

Charles Schwab Corp.

4Q23 First Impression – Mixed financial results but improved NNAs in December

Maintain Rating: UNDERPERFORM | PO: 54.00 USD | Price: 64.31 USD

Charles Schwab reported better than core earnings (\$0.68 vs. \$0.67 BofA / \$0.64 consensus) and improved organic growth (annualized NNA = 3.4% vs. 2.5% q/q). Overall, we view the financial results as mixed given the below-target NNAs and the lower-than-expected NIM as sorting continued to weigh on interest-bearing liability costs. We expect new guidance metrics for 2024 on the upcoming call (NIM, revenue, expenses, capital management). Following results today, we maintain our Underperform rating due to three items: Ameritrade/Thinkorswim integration, lingering sorting (slower-than-expected deposit growth), and lower long-term organic growth given multiple factors.

Profit beat driven by higher operating margin

SCHW reported 4Q23 adjusted EPS of \$0.68, which came in above our estimate (\$0.67) and consensus (\$0.64). The core beat was driven mostly by adjusted expense add-backs (\$216M restructuring costs), while BDA fees missed. IEA fell by -2.7% q/q, while interest-bearing liability costs rose by +10bps (1.74% vs. 1.64% q/q) as sorting continues to weigh down its NIM.

Earnings call at 8:30am ET

We are focused on the following topics on the upcoming call: guidance, interest rate sensitivity, cash sorting, Thinkorswim integration, RIA attrition, expense management, and capital management.

Exhibit 1: SCHW's 4Q23 actuals vs. BofA forecasts

SCHW missed on adjusted EPS and revenues

	4Q22	3Q23	4Q23E	4Q23A	4Q23	
					QoQ	YoY
Adjusted EPS	\$ 1.07	\$ 0.77	\$ 0.67	\$ 0.68	-12%	-36%
Revenue	5,497	4,656	4,606	4,459	-4%	-19%
Adjusted Pretax Margin	51.6%	41.3%	37.8%	36.0%	-5.3%	-15.6%
NIM	2.24%	1.94%	1.98%	1.89%	-0.05%	-0.4%
Annualized Organic Growth	7.7%	2.4%	2.5%	3.4%	1.0%	-4.3%

Source: BofA Global Research

BofA GLOBAL RESEARCH

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	3.26	3.91	3.12	3.55	3.97
GAAP EPS	2.83	3.51	2.60	3.14	3.55
EPS Change (YoY)	35.2%	20.0%	-20.0%	13.5%	11.8%
Consensus EPS (Bloomberg)			3.11	3.69	4.66
DPS	0.74	0.84	1.00	1.10	1.21
Valuation (Dec)					
P/E	19.8x	16.5x	20.6x	18.1x	16.2x
GAAP P/E	22.8x	18.3x	24.7x	20.5x	18.1x
Dividend Yield	1.2%	1.3%	1.6%	1.7%	1.9%

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17 January 2024

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Stock Data

Price	64.31 USD
Price Objective	54.00 USD
Date Established	3-Oct-2023
Investment Opinion	B-3-7
52-Week Range	45.00 USD -84.51 USD
Mkt Val / Shares Out (mn)	113,937 USD / 1,771.7
Free Float	80.9%
Average Daily Value	649.25 USD
BofA Ticker / Exchange	SCHW / NYS
Bloomberg / Reuters	SCHW US / SCHW.N
ROE (2023E)	0%
ESGMeter™	Medium

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BDA: Bank deposit account

IEA: Interest earning asset

NIM: Net interest margin

NNA: Net new asset

vs. versus

iQprofileSM Charles Schwab Corp.

Income Statement Data (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
Net Revenues	18,521	20,762	19,023	19,991	21,620
Compensation & Benefits	(6,444)	(6,968)	(7,483)	(7,054)	(7,507)
% of Net Revenue	34.8%	33.6%	39.3%	35.3%	34.7%
Non-Compensation Expenses	(4,363)	(4,406)	(4,842)	(4,791)	(4,945)
Net Income to Ordinary Shareholders	5,361	6,635	4,766	5,739	6,490

Balance Sheet Data (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
Total Assets	667,270	551,772	480,920	466,482	509,529
Deposits	443,778	366,724	0	0	0
Long Term Debt	18,914	20,828	24,800	24,800	24,800
Total Equity	56,261	36,608	38,878	44,576	50,823

Sector Metrics (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
DARTs	6,507	5,925	5,442	5,501	5,687
Net Interest Margin	3.38%	3.49%	4.04%	4.65%	4.81%
Interest Earning Assets	588,125	533,318	439,705	424,807	467,394
Net New Assets	516	407	320	396	488
Growth	7.7%	5.0%	4.5%	4.7%	5.2%
Total Client Assets	8,139	7,051	8,458	9,376	10,445

Performance Metrics (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
Operating Margin	41.7%	45.2%	35.2%	40.8%	42.4%
Net Profit Margin	33.3%	35.6%	30.1%	32.4%	33.5%
Comp Expense/Revenue	34.8%	33.6%	39.3%	35.3%	34.7%
Non-Comp Expense / Revenue	23.6%	21.2%	25.5%	24.0%	22.9%
Net Revenue Growth	58.4%	12.1%	-8.4%	5.1%	8.1%

Company Sector

Asset Management

Company Description

SCHW is a financial services firm that services retail and RIA customers directly through its online brokerage and institutional services platform. The company also operates a number of other businesses including a bank, asset management and custody businesses. Collectively, it manages over \$7Tn in total client assets.

Investment Rationale

SCHW operates industry leading businesses in two secular growth verticals which support positive annualized organic growth over the next five years. However, we also expect client cash sorting and lower net new assets to cause downside to long-term EPS expectations. Additionally, if organic growth is weaker than expected, the SCHW stock may trade at a lower valuation.

Quarterly Earnings Estimates

	2022	2023
Q1	0.77A	0.93A
Q2	0.97A	0.75E
Q3	1.10A	0.77E
Q4	1.07A	0.67E

Additional information

NNA growth has missed target for last 3 quarters...

SCHW has now posted 3 consecutive quarters of organic growth, which is below its 5-7% target. In 4Q23, its organic growth was 3.4%, but we were surprised to see a strong December month (+6.4% annualized), led by a pickup in Advisor Services, which has been previously negatively impacted by Ameritrade merger-related attrition. We continue to believe that there will be some registered investment advisor (RIA) attrition longer term given SCHW's more limited technology menu vs. Ameritrade's Veo One and low-yielding client cash sweep rate, which should hurt NNA growth. SCHW has now integrated 100% of Ameritrade's RIAs and 90% of its retail clients, with the remaining occurring in the next few months (Thinkorswim, active trader).

Underperform; expect lower NNAs & deposit growth

We look for sorting activity to continue through 2024, although at a decelerated pace from the 1Q23 highs. This impacts the size of SCHW's balance sheet and the time period that it will continue to fund its balance sheet with expensive sources (FHLB + CDs) and ultimately reinvest its securities portfolio at higher yields. However, a smaller balance sheet and no share buybacks for 2 years should allow SCHW to start repurchasing stock again in 2025 after its Tier 1 + AOCI (accumulated other comprehensive income) ratio reaches its 6.5-7% target. We also expect organic growth to miss expectations, while SCHW has a stable upward NIM trajectory as it repays its expensive funding sources and eventually is able to reinvest its low-yielding securities portfolio.



Price objective basis & risk

Charles Schwab Corp. (SCHW)

Our price objective (PO) for SCHW is \$54 and is derived from a price to earnings method. We apply a 12x multiple on our 2026E EPS to obtain our PO. We use 12x given (1) elevated sorting will continue through mid-2023, (2) "bank" risks would weigh on SCHW's multiple and (3) forecast net new assets to slow over the near-term.

Risks to our PO are an extension of the Fed hiking cycle positively affecting SCHW's securities portfolio reinvestment opportunity and muted sorting activity.

Analyst Certification

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US - Brokers, Asset Managers, & Exchanges Coverage Cluster

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	Ares Management Corp	ARES	ARES US	Craig Siegenthaler, CFA
	BlackRock, Inc.	BLK	BLK US	Craig Siegenthaler, CFA
	Blackstone	BX	BX US	Craig Siegenthaler, CFA
	Blue Owl Capital	OWL	OWL US	Craig Siegenthaler, CFA
	Cboe Global Markets	CBOE	CBOE US	Craig Siegenthaler, CFA
	Interactive Brokers	IBKR	IBKR US	Craig Siegenthaler, CFA
	Intercontinental Exchange	ICE	ICE US	Craig Siegenthaler, CFA
	KKR & Co. Inc.	KKR	KKR US	Craig Siegenthaler, CFA
	Raymond James Financial	RJF	RJF US	Mark McLaughlin, CFA
	TPG Inc	TPG	TPG US	Craig Siegenthaler, CFA
	Tradeweb Markets Inc.	TW	TW US	Craig Siegenthaler, CFA
	Victory Capital Holdings, Inc.	VCTR	VCTR US	Craig Siegenthaler, CFA
	Virtu Financial	VIRT	VIRT US	Craig Siegenthaler, CFA
NEUTRAL				
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	Brookfield Asset Management	BAM	BAM US	Craig Siegenthaler, CFA
	CME Group Inc	CME	CME US	Craig Siegenthaler, CFA
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	Robinhood Markets	HOOD	HOOD US	Craig Siegenthaler, CFA
	T. Rowe Price	TROW	TROW US	Craig Siegenthaler, CFA
	The Carlyle Group	CG	CG US	Craig Siegenthaler, CFA

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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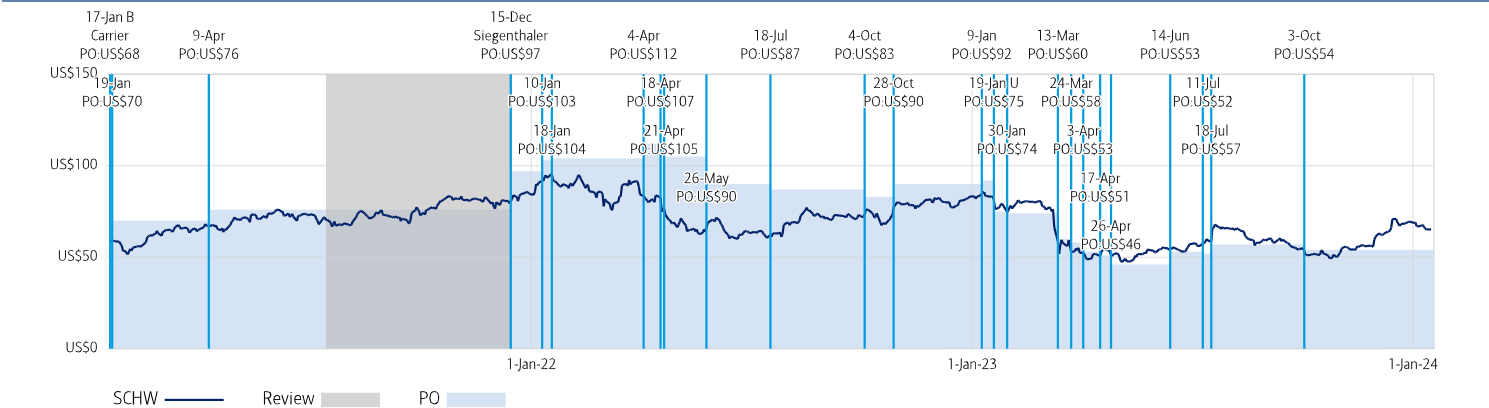
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Charles Schwab (SCHW) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Equity Investment Rating Distribution: Financial Services Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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Underperform	N/A	≥ 20%

^{R2}Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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