

PRICE T ROWE GROUP INC
Form 10-Q
October 25, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
Commission File Number: 000-32191

T. ROWE PRICE GROUP, INC.
(Exact name of registrant as specified in its charter)
Maryland 52-2264646
(State of incorporation) (I.R.S. Employer Identification No.)
100 East Pratt Street, Baltimore, Maryland 21202
(Address, including Zip Code, of principal executive offices)
(410) 345-2000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer" "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer (do not check if smaller reporting company) Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
 Yes No

The number of shares outstanding of the issuer's common stock (\$.20 par value), as of the latest practicable date, October 23, 2018, is 240,654,698.

The exhibit index is at Item 6 on page 49.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

	12/31/2017	9/30/2018
ASSETS		
Cash and cash equivalents	\$ 1,902.7	\$ 2,090.6
Accounts receivable and accrued revenue	565.3	583.1
Investments	1,477.3	2,414.4
Assets of consolidated T. Rowe Price investment products (\$1,839.6 million at December 31, 2017 and \$1,613.8 million at September 30, 2018, related to variable interest entities)	2,048.4	1,917.8
Property and equipment, net	652.0	657.0
Goodwill	665.7	665.7
Other assets	224.0	202.0
Total assets	\$ 7,535.4	\$ 8,530.6
LIABILITIES		
Accounts payable and accrued expenses	\$ 216.2	\$ 249.9
Liabilities of consolidated T. Rowe Price investment products (\$39.5 million at December 31, 2017 and \$61.0 million at September 30, 2018, related to variable interest entities)	55.9	74.7
Accrued compensation and related costs	108.5	511.6
Supplemental savings plan liability	269.3	293.0
Income taxes payable	68.3	80.3
Total liabilities	718.2	1,209.5
Commitments and contingent liabilities		
Redeemable non-controlling interests	992.8	860.6
STOCKHOLDERS' EQUITY		
Preferred stock, undesignated, \$.20 par value – authorized and unissued 20,000,000 shares	—	—
Common stock, \$.20 par value—authorized 750,000,000; issued 245,111,000 shares at December 31, 2017 and 242,599,000 at September 30, 2018	49.0	48.5
Additional capital in excess of par value	846.1	654.5
Retained earnings	4,932.9	5,788.5
Accumulated other comprehensive loss	(3.6) (31.0)
Total permanent stockholders' equity	5,824.4	6,460.5
Total liabilities, redeemable non-controlling interests, and permanent stockholders' equity	\$ 7,535.4	\$ 8,530.6

The accompanying notes are an integral part of these statements.

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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in millions, except per-share amounts)

	Three months ended		Nine months ended	
	9/30/2017	9/30/2018	9/30/2017	9/30/2018
Revenues				
Investment advisory fees	\$1,098.9	\$1,263.3	\$3,137.6	\$3,666.9
Administrative, distribution, and servicing fees	139.8	131.3	419.7	400.7
Net revenues	1,238.7	1,394.6	3,557.3	4,067.6
Operating expenses				
Compensation and related costs	417.4	454.3	1,218.6	1,351.7
Distribution and servicing	67.4	71.4	192.0	213.3
Advertising and promotion	14.0	20.2	58.4	63.8
Product-related costs	37.9	37.9	110.9	117.1
Technology, occupancy, and facility costs	86.3	96.5	254.7	283.8
General, administrative, and other	67.2	73.7	194.9	218.8
Nonrecurring insurance recoveries related to Dell appraisal rights matter	—	—	(50.0)	—
Total operating expenses	690.2	754.0	1,979.5	2,248.5
Net operating income	548.5	640.6	1,577.8	1,819.1
Non-operating income				
Net gains on investments	28.9	116.1	165.1	147.9
Net gains on consolidated investment products	37.5	8.7	125.8	28.6
Other income (loss)	.9	.1	3.4	(1.4)
Total non-operating income	67.3	124.9	294.3	175.1
Income before income taxes	615.8	765.5	1,872.1	1,994.2
Provision for income taxes	211.6	183.9	677.5	497.5
Net income	404.2	581.6	1,194.6	1,496.7
Less: net income (loss) attributable to redeemable non-controlling interests	13.3	(1.4)	43.9	11.1
Net income attributable to T. Rowe Price Group	\$390.9	\$583.0	\$1,150.7	\$1,485.6
Earnings per share on common stock of T. Rowe Price Group				
Basic	\$1.59	\$2.34	\$4.67	\$5.97
Diluted	\$1.56	\$2.30	\$4.60	\$5.85
Dividends declared per share	\$.57	\$.70	\$1.71	\$2.10

The accompanying notes are an integral part of these statements.

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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in millions)

	Three months ended		Nine months ended	
	9/30/2018	9/30/2017	9/30/2018	9/30/2017
Net income	\$404.2	\$ 581.6	\$1,194.6	\$1,496.7
Other comprehensive income (loss)				
Net unrealized holding gains on available-for-sale investments	4.9	—	37.1	—
Reclassification losses recognized in non-operating income upon dispositions, determined using average cost	(.1)	—	(78.0)	—
Net unrealized losses recognized upon the transfer to trading investments	—	—	(23.6)	—
Total net unrealized holding gains (losses) recognized in other comprehensive income	4.8	—	(64.5)	—
Currency translation adjustments				
Consolidated T. Rowe Price investment products - variable interest entities	16.7	(5.8)	53.7	(29.6)
Reclassification losses recognized in non-operating income upon deconsolidation of certain T. Rowe Price investment products	(.1)	—	(.1)	(3.6)
Consolidated T. Rowe Price investment products - variable interest entities, net	16.6	(5.8)	53.6	(33.2)
Equity method investments	1.0	(7.1)	4.5	(6.6)
Total currency translation adjustments	17.6	(12.9)	58.1	(39.8)
Other comprehensive income (loss) before income taxes	22.4	(12.9)	(6.4)	(39.8)
Net deferred tax benefits (income taxes)	(7.1)	2.3	8.2	5.8
Total other comprehensive income (loss)	15.3	(10.6)	1.8	(34.0)
Total comprehensive income	419.5	571.0	1,196.4	1,462.7
Less: comprehensive income (loss) attributable to redeemable non-controlling interests	17.5	(4.7)	57.7	(5.7)
Comprehensive income attributable to T. Rowe Price Group	\$402.0	\$ 575.7	\$1,138.7	\$1,468.4

The accompanying notes are an integral part of these statements.

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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS⁽¹⁾
(in millions)

	Nine months ended	
	9/30/2017	9/30/2018
Cash flows from operating activities		
Net income	\$1,194.6	\$1,496.7
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation and amortization of property and equipment	106.9	114.9
Stock-based compensation expense	110.6	135.3
Realized gains on dispositions of available-for-sale T. Rowe Price investment products	(78.0)	—
Gains recognized upon transfer of an investment in a T. Rowe Price mutual fund from available-for-sale to held as trading	(23.6)	—
Net gains recognized on investments	(40.4)	(106.2)
Net investments in T. Rowe Price investment products to economically hedge supplemental savings plan liability	(129.0)	(14.4)
Net change in securities held by consolidated T. Rowe Price investment products	(1,210.5)	(578.3)
Other changes in assets and liabilities	422.2	438.4
Net cash provided by (used in) operating activities	352.8	1,486.4
Cash flows from investing activities		
Purchases of T. Rowe Price investment products	(39.0)	(1,118.7)
Dispositions T. Rowe Price investment products	295.8	343.6
Net cash of T. Rowe Price investment products on consolidation (deconsolidation)	(46.0)	(22.5)
Additions to property and equipment	(129.1)	(121.5)
Other investing activity	(6.3)	88.7
Net cash provided by (used in) investing activities	75.4	(830.4)
Cash flows from financing activities		
Repurchases of common stock	(456.7)	(543.0)
Common share issuances under stock-based compensation plans	142.8	116.0
Dividends paid to common stockholders of T. Rowe Price Group	(420.8)	(522.3)
Net subscriptions into consolidated T. Rowe Price investment products	1,005.3	486.2
Net cash provided by (used in) financing activities	270.6	(463.1)
Effect of exchange rate changes on cash and cash equivalents of consolidated T. Rowe Price investment products	6.9	(2.4)
Net change in cash and cash equivalents during period	705.7	190.5
Cash and cash equivalents at end of period, including \$65.6 million at December 31, 2016, and \$103.1 million at December 31, 2017, held by consolidated T. Rowe Price investment products	1,270.5	2,005.8
Cash and cash equivalents at end of period, including \$106.8 million at September 30, 2017, and \$105.7 million at September 30, 2018, held by consolidated T. Rowe Price investment products	\$1,976.2	\$2,196.3

⁽¹⁾ See note 12 for supplementary consolidating cash flow statements.

The accompanying notes are an integral part of these statements.

UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(shares in thousands; dollars in millions)

	Common shares outstanding	Common stock	Additional capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Total stockholders' equity	Redeemable non-controlling interests
Balances at December 31, 2017	245,111	\$ 49.0	\$ 846.1	\$ 4,932.9	\$ (3.6)	\$ 5,824.4	\$ 992.8
Cumulative effect adjustment upon adoption of new financial instruments and accumulated other comprehensive income guidance on January 1, 2018 ⁽¹⁾	—	—	—	22.4	(7.9)	14.5	—
Reclassification adjustment of stranded tax benefits on currency translation adjustments upon adoption of new accumulated other comprehensive income guidance on January 1, 2018	—	—	—	2.3	(2.3)	—	—
Balances at January 1, 2018	245,111	49.0	846.1	4,957.6	(13.8)	5,838.9	992.8
Net income	—	—	—	1,485.6	—	1,485.6	11.1
Other comprehensive income (loss), net of tax	—	—	—	—	(17.2)	(17.2)	(16.8)
Dividends declared	—	—	—	(522.5)	—	(522.5)	—
Common stock-based compensation plans activity							
Shares issued upon option exercises	2,770	.6	116.6	—	—	117.2	—
Restricted shares issued, net of shares withheld for taxes	8	—	(.1)	—	—	(.1)	—
Shares issued upon vesting of restricted stock units, net of shares withheld for taxes	71	—	(1.9)	—	—	(1.9)	—
Forfeiture of restricted awards	(8)	—	—	—	—	—	—
Stock-based compensation expense	—	—	135.3	—	—	135.3	—
Restricted stock units issued as dividend equivalents	—	—	.1	(.1)	—	—	—
Common shares repurchased	(5,353)	(1.1)	(441.6)	(132.1)	—	(574.8)	—
Net subscriptions into consolidated T. Rowe Price investment products	—	—	—	—	—	—	468.5
Net deconsolidations of T. Rowe Price investment products	—	—	—	—	—	—	(595.0)
Balances at September 30, 2018	242,599	\$ 48.5	\$ 654.5	\$ 5,788.5	\$ (31.0)	\$ 6,460.5	\$ 860.6

⁽¹⁾ Includes the reclassification of \$1.7 million of stranded income taxes on available-for-sale investments resulting from U.S. tax law changes enacted on December 22, 2017, from accumulated other comprehensive income to retained earnings.

The accompanying notes are an integral part of these statements.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – THE COMPANY AND BASIS OF PREPARATION.

T. Rowe Price Group (Price Group) derives its consolidated revenues and net income primarily from investment advisory services that its subsidiaries provide to individual and institutional investors in the T. Rowe Price U.S. mutual funds (U.S. mutual funds) and other investment products, including separately managed accounts, subadvised funds, and other T. Rowe Price investment products. We also provide certain investment advisory clients with related administrative services, including distribution, mutual fund transfer agent, accounting, and shareholder services; participant recordkeeping and transfer agent services for defined contribution retirement plans; brokerage; and trust services.

Investment advisory revenues depend largely on the total value and composition of assets under our management. Accordingly, fluctuations in financial markets and in the composition of assets under management impact our revenues and results of operations.

These unaudited condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, which require the use of estimates and reflect all adjustments that are, in the opinion of management, necessary to a fair statement of our results for the interim periods presented. All such adjustments are of a normal recurring nature. Actual results may vary from our estimates.

In order to increase transparency of operating expenses and better align expenses that have similar cost drivers, we have changed, as of January 1, 2018, the presentation of certain line items of our income statement. In doing so, we have reclassified certain prior year amounts to conform to the 2018 presentation. These reclassifications are shown along with the impact of the new revenue recognition accounting standard adopted on January 1, 2018, in the New Accounting Guidance section below.

The unaudited interim financial information contained in these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements contained in our 2017 Annual Report.

NEW ACCOUNTING GUIDANCE.

We adopted Accounting Standards Codification Topic 606: Revenue from Contracts with Customers (ASC 606), on January 1, 2018, using the retrospective method, which required adjustments to be reflected as of January 1, 2016. In connection with the adoption of this guidance, we reevaluated all of our revenue contracts and determined that the new guidance does not change the timing of when we recognize revenue. However, we did conclude that certain fees earned from the U.S. mutual funds associated with our mutual fund transfer agent, accounting, shareholder servicing, and participant recordkeeping activities could no longer be reported net of the expenses paid to third parties that perform such services, as we are deemed, under the guidance, to have control over the services before they are transferred to the U.S. mutual funds. No transition-related practical expedients were applied. Certain immaterial balance sheet reclassifications were made to conform to the 2018 presentation and all related note disclosures have been recast. Updates to our revenue recognition disclosures are included in Note 2 - Information about Receivables, Revenues, and Services and our updated revenue recognition accounting policy is included in the Summary of Significant Accounting Policies section below.

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The impact of ASC 606 and other income statement reclassifications, as previously described, on the unaudited condensed consolidated statements of income for each quarter of 2017 follows:

(in millions)	Three months ended 3/31/2017				Three months ended 6/30/2017			
	As previously reported	Change in Presentation	Impact of ASC 606	Recast	As previously reported	Change in Presentation	Impact of ASC 606	Recast
Revenues								
Investment advisory fees	\$991.1	\$ —	\$ 1.6	\$992.7	\$1,043.9	\$ —	\$ 2.1	\$1,046.0
Administrative, distribution, and servicing fees ⁽¹⁾	122.5	—	17.4	139.9	127.7	—	12.3	140.0
Net revenues	1,113.6	—	19.0	1,132.6	1,171.6	—	14.4	1,186.0
Operating expenses								
Compensation and related costs	397.4	—	—	397.4	403.8	—	—	403.8
Distribution and servicing	35.2	22.9	1.7	59.8	36.4	26.4	2.0	64.8
Advertising and promotion	25.6	—	.1	25.7	18.6	—	.1	18.7
Product-related costs	—	21.4	17.2	38.6	—	22.4	12.0	34.4
Technology, occupancy, and facility costs ⁽²⁾	81.0	1.8	—	82.8	83.1	2.5	—	85.6
General, administrative, and other	102.7	(46.1)	—	56.6	122.1	(51.3)	.3	71.1
Nonrecurring insurance recoveries related to Dell appraisal rights matter	(50.0)	—	—	(50.0)	—	—	—	—
Total operating expenses	591.9	—	19.0	610.9	664.0	—	14.4	678.4
Net operating income	\$521.7	\$ —	\$ —	\$521.7	\$507.6	\$ —	\$ —	\$507.6
(in millions)	Three months ended 9/30/2017				Three months ended 12/31/2017			
	As previously reported	Change in Presentation	Impact of ASC 606	As reported herein	As previously reported	Change in Presentation	Impact of ASC 606	Recast
Revenues								
Investment advisory fees	\$1,096.7	\$ —	\$ 2.2	\$1,098.9	\$1,156.0	\$ —	\$ 2.2	\$1,158.2
Administrative, distribution, and servicing fees ⁽¹⁾	125.0	—	14.8	139.8	130.1	—	9.3	139.4
Net revenues	1,221.7	—	17.0	1,238.7	1,286.1	—	11.5	1,297.6
Operating expenses								
Compensation and related costs	417.4	—	—	417.4	446.3	—	—	446.3
Distribution and servicing	37.4	27.9	2.1	67.4	38.0	30.2	2.4	70.6
Advertising and promotion	14.0	—	—	14.0	33.8	—	.2	34.0
Product-related costs	—	23.4	14.5	37.9	—	26.0	9.1	35.1
Technology, occupancy, and facility costs ⁽²⁾	84.0	2.2	.1	86.3	90.4	5.5	(.1)	95.8
General, administrative, and other	120.4	(53.5)	.3	67.2	146.6	(61.7)	(.1)	84.8
Total operating expenses	673.2	—	17.0	690.2	755.1	—	11.5	766.6
Net operating income	\$548.5	\$ —	\$					