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COMPANY PROFILE

The Charles Schwab Corporation

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COMPANY OVERVIEW

The Charles Schwab Corporation (Charles Schwab) is a savings and loan holding company that offers financial services, primarily investment solutions. It includes brokerage accounts, mutual funds, exchange traded funds, stocks, options, futures, trust funds, custody, practice management, retirement plans, equity compensation plan, trading and recordkeeping services. The company also offers banking products such as checking and savings accounts, real estate mortgage loans, pledged asset lines and home equity lines of credit. It provides advisory solutions including customized personal advice for tailored portfolios, separately managed accounts, portfolio management and specialized planning. These solutions are offered to individuals, registered investment advisors, record keepers, and retirement advisors. The company has operations in the US, Singapore, England, Hong Kong and Australia. Charles Schwab is headquartered in San Francisco, California, the US.

The company reported revenues of (US Dollars) US$8,960 million for the fiscal year ended December 2017 (FY2017), an increase of 17.2% over FY2016. In FY2017, the company's operating margin was 40.7%, compared to an operating margin of 39.2% in FY2016. In FY2017, the company recorded a net margin of 26.3%, compared to a net margin of 24.7% in FY2016.

KEY FACTS

Head Office	The Charles Schwab Corporation 211 Main St San Fransico California San Fransico California USA
Phone	1 415 6677000
Fax	1 415 6278538
Web Address	www.schwab.com
Revenue / turnover (USD Mn)	8,960.0
Financial Year End	December
Employees	17,600
New York Stock Exchange Ticker	SCHW

SWOT ANALYSIS

The Charles Schwab Corporation (Charles Schwab) is a savings and loan holding company. Improved net interest margin, client metrics and cost efficiency; and strong capital adequacy are its major strengths, even as lack of presence in emerging markets could be an area of concern. However, strategic initiatives, growing wealth management prospects, and corporate tax cuts in the US may provide growth opportunities for the company. In Future, price competition, regulatory changes in the US, and prolonged low interest rate environment may pose challenges to the company.

Strength	**Weakness**
Net Interest Margin Capital Adequacy Cost Efficiency Client Metrics	Lack of Presence in Emerging Markets
Opportunity	**Threat**
Growing Wealth Management Prospects: The US Strategic Initiatives Corporate Tax Cuts in the US	Prolonged Low-Interest-Rate Environment Regulatory Changes: The US Price Competition

Strength

Net Interest Margin

Charles Schwab reported improvement in its net interest margin (NIM) in FY2017, which enhanced its net interest income. During the year, the NIM improved to 1.97% from 1.73% in the previous year. The company's net interest spread expanded to 1.97% from 1.73% in FY2016, due to higher increase in yield on average interest-earning assets than the increase in cost of interest-bearing liabilities. Its yield on average interest- earning assets grew to 2.12% from 1.82%, a year ago, whereas, the cost of interest-bearing liabilities increased marginally to 0.15% in FY2017 from 0.09% in FY2016.

Capital Adequacy

Charles Schwab's strong capital adequacy ensured better capital management and solvency position. Adequate capital enabled the company to meet regulatory capital requirements with respect to its risk-weighted assets and address bank stress tests conducted by national banking regulators. In FY2017, the company's common equity Tier I ratio, Tier 1 capital ratio, total capital adequacy ratio and leverage ratio were 19.3%, 23%, 23%, and 7.6%, respectively; as compared to 18.4%, 22.5%, 22.6% and 7.2%, respectively, in the previous year. All the ratios were well and above the minimum statutory requirements of 4.5%, 6%, 8% and 4%, respectively.

Cost Efficiency

Charles Schwab reported improvement in its cost efficiency in FY2017, which enhanced its profitability. In FY2017, its cost efficiency ratio improved to 57.65%, from 59.98% in the previous year. The ratio represents non-interest expenses as a percentage of net revenue. During the year, the company's non-interest expenses grew 10.8% to US$4,968 million from US$4,485 million in the previous year. The increase was due to higher expenses in compensation and benefits, professional services, occupancy and equipment, advertising and market development, depreciation and amortization, regulatory fees and assessments, and others. Its net revenue rose 15.2% to US$8,618 million from US$7,478 million in FY2016.

Client Metrics

Charles Schwab reported improvement in its client metrics in FY2017, which ensures client engagement. During the year, it had client assets of US$3,361.8 billion, which grew 20.9% over US$2,779.5 billion in FY2016. The company's net new client assets increased 85.7% to US$233.1 billion in FY2017 from US$125.5 billion in FY2016. Its core net new client assets also rose by 58.3% to US$198.6 billion from US$125.5 billion in the previous year. The company's client cash as a percentage of client assets stood at 10.8% in FY2017 as compared to 13% a year ago.

Weakness

Lack of Presence in Emerging Markets

Charles Schwab primarily operates in the US (345 branch offices in 46 states), has a branch each in Puerto Rico and London, and a subsidiary in Hong Kong. Charles Schwab relies almost entirely on the US market for revenue generation. This exposes it to the market risks and macro-economic conditions prevailing in the country. Limited international presence restricts the company from diversifying its risk. On the other hand, some of the company's key competitors have more geographically diverse revenue streams, putting the company at a competitive disadvantage.

Opportunity

Growing Wealth Management Prospects: The US

The growing wealthy population in the US may provide ample growth opportunities to private banking/wealth management providers. According to in-house research, the population is projected to reach 204.4 million by 2020, including high net worth individuals (HNWIs) to 5.4 million and mass affluent to 199 million. The retail wealth of the population is forecasted to reach US$51,637.9 billion, including the wealth of HNWIs and mass affluent to US$19,331.2 billion and US$32,306.8 billion, respectively. The growth is expected to be driven by increasing retail savings and positive investments in the market on the back of optimistic economic forecast, corporate tax cuts, and focus on alternative investments.

Strategic Initiatives

Charles Schwab has been focusing on a number of initiatives to expand its offerings and enhance customer experience for both active traders and long-term investors. In line with this, in January 2018, it added 12 new exchange traded funds (ETFs) to Schwab ETF OneSource, a program that offers investors and advisors the most commission-free ETFs anywhere in the industry. In December, 2017, the company through its subsidiary, Charles Schwab Investment Management, launched three new index funds including large cap growth index fund, large cap value index fund, and mid cap index fund. With these new funds, it provides all of the core foundational products that investors need for US equity allocation. Also in October 2017, it launched two new web and mobile trading platforms, StreetSmart Central and StreetSmart Mobile, to provide OptionsXpress derivatives trading experience into the company's trader offering. These platforms enable OptionsXpress clients to trade equities, options, and futures.

Corporate Tax Cuts in the US

Corporations across the US would benefit from the reduced corporate tax cut bill, which was signed into law in December 2017. Among them, financial services firms are expected to be among the biggest gainers as they pay some of the highest effective tax rates in the country. Banks could benefit from increase in borrowing by businesses. Along with increase in borrowing, higher interest rates will further boost banks' profit margins. Banks with overseas businesses would become more competitive, relative to their international counterparts in countries with lower corporate tax rates. The bill includes provisions related to repatriation of overseas cash, which could boost the US mergers and acquisitions that in turn would spur investment banking. The wealth management firms are also likely to witness substantial growth in their asset under management as the bill reduces tax rates for the wealthy. Most of the corporate America is likely to increase dividends and share buybacks that would further boost the US equity markets, in turn increasing the value of investments held by asset managers.

Threat

Prolonged Low-Interest-Rate Environment

Prolonged low-interest-rate environment could pose significant challenges to a banking institution. According to an IMF research, lower interest rates may boost banks' earnings in the short-term. However, they adversely affect profitability in the steady state once they fall below a particular positive threshold. With flattened yield curves, if bank deposit rates cannot fall below zero, the profitability would be contracted further. In such a scenario, regional and deposit-funded banks are likely to be most adversely impacted. In order to enhance yield, larger banks would increase their risk exposures in other countries that offer higher returns and rely more on wholesale funding, whereas their smaller counterparts would take more interest rate risk by increasing the duration of bond portfolios. Prolonged challenging interest rate environment would result in consolidation of smaller banks.

Regulatory Changes: The US

Implementation and compliance of regulatory changes could render the company incur additional costs. In April 2016, the United States Department of Labor (DOL) issued the DOL Rule and related exemptions, which broaden the circumstances under which the company may be considered a fiduciary with respect to certain accounts that are subject to the Employee Retirement Income Security Act of 1974 (ERISA), and the prohibited transaction rules of section 4975 of the Code, including many employer-sponsored retirement plans and IRAs. The DOL also finalized certain prohibited transaction exemptions that allow investment advisors to receive compensation for providing investment advice under arrangements that would otherwise be prohibited due to conflicts of interest. The rule may increase the compliance costs for advisors and registered representatives. The advisors are required to act in the best favor of customers and disclose all commissions and fees to be disclosed to clients in terms of US$. It may eliminate several commissions. All advisors, agents, brokers, and financial planners will be bound to provide clients with a disclosure agreement, called a Best Interest Contract Exemption, in case of any conflict in interest.

Price Competition

Charles Schwab faces stiff price competition from other financial firms offering reduced commission rates, which could decrease the effectiveness of the company's strategies. Revenues lost through lower commissions may not be offset by new account growth as the major discount brokers have to, a large extent, neutralize each other's price strategies. The company’s operations may also be affected if its peers maintain lower expense ratio and offer higher interest rates on deposits. Some of its competitors’ include Fidelity investments, E*Trade Financial, Morgan Stanley and Goldman Sachs.