THE SCRATCH REPORT

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BlackRock Will Likely Emerge Stronger From the Financial Crisis and it Should Benefit From the Trillions of Dollars of Expected New Treasury Bond Issuance

Company	BlackRock , Inc.
Ticker	NYSE: BLK
Price (2/17/09)	$105.40
52 - week range	$94.78 - $249.37
Shares outstanding (mill.)	129.9
Market capitalization (mill.)	$13,800
Dividend yield	2.80%
Price/Earnings (2009 consensus est.)	17.3x
Price/Book value	1.1x
Total debt (in millions)	$4,479
Net Debt/capital	22%
Recommendation	Buy

Overview

- *BlackRock's earnings declined sharply last year as adverse market conditions resulted in poor performance for its funds. Even so, the company ended 2008 with assets under management more or less flat compared to the beginning of the year. In addition, the Federal Reserve Bank of New York has engaged BlackRock as a manager for various 'financial rescue' programs and the company will likely benefit from the unprecedented financial stimulus that will shortly be injected into the US economy as trillions of dollars worth of new Treasury securities will have to be created over the next few years. BlackRock will most likely become one of the main managers of these assets. Therefore, if market conditions improve compared to last year, the company appears to be very well positioned to resume its strong historical growth rates. Even in the absence of a meaningful market rebound, though, its involvement in these government programs could insulate it to a large extent from further declines.*

Investment Thesis

BlackRock is one of the most successful asset management companies in the world. Its successful integration of Merrill Lynch Investment Managers, which it merged with in 2006, transformed the company from a primarily domestic fixed-income firm to a globally diversified asset manager. Whereas, traditionally, BlackRock offered mainly fixed-income and cash products, equity funds now make up over 20% of its assets under management and it has also expanded its alternative investments and advisory businesses. Even so, 63% of BlackRock's assets are still in fixed-income and cash management products. Ironically, the bond market, apart from Treasuries, declined nearly as much as the equity market in 2008 and, consequently, the company's earnings were significantly diminished. However, despite the fact that 2008 was the worst year in decades, as far as market performance is concerned, BlackRock managed to keep its assets under management to a decline of only 3.7%. By contrast, the average money management company in the US lost over 20% of its assets in 2008. That being said, the character of the inflows and outflows changes from quarter to quarter and in the most recent quarters, BlackRock's inflows were concentrated on cash management products, for reasons that are probably self-evident. The profit margin on the management of these assets is generally much lower compared to equity funds or hedge funds. As a result, earnings declined disproportionately to the decline in assets. Despite some steps to reduce its expenses, including layoffs, the fourth quarter operating income declined by 26% compared to the same period last year. It is noteworthy, though, that BlackRock maintained, throughout the decline in 2008, an organic growth rate of 10% - 12%. The organic growth rate is defined as new assets under management, ignoring the decline in market value of existing assets. In fact, BlackRock has grown its assets under management from approximately $52 billion at the end of 1994 to $1.3 trillion as of the end of 2008, a compounded annual growth rate of almost 26%.

BlackRock, together with Pimco, is one of the premier bond managers in the world. The bond market is in each and every aspect a dealer market, so if a large company such as BlackRock has a pool of liquidity with lots of cash flow, it is known as a buyer of last resort for a dealer in a volatile market. As a result, the company can most likely buy bonds at slightly better prices than less well-endowed asset managers can. As a result, the performance of BlackRock's fixed-income funds should have a slight advantage over those managed by smaller companies. Such advantages may be enough to attract new capital to the funds, particularly for products such as cash management funds. More importantly, at the current time, the real rate of return for bond investors is the highest it has been in decades as a result of the ongoing credit crisis. In the world of equities when stock prices decline, that may well be a prognostication of lower returns in equity going forward. In the world of bonds, however, when bond prices decline, the fixed coupon payment remains the same and, as a result, it is an almost infallible indicator that the expected future rate of return will increase because the yield is higher. It would require an unprecedented default rate to change this scenario.

As a result, over the next few years, investors in BlackRock's fixed-income funds will likely do very well. That should lead to an expansion of the company's assets under management, both due to capital appreciation and its improved ability to attract additional capital to manage. However, unlike many other companies in the financial services segment, BlackRock clearly does not require external funding. Instead, it has enough cash flow and capital to seed all sorts of new products. Also, it has enough capital to repurchase a significant number of shares over the next few years if its share price remains depressed. If the company generates $24 per share in net income over the next three years, which can be derived by using the consensus estimates for 2009, 2010 and 2011, BlackRock can, theoretically, repurchase almost 30 million shares at current market prices, which represents 23% of the total number of shares outstanding.

BlackRock's scale has also worked in its favor in its appointment by the Federal Reserve Bank of New York to manage assets acquired by an entity known as Maiden Lane from Bear Stearns and AIG. BlackRock is also one of the four managers of the Federal Reserve Agency MBS Purchase Program. Under this program, the Federal Reserve is planning to buy a total of $600 billion of agency and mortgage backed paper. While these assets grew substantially in 2008 and now represent just over $100 billion of BlackRock's total AUM, it is possible that additional financial rescue programs by the government will result in further increases. Certainly the substantial amount of new Treasury securities that will be issued over the next few years, perhaps $4 trillion according to some projections, should have a significant impact on BlackRock's AUM as it is one of the main managers for this type of assets.

Given the dire forecasts that are currently placed upon asset managers all over the world, forecasts which seem to be based on an extrapolation of the market environment that has been in place for the past 15 months, it is perhaps not surprising that BlackRock's shares have declined by 56% since last summer. The company currently trades at 17x earnings, but those earnings represent diminished earnings compared to the prior high simply because the market value of the assets under management has fallen. Looking forward, however, it is likely that the market value of BlackRock assets under management are going to increase, and the company will likely have much more in the way of assets under management in 2-3 years time.

If one accepts the view that 2008 was an anomaly in terms of market performance and that BlackRock will revert to an annual AUM (asset under management) growth rate of 20% per year over the next three years, aided by both double-digit organic growth as well as capital appreciation, it could end 2011 with $2.26 trillion under management.

As earnings are highly correlated with assets under management, all else being equal, BlackRock would have created the opportunity to grow its earnings by 73% over the next three years. In reality, if the market improves, the company's earnings will likely expand even faster. The reason for this is that the company will most likely receive insignificant performance fees in the current year, but in a strong market these performance fees can add approximately $4.00 per share in earnings. As a result, if the 2009 consensus earnings estimate of $6.13 per share is realized, assuming that the company can increase its assets as outlined above, its base earnings could increase by 73% over the next three years and performance fees could add another $4.00 per share. Consequently, under this scenario, BlackRock would grow its EPS to $14.60 by 2011, or almost 140% compared to the current year's estimate. If, by the end of 2011, market conditions have improved to the point where the market is once again willing to apply BlackRock's historical 22.3x P/E multiple upon these earnings, the company's shares would trade at $326. Alternatively, the average asset manager in the US is currently trading at an enterprise value of 1.7% of its assets under management, down from approximately 3% just a few years ago. Assuming again that BlackRock will be managing $2.26 trillion three years from now, if it is valued at 1.7% of assets under management, its shares will be worth $265. Therefore, it appears that the potentially negative developments have been priced into BlackRock's market valuation whereas the potentially positive developments over the next few years have not been priced in. Consequently, the shares are recommended for purchase.

The Inherent Advantage of Asset Managers as Investments

If the Ibbotson study of historical financial market returns is correct, such that equity values increase on average at a 10% compound annual rate over time and assuming that fixed income products can sustain a 6% compound annual rate of return over time, it requires very little imagination to see that a diversified asset manager might exhibit an 8% organic growth rate by virtue of asset appreciation. This should result in an 8% revenue growth rate from capital appreciation alone. If the client base of pension funds, assorted other institutions and individual investors can add to funds under management such that asset growth will be 15% per annum (8% appreciation, 7% savings), the asset managers should exhibit a 15% growth rate in revenue. Let us assume an inflation rate of 3% per annum and that the staff enjoys a rate of compensation increase of twice the inflation rate or 6% per annum. The net profit margin has historically been around 20% of revenues for asset managers but is currently 14% based on 2009 estimates. Thus, if revenue increases 15% per annum and costs increase at 6%, given a current net profit margin of 14%, it must follow that profits will grow at a rate that is far more rapid than revenues.

Enormous asset declines are normally required to disrupt this process. In 2008, the fact that BlackRock's investors took capital out of its more profitable equity funds and hedge funds and its lower-margin cash management products experienced inflows, coupled with significant declines in performance fees as well as substantial losses on its own invested capital were, combined, enough to disrupt the profit growth. That being said, its 2008 earnings declined only 20.5% from the peak-year of 2007. In addition, 2008 was likely an anomaly as far as market returns are concerned and BlackRock's growth process will likely be re-established once the market recovers.

Federal Reserve Programs

BlackRock has been appointed the manager of the assets that the government acquired in connection with the rescue of Bear Stearns and AIG. An entity known as Maiden Lane (named after a street near the Federal Reserve Bank of New York's headquarters) was formed to facilitate the acquisition of Bear Stearns by JP Morgan Chase, and Maiden Lane II and Maiden Lane III were formed in connection with the government assistance provided to AIG.

In March 2008, the Federal Reserve Bank of New York made a $28.8 billion loan to Maiden Lane, whose portfolio included debt backed by mortgages and other items JP Morgan deemed too risky when taking over the firm. BlackRock is now managing and selling assets in the portfolio. The loan has a 10-year term, which gives BlackRock an opportunity to dispose of the assets in an orderly manner over time. In similar deals related to the AIG rescue, Maiden Lane II holds residential mortgage-backed securities while Maiden Lane III holds the collateral debt obligations purchased from the credit default swap counterparties. In terms of size, Maiden Lane had assets of $25.1 billion, Maiden Lane II had assets of $19.0 billion and Maiden Lane III had $27.5 billion as of February 4th, 2009.

The Federal Reserve has also initiated an agency mortgage-backed securities (MBS) purchase program. First announced on November 25, 2008, the program involves the purchase of up to $100 billion in GSE direct obligations through a series of competitive auctions and up to $500 billion of MBS through four asset management companies. BlackRock, Goldman Sachs Asset Management, PIMCO and Wellington Management have been appointed to conduct the transactions. This program is separate from the Term Asset-Backed Securities Loan Facility (TALF) program. The MBS program is intended to lower rates by reducing the supply of outstanding agency mortgage bonds, boosting their prices and thus lowering their yields. Lower yields in turn reduce the interest rates banks need to charge on new mortgages to ensure profitable sales of the securities. Only fixed-rate agency mortgage-backed securities guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae will be eligible for purchase. The purchases, which have already begun, include securities with maturities of 30, 20, and 15 years, and will exclude riskier securities such as interest-only bonds. The investment managers are required to purchase securities frequently and to disclose the Federal Reserve as principal. In total, as of the end of 2008, BlackRock had attracted more than $101 billion in troubled assets such as these.

Furthermore, if the United States government actually borrows $2 trillion in the current fiscal year and $2 trillion in the next fiscal year, as some estimates indicate, whatever the agencies might ultimately do, there will be $4 trillion more of Treasury securities that need to be managed. By contrast, the pool of Treasuries that exist today (the U.S. national debt) is approximately $10.8 trillion, and around $5.8 trillion of that amount could never actually be managed as it is comprised of special purpose issuances by the Treasury and Social Security Administration. Consequently, there is currently approximately $5.0 trillion of paper that can theoretically be managed, and over the next 24 months, there might be an additional $4 trillion of debt that needs to be managed, if the current plans are executed. This increase of approximately 80% compared to the current level represents a significant opportunity for BlackRock over the next two years.

Company Overview

BlackRock, Inc., headquartered in New York City, is one of the largest financial services companies in the world. It invests in public equity, fixed income, real estate, and alternative assets across the globe. In addition, the company provides risk management and advisory services. BlackRock provides these services to corporate and public pension plans, insurance companies, mutual funds, endowments, foundations, nuclear decommissioning trusts, banks, charities, corporations, official institutions, and individuals worldwide. The company also manages separate client-focused equity, fixed income, and balanced portfolios; open-end and closed-end funds; offshore funds; unit trusts; and alternative investment vehicles including hedge funds and structured funds. BlackRock employs a fundamental analysis with a bottom-up approach to construct its various investment portfolios. The company generates most of its revenue (over 80% in 2008) from advisory fees for managing financial assets including fixed income, equity, real estate, and alternative products. The firm now manages $1.31 trillion, which makes it the second largest money manager in the world behind State Street Global Advisors. Fidelity Investments and The Vanguard Group follow closely behind.

As an investment firm dependent on service fees, BlackRock's performance is linked closely with market volatility and its ability to react to changing conditions. Its significant fixed-income holdings are very sensitive to changing interest rates and its cash holdings, especially in foreign currency, are affected by the movements of the dollar. The diversity of BlackRock's portfolio has given it some protection from fluctuations in general economic cycles. While its large equity holdings allow it participate strongly in bull markets, as evidenced by its earnings growth of more than 50% in 2007, the company's strong presence in the more stable cash management and fixed-income segments most likely allowed BlackRock to escape the recent downturn in better shape than it otherwise would have.

While BlackRock's funds overall experienced negative investment performances in 2008, in relative terms, the firm's funds performed well, as 59% of its products beat their respective benchmark or peers. The company's strong relative performance was most likely a contributing factor to its manageable 3.7% decline in AUM in 2008 and its ability to grow 12% organically for the year. Also, based on three-year returns, 81% of BlackRock's products beat their peers and benchmarks as of the end of 2008.

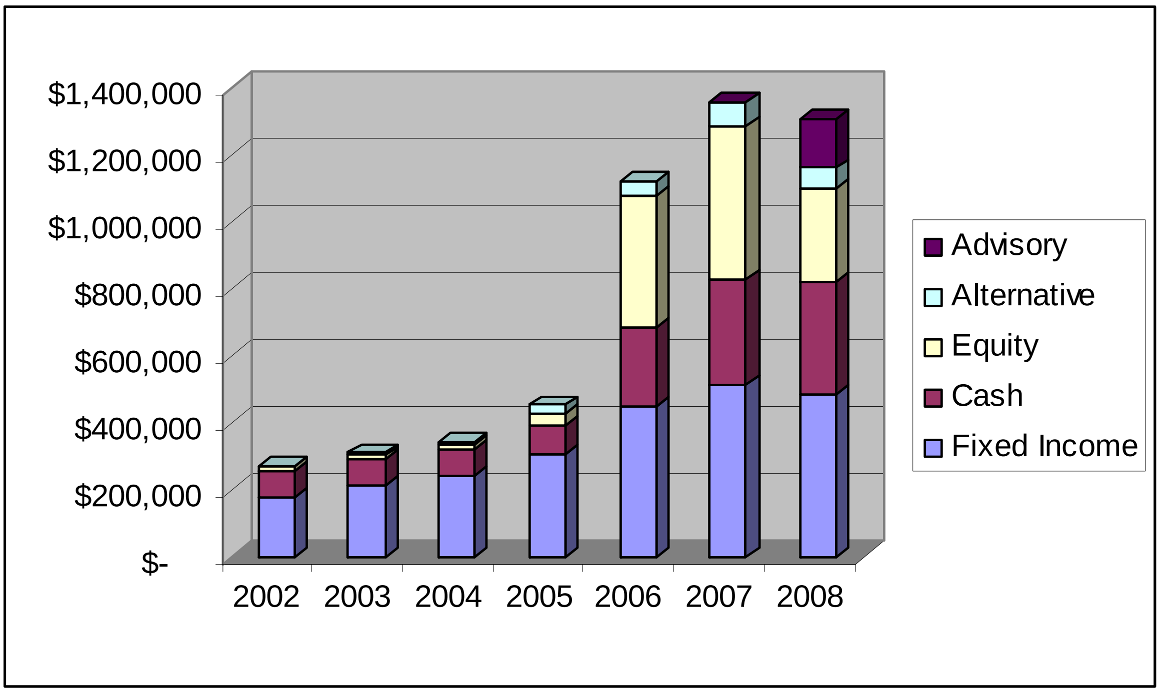
Background

BlackRock was founded in 1988 as the Financial Management Group within the private equity firm Blackstone Group. Larry Fink, BlackRock's founder and CEO, had joined Blackstone in 1988 as a partner, along with Ralph Schlosstein, former White House aide under the Carter administration, among others. Before joining Blackstone, Fink was a managing director at First Boston, where he pioneered the mortgage-backed securities market in the United States. In 1992, Mr. Fink and Mr. Schlosstein separated from the Blackstone Group under the name BlackRock and aggressively re-invented it as an independent asset-management company. In 1995, PNC Financial Services Group purchased BlackRock, which set the stage for a significant increase in assets under management, from $53 billion in the end of 1994 to $165 billion in 1999, at which time BlackRock went public.

In 2006, the company merged with Merrill Lynch Investment Managers, which more than doubled its assets under management and diversified the company's assets beyond its then-historical focus on fixed income products such as bonds. The transaction also gave Merrill Lynch a 49% stake in BlackRock. However, when Merrill Lynch was acquired by Bank of America, it was contractually obligated to reduce its voting stake, which it did. Consequently, Bank of America now has a 4.9% voting stake while PNC's total voting stake in BlackRock has grown to 47% from 36.5% prior to the takeover of Merrill Lynch. However, in terms of ownership, Bank of America owns 49% of BlackRock and PNC owns 33%.

Breakdown of Assets Under Management

The chart below shows the breakdown in BlackRock's AUM over the past seven years:



(in millions)

We note that this significant growth in AUM includes acquired AUM of $660.8 billion. In September, 2006, Merrill Lynch contributed the entities and assets that constituted its investment management business to the company, adding $589.2 billion in AUM. Furthermore, acquired AUM also includes approximately $21.9 billion acquired as a result of BlackRock's acquisition of the fund of funds business of Quellos Group, which closed in October, 2007 and approximately $49.7 billion acquired as a result of BlackRock's acquisition of SSRM Holdings from MetLife in January 2005. These acquisitions diversified BlackRock's AUM from being 70% in fixed-income in 2004 to only 37% at the end of 2008.

Products

BlackRock offers a wide variety of fixed income, equity and balanced, cash management and alternative investment products. Revenue from these products are usually made up of management fees (also referred to as 'advisory fees', which are typically structured as a percentage of AUM) as well as performance fees expressed as a percentage that the company earns on a limited number of its investment vehicles. Traditionally, management fees have been much more stable than the more volatile and highly market dependent performance fees. BlackRock also offers risk management, investment system outsourcing, financial advisory and transition management services to institutional investors under the BlackRock Solutions name. Below, these revenue sources are discussed in more detail:

Fixed Income

BlackRock offers an array of fixed income products across various bond markets and sectors as well as various maturities along the yield curve. In 2008, BlackRock's fixed income AUM declined 6% year-over-year to $483 billion at year-end. During the fourth quarter, BlackRock had net outflows of $15.2 billion in fixed income products.

Equity and Balanced

BlackRock manages a range of equity strategies that span the risk/return spectrum, along with several targeted opportunities in specific market sectors. Most of its equity products came from the merger with Merrill Lynch's asset management division in 2006. BlackRock closed 2008 with equity and balanced AUM of $281 billion, down 39% compared to the year-end 2007. Net withdrawals totaled $2.3 billion in the fourth quarter of 2008, or less than 1% of assets.

Cash Management

BlackRock cash management products cover the short end of the duration spectrum and focuses on credit quality and risk management. The company managed $338 billion in global cash management at the end of 2008, including a variety of money market funds and customized portfolios. AUM in these strategies increased $25.1 billion, or 8%, during 2008 as investors returned to cash management products, as government support helped stabilize the money markets. During fourth the quarter, BlackRock had $48.6 billion of net inflows in its cash management products, recovering 91% of the net outflows it experienced in the third quarter. New business during the quarter included $46.0 billion of net inflows in prime and government portfolios and $6.3 billion in offshore funds, partially offset by $3.5 billion of outflows in securities lending portfolios. Because of its relative outperformance in the cash management segment, BlackRock has been able to increase its market share in the money market industry. Even so, with yields of only a fraction of one percent, some investors might seek higher returns once the credit crisis is abating.

Alternative
In 2007, the company launched BlackRock Alternative Advisors, created by the merger of the Quellos Business with its existing absolute return and private equity fund of funds business. BlackRock's alternative investment products include private equity, private equity funds of funds, real estate equity and debt, hedge funds of funds, single-strategy hedge funds, long-only absolute return strategies, commodities and structured products. Total assets managed in alternative investments declined by $11.4 billion in the fourth quarter to $59.7 billion at December 31, 2008.

BlackRock Solutions
Since its formation, BlackRock has developed and maintained proprietary investment systems to support its business. These products include tools that support the investment process including a variety of risk management and financial advisory services. BlackRock Solutions provides services for clients including banks, insurance companies, broker-dealers, asset managers, hedge funds, pensions, endowments, foundations and other financial institutions. In 2008 BlackRock Solutions' revenues from system outsourcing, risk management, advisory, transition and investment services increased by 105% in the aggregate to $406.4 million compared to the prior year. However, we note that these figures also include revenues from the company's advisory business with respect to its involvement with the various Federal Reserve asset management programs.

Financial Performance

BlackRock has grown rapidly in the last seven years as the table below shows:

	2008	2007	2006	2005	2004	2003	2002
Revenue	$5,064	$4,845	$2,098	$1,191	$725	$598	$577
Operating income*	$1,662	$1,518	$688	$426	$271	$234	$217
Net income*	$858	$1,080	$445	$270	$178	$155	$133
EPS*	$6.45	$8.17	$5.33	$4.03	$2.69	$2.36	$2.04

(*=adjusted. In millions, except for per share data)

Again, the company more or less doubled in size in 2006 when it merged with the asset management operations of Merrill Lynch. Even so, the fact that BlackRock was able to quadruple its earnings per share between 2002 and 2007 is remarkable, particularly as the shares outstanding doubled over the period as a result of its acquisitions. That being said, the company's financial results worsened throughout 2008 as a result of the ongoing credit crisis and stock market declines.

Revenues in the fourth quarter of 2008 declined 26% to $1.06 billion from $1.44 billion in the same quarter last year, as investment advisory and administration fees also fell 26% and performance fees dropped 84% to $24 million from $153 million in the fourth quarter of 2007, mostly as a result of the adverse market environment. BlackRock Solutions and advisory revenue was $134 million for fourth quarter 2008 compared to $62 million in fourth quarter 2007, a 116% year-over-year growth rate, partially driven by the expanding Federal Reserve programs with which BlackRock is involved.

Employee compensation expenses decreased $185 million in the fourth quarter, mostly as incentive-based compensation declined due to the company's 84% year-over-year decline in performance fee revenues. Even so, adjusted operating income decreased 28% to $338 million in the fourth quarter from $468 million in the fourth quarter 2007. However, this year's number included the impact of a $38 million restructuring charge related to its reduction of workforce. Adjusted operating margin in the fourth quarter actually widened to 35.0% compared to 33.9% in the same quarter last year. Full year operating margin, as adjusted, was 38.7%, also an improvement compared to the 37.5% achieved in 2007, driven by aggressive expense management.

For the fourth quarter, BlackRock earned a net income of $53 million, or $0.40 per share, compared to $322.4 million, or $2.43 per share, in the same period last year. However, this includes non-operating expenses of $293 million, including investment losses of $124 million stemming from BlackRock's own capital investments in its hedge funds and fund of funds, $91 million in losses from investing in real estate products, $35 million in losses from private equity products and $23 million in losses related to other investments. Adjusted profit totaled $91 million, or $0.68 per share, including operating income of $1.81 per share, non-operating losses of $1.32 per share and a $0.19 per share adjustment to bring the full year effective tax rate down from 35% to 33%.

We note that BlackRock has generated almost $1.3 billion in trailing twelve months free cash flow up until September 30, 2008. One-third of this has been paid out in dividends and approximately half was used to reduce debt. As its shares are currently trading near a 3-year low, it is possible that BlackRock will use its cash flow for share repurchases. The company has spent almost $400 million on share repurchases in the past four years.

Pipeline

BlackRock's assets under management may rise solely as a result of its pipeline, which at January 16, 2009, stood at $59.5 billion, including $21.1 billion of long-dated mandates, $5.5 billion of cash management products, and $32.9 billion of advisory assignments. This excludes BlackRock's engagement as one of the managers for the Federal Reserve's MBS purchase program. Because of its strong pipeline, coupled with its proven ability to grow its business organically by double-digits, even in a difficult year such as 2008, it is reasonable to expect the company to continue to grow its AUMs at a rapid rate. Particularly as it now holds bonds that, in general, trade at low prices, which corresponds to high yields, which in the long run should provide excellent returns for its investors.

Valuation

No one should fail to respect the achievement of the management of Blackrock in creating a large firm from the most humble beginnings not so very many years ago. However, the investment characteristics of fixed income are an objective reality. While yields on Treasuries are very low and, therefore, convexity, which is really fixed income risk, is near a historical maximum, yields on agency bonds and corporate bonds are near historic highs relative to the risk-free rate and, therefore, convexity risk is not a meaningful factor. It is much more likely, given the Federal Reserve's unprecedented intervention, that yield-spreads will narrow significantly and revert to the mean over the next few years. Such a move would increase the value of BlackRock's fixed-income holdings. However, even if yield spreads do not narrow, BlackRock's investors should still continue to benefit from the historical high real yield generally manifested by these bonds. Assuming that the market recovers and that the company will be able to grow its AUM by 20% per year over the next three years, it would end 2011 with $2.26 trillion under management. This may not be far-fetched. If the market recovers, BlackRock's assets should benefit from capital appreciation as well as an improved fund raising environment.

Net Income / AUM Correlation

Generally, for an asset management company, when assets under management increase due to capital appreciation or successful fund raising, its net income increases at a higher rate. This is a result of the fact that the additional income an incremental dollar under management generates does not generally have an offsetting expense. However, as will be discussed in the next section, performance fees have a disproportionate impact, and as BlackRock generates both management fees and advisory fees, in addition to performance fees, the relationship between assets under management and net income is perhaps not as linear as it would be for a company that only manages assets for a management fee. Even so, the Net Income/AUM trend line has been rising:

Year	AUM (billions)	Net Income (mil)	Net Income / AUM
1998	$130.8	$35.6	3.4 basis points
1999	$164.5	$59.4	4.5bps
2000	$203.7	$87.6	5.3bps
2001	$238.6	$107.3	5.3bps
2002	$272.8	$133.2	5.6bps
2003	$309.4	$155.4	5.7bps
2004	$341.8	$177.8	5.7bps
2005	$452.7	$269.6	7.9bps
2006	$1,124.6	$444.7	9.8bps
2007	$1,356.6	$1,079.7	9.6bps
2008	$1,307.2	$858.1	6.3bps
			6.3bps

(Net income in year x is divided by the ending AUM in year x-1)

If we use the average Net Income/AUM percentage of 0.063%, based on $2.26 trillion under management at the end of 2011, BlackRock would earn $1.42 billion in that year. Assuming that the company uses half of its net income between now and the end of 2011 to repurchase its shares and that it could repurchase these shares at the current stock price of $106, it would end 2011 with approximately 115 million shares outstanding. Consequently, its 2011 earnings, based on these assumptions, would be approximately $12 per share. If the company can revert to its peak Net Income/AUM ratio in the table above of 0.098% which was achieved in 2006, it would generate net income of $2.2 billion in 2011, or $19 per share using these assumptions. The latter figure is more likely to be achieved with the aid of substantial performance fees, whereas the former figure may be reached without significant contributions from performance fees.

The Question of Performance Fees

Performance fees are, perhaps, the highest margin revenue possible to attain. These are revenues with essentially zero marginal cost. BlackRock's ability to generate performance fees is clearly very cyclical in that it is highly correlated with overall market performance. Over the past 10 years, the company's performance fees have varied from just 1.5% of overall revenues in 2003 to as high as 14.1% of revenues in 2005, as the table below indicates:

	Performance Fees (mil.)	Percentage of Total Revenues
1999	$24.7	6.5%
2000	$50.2	10.5%
2001	$56.1	10.5%
2002	$40.7	7.1%
2003	$8.9	1.5%
2004	$41.6	5.7%
2005	$168.0	14.1%
2006	$242.3	11.5%
2007	$350.2	7.2%
2008	$177.0	3.5%

This trend continued to worsen in 2008 as BlackRock only generated performance fees of $23.7 million in the fourth quarter, down 84% year-over-year. At 2.2% of total revenues, the fourth quarter performance fee as a percentage of total revenues was the lowest since 2003. By adding a column showing employee compensation as a percentage of overall revenues, it seems that there is a correlation between higher performance fees and higher employee compensation, which should be expected:

	Performance Fees (mil.)	Percentage of Total Revenues	Employee Compensation
1999	$24.7	6.5%	36.2%
2000	$50.2	10.5%	39.8%
2001	$56.1	10.5%	40.3%
2002	$40.7	7.1%	40.0%
2003	$8.9	1.5%	37.8%
2004	$41.6	5.7%	53.2%
2005	$168.0	14.1%	49.3%
2006	$242.3	11.5%	44.6%
2007	$350.2	7.2%	36.5%
2008	$177.0	3.5%	35.8%

Even so, if market conditions improve, BlackRock's ability to generate performance fees could have a significant impact on its overall income. BlackRock's ability to keep assets under management at the end of 2008 at more or less the same level as the end of 2007, despite what was the worst market environment in decades, indicates that the company is an exceptional fund raiser. The table below outlines the asset growth since the company was founded in 1994:

Year	Assets
1994	$52.7
1995	$69.0
1996	$82.7
1997	$105.4
1998	$130.8
1999	$164.5
2000	$203.7
2001	$238.6
2002	$272.8
2003	$309.4
2004	$341.8
2005	$452.7
2006	$1,124.6
2007	$1,356.6
2008	$1,307.2

(assets in billions)

Blackrock has grown its assets under management by a most remarkable 25.8% compound annual rate since the end of 1994. This includes $589 billion from the 2006 merger with Merrill Lynch's asset management business, which more or less doubled its assets under management. Up until the time of this merger in 2006, however, BlackRock had still managed to grow its AUM by 21.6% per year from 1994 to 2005. The following table indicates that BlackRock, at its peak in 2006, generated performance fees equivalent to 0.054% of assets under management:

Year	AUM (billions)	Perf. Fees as % of Assets
1999	$164.5	0.019%
2000	$203.7	0.031%
2001	$238.6	0.028%
2002	$272.8	0.017%
2003	$309.4	0.003%
2004	$341.8	0.013%
2005	$452.7	0.049%
2006	$1,124.6	0.054%
2007	$1,356.6	0.031%
2008	$1,307.2	0.013%

Assuming that in 2011, BlackRock will again generate performance fees equivalent to 0.054% of its assets under management ($2.26 trillion in this example), it would generate $1.2 billion in performance fees. Assuming incremental employee compensation and taxes will reduce that amount by 60%, the company would still be able to realize a net profit of $488 million based on these assumptions. Consequently, if the market recovers, performance fees for 2011 could boost BlackRock's EPS by $4.00.

Market Capitalization in Relation to Assets Under Management

The most universally recognized method of valuation for investment management firms is the ratio of enterprise value to assets under management. This is because the cost associated with the management of a given quantity of assets is knowable and quite transparent. The same applies to the associated fee income. The theory is that the management of assets has a large, and even intrinsically large, profit margin. The assets under management of comparable firms are provided below:

	AUM	Enterprise Value	EV/AUM
Franklin Resources	$507	$9.3MMM	1.84%
Alliance Bernstein	$462	$1.6MMM	0.34%
Janus Capital	$161	$1.7MMM	1.04%
Waddell & Reed	$60	$1.3MMM	2.09%
T. Rowe Price	$376	$6.8MMM	1.82%
Legg Mason	$842	$1.3MMM	0.15%
Eaton Vance	$123	$2.8MMM	2.31%
GAMCO Investors	$26	$980MM	3.83%
Affiliated Managers	$207	$3.0MMM	1.46%
			1.65%

(assets as of last reporting date, in billions)

As this table indicates, while these companies trade in a wide range, mostly based on the type of assets they manage and the fees they can charge for their services, the average asset management company in the group trades at a market capitalization equal to 1.8% of assets. BlackRock, on the other hand, trades at an enterprise value of $17.7 billion, or 1.35% of its assets under management. This entails that Blackrock is actually less expensive than its peers in the money management industry. Historically, this could have been due to the lower fees on its fixed income funds as opposed to equity assets. Quite simply, for fixed-income mangers, more assets under management are required to generate a given quantity of fee income. However, since 2006, BlackRock has become a much more diversified money manager with significant assets in equity and hedge funds. Consequently, the asset-mix argument is no longer valid as a means to justify the valuation discount for BlackRock vis-à-vis its peer group.

This valuation discount exists even though Blackrock is more profitable than the typical investment advisory firm. Of course, if Blackrock were to be valued in a manner comparable to that of the classical investment advisory firm, at 1.65% of assets under management, it would trade at $144 per share, or 35% above of its current share price. At the current level of earnings, this would amount to a forward P/E ratio of 23.5x based on the depressed consensus earnings estimate for the current year of $6.13. The critical question, as is always the case in such instances, is whether or not the current level of earnings represents a normal situation. Given the below high-water status of many funds, performance fees are not likely to be meaningful in 2009. However, looking out over the next 2-3 years, it appears that BlackRock's normalized earnings 2-3 years from now could exceed $10 per share.

Price Earnings Ratio Method

Ultimately, the most significant expense at an investment management firm is the salary and benefit expense for the investment professionals. In many cases, the investment professionals are also the management of the firm and significant equity owners. Thus, in a very loose sense, the salary expense is controllable by management and earnings can be produced, if needed, by salary restraint upon the part of the investment staff. The P/E ratios of most investment management firms have traditionally been low. This reflects the unavoidable cyclical nature of the business. At the current time, however, these P/E multiples are actually higher than the overall market multiple as the market recognizes that the consensus earnings estimates for the current year are depressed by the current market conditions and likely to be higher in the future. The P/E ratios of investment advisory firms are depicted in the table below:

P/E Ratios of Publicly Traded Investment Advisory Firms

	2009P/E
Franklin Resources	16.7x
Alliance Bernstein	9.8x
Janus Capital	17.1x
Waddell & Reed	17.0x
T. Rowe Price	24.2x
Legg Mason	11.0x
Eaton Vance	18.9x
GAMCO Investors	25.5x
Affiliated Managers	11.6x
	16.9x

If the depressed consensus earnings estimate for Blackrock of $6.13 per share for 2009 is indeed accurate, and the firm were to trade at 17x earnings, inline with its peer group above, Blackrock would trade at $104, which is more or less consistent with the current level. However, over the past seven-year period BlackRock has traded at an average P/E multiple of 22.3x and a significant premium compared to its peer group:

	2008	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**	Average:
P/E	28.7x	20.6x	25.5x	20.6x	23.4x	18.2x	19.1x	*22.3x*

Over the past seven years it has been considered a best-of-breed asset management company, and has expended its assets faster than its peer group in strong markets and lost less assets in difficult markets, as the table below indicates:

Company	AUM as of December 07	AUM as of December 08	Asset Contraction
Franklin Resources	$652	$507	-22.1%
Alliance Bernstein	$800	$462	-42.3%
Janus Capital	$207	$161	-22.4%
Waddell & Reed	$65	$60	-7.8%
T. Rowe Price	$400	$376	-6.0%
Legg Mason	$999	$842	-15.7%
Eaton Vance	$162	$123	-23.9%
GAMCO Investors	$31	$26	-17.4%
Affiliated Managers	$275	$207	-24.6%
			-20.2%

(in billions)

As is shown, the average money management company experienced a 20% loss in assets under management in 2008. BlackRock's assets declined to a much lesser extent at approximately 3.7%. Because the earnings of an asset management company are highly correlated to its assets under management, the market should, ceteris paribus, be willing to pay a higher multiple for BlackRock given that its assets under management, and presumably earnings, appear to be more stable compared to most of its peers. BlackRock's immense size, with well over $1 trillion in AUM, also enables it to generate economies of scale and very respectable operating margins. In fact, BlackRock has generated slightly higher operating margins in the past four quarters than the average for its peer group:

		Operating Margin
Franklin Resources		27.7%
Alliance Bernstein		26.1%
Janus Capital		32.1%
Waddell & Reed		23.2%
T. Rowe Price		44.7%
Legg Mason		19.4%
Eaton Vance		33.2%
GAMCO Investors		36.8%
Affiliated Managers		31.8%
	Average:	30.5%
BlackRock		31.5%

(unadjusted)

At the current time, Wall Street's analyst forecast average 2010 earnings per share of $7.77. If the market continues to be forward-looking, if these earnings are ultimately realized and if the historical P/E multiple will be restored, BlackRock's shares will trade at $173 within approximately 12-15 months for a gain of almost 65%. However, assuming the asset growth outlined above and the corresponding EPS projections for 2011 of $12 per share in a slightly positive market and $19 per share in a strong market, including the collection of substantial performance fees, BlackRock's shares could trade as high as $204 - $424, respectively.

Summary and Recommendation

The historical achievement of Blackrock has been to grow from a very small firm to one that assumes a significant position in its field with very few peers. The rate of growth in the past year has been well below the historical average, as a result of the market conditions that have prevailed over the past 15 months. However, BlackRock has proven that even though the market had its worst year in decades, which resulted in a decline in the company's high-margin performance fees of almost 50% in 2008, the company still managed to keep its assets under management virtually flat and earnings declined by only 20.5%, from $8.17 per share in 2007 to $6.45 per share in 2008. The consensus earnings estimate for the current year of $6.13 appears to be based on another very difficult year in the securities market. Even so, based on this depressed estimate, BlackRock trades more or less in line with its peer group and at a 24% discount to its historical P/E multiple. On the other hand, if the securities markets recover over the next three years, BlackRock's assets, revenues and earnings will most likely grow rapidly and a much higher stock price could be justified. In addition, an investment in BlackRock also contains a 'free call option' on the strong prospects that BlackRock will earn a significant profit on its involvement in the various 'financial rescue' and stimulus programs implemented by the Federal Reserve and Department of Treasury. Therefore, it appears BlackRock's current market valuation discounts the vast majority of the negative scenarios whereas no weight is given to the prospect of an improvement in its business fundamentals. Consequently, the shares are recommended for purchase.

BlackRock, Inc.
Condensed Consolidated Statements of Financial Condition
(Dollar amounts in thousands, except per share data)
(unaudited)

	September 30, 2008	December 31, 2007
Assets		
Cash and cash equivalents	$ 1,793,293	$ 1,656,200
Accounts receivable	1,208,577	1,235,940
Due from related parties	241,419	174,853
Investments	2,145,744	1,999,944
Separate account assets	3,532,448	4,669,874
Deferred mutual fund sales commissions, net	156,083	174,849
Property and equipment (net of accumulated depreciation of $240,506 at September 30, 2008 and $225,645 at December 31, 2007)	274,295	266,460
Intangible assets (net of accumulated amortization of $288,148 at September 30, 2008 and $178,450 at December 31, 2007)	6,476,773	6,553,122
Goodwill	5,543,993	5,519,714
Other assets	324,047	310,559
Total assets	$21,696,672	$22,561,515
Liabilities		
Accrued compensation and benefits	$ 825,561	$ 1,086,590
Accounts payable and accrued liabilities	731,367	788,968
Due to related parties	116,408	114,347
Short-term borrowings	200,000	300,000
Long-term borrowings	946,693	947,021
Separate account liabilities	3,532,448	4,669,874
Deferred tax liabilities	2,039,467	2,059,980
Other liabilities	248,572	419,570
Total liabilities	8,640,516	10,386,350
Non-controlling interests	868,992	578,210
Commitments and contingencies		
Stockholders' equity		
Common stock ($0.01 par value, 500,000,000 shares authorized, 118,573,367 shares issued, 117,233,559 and 116,059,560 shares outstanding at September 30, 2008 and December 31, 2007, respectively)	1,186	1,186
Series A participating preferred stock ($0.01 par value, 500,000,000 shares authorized and 12,604,918 shares issued and outstanding at September 30, 2008 and December 31, 2007)	126	126
Additional paid-in capital	10,407,129	10,274,096
Retained earnings	2,042,520	1,622,041
Accumulated other comprehensive income (loss)	(53,615)	71,020
Escrow shares, common, at cost (911,266 and 1,191,785 held at September 30, 2008 and December 31, 2007, respectively)	(143,367)	(187,500)
Treasury stock, common, at cost (428,542 and 1,322,022 shares held at September 30, 2008 and December 31, 2007, respectively)	(66,815)	(184,014)
Total stockholders' equity	12,187,164	11,596,955
Total liabilities, non-controlling interests and stockholders' equity	$21,696,672	$22,561,515

BlackRock, Inc.
Condensed Consolidated Statements of Income
(Dollar amounts in thousands, except per share data) (unaudited)

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007	Year Ended December 31, 2008	Year Ended December 31, 2007
Revenue				
Investment advisory and administration base fees	$ 852,694	$ 1,159,511	4,231,328	4,010,061
Investment advisory performance fees	23,720	152,670	177,023	350,188
Investment advisory & admin base and performance fees	876,414	1,312,181	4,408,351	4,360,249
BlackRock Solutions	134,419	61,969	406,378	198,262
Distribution fees	35,339	33,055	138,570	123,052
Other revenue	17,428	36,974	110,609	163,092
Total revenue	1,063,600	1,444,179	5,063,908	4,844,655
Expenses				
Employee comp. and benefits	325,994	511,246	1,814,991	1,767,063
Portfolio admin & service costs	137,780	146,606	597,395	547,620
Amortization of deferred mutual fund sales commissions	32,259	29,057	129,747	108,091
General and administration	154,528	253,010	744,823	870,367
Amortization of intang. assets	36,304	36,544	146,002	129,736
Total expenses	725,218	976,463	3,471,311	3,550,991
Operating income	338,382	467,716	1,592,597	1,293,664
Non-operating income (expense)				
Net gain (loss) on investments	(410,055)	25,543	(572,564)	504,001
Interest and dividend income	12,853	22,262	64,721	74,466
Interest expense	(14,867)	(18,389)	(65,702)	(49,412)
Total non-operating income (expense)	(412,069)	29,416	(573,545)	529,055
Inc bef inc taxes & non-control inter	(73,687)	497,132	1,019,052	1,822,719
Income tax expense	(7,597)	165,747	387,340	463,832
Income bef non-controlling interests	(66,090)	331,385	631,712	1,358,887
Non-controlling interests	(119,056))	8,946	(154,707)	363,615
Net income	$ 52,966	$ 322,439	$ 786,419	$ 995,272
Earnings per share:				
Basic	$ 0.41	$ 2.51	$ 6.07	$ 7.75
Diluted	$ 0.40	$ 2.43	$ 5.91	$ 7.53
Cash dividends per share	$ 0.78	$ 0.67	$ 3.12	$ 2.68
Weighted-ave shares outstanding:				
Basic	129,888,110	128,449,943	129,543,443	128,488,561
Diluted	133,403,419	132,578,679	132,996,426	132,088,810