mason	7,757	0.47	0.28	32,751	0.35	0.24	0.12	0.04
Schwab	84,958	0.60	0.31	40,566	0.64	0.32	-0.04	-0.01
weighted avg	339,980	0.47	0.24	215,650	0.50	0.27	-0.02	-0.02

Source: Strategic Insight Simfund, Citi Research

Companies mentioned: (BLK.N; US\$176.37; 2); (FII.N; US\$21.22; 1); (IVZ.N; US\$23.68; 1); (LM.N; US\$24.58; 1); (SCHW.N; US\$13.49; 2)

Figure 2. FII Summary Model

Federated Investors
Earnings Results and Forecasts
(\$ Millions, Except As Noted)

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KEY FORECAST VARIABLES:	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	Forecast:		2011	Forecast:			% Change				
							3Q12E	4Q12E		2012E	2013E	2014E	3QE/2Q	3QE/3Q	12E/11	13E/12E	14E/13E
Investment advisory fees	159.6	149.1	139.4	138.2	149.3	154.4	154.8	160.1	586.3	618.6	666.5	775.1	0.3	11.0	5.5	7.7	16.3
Administrative fees	54.0	54.6	54.9	56.8	57.3	55.0	56.1	56.4	220.4	224.8	231.3	237.1	2.1	2.2	2.0	2.9	2.5
Other Service fees (distribution fees) - 4 bps mmkts mfs	24.7	21.5	19.0	20.2	22.7	22.0	23.0	25.1	85.4	92.7	110.8	156.0	4.3	20.8	8.6	19.5	40.8
Investment & other income	0.6	0.6	0.7	1.1	1.0	0.8	0.8	0.8	3.0	3.3	3.5	3.5	-2.8	5.2	7.5	7.4	0.0
Memo: gross fee waivers	63.4	79.4	88.9	89.0	80.4	70.3	70.0	65.0	320.7	285.7	250.0	150.0	-0.4	-21.3	-10.9	-12.5	-40.0
Total Revenue	238.9	225.8	214.0	216.4	230.3	232.1	234.6	242.4	895.1	939.4	1,012.0	1,171.7	1.1	9.6	5.0	7.7	15.8
Compensation	64.4	62.5	57.9	60.6	64.1	65.2	65.5	64.6	245.4	259.3	268.2	277.6	0.4	13.1	5.7	3.4	3.5
Distribution, Net of Fee Waivers	64.7	57.8	54.4	58.7	61.7	62.3	63.2	67.2	235.7	254.4	289.8	381.6	1.4	16.1	7.9	13.9	31.7
Professional Service Fees	26.2	8.5	9.4	9.6	10.3	9.9	10.0	10.0	53.7	40.2	42.3	44.4	0.7	6.0	-25.1	5.0	5.0
Office & Occupancy	6.2	6.0	6.2	6.3	6.3	6.1	6.1	6.2	24.7	24.7	26.4	28.3	0.5	-0.8	0.1	7.0	7.0
Systems & Communications	5.6	5.7	5.8	5.8	6.3	6.8	6.8	6.8	23.0	26.7	27.8	28.9	0.5	16.9	16.4	4.0	4.0
Advertising & Promotion	3.2	2.8	3.9	3.5	2.9	3.3	3.5	3.5	13.4	13.2	14.2	15.2	5.5	-10.0	-1.3	7.0	7.0
Travel & Related	2.4	3.3	2.8	3.7	2.8	3.3	3.4	3.4	12.2	12.8	13.6	14.4	0.5	19.4	5.2	6.0	6.0
Other	3.2	3.5	3.9	3.7	5.6	5.3	5.3	5.3	14.3	21.4	22.4	23.6	-0.4	34.4	49.8	5.0	5.0
Amortization of intangible assets	3.8	1.6	1.3	1.2	0.0	0.8	0.8	0.8	7.9	2.5	3.3	3.4	0.0	-34.9	-68.6	30.7	5.0
Amortization of deferred sales commissions	2.8	1.9	1.3	1.4	0.0	0.0	0.0	0.0	7.4	0.0	0.0	0.0	N/A	N/A	N/A	N/A	N/A
Memo: net fee waivers	13.1	19.4	23.2	26.1	22.9	17.2	17.5	16.3	81.8	73.9	62.5	37.5	1.7	-24.6	-9.7	-15.4	-40.0
Total Operating Costs	182.4	153.7	147.0	154.5	159.9	163.1	164.6	167.7	637.7	655.3	707.9	817.3	0.9	11.9	2.8	8.0	15.5
Operating Income	56.5	72.1	67.0	61.9	70.3	69.0	70.0	74.7	257.5	284.1	304.2	354.4	1.5	4.5	10.4	7.1	16.5
Non Operating Income/(Expense)	-0.8	-3.5	-5.3	-1.4	-0.4	-1.5	-1.2	-1.5	-11.1	-4.7	-2.9	1.0	-20.5	-76.9	-57.6	-38.7	-133.1
Pretax Income	55.7	68.6	61.7	60.4	69.9	67.5	68.8	73.2	246.4	279.4	301.3	355.4	2.0	11.6	13.4	7.8	17.9
Income Taxes	20.6	25.7	23.2	21.8	25.5	24.4	25.1	26.7	91.3	101.8	111.5	131.5	2.9	8.4	11.5	9.5	17.9
Tax Rate (%)	37.0	37.5	37.6	36.1	36.5	36.2	36.5	36.5	37.1	36.4	37.0	37.0	0.9	-2.8	-1.7	1.6	0.0
Income before noncontrolling interests	35.1	42.9	38.5	38.6	44.4	43.1	43.7	46.5	155.1	177.7	189.8	223.9	1.4	13.4	14.6	6.8	17.9
Noncontrolling interest	1.8	0.5	0.2	1.7	2.1	2.7	2.7	2.9	4.2	10.3	11.1	12.9	1.5	1251.2	147.3	7.1	16.5
Net income attributable to Federated	33.2	42.4	38.3	36.9	42.3	40.4	41.0	43.6	150.9	167.3	178.8	211.0	1.4	7.0	10.9	6.8	18.0
Discontinued Operations, Net (p.s.)																	
Average Fully Diluted Shares	100.7	100.9	100.7	100.3	100.1	100.3	100.3	100.3	100.6	100.3	100.0	99.5	0.0	-0.4	-0.4	-0.2	-0.5
Operating EPS (FD)	0.42	0.41	0.37	0.36	0.41	0.39	0.39	0.42	1.55	1.61	1.72	2.04	1.5	6.8	3.9	7.1	18.6
GAAP EPS (FD)	0.32	0.41	0.37	0.36	0.41	0.39	0.39	0.42	1.45	1.61	1.72	2.04	1.5	6.8	10.9	7.1	18.6
Cash EPS (FD)	0.45	0.42	0.38	0.37	0.41	0.40	0.40	0.43	1.55	1.61	1.72	2.04	1.5	5.4	3.9	7.1	18.6
Margins (%)																	
Operating Income	31.3%	31.9%	31.3%	28.6%	30.5%	29.7%	29.9%	30.8%	30.8%	30.2%	30.1%	30.2%					
EBITDA	30.0%	33.1%	31.5%	29.8%	31.6%	30.0%	30.2%	30.9%	31.1%	30.7%	30.5%	30.6%					
Net Income	17.6%	18.2%	17.3%	16.5%	17.7%	16.8%	16.8%	17.3%	17.4%	17.2%	17.0%	17.4%					
Return on Common Equity	33.0%	31.1%	28.0%	26.6%	29.3%	26.9%	26.6%	27.7%	120.2%	110.4%	108.2%	118.2%					
Compensation/Revenue	27.0%	27.7%	27.1%	28.0%	27.8%	28.1%	27.9%	26.6%	27.4%	27.6%	26.5%	23.7%					
MF - Money Markets AUM (\$mm)	238,990	236,077	245,293	255,857	245,232	238,610	241,110	237,610	255,857	237,610	242,610	247,610	1.0	-1.7	-7.1	2.1	2.1
Net Flows (\$mm)	(5,806)	(2,913)	9,216	10,564	(10,625)	(6,622)	(2,500)	(3,500)	11,061	(23,247)	5,000	5,000	-62.2	-127.1	-310.2	-121.5	0.0
% of Beginning AUM	(2.4)	(1.2)	3.9	4.3	(4.2)	(2.7)	(1.0)	(1.5)	4.5	(9.1)	2.1	2.1					
MF - Fixed Income AUM (\$mm)	32,689	34,874	35,620	37,241	38,526	39,494	41,051	42,466	37,241	42,466	47,225	51,664	3.9	15.2	14.0	11.2	9.4
Net Flows (\$mm)	517	1,814	371	1,317	776	487	1,000	1,000	4,019	3,263	3,000	2,500	105.3	169.5	64.8	-18.8	-8.1
% of Beginning AUM	1.6	5.5	1.1	3.7	2.1	1.3	2.5	2.4	12.6	8.8	7.1	5.3					
MF - Equity AUM (\$mm)	22,848	22,678	20,140	21,930	23,612	22,671	22,669	22,788	21,930	22,788	24,642	26,885	0.0	12.6	3.9	8.1	9.1
Net Flows (\$mm)	(464)	(250)	428	382	(376)	(265)	(275)	(275)	96	(1,191)	250	500	3.8	-164.3	-112.0	-1340.6	-121.0
% of Beginning AUM	(2.1)	(1.1)	1.9	1.9	(1.7)	(1.1)	(1.2)	(1.2)	0.4	(5.4)	1.1	2.0					
Separate Accounts AUM (\$mm)	50,011	45,820	41,454	45,813	47,672	46,962	47,725	57,973	45,813	57,973	61,226	64,981	1.6	15.1	26.5	5.6	6.1
Net Flows (\$mm)	1,197	(4,418)	(3,386)	3,494	1,104	(709)	500	9,950	(3,113)	10,845	1,950	2,250	-170.5	-114.8	-360.5	-448.4	-82.0
% of Beginning AUM	2.5	(8.8)	(7.4)	8.4	2.4	(1.5)	1.1	20.8	(6.5)	23.7	3.4	3.7					
Total Assets Under Mgmt (\$mm)	354,922	349,413	351,651	369,697	363,625	355,861	360,179	367,962	369,697	367,962	381,077	394,763	1.2	2.4	-0.5	3.6	3.6
% Change Q/Q	-0.9%	-1.6%	0.6%	5.1%	-1.6%	-2.1%	1.2%	2.2%									
Net Flows (\$mm)	(4,879)	(6,187)	5,809	15,469	(9,394)	(7,567)	(1,775)	6,675	10,212	(12,061)	8,450	8,500	-76.5	-130.6	-218.1	-170.1	0.6
% of Beginning AUM	(1.4)	(1.7)	1.7	4.4	(2.5)	(2.1)	(0.5)	1.9	2.9	(3.3)	2.3	2.2					
Ann'l Organic Growth (Loss) Rate	-5.4%	-7.0%	6.7%	17.6%	-10.2%	-8.3%	-2.0%	7.4%	2.9%	-3.3%	2.3%	2.2%					
Average AUM (\$MM)	356,319	354,196	348,765	358,270	370,123	360,600	358,020	364,070	344,635	355,127	368,271	383,421	-0.7	2.7	3.0	3.7	4.1
Revenue Yield on AUM (bps)	18.2	16.9	15.9	15.3	16.2	17.2	22.0	21.9	17.0	19.8	22.3	22.6					
Dividend Per Share	0.24	0.24	0.24	0.24	0.24	0.27	0.27	0.27	0.96	1.05	1.09	1.12	0.0	12.5	9.4	3.8	2.8
EBITDA (\$mm)	71.8	74.8	67.5	64.5	72.8	69.6	70.8	74.9	278.5	288.1	308.9	358.6	1.8	5.0	3.4	7.2	16.1
Free Cash Flow (\$mm)	48.5	42.6	40.2	38.7	42.0	40.3	40.0	42.5	169.9	164.8	176.3	207.3	-0.7	-0.4	-3.0	7.0	17.6
Free Cash Flow Per Share	0.48	0.42	0.40	0.39	0.42	0.40	0.40	0.42	1.69	1.64	1.76	2.08	-0.6	0.0	-2.7	7.3	18.2
Net Debt (Cash) Per Share	\$0.35	\$0.47	\$0.07	-\$0.04	-\$0.02	-\$0.30	-\$0.51	-\$0.73	-\$0.04	-\$0.73	-\$1.61	-\$2.47					

Source: Company reports, Citi Research

Federated Investors, Inc

Company description

Federated Investors, Inc. provides investment management services to institutions and intermediaries including corporations, government entities, insurance companies, foundations and endowments, banks and broker/dealers. Through its subsidiaries, it manages separate client-focused equity, fixed income, and money market mutual funds and separate client-focused equity, fixed income, and balanced portfolios. It invests in growth and value stocks of small-, mid- and large-cap companies. Its fixed income investments are in ultra-short, short-term and intermediate-term mortgage-backed, U.S. Government, U.S. Corporate, high yield and municipal securities. The company ranks in the top 3% of money market fund managers in the industry and money markets make up ~80% of total assets under management (AUM). It was founded in 1955 and is based in Pittsburgh, PA.

Investment strategy

We rate the shares of Federated Investors Buy. We see the four key factors to our Buy rating: 1) franchise risk sharply cut should allow for higher multiple; 2) strategic optionality should accelerate, driving accretive growth/diversification, and further bolster the stock; 3) we see further "short squeeze" as bearish argument has all but dissipated; and, 4) FII is quietly putting up superior LT flow dynamics, which should garner more focus with headline risks dissipating, we believe.

Valuation

We value the shares of Federated Investors using normalized EPS. Based on rate expectations, we do not see EPS normalizing until late 2014/early 2015. Here, stripping out all fee waivers, and assuming no growth into 2015 (likely conservative), we get to \$2.25 in "normalized" EPS. We believe 13x – about a 1x to 2x discount to history but in line with target multiples for traditional is reasonable for two reasons. First, FII is generating solid LT flows. Second, we no longer see radical discount on money markets, where FII is a top 5 player. Finally, if we assume normalized EPS in 2014, we arrive at \$26 target for next 12 months, against 10% cost of capital. If we assume the Fed will extend lower for longer into 2015, our target drops to \$24. Our revised target is the midpoint of this analysis, or \$25.

Risks

Negative risks to our Buy rating include: 1) already solid performance through August 2012; and, 2) a worsened flow picture for the LT business.

Additionally, if the impact from any of the following factors proves to be greater than we expect, the stock may have difficulty reaching our target price. If market conditions improve faster than anticipated, the stock 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.

If the impact on the company from any of these factors proves to be greater than we anticipate, the stock will likely have difficulty achieving our target price. However, should they be less than anticipated, the stock could trade above our target price.³

BlackRock Inc

Valuation

We value the shares of BlackRock using the target P/E method. Our \$190 12-month target price is derived by applying a ~14x target P/E multiple to our 2013 adjusted EPS estimate discounted six months. The 13.5x target P/E is below the company's historical average but premium to industry average.

Risks

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. Other risks include:

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 — That said, management has an impeccable track record, merging in increasingly sizable State Research and Merrill Lynch Investment Managers platforms. BGI integration will run over two years.

Invesco Ltd

Valuation

We value the shares of Invesco using the target P/E method. Our \$29.00 12-month price target is derived by applying a ~14.5x target P/E to our FTM adjusted EPS

estimate. The ~14.5x target P/E is moderately below the historical GAAP median of 16x but at the high range of the sector.

Risks

The three central risks to our 12-month price target reflect below average markets, and outsized FX swings, 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.

Legg Mason Inc

Valuation

We value the shares of LM using a combination of Target P/E method and sum-of-the-parts. Our \$30 12-month target price is derived by applying a ~11x-11.5x target P/E multiple to our calendarized 2013 EPS estimate (discounted back 3 months at 10% cost of capital) plus adding \$7 per share related to the estimated NPV of the company's NOL and purchase goodwill tax shields. We believe a 11x-11.5x target P/E multiple, below the company's 15x historical FTM P/E, is warranted given uneven organic growth prospects.

Risks

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.

The Charles Schwab Corporation

Valuation

We value SCHW using the target P/E method. Our \$13.50 target factors a target P/E multiple of ~20x our FTM EPS estimate. Since 2003, SCHW's FTM P/E averaged 21x. We use a below LT average target multiple to reflect changing business mix.

Risks

If the impact on the company from any of the following factors proves to be greater than we anticipate, the stock will likely have difficulty achieving our target price.

Equity levels and volatility — Market changes have a direct impact on AUM. Market volatility can also impact clients' trading volumes. Trading revenue comprised ~20% of total 2011 revenue.

Interest rates — Interest revenue (~37% of 2011 revenue) increases when rates rise and decreases when rates fall as interest-earning assets re-price more quickly than liabilities. SCHW has also been waiving fees on certain money market products in order to stay competitive. If the Fed Funds rate stay in the 0–0.25% range during 2011, waivers could continue to pressure revenue.

Integration risk — On March 21, 2011, Schwab announced it signed a definitive agreement to acquire optionsXpress. Failure to meet expected deal synergies or delays in meeting those synergies could pressure the stock or prevent it from reaching our target price.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

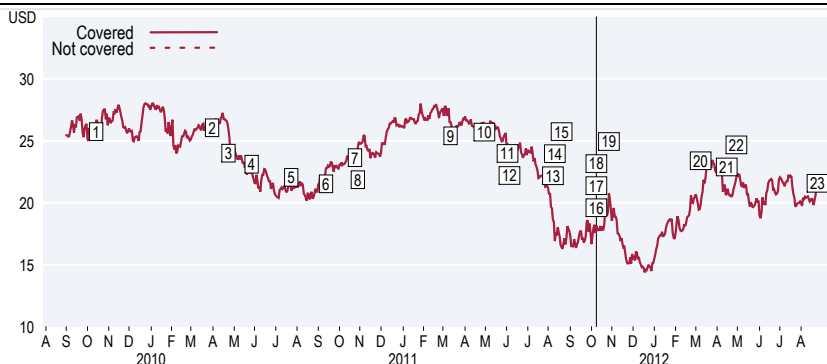
IMPORTANT DISCLOSURES

Federated Investors, Inc (FII)

Ratings and Target Price History Fundamental Research

Analyst: William R Katz

Covered since March 31 2010



Date	Rating	Target Price	Closing Price
1 14-Oct-09	2M	*26.00	26.62
2 31-Mar-10	2M	*28.00	26.38
3 23-Apr-10	2M	*27.00	25.90
4 27-May-10	2M	*24.00	22.73
5 23-Jul-10	2M	*22.00	20.98
6 13-Sep-10	2M	*24.00	22.78
7 25-Oct-10	2M	*26.00	24.14
8 28-Oct-10	2M	*27.00	24.48

* Indicates change

Date	Rating	Target Price	Closing Price
9 11-Mar-11	2M	*26.00	26.54
10 29-Apr-11	2M	*25.00	25.78
11 2-Jun-11	2M	*24.00	24.78
12 6-Jun-11	2M	*23.50	23.99
13 8-Aug-11	2M	*21.00	18.63
14 10-Aug-11	*3M	*16.00	16.91
15 19-Aug-11	3M	*15.00	16.39
16 8-Oct-11	Stock rating system changed		

Date	Rating	Target Price	Closing Price
17 8-Oct-11	*3	15.00	17.56
18 10-Oct-11	3	*15.50	18.15
19 27-Oct-11	3	*16.00	20.78
20 8-Mar-12	3	*17.00	19.87
21 16-Apr-12	3	*18.00	20.73
22 30-Apr-12	*2	*22.00	22.08
23 24-Aug-12	*1	*25.00	21.57

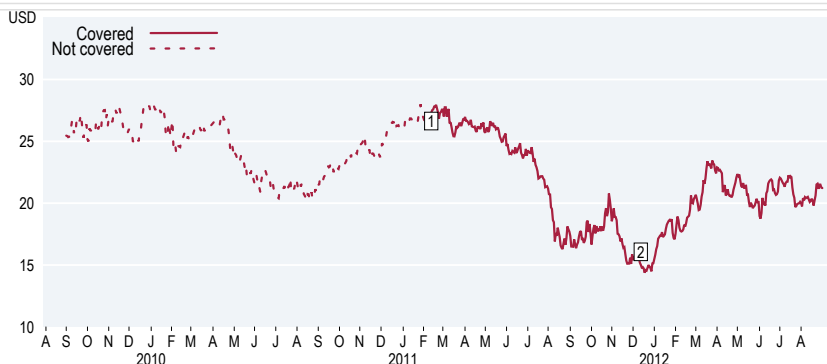
Rating/target price changes above reflect Eastern Standard Time

Federated Investors, Inc (FII)

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 LP	-	27.32

* Indicates change

Date	Rating	Target Price	Closing Price
2 13-Dec-11	*REM LP	-	15.02

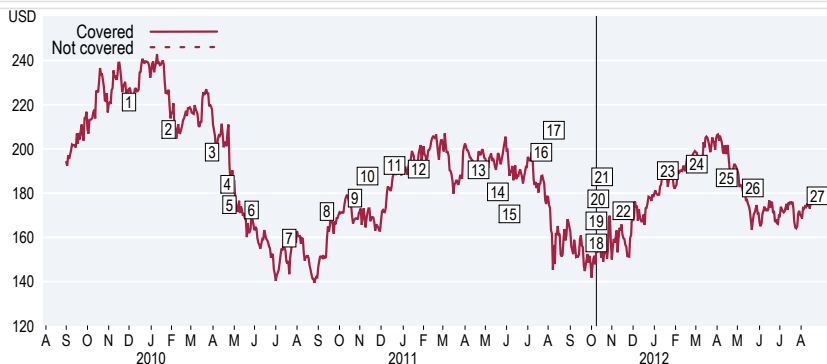
Rating/target price changes above reflect Eastern Standard Time

BlackRock Inc (BLK)

Ratings and Target Price History Fundamental Research

Analyst: William R Katz

Covered since March 31 2010



Date	Rating	Target Price	Closing Price
1 1-Dec-09	1M	*265.00	226.74
2 27-Jan-10	1M	*269.00	226.77
3 31-Mar-10	*3M	*190.00	217.76
4 22-Apr-10	*2M	*198.00	207.79
5 26-Apr-10	2M	*200.00	192.95
6 27-May-10	2M	*175.00	172.39
7 21-Jul-10	2M	*165.00	143.33
8 14-Sep-10	2M	*175.00	159.55
9 25-Oct-10	2M	*180.00	168.39

* Indicates change

Date	Rating	Target Price	Closing Price
10 11-Nov-10	*1M	*210.00	171.20
11 21-Dec-10	1M	*225.00	192.51
12 25-Jan-11	1M	*240.00	198.01
13 21-Apr-11	1M	*250.00	198.88
14 19-May-11	1M	*265.00	198.10
15 6-Jun-11	1M	*255.00	187.85
16 21-Jul-11	1M	*250.00	187.72
17 9-Aug-11	1M	*225.00	156.54
18 8-Oct-11	Stock rating system changed		

Date	Rating	Target Price	Closing Price
19 8-Oct-11	*1	225.00	147.78
20 12-Oct-11	1	*190.00	156.00
21 18-Oct-11	1	*180.00	156.30
22 17-Nov-11	1	*190.00	159.60
23 20-Jan-12	*2	*193.00	182.82
24 2-Mar-12	2	*197.00	198.25
25 16-Apr-12	2	*201.00	198.18
26 23-May-12	2	*180.00	167.50
27 24-Aug-12	2	*190.00	178.27

Rating/target price changes above reflect Eastern Standard Time

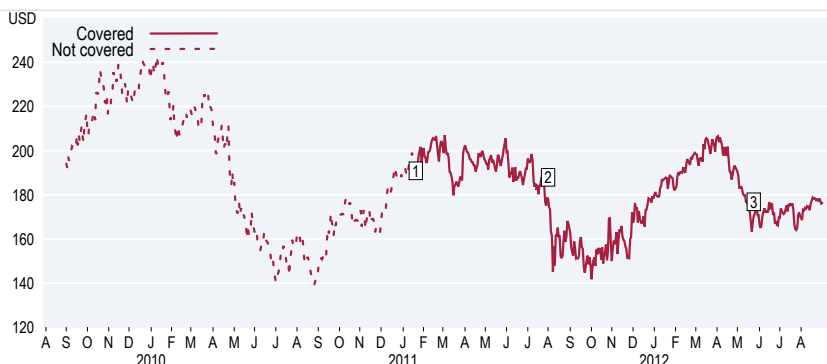
BlackRock Inc (BLK)

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]	20-Jan-11	*ADD MP	-	190.87

* Indicates change

	Date	Rating	Target Price	Closing Price
[2]	1-Aug-11	*REM MP	-	178.36

	Date	Rating	Target Price	Closing Price
[3]	24-May-12	*ADD MP	-	170.44

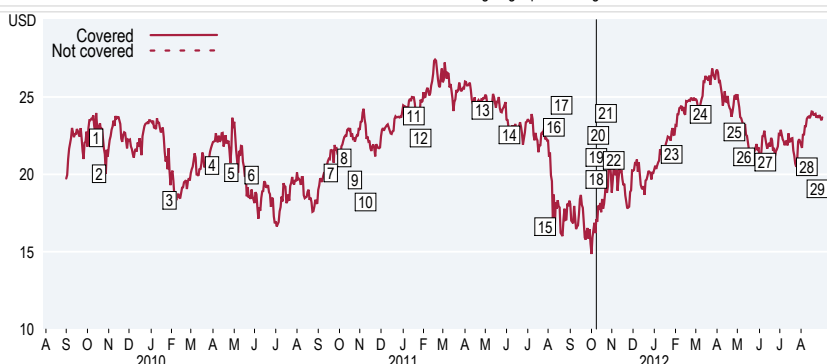
Rating/target price changes above reflect Eastern Standard Time

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]	14-Oct-09	1M	*27.00	23.97
[2]	19-Oct-09	1M	*30.00	23.12
[3]	28-Jan-10	1M	*27.00	20.21
[4]	31-Mar-10	1M	*26.00	21.91
[5]	28-Apr-10	1M	*27.00	21.61
[6]	27-May-10	1M	*25.00	19.02
[7]	20-Sep-10	1M	*26.00	21.60
[8]	8-Oct-10	1M	*27.00	22.41
[9]	25-Oct-10	1M	*28.00	22.11
[10]	9-Nov-10	1M	*26.50	23.20

* Indicates change

	Date	Rating	Target Price	Closing Price
[11]	18-Jan-11	*2M	26.50	24.98
[12]	27-Jan-11	2M	*27.00	24.83
[13]	27-Apr-11	2M	*25.50	24.82
[14]	6-Jun-11	2M	*24.50	22.55
[15]	27-Jul-11	2M	*24.00	22.26
[16]	9-Aug-11	2M	*18.50	18.69
[17]	19-Aug-11	2M	*17.00	16.11
[18]	8-Oct-11	Stock rating system changed		
[19]	8-Oct-11	*2	17.00	16.20
[20]	12-Oct-11	*1	*21.00	17.98

	Date	Rating	Target Price	Closing Price
[21]	24-Oct-11	1	*23.00	19.67
[22]	3-Nov-11	1	*25.00	20.45
[23]	26-Jan-12	1	*27.00	22.78
[24]	8-Mar-12	1	*30.00	24.60
[25]	26-Apr-12	1	*31.00	25.06
[26]	10-May-12	1	*28.50	22.74
[27]	11-Jun-12	1	*27.00	22.35
[28]	9-Aug-12	1	*28.00	23.59
[29]	24-Aug-12	1	*29.00	23.80

Rating/target price changes above reflect Eastern Standard Time

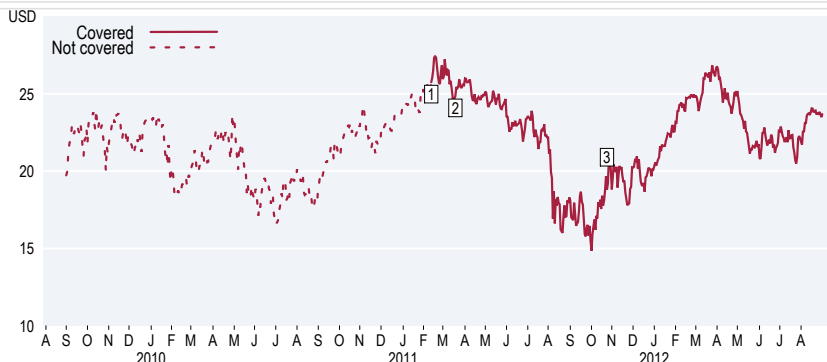
Invesco Ltd (IVZ)

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

Rating/target price changes above reflect Eastern Standard Time

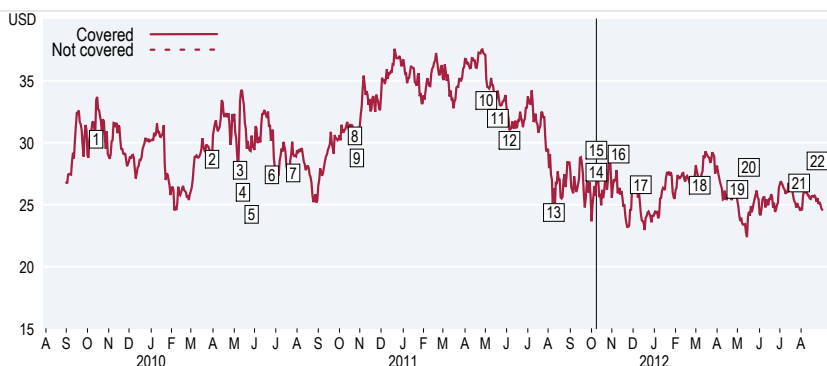
Legg Mason Inc (LM)

Ratings and Target Price History

Fundamental Research

Analyst: William R Katz

Covered since March 31 2010



	Date	Rating	Target Price	Closing Price
1	14-Oct-09	2H	*32.00	33.45
2	31-Mar-10	*2M	*29.50	28.67
3	11-May-10	2M	*33.50	33.38
4	14-May-10	*1M	*44.00	33.57
5	27-May-10	1M	*41.00	30.57
6	25-Jun-10	1M	*42.00	30.70
7	27-Jul-10	1M	*44.00	29.07
8	25-Oct-10	1M	*45.00	30.96

* Indicates change

	Date	Rating	Target Price	Closing Price
9	27-Oct-10	1M	*46.00	30.58
10	3-May-11	1M	*41.00	35.13
11	19-May-11	1M	*40.00	34.20
12	6-Jun-11	1M	*38.00	31.01
13	9-Aug-11	1M	*34.00	26.30
14	8-Oct-11	Stock rating system changed		
15	8-Oct-11	*1	34.00	25.72
16	10-Nov-11	1	*33.00	26.04

	Date	Rating	Target Price	Closing Price
17	13-Dec-11	*2	*27.00	24.31
18	7-Mar-12	2	*29.00	26.69
19	1-May-12	2	*27.50	25.32
20	17-May-12	*1	*32.50	24.43
21	30-Jul-12	1	*29.50	24.77
22	24-Aug-12	1	*30.00	25.53

Rating/target price changes above reflect Eastern Standard Time

Legg Mason Inc (LM)

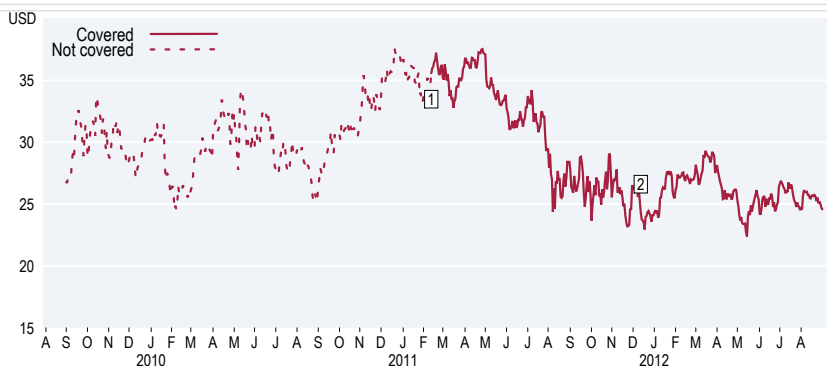
Ratings and Target Price History

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	-	35.58

* Indicates change

	Date	Rating	Target Price	Closing Price
2	13-Dec-11	*REM MP	-	24.31

Rating/target price changes above reflect Eastern Standard Time

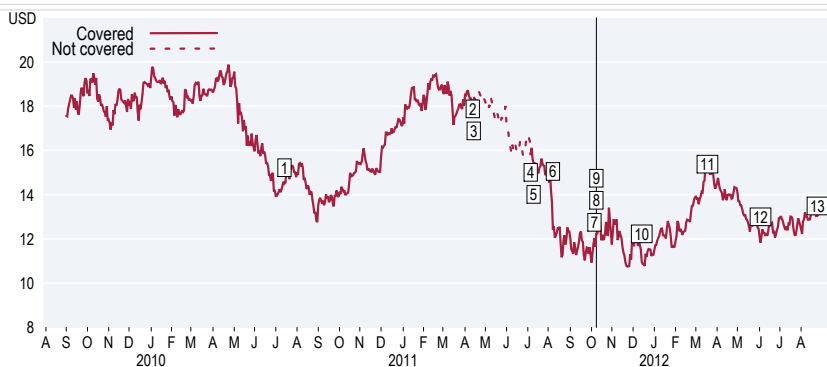
The Charles Schwab Corporation (SCHW)

Ratings and Target Price History

Fundamental Research

Analyst: William R Katz

Covered since July 6 2011



	Date	Rating	Target Price	Closing Price
1	14-Jul-10	2M	*16.00	14.50
2	13-Apr-11	2M	*19.00	18.18
3	14-Apr-11	Coverage terminated		
4	6-Jul-11	2M	*18.00	15.79
5	11-Jul-11	2M	*17.50	15.40

* Indicates change

	Date	Rating	Target Price	Closing Price
6	8-Aug-11	2M	*15.50	12.41
7	6-Oct-11	2M	*13.00	12.04
8	8-Oct-11	Stock rating system changed		
9	8-Oct-11	*2	13.00	11.64
10	14-Dec-11	2	*12.00	10.97

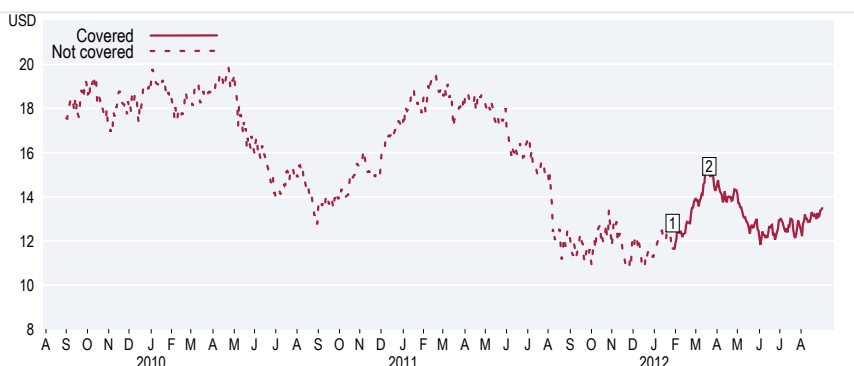
	Date	Rating	Target Price	Closing Price
11	19-Mar-12	*1	*20.00	15.31
12	4-Jun-12	*2	*13.00	11.83
13	24-Aug-12	2	*13.50	13.27

Rating/target price changes above reflect Eastern Standard Time

The Charles Schwab Corporation (SCHW)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: William R Katz
Covered since July 6 2011



Date	Rating	Target Price	Closing Price
1 27-Jan-12	*ADD LP	-	11.67

Date	Rating	Target Price	Closing Price
2 21-Mar-12	*REM LP	-	15.26

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Within the past 12 months, Citigroup Global Markets Inc. or its affiliates has acted as manager or co-manager of an offering of securities of BlackRock Inc, Legg Mason Inc, The Charles Schwab Corporation.

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Citi Research Ratings Distribution

Data current as of 1 Jul 2012

Citi Research Global Fundamental Coverage

% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
53%	37%	10%	10%	80%	10%
44%	43%	40%	48%	43%	45%

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Citi Research stock recommendations include an investment rating and an optional risk rating to highlight high risk stocks.

Risk rating takes into account both price volatility and fundamental criteria. Stocks will either have no risk rating or a High risk rating assigned.

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