

Charles Schwab Corp.

4Q23E: Maintain U/P due to expected softness in organic & deposit growth

Reiterate Rating: UNDERPERFORM | PO: 58.00 USD | Price: 63.45 USD

Forecast softer than expected deposit & organic growth

We remain cautious on two fronts: (1) expect risk to SCHW's 5-7% organic growth target in 2024-25 (it missed this target last year, Thinkorswim integration scheduled for May); (2) forecast cash sorting to improve but linger and pressure deposit growth in 2024. Combined, these two factors drive our expected 17% downside to the 2025 consensus. We agree with the bull thesis that there is a solid NIM trajectory higher as SCHW pays off expensive FHLB borrowings and then reinvests into higher yielding securities. However, a smaller deposit base due to lingering sorting and softer net new assets could continue to negatively surprise investors. Additionally, if SCHW's organic growth trends at 2-3% in 2024, this may weigh on its premium valuation relative to public broker peers that are growing faster and trading at lower valuations (Organic growth: LPLA 8-10%, IBKR >20%, HOOD 20-25%, RJF 5-7%).

Raising 2026 EPS & PO (lowering 2024 & 2025)

We adjusted our 2024/2025/2026 EPS estimates to \$3.33/\$3.81/\$4.67 from 3.55/\$3.97/\$4.29 due to several adjustments: lower expenses, lower NIM, lower organic growth. We increased our PO to \$58 (previously \$54) which implies roughly -10% return potential and is derived from a 12.5x multiple (no change) on our 2026 EPS estimate. This multiple represents a premium to broker peers (despite SCHW's lower organic growth).

Reiterate Underperform: Thinkorswim integration risk

We look for cash sorting to improve but linger in 2024 which impacts the size of SCHW's balance sheet and the time it will take to repay its expensive liability sources (FHLB + CDs) and reinvest its securities portfolio at higher yields. However, a smaller balance sheet and no share buybacks for 1-2 years should allow SCHW to start repurchasing shares again in 2025 after its adjusted Tier 1 + AOCI ratio reaches its 6.5-7% target (currently 4.9%). Additionally, despite lower interest rates, SCHW has an upward sloping NIM trajectory as it repays its expensive funding sources and eventually is able to reinvest its low yielding securities portfolio.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	3.26	3.91	3.14	3.33	3.81
GAAP EPS	2.83	3.51	2.54	2.96	3.45
EPS Change (YoY)	35.2%	20.0%	-19.7%	6.1%	14.6%
Consensus EPS (Bloomberg)			3.11	3.69	4.66
DPS	0.74	0.84	1.00	1.10	1.21
Valuation (Dec)					
P/E	19.5x	16.2x	20.2x	19.1x	16.6x
GAAP P/E	22.5x	18.1x	25.0x	21.4x	18.4x
Dividend Yield	1.2%	1.3%	1.6%	1.7%	1.9%

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Timestamp: 17 January 2024 08:11PM EST

17 January 2024

Equity

Key Changes (US\$)	Previous	Current
Price Obj.	54.00	58.00
2023E Rev (m)	19,023.1	18,837.0
2024E Rev (m)	19,990.9	19,551.7
2025E Rev (m)	21,620.0	21,408.3
2023E EPS	3.12	3.14
2024E EPS	3.55	3.33
2025E EPS	3.97	3.81

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Stock Data

Price	63.45 USD
Price Objective	58.00 USD
Date Established	17-Jan-2024
Investment Opinion	B-3-7
52-Week Range	45.00 USD -84.51 USD
Mkt Val / Shares Out (mn)	112,413 USD / 1,771.7
Free Float	80.9%
Average Daily Value	624.50 USD
BofA Ticker / Exchange	SCHW / NYS
Bloomberg / Reuters	SCHW US / SCHW.N
ROE (2023E)	0%
ESGMeter™	Medium

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Glossary:

NNA = net new assets

ToS = Thinkorswim

AOCI = accumulated other comprehensive income

NIM = net interest margin

FHLB = Federal Home Loan Bank

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Income Statement Data (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
Net Revenues	18,521	20,762	18,837	19,552	21,408
Compensation & Benefits	(6,444)	(6,968)	(7,373)	(6,779)	(7,223)
% of Net Revenue	34.8%	33.6%	39.1%	34.7%	33.7%
Non-Compensation Expenses	(4,363)	(4,406)	(5,086)	(4,991)	(5,261)
Net Income to Ordinary Shareholders	5,361	6,635	4,649	5,415	6,258

Balance Sheet Data (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
Total Assets	667,270	551,772	493,200	468,105	508,411
Deposits	443,778	366,724	290,000	0	0
Long Term Debt	18,914	20,828	26,100	26,100	26,100
Total Equity	56,261	36,608	41,000	46,416	51,104

Sector Metrics (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
DARTs	6,507	5,925	5,393	5,382	5,518
Net Interest Margin	3.38%	3.49%	4.00%	4.62%	4.88%
Interest Earning Assets	588,125	533,318	441,339	415,784	455,630
Net New Assets	516	407	337	243	434
Growth	7.7%	5.0%	4.8%	2.9%	4.7%
Total Client Assets	8,139	7,051	8,517	9,282	10,291

Performance Metrics (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
Operating Margin	41.7%	45.2%	33.9%	39.8%	41.7%
Net Profit Margin	33.3%	35.6%	30.5%	31.1%	32.3%
Comp Expense/Revenue	34.8%	33.6%	39.1%	34.7%	33.7%
Non-Comp Expense / Revenue	23.6%	21.2%	27.0%	25.5%	24.6%
Net Revenue Growth	58.4%	12.1%	-9.3%	3.8%	9.5%

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 \$9Tn 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	0.68E

Additional information

Lagging NNAs continue (driven by RIA channel)...

SCHW has now posted 3 consecutive quarters of organic growth that is below its 5-7% target. In 4Q23, its organic growth rate was +3.4% but SCHW did see a noticeable pickup in December to +6.4% driven by Advisor Services. The weakness in 2023 was partially driven by Ameritrade merger-related attrition, especially in the months of July and August before its Labor Day weekend conversion. Going forward, we look for NNAs to remain below its LT averages due to several factors. In 1H24 there will be negative seasonality (taxes), residual Ameritrade RIA attrition and also outflows relating to the Thinkorswim integration in May. In the RIA segment, SCHW's offering is more limited vs. Ameritrade's Veo One and its low yielding client cash sweep rates are another factor. SCHW also faces more competition from new and differentiated offerings that attempt to compete on more than just price including white-glove services or a larger suite of integrated third-party vendors and customizable technology stack. Additionally, SCHW AuA base is approaching \$9Tn with the law of large numbers making future growth more difficult than when it was just \$3-4Tn a few years. We also think the covid backdrop in 2020-21 provided an optimal scenario for organic growth in the wealth management industry. For these reasons, we think SCHW's net new assets will remain below the low end of its 5-7% in 2024, 2025 and 2026.

...could continue with negative catalyst in 1H24 from ToS

SCHW expects to onboard Ameritrade's "active trader" base this May which constitutes roughly 10% of the remaining accounts and assets from the merger. While only a small percentage of total AuC, we believe the active trader base which includes having the highest margin loan usage and options volumes makes the accounts much more lucrative than the more passive retail cohort which have already been onboarded. Compared to RIAs which are required to undergo a cumbersome "repapering" process in order to switch brokers, retail accounts need to simply initiate an outgoing ACATS (Automated Account Transfer Service) and pay a small fee. The retail brokerage market has undergone a seismic shift over the last few years with many new entrants competing with better pricing/execution (TastyTrade, IBKR) or sleek differentiated offerings (HOOD). We believe the integration will cause these active traders to try competing platforms which may cause a pickup in attrition.

Expecting multiple headwinds for cash sorting in 1H24

SCHW pointed out that it expects clients to re-risk in early 1Q24 and its RIA advisory payments will also lower cash in January. Additionally, tax related outflows should pressure cash in March and April. Accordingly, we think core deposit growth will be under pressure for the next few months. Additionally, we continue to expect sorting to improve y/y but linger as there will be a delayed response to the 45bps cash sweep rate versus cash alternatives >5%. In SCHW's revenue/scenario targets, it included a -10% q/q transaction cash assumption as the low end of its expected range which we interpret as a worst-case scenario. SCHW's NIM target for 4Q25 is now "approach 3.00%" while it was meet/exceed 3.00% earlier last year. We believe the lower interest rate backdrop has dampened the securities reinvestment opportunity which we think is the main factor for the change in language.

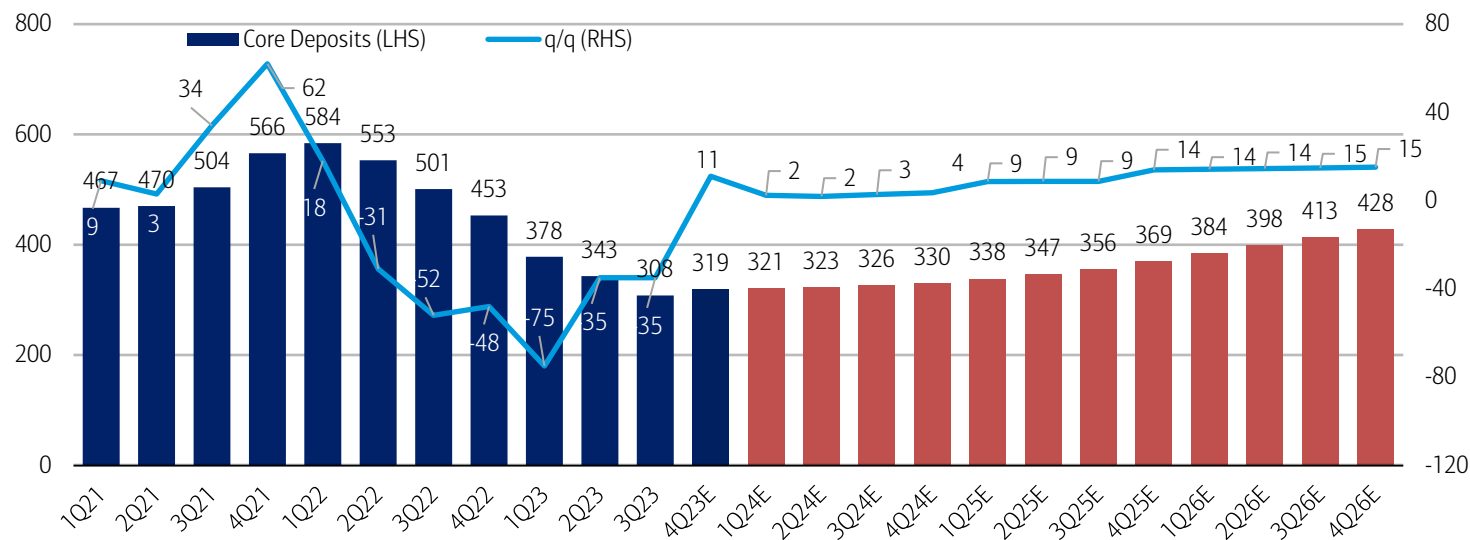
Expecting share repurchases to restart in 1Q25

On the update call, SCHW provided a chart which showed them crossing 6.5% adjusted Tier 1 Leverage (including AOCI) by 4Q24. This implies that share buybacks should restart in 1Q25, which is what we embed in our model. We initially target a 20% of earnings level for buybacks but expect SCHW could accelerate this in 2026 as its capital cushion improves or if AOCI declines faster than we are forecasting (given an even lower

interest rate backdrop). While the ability to repurchase shares is a positive, we calculate the negative impact from lower rates on reinvestment opportunities outweighs any benefits of an accelerated buyback timeline from the AOCI decline.

Exhibit 1: SCHW Core deposits (\$B)

Core deposits grew \$11B q/q in 4Q23 and we believe core deposits will grow organically in 1H24. However, we look for cash sorting to improve but linger and limit deposit growth.



Source: BofA Global Research, company filings

BofA GLOBAL RESEARCH

Price objective basis & risk

Charles Schwab Corp. (SCHW)

Our price objective (PO) for SCHW is \$58 and is derived from a price to earnings method. We apply a 12.5x multiple on our 2026E EPS to obtain our PO. We use 12.5x 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

I, Craig Siegenthaler, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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
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	Brookfield Asset Management	BAM	BAM US	Craig Siegenthaler, CFA
	CME Group Inc	CME	CME US	Craig Siegenthaler, CFA
	Invesco	IVZ	IVZ US	Craig Siegenthaler, CFA
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	LPL Financial Holdings	LPLA	LPLA US	Craig Siegenthaler, CFA
	Patria	PAX	PAX US	Craig Siegenthaler, CFA
UNDERPERFORM				
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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

$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$

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

$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} +$

Other LT Liabilities

Enterprise Value

Denominator

$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$

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

$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$

Sales

Basic EBIT + Depreciation + Amortization

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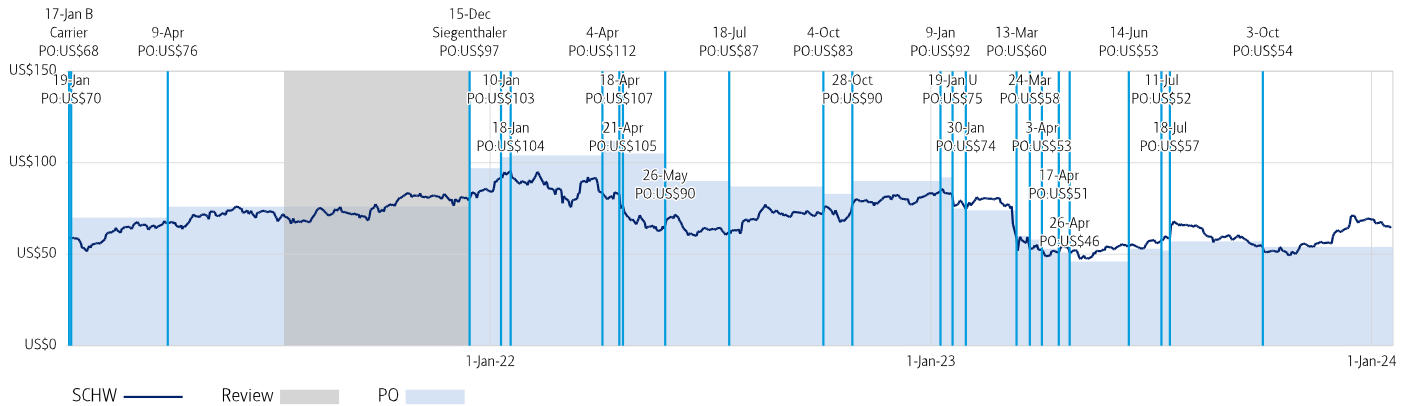
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Charles Schwab (SCHW) Price Chart



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

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

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%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
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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