

Issue 2

September 2009

New York • London

Servicing, Processing & Technology

Freeman & Co. LLC

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Indices at August 31, 2009

DJIA	9,496
NASDAQ	2,009
S&P 500	1,021
FTSE 100	4,909
10-yr US T-Bond	3.409%
USD per GBP	\$1.62
USD per Euro	\$1.43

Happy to Have No Balance Sheet

There are times when not having a balance sheet can be a good thing. Many Servicing, Processing & Technology (SP&T) companies have performed well during the recent financial turmoil by relying on servicing models linked to different types of client or transaction volumes. Most, but not all of these firms, do not rely on a leveraged business model, making them ideal for surviving the credit storm.

We believe that Servicing, Processing & Technology companies will benefit from four key trends developing out of the Credit Crisis:

- **Outsourcing:** With operating margins under pressure for financial companies, outsourcing can be a key way to lower costs and improve margins. SP&T firms in the outsourcing business that reach scale can have lower average costs per unit than their customers, who try to do it in-house. We expect this need for cost reduction and margin improvement to be a positive boost to SP&T outsourcers over the next 3 years. Also, Madoff gave fund administrators a boost, as now investors will not consider an alternative manager that self-administers its funds
- **Risk Management Focus:** Lots of newly perceived or understood risks in the world increases the need for risk management services for companies, Boards and Trustees. Firms such as RiskMetrics, BlackRock Solutions and others are benefiting from this trend. Again, Madoff has been a boost for risk managers as clients seek due diligence and transparency solutions
- **Innovation:** New risks yield new perspectives and new products. While product "innovation" in sub-prime CDOs and in credit default swaps may have created the crisis, new products are already being launched: more capital preservation funds for retail investors and "alternative" alternative funds in life settlement and intellectual property, are some examples. Each new product and its growth can provide 5 to 50 bps of fees to the SP&T firms that can provide the infrastructure support
- **Consolidation:** Some SP&T firms are under pressure, primarily those with AUM-based revenue. Fund administration, custody and some risk management business models based on AUM may struggle with operating margins and scale due to the 20-40% drop in some asset classes. Cost cutting alone may not be enough if AUM-based revenue is down 30%. Unless there is a sustained market recovery, we anticipate an increase in M&A as a result

As usual, this SP&T report covers three main areas:

1. Trends in the securities and asset management sectors that SP&T firms service
2. Comparison of the 5 SP&T sub-sectors: growth, margins, revenue, etc.
3. Analysis of each of the 5 SP&T sectors: financials, valuation, key trends, etc.

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