Charles Schwab (SCHW)

Current Price $47.28  Date: 02/13/2020  P/S: 5.52  Market Cap: 61.39B
P/E: 17.83  P/CF: 4.93  P/B: 3.33

The Charles Schwab Corporation provides a broad range of financial services, including banking and securities brokerage, to individual investors, independent investment managers, institutions, and retirement plans. Charles Schwab has offices throughout the United States, Puerto Rico, and the United Kingdom.

Charles Schwab manages over $4.0 trillion assets for 13.8 million individual investors and institutional clients. Since 2013, Charles Schwab has increased its average client assets by more than 60%, resulting in strong profit growth. Charles Schwab generates about 50% of its revenue from interest income on cash, loans to clients and investment securities. Furthermore, 40% of its revenue comes from asset management and administration fees while trading revenue makes up the final 10% through commissions and principal transaction income.

What makes SCHW unique?
Charles Schwab delivers high quality service at low prices. The company has impressive economies of scale, allowing SCHW to aggressively implement no cost online trading accounts. The discount brokerage also offers financial research, advice, planning, investment management, and retirement plans. Looking ahead, Charles Schwab is positioned to capitalize on their recent acquisition of TD Ameritrade, which gives them a significant market share in the industry. Charles Schwab will gain 12 million brokerage accounts and $1.3 trillion in assets when the deal closes in the second half of 2020. The merger will increase cost synergies for the company which will ultimately raise profit margins. Additionally, the broker will look toward capitalizing off the growth in passive investing. As investors shift away from high fee wealth managers, Schwab will be an attractive alternative.

Our valuation model indicates that SCHW is underpriced. The discounted cash flow model presents a value of $61.98, giving us a return potential of 29.73%. This model is unique because it incorporates forward looking estimates for both TD and Schwab by combining the financial statements of the companies. We project the operational expense margin will decrease because there will be cost synergies from the reduction of total employees and the combined strength of technology. Income margins will initially decrease as some customers will move away from Schwab to prevent difficulties in adjusting to new systems after the merger, but margins will eventually increase as the once separate companies begin to adjust to a single unit system.

Discussion of Economic Moat: Charles Schwab is one of the largest discount brokers on the market and will only continue to grow after the potential acquisition of TD Ameritrade. Analysts project that the combined value of total client assets under management will be over $5T. The combination of the back office of Charles Schwab and the sleek tools and technology of TD Ameritrade will create an unmatched force among discount brokers. The behemoth of a company will be able to attract new customers as its size will give it the ability to offer products at ultra low prices. If the trend of passive investing continues, investors will flock to Schwab’s diverse offerings of ETFs, index funds, and robo advising services.