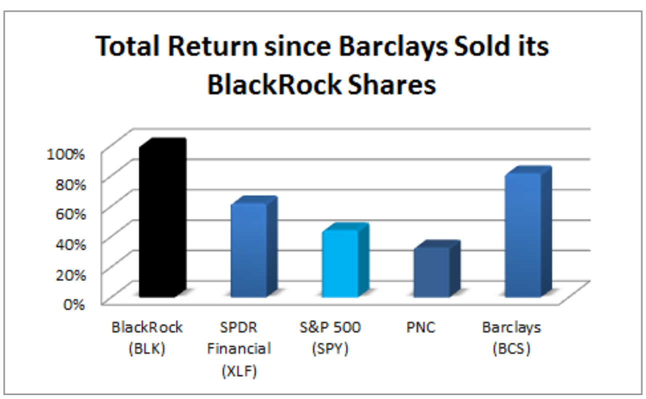
BlackRock: Industry Leading Asset Manager Offers Double Digit Dividend Growth

Accumulate

We enjoy covering BlackRock (BLK) because it is the industry leader in our favorite industry (asset management). We were pleased that Ignites Europe (Financial Times' subscription only subsidiary that covers the asset management industry) cited our research in an article that firm wrote about BlackRock's $1B stock buyback. We were disappointed that BlackRock only bought $1B of stock from Barclays instead of the $6.1B that Barclays (BCS) was selling but for some reason, BlackRock's management felt it could generate a favorable image in the investment community and make it more well-known to investors by having the majority of the Barclays shares sold on the secondary market in a road show. At least BlackRock generated a total return of 100% after Barclays sold its stake in the company in 2012.

Considering that BlackRock's share price snapped its two year streak of price declines in 2012 and its total return was 100% since Barclays announced it would sell its shares, we're content with management's decision here. BlackRock's shares have significantly outperformed the 28.5% that the S&P Financial Sector SPDR ETF (XLF) achieved during this period. We attribute this to the following:

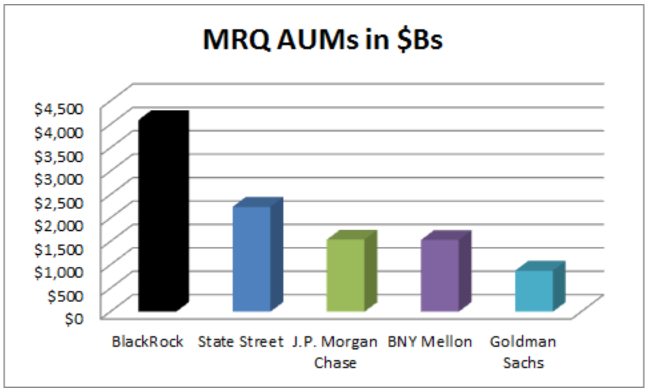
- Continued growth in the equity markets
- Improved growth in organic fund flows
- Bolt-on acquisitions of smaller firms
- Steady, consistent execution of share repurchases
- Strong dividend growth



Source: Morningstar Direct

In 2013, BlackRock beat its adjusted consensus EPS estimates by $.06 in Q1 2013 and $.33 in Q2 2013 but met its Q3 2013 estimates of $3.88/share. We believe that BlackRock is nearly 9% undervalued relative to our fair value target price based on its strong record of past revenue growth and our projections for solid future revenue growth of 8.5%, operational leverage, double-digit dividend growth and 2% annual reductions in its outstanding share count. We expect BlackRock's EPS to grow by 12.25% annually over the next five years, which is close to the 13.9% average projected annual growth for the asset management industry during this time horizon. Here is our latest analysis of BlackRock's recent performance.

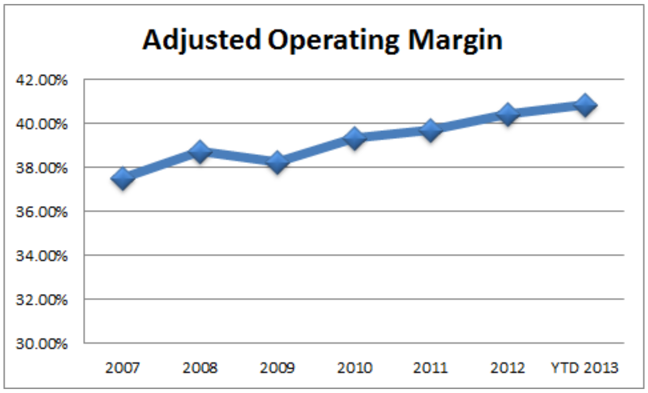
BlackRock grew its Q3 2013 adjusted 2012 EPS by 12% versus Q3 2012. The EPS growth was due to a 7% revenue increase, a 50bp increase in its operating margin and a $79M positive shift year-over-year in its non-operating income. BlackRock manages just under $4.1 Trillion in AUMs, which is well ahead of its competitive peers in the asset management industry



Source: MRQ Reports for BlackRock and its peers

Blackrock increased its AUMs by 6.2% on a linked-quarter basis in Q3 2013 and by 8% in the first nine months of 2013. Increases in AUM were due to market appreciation due to continued central bank monetary easing in order to combat the weak global macroeconomic environment. BlackRock's organic growth from net fund flows was 70bp in Q3 2013, 1.75% in YTD 2013 and 3.46% in the last twelve months.

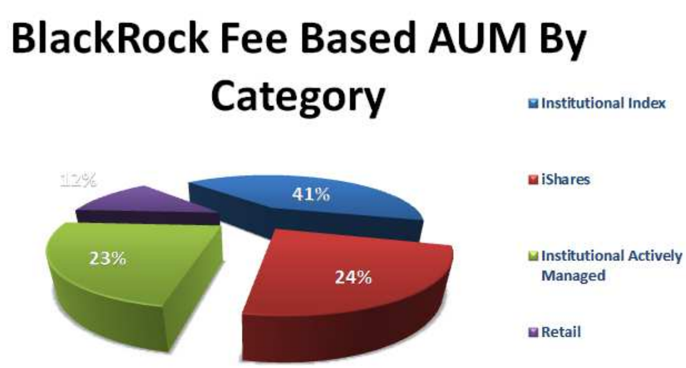
BlackRock also reported strong operating margins of 41.2%, as the company continues its expense management discipline in the wake of the volatile revenue environment. BlackRock saw its greatest base fee revenue growth from its BlackRock Solutions/advisory business (up 22%) its passive products (13%), its core alternative products (9%) and its multi-asset class asset allocation products (9.6%). BlackRock's performance fees dipped by 7% year-over-year due to a $17M decline in fixed income and equity performance advisory fees and a $10M increase in multi-asset and alternative performance advisory fees.



Source: BlackRock's 2012 Annual Report and MRQ Earnings Report

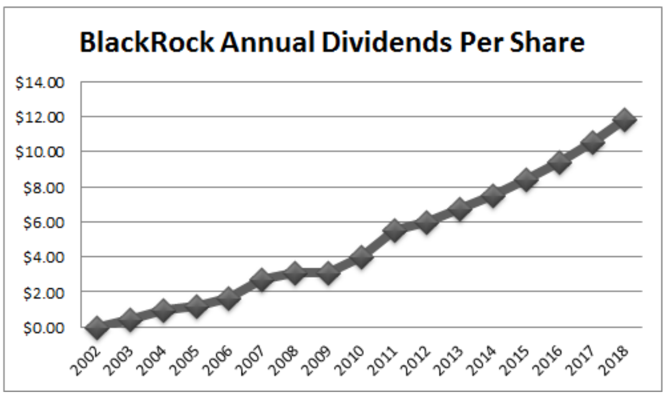
BlackRock has also been involved in a few bolt-on acquisitions over the last two years. In H1 2012, BlackRock increased its AUMs by $7.6 billion by acquiring Claymore's Canadian ETF business and rebranding those products under the iShares brand. BlackRock closed the acquisition of Swiss Re Private Equity Partners from Swiss Re in Q3 2012 and this deal added $6.2B in AUMs and created a private equity operation with a total of $15B in funding. In January 2013, it announced the acquisition of Credit Suisse's ETF business, which added $16B ETF AUMs to BlackRock's iShares ETF product line when the deal closed in July.

We have already discussed how BlackRock is working to expand its brand through its "New World of Investing" campaign, as well as our opinion of it in relation to PIMCO's New Normal program. We have seen an increasing amount of advertising by BlackRock promoting its "New World of Investing" campaign in order to increase its brand awareness amongst fund investors. As retail assets under management for long-term investment products only represent about 12% of BlackRock's AUM (up from 11% in Q1 2012), we believe that BlackRock has potential to increase its brand recognition amongst individual investors.



Source: BlackRock's MRQ Earnings Report

BlackRock historically announced whether it would increase dividends in February for the year. However, in 2013, BlackRock announced it would increase its dividends by 12% in January one day before it announced its Q4 2012 results. We expect that BlackRock will increase its dividends per share by 12% in 2014 and will announce this no later than February. BlackRock's dividend yield of 2.1% is in line with the yield on the SPDR S&P 500 ETF and we forecast that BlackRock will grow its dividend per share by 12% annually from 2014 to 2018. BlackRock also repurchased 872,164 shares in the quarter and 2.6M shares in YTD 2013 net of share issuance for employee equity programs. BlackRock spent $929M on share buybacks and $882M on dividends and this represented 87% of its net income for 2012. We're not worried about such a high payout considering it has $5.9B in cash and investments as of Q3 2013 versus $4.9B in long-term debt that carries a low weighted-average coupon of 4%. In January 2013, BlackRock increased its share repurchase authorization from 2.7M shares to 10.2M shares and it has 7.3M shares still authorized for repurchase. This represents 4.3% of BlackRock's outstanding share count and if BlackRock was to make any additional acquisitions, the proposed deal would have to add more value to BlackRock's shareholders than a share repurchase transaction. BlackRock has also increased its dividend by a compounded annual growth rate of 28.55% since 2003, though we expect future dividend growth to be around 12% annually.



Source: BlackRock's Dividend History Page and Our Estimates

In conclusion, we believe that BlackRock is 10.5% undervalued. While we would prefer to wait for a pullback to add more shares, we can see why it has bounced back by 100% over the last 18 months. We believe that BlackRock's ability to generate strong cash flows and industry leading presence in asset management result in it being a strong core holding for investors. We like that BlackRock is the industry leader in asset management and we love the fantastic business model that asset management firms enjoy. We are happy that BlackRock improved its net fund flows performance and it is positioning itself amongst the asset management industry's blue chip firms. We can see why PNC Financial maintains its 21% stake in its former subsidiary and why Norway's sovereign wealth fund took a 9% stake in BlackRock.

VALUATION ANALYSIS

DCF/NPV Model Summary

Fiscal Year $M	2012A	2013E	2014E	2015E	2016E	2017E	2018E	
Investment Fees	$9,337	$10,177	$11,042	$11,981	$12,999	$14,104	$15,303	8.5% Growth
Compensation & Related Costs	$3,287	$3,550	$3,834	$4,141	$4,472	$4,830	$5,216	8% Growth
Distribution & Servicing Expenses	$364	$368	$371	$375	$379	$383	$386	1% Growth
Deferred Sales Commission Expenses	$55	$50	$45	$40	$36	$32	$29	10% Decline
Direct Fund Expenses	$591	$650	$702	$758	$819	$884	$955	8% Growth
General And Admin Expenses	$1,359	$1,500	$1,620	$1,750	$1,890	$2,041	$2,204	8% Growth
Restructuring, Deprec & Amort	$157	$160	$162	$163	$165	$167	$168	1% Growth
Total Operating Income	$3,524	$3,900	$4,309	$4,754	$5,239	$5,768	$6,344	
Non Operating Income/Expense	-$36	$92	$40	$46	$53	$61	$70	NM
Income Taxes	$1,030	$1,134	$1,300	$1,435	$1,582	$1,742	$1,917	30% Tax Rate
Net Income	$2,458	$2,858	$3,049	$3,365	$3,710	$4,086	$4,497	
Diluted EPS	$13.79	$16.43	$18.30	$20.61	$23.19	$26.06	$29.26	6 Share Buyba
DVD/Share	$6.00	$6.72	$7.53	$8.43	$9.44	$10.57	$11.84	12% Growth
PV of Dividend Stream	N/A	N/A	$6.78	$6.84	$6.90	$6.97	$7.03	$34.52
				PE	2018 Stock Price			
Terminal Value of Stock				18	$526.71			$312.58
Cumulative PV of Stock & DVD								$347.10
Current Price								$310.52
Net Present Value								$36.58
Discount to Estimated Intrinsic Value								**10.54%**
Estimated Annual Total Return								13.10%
Discount Rate/Cost of Capital								11.00%

Source: Saibus Research forecasts

DISCLOSURES

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Disclosure: Analyst(s) covering this company does not have a position in BLK.

RECOMMENDATION SCALE

INVESTMENT RATING	DEFINITION
STRONG BUY	Stocks expected to be 20% underpriced relative to its intrinsic value and whose total return is expected to significantly exceed the market index benchmarks.
ACCUMULATE	Stocks expected to be at least 10% underpriced relative to its intrinsic value and whose total return is expect to exceed the market index benchmarks.
NEUTRAL	Stocks expected to be fairly priced relative to its intrinsic value and whose total return is expected to closely track the market index benchmarks.
AVOID	Stocks expected to be slightly overpriced and to either potentially see a small, incremental decline in its price to converge with its intrinsic value or expected to appreciate at a slower pace relative to the market index benchmarks.
STRONG SELL	Stocks expected to be strongly overpriced and to potentially see a rapid decline in price to converge with its intrinsic value or expected to significantly underperform relative to the market index benchmarks.

Relevant benchmarks: In North America, the relevant benchmark is the S&P 500 Index