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IVZ - Q2 2009 Invesco Ltd. Earnings Conference Call

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PRESENTATION

Unidentified Company Representative - Invesco Ltd.

This presentation and comments made in the associated conference call today may include forward-looking statements. Forward-looking statements include information concerning future results of our operations, expenses, earnings, liquidity, cash flow, and capital expenditures, industry or market conditions, AUM, acquisition, debt, and our ability to obtain additional financing or make payments, regulatory developments, demand for and pricing of our products, and other aspects of our business or general economic conditions.

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We caution investors not to rely unduly on any forward-looking statements, and urge you to carefully consider the risks described in our most recent Form 10-K and subsequent Form 10-Q filed with the Securities and Exchange Commission. You may obtain these reports from the SEC's Website at www.sec.gov. We expressly disclaim any obligations to update the information in any public disclosure if any forward-looking statement later turns out to be inaccurate.

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Operator

Welcome to Invesco's second quarter results conference call. All participants will be on a listen-only mode until the question-and-answer session. (Operator Instructions). Today's conference is being recorded. If you have any objections you may disconnect at this time. Now I would like to turn call over to the speakers for today, Mr. Martin L. Flanagan, President and CEO of Invesco, and Mr. Loren Starr, Chief Financial Officer. Mr. Flanagan, you may now begin.

Martin Flanagan - Invesco Ltd. - President, CEO

Thank you, and thanks to everybody for joining us today for our second quarter briefing. As is our practice, I will review the business results. Loren will go into the financials in greater detail, and then we will open it up for the Q&A. And I want to note we are going to be speaking to the presentation that's available on the Web site if you are so inclined to follow. But, of course, you can always pick it up at your leisure. So let me get started.

During the second quarter, we remained very focused on very disciplined management of our business. It was an important factor in helping strengthen our long term flows, operating income and margins. All in all it was a very strong quarter, really led by the commitment to investment excellence, which resulted in strong relative performance. And again, we will go into more detail as I get into the presentation. Our margins expanded as we continue to focus on operating effectiveness and the expense management discipline in this improving marketplace that we are operating in.

And finally, we demonstrated our financial flexibility by raising just north of \$400 million of equity, giving us the resources to take advantage of the opportunities that we see in the marketplace, and to strengthen our competitive position and help further growth of the organization.

During the quarter, there are a number of developments that I would like to highlight that we believe strengthened our relative position in the marketplace. We saw improved flows across the firm, including positive flows in the US retail market, which has been a challenge for the industries in total, but also for us it was a real good sign of progress. We are also very pleased in being selected as one of the nine firms in the United States to prequalify as a fund manager for the PPIP. And during the quarter, in conjunction or follow on to that, we launched the Invesco Mortgage Capital REIT during the quarter which will take advantage of the opportunities in the mortgage markets and also have the ability to invest in PPIP.

The equity that was raised was \$200 million, and we expect further capital raises in the future. Also, to get a sense of what people are doing with some of their money around the world, we had a Chinese equity fund launch that raised \$540 million in Japan, and we see that as a sign of investor confidence in the marketplace. And finally, we are seeing continued strength across the firm in areas such as real estate continues to be strong and also our money fund business continues to improve its market share.

So let me spend a minute and go through the second quarter results to give you some of the high points before Loren goes into more details. Assets in our management ended the quarter at \$388 billion, building on progress from first quarter results, continued improvement in our net flows and in our money fund business during this quarter. The net operating margin, as I mentioned, increased 25%, improving from 16.5% in the first quarter. And we remain focused on carefully managing our expenses across the enterprise. Loren is going to provide an update on our 2009 expense guidance, and we continue to prudently manage our cash and balance sheet, ending with quarter with \$818 million of cash.

And finally, our second quarter dividend is \$0.1025, which is consistent with the first quarter, but again up from \$0.10 in the fourth quarter of last year. So spending a minute on flows, gross sales of our long-term flows increased 26% during the quarter while redemptions grew 11%. This turns out to be an improvement in net flows of \$2.3 billion to \$3 billion of long term net flows during the quarter.

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Also, our cash management business had another strong quarter, increasing net flows of \$1.7 billion during the quarter, and this is particularly impressive given that the cash management industry as a whole saw a decline during the quarter. If we take a look at flows by distribution channel, you can see the gross flows improved both in retail and institutional business and were flat in our private wealth management business. Net flows in the retail channel were strong across the organization, the UK, Asia Pacific in the US, not just in mutual funds but also in ETS and continental Europe. The institutional side of the business saw improving sales trends, but it was offset by a \$500 million low fee redemption during the quarter, and as a result you get a sense for what we believe is building strength in our institutional business.

Taking a look at investment performance overall, you can see that at June 30, 71%, 73%, and 79% of our assets were in the top half of peer groups for one, three and five year time periods. As we have done in the past, the detailed charts of our performance is in the appendix of the presentation, but let me highlight a few of those performance elements that you will see in those charts.

During the quarter, we continue to demonstrate the strong investment performance in key areas. Invesco Aim continued the trend you have seen the past several months and quarters, building strong investment performance. Now 65% of Invesco Aim assets are in the top half of peers for one, three and five years, and 51% of the assets under management were four or five-star rated. Invesco Asia-Pacific did well versus peers and benchmarks on a three and five year basis. Long term performance remained very strong at Invesco Perpetual, again, both equity and fixed income.

Global and quantitative equities remain strong against relative benchmarks over one, three and five years. And finally, the fixed income team continued to generate strong performance versus peers. So those are the highlights, and let me turn it over to Loren, and then we will get on to questions after that.

Loren Starr - *Invesco Ltd. - CFO*

Great. Well, thank you, Marty, and thanks everyone on the call. During the quarter, we saw positive flow, increased market values and favorable FX, resulting in a \$40.5 billion increase in AUM. We ended the quarter with \$388.7 billion in assets under management. That's up 11.6% since the end of March. Importantly, our net revenue yield driven by the growth in our higher fee asset categories increased by 3.2 basis points in the second quarter.

Let's turn to the operating results. The total operating revenues increased \$76.5 million, that's up 13.9% quarter-over-quarter, with \$25.8 million of the increase due to foreign exchange. Our investment management fees were up 14.9%, and this increase was driven by our positive mix shift, higher average assets under management and also FX. So within our asset mix, equities as a percentage of total AUM increased from 33% in the first quarter to 36% in the second quarter. Performance fees came in at \$8 million for the quarter, service and distribution was up 12.8% due to higher average assets, and then other revenues increased by 23.8%, and this was due to increased transaction commissions within our private equity business.

Moving on down the slide, you will see that our total operating expenses at \$515 million grew quarter-over-quarter by \$28 million or 5.7%, and this increase is primarily due to market driven expenses and foreign exchange. The changes in FX rates increased operating expenses by \$18.8 million in the second quarter compared to the first quarter. Employee compensation expenses declined by \$7 million or 2.9% versus the first quarter. Our second quarter compensation included a reduction of \$8.4 million in payroll taxes.

Compensation expenses for the quarter also included \$4.3 million of transition expenses as compared to the \$13 million that we saw in the first quarter. So the net impact of these three factors would lead one to expect a compensation decline of \$17.1 million, that's a \$13 million and \$8.4 million less the \$4.3 million. And that would have been about \$10 million less than our actual results. However, FX increased compensation by \$6.4 million, and so the remaining \$4 million offset is primarily explained by greater sales commissions and other variable compensation.



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Our third party distribution service and advisory increased \$18 million or 12.2%, and that's in line with the higher investor management and service and distribution fees. Marketing was down \$3 million or 11.2% due to generally lower levels of advertising spend. Property, office and technology increased marginally \$3 million. That was mainly due to foreign exchange. That was \$1.4 million of the \$3 million.

Consistent with our strategy of building a global operating platform, I should point out we have taken steps to reallocate some of our transfer agency work from Denver to both our Houston and Prince Edward Island locations, and as a result in Q3, I just want to let people know we will incur a [\$1 million] noncash charge in property due to vacating this leased office space. The good news is that this charge will be largely offset throughout the year by lower expenses, property and compensation, as well as due to higher service and distribution fee revenues.

Continuing to move down, looking at G&A we came in at \$47 million in the quarter, that was up \$17 million versus the first quarter, and this increase is due primarily because of the \$9.5 million of insurance recovery that we saw in Q1. We also had \$1.3 million of foreign exchange in Q2. And the remaining \$6 million was due to seasonally higher fund expenses in the UK, as well as some additional legal expenses related to new product launches.

So year-to-date, looking at the total operating expenses, they were \$53 million better than our expense guidance for 2009, in terms of what that would indicate. In other words, our actual expenses were \$1.002 billion versus the half year forecast of \$1.055 billion. And as you will remember, we indicated in the fourth quarter, \$2.11 billion in expenses as a guidance, assuming flat markets from year-end 2008 and with no change in foreign exchange. And despite the changes in market and foreign exchange that we have seen, particularly in the second quarter, we do believe that we are still tracking our original guidance for the full year, and you should expect us to continue to embrace a very disciplined approach to expense management through the remainder of the year.

Next, further moving down the P&L, you will see that operating income increased \$48 million or 78.6% to \$110 million. And below the operating income line, equity and earnings of unconsolidated affiliates increased to \$8 million from \$3 million in the first quarter. The second quarter saw improved performance in our Great Wall joint venture. While in the first quarter we saw net losses of about \$3.9 million in certain of our partnership investments.

Then we see gains of consolidated investment products, again as always the case, these are largely offset by losses, attributable to noncontrolling interest in consolidated entities. These two line items are a result of FIN 46 which requires us to consolidate certain investment products, and you will note that the minority interest line item that had been in previous presentations is now called losses attributable to noncontrolling interest in consolidated entities. So this change is consistent with the adoption of the FASB 160 that occurred at the beginning of this year. Then moving on down, we see other gains in the quarter came in at \$10 million, and that included a gross gain of the \$4.3 million on the completion of our debt tender offer, as you all know as well as we saw some benefit from foreign exchange gains.

In the quarter, our effective tax rate was 32.2%, similar to last year. Just as a looking forward, we expect a lower effective rate in the third quarter. This lower rate is driven by the release of part of our income tax reserves that is recorded in accordance with FIN 48. And as we have done in the past, we give you guidance for the full year, we expect our full year effective tax rate to come in around 32%. So then finally, EPS came in at \$0.18 for the quarter. So now I would like to turn it back to Marty before we open the call up for Q&A.

Martin Flanagan - Invesco Ltd. - President, CEO

Thank you, Loren. If I could, let me just spend a minute, and as you ask us and we ask ourselves, how are we positioned for long term success and I'll give you some recent feedback. We have been meeting extensively with client, consultants, gatekeepers and it is clear from those conversations, Invesco is well positioned to expand our existing relationships and also to earn the right for further relationships as we move forward. And really, given the challenges of the past year, it is not surprising that



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clients are intensely interested in stability of money management firms these days, and they want firms that have the resources to meet their needs and the proven ability to deliver against their commitments while avoiding problems.

We think we have stacked up pretty well during this very challenging period. The strong balance sheet, global footprint, broad range of capabilities, strong investment performance, really put us in a position, we think, to compete very well as we look forward.

As Loren mentioned, we are going to continue to be very disciplined as we approach our business, while taking steps to further enhance our competitive position. And really it is the strength of the organization in total from our investment management capability through our ability to manage the business that we think our position is well in the marketplace. So with that, let me stop and Loren and I will answer any questions that anybody has on the phone.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). The first question comes from Dan Fannon with Jefferies.

Dan Fannon - Jefferies - Analyst

Good morning. Thanks for taking my questions. Can you discuss some of the trends we are seeing in the institutional channel? You had gross sales were up. Can you talk about where you are seeing the greatest success with which products and areas, and where you're seeing still some weakness. And then talk about trends you are seeing thus far in July, maybe improvement in RFP activity replacements.

Martin Flanagan - Invesco Ltd. - President, CEO

Let me take a crack at that and Loren can chime in. The feedback we are getting, as you can imagine, from November, December and January, February, March, they're sort of different from literally frozen, to what do we do, and to really stepping back to say how is my asset allocation, are we on the right things? Yes or no. So it really, from our point of view, we thought it was the second half of the year before you would start to see movement, and it depends on where you are talking in the institutional market where people -- their first movement into risk areas was seeming to be sort of the credit area opposed to the equity market.

That's not inconsistent with what we are seeing as an organization. But at the same time, you will see natural strengths. We continue to do very well, not just in the credit area but in the distressed area. Real estate, direct real estate, we were very strong and also on the money fund business. So, those would be the natural things you would think happen. We would expect if equity markets continue to be sort of flat to up from here, that you can start to see some more equity movements. But the other area where you are seeing change, though, if you go more to the platforms 401-k, there is equity movement but it tends to be replacement manager searches. And that's an area where we are getting some attention, too.

With regard to second half of the year, we are, as you know, very conservative, and really don't want to get out on the prediction side. But again, I think the way to get a sense of it is just continue to look at some of the flows that we've had and indicative if we stay doing what we have been doing, we should do fine.

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Dan Fannon - *Jefferies - Analyst*

Okay. Thank you. And then just a question here, are you surprised somewhat that retail is coming back? We are seeing the flows come in quicker here, certainly with our business, but then just in aggregate more than, say, institutional reallocating at this point?

Martin Flanagan - *Invesco Ltd. - President, CEO*

No, I'm not. And I think that's -- I think we -- all of us that have been in the business for a long time, we make these great declarations about what retail does, and it does tend to move when you see the type of equity markets that we've had, there is that movement towards it. And I know the greater predictions were will retail investors ever come back in. I think people are starting to realize that if you want to make sure you don't recover, that your capital that was in the marketplace, stay in cash. And so I think it as advisors determine that there is greater risk to be in cash than to start to extend some of the risk. That's why you're starting to see some of that movement. And I think all of us have seen some of the various, the amount of cash on the sidelines, it is just enormous. You don't need a lot of movement and exposure to support these equity markets.

Dan Fannon - *Jefferies - Analyst*

Great. Lastly, the \$900 million real estate mandate, was that funded in the second quarter or is that something we should anticipate in the third quarter?

Martin Flanagan - *Invesco Ltd. - President, CEO*

Loren, do you want to --

Loren Starr - *Invesco Ltd. - CFO*

Yes. That was funded in the second quarter.

Dan Fannon - *Jefferies - Analyst*

Okay. Thank you.

Operator

The next question comes from Ken Worthington of JPMorgan. Your line is open.

Ken Worthington - *JPMorgan - Analyst*

Hi. Good morning. About three or four months ago it seemed like the stronger asset managers felt pretty good about the potential for some deals being executed at some point this year. What do you think now? Do you think the industry sees some deals in the second half of the year, and if so, do you think they're the bigger ones or the smaller ones?

Martin Flanagan - *Invesco Ltd. - President, CEO*

Great question. Here is my general feeling. I think you will probably still see some deals, but I think you have to put it in the context of what's happened in the marketplace. I think if we saw if the equity markets stayed where they were the first part of

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March, you would have seen a number of deals already by now. I really think it's the strength of the equity markets has taken off a lot of pressure where you would have seen transactions happen. So I think the predictions of rapid and massive consolidation, I think, are probably overstated and they probably were at that time, too.

But that's probably been the biggest factor, I think in, slowing that down. But again, I do think people have looked at their businesses, whoever is in asset management, and said -- done the analysis, do I have what it takes to be competitive in this marketplace going forward. And that's just not peer asset management, but that's asset management within larger financial institutions. So I would suggest that you are going to see some transactions in the second half of the year.

Ken Worthington - *JPMorgan - Analyst*

Great. And then second, with regard to compensation, at what point do Invesco margins improve enough where you can start to accrue a little more aggressively in terms of compensation. Is that like the 25% level, the 30% level, is it somewhere in between or higher or lower?

Martin Flanagan - *Invesco Ltd. - President, CEO*

Let me make a general statement and then Loren can chime in. We have a compensation philosophy that has been adopted by the Board and that is executed, and first and foremost on the investment management side, it is largely driven by relative investment performance but, of course, with appropriate economics around it. So as we continue to do well, that will be a driver. Which I think is important, just keeping, retaining, motivating the talent and the alignment to investors. But maybe Loren, do you want to give Ken some --

Loren Starr - *Invesco Ltd. - CFO*

Ken, as we discussed, I think we all felt uncomfortable with the first quarter margins and we wanted to see margins expand, and they have to about 25%. And I think a lot of it will depend on what happens through the rest of the year in terms of how variable compensation may grow or not. There was some growth in variable compensation. As we discussed quarter over quarter, roughly \$4 million on a net basis, and it is extremely feasible to see variable compensation increase marginally into the third quarter and possibly into the fourth quarter. But I do think it is something we will pay attention to as we go through the quarter. We are going to make sure that margins -- we want to see steady improvement in margins and that's part of our plan.

Ken Worthington - *JPMorgan - Analyst*

Okay. Great. And then lastly for Loren, the interest expense was up during the quarter but you guys paid down some debt. Were there some transaction-related fees in that interest expense line?

Loren Starr - *Invesco Ltd. - CFO*

Well, we certainly have some higher expenses related to our new credit facility, and so there's some of that is adding to the overall interest expense. There may be some marginal transaction fees as well that is augmenting that, but I would have to look deeper into that. Sorry.

Ken Worthington - *JPMorgan - Analyst*

Okay. Great. Thank you.

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Operator

Your next question comes from Michael Kim of Sandler O'Neill. Your line is open.

Michael Kim - Sandler O'Neill - Analyst

Good morning. Maybe just to start off with a more strategic question for Marty, I think one of the big selling points of the Black Rock BGI deal was to be able to offer retail investors actively managed funds side by side with kind of a suite of ETFs. Just seems like you're ahead of the curve with your Aim funds and Power Shares ETFs, so I guess the question is how much of an advantage is it to have both active and passive capabilities in the retail channel, particularly as distributors seemingly continue to gravitate toward bigger more diversified managers?

Martin Flanagan - Invesco Ltd. - President, CEO

Yes, where to start on that. We like the line up that we have. There's no question about it, and to be clear, our fundamental point is our investment management capabilities and, secondarily, the packaging is important. But that is secondary to the capabilities. That said, having the active capabilities and being able to deliver them through institutionally separate accounts and then mutual funds, comingle trust and ETFs, we think is very, very important.

And that was one of the very important attractions to us with Power Shares. It was different than a number of the other ETF providers out there. That was what we focused on, where it was, in my opinion, sort of further up the quantitative side of the risk spectrum, even though they were index basis. They had to be because the SEC focused all of us there. And as we put our toe in the water just about a year ago on the active side, it is going to be an appropriate vehicle for some types of active management. And we think the way the advice channel is changing, it is very, very supportive of it.

We probably were a little bit ahead of the curve on the point of where we saw the advice channel going, but again, when you get other people following you into that model, that's a good thing. It confirms the notion of what's out there. So we like what we have and we think one, two, three years you are going to look back and it will have served us very, very well.

Michael Kim - Sandler O'Neill - Analyst

That's helpful. Can you just give us an update on where you stand on the PPIT fund and, additionally, where does will Wilbur Ross currently stand in terms of the Recovery Fund IV. And then finally, once that reaches, I guess, the 70% level, how quickly would you anticipate him coming back to market?

Martin Flanagan - Invesco Ltd. - President, CEO

Let me take the first part of the question, Loren can take up the second. With regard to the PPIP, as I said earlier, we are obviously very thrilled to be one of the managers, but much to your disappointment we can't talk about where we are, in that it is a private placement. And so that is just one area where we can't give the transparency that you would like, although needless to say, we think it is a great program, and we are looking forward to participating. So again, I know that's not the question you asked, but that's the best I can do with an answer. Loren, do you want to pick up the other part of his question?

Loren Starr - Invesco Ltd. - CFO

Obviously, Michael, we are in fund raising on the whole PPIP so we can't talk about it. The good news is we are in fund raising, so a lot of activity on that. In terms of the Recovery IV fund, we are 45% invested in the Recovery IV fund so far. We need to be

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75% invested before we can consider Fund V. I think the focus of getting it out quickly is -- I think we are focused on the PPIP as the primary element right now this year. The expectation of Fund V this year, it is possible, but it is probably more likely to be early next year, quite honestly.

Michael Kim - Sandler O'Neill - Analyst

Okay. And then just finally, in terms of the money market business, do you feel like you're more insulated to investors reallocating back into equities, just given your institutional skew. And then, are any of your funds currently waiving fees at this point to maintain 0 or positive yields?

Martin Flanagan - Invesco Ltd. - President, CEO

I will take the first half and Loren can pick up the other part. Again, it is largely -- we're largely in the institutional money fund business. So there's always going to be a need for those products, and we think we do it very, very well. That said, the elements of people within that category that would have had a riskier, whether it is further out the credit spectrum or some equity exposure, naturally you would expect that to be at risk of leaving money funds to reallocate into riskier asset classes. But as you can see so far, so far so good for us. But Loren, you want to talk more about the funds specifically?

Loren Starr - Invesco Ltd. - CFO

In terms of fee waivers, we've been certainly fortunate, given that our institutional money market product is a low fee -- lower fee type of product,, 12 basis points on average and that we can invest the assets at rates that are well above that. That we haven't had to waive fees nor is that a concern of ours. So I think we feel good about the business, we feel good about the growth prospects, and as you mentioned, the institutional aspect of it is favorable for us relative to the pure retail kind of trend where you might see more of those assets rotate out.

Michael Kim - Sandler O'Neill - Analyst

Okay. Thanks for taking all of my questions.

Operator

The next question comes from Craig Siegenthaler with Credit Suisse. Your line is open.

Craig Siegenthaler - Credit Suisse - Analyst

Thanks and good morning.

Loren Starr - Invesco Ltd. - CFO

Morning, Craig. Hey, Craig.

Craig Siegenthaler - Credit Suisse - Analyst

First, just maybe to hit on the M&A question in a different way. Just looking at Invesco posted a capital raise and a stronger balance sheet, is Invesco still looking at potential acquisitions here. Or from your last comments, has the rebound in equities

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really priced you guys out and other players out. And when you look at potential acquisitions, is US value in emerging markets, two areas you have discussed previously as where there's interest, are they still the two asset classes most at focus?

Martin Flanagan - *Invesco Ltd. - President, CEO*

Yes. Good question, and let me try to clarify. What more specifically to us than sort of a more industry comments I was trying to make earlier, is that we haven't changed our stripes. What we are going to do is with the capital that we have is, first is reinvestment in business and take advantage as we can of the opportunities that we see. But we will continue to pay attention to M&A opportunities in the marketplace, but it has got to fill skill gap, product gap. So that has not moved at all, and that's first and foremost. And secondly, it has to make economic sense to us.

So what I was speaking of earlier was, again, if you are at March levels, there was much greater need, I think, emerging for people to enter into transactions because their economic outlook was very, very difficult. I don't want to give you the impression that prices have run so high you are not going to see any deals, I don't think that's the case. I think you will see some transactions, but not at the rapid pace you would have expected at the March time frame. And then, again just we are just we don't have specific gaps we are paying attention to right now. And then again, we don't have specific gaps we're paying attention to right now, we are just really paying attention to the marketplace, and if it fills a need, we will respond to it.

Craig Siegenthaler - *Credit Suisse - Analyst*

Got it. And then a follow up question, really, on the nonoperating income. I didn't see a balance sheet in the Press Release, and there's probably some moving pieces post the capital raise. But I am wondering when you look at that other gains and losses line, what is the asset base that that's really earned off of, and when we think of a normal run rate seeing equity markets up 2%, how should we think about that line item going forward?

Loren Starr - *Invesco Ltd. - CFO*

I take it, Marty, you want me to answer that one?

Martin Flanagan - *Invesco Ltd. - President, CEO*

Yes.

Loren Starr - *Invesco Ltd. - CFO*

The other gains and losses is really based on other -- we have seen other than temporary impairments on some of our seed capital in the past, with markets going down/ And as we expect over a six month period, we need to reflect that valuation in some of our seed capital. So that you will see on the way down.

The way it works, though, as markets improved you don't actually see the upside until you actually liquidate the seed capital. So the gains could actually come at some point in the future when we actually sell the seed capital. So it happens sporadically, but it is something you would expect to happen over the course of a year as we continually recycle our seed capital. We try to -- whatever we put in, we try to eventually take out. So again, it is hard to predict exactly when it all comes together because it has a lot to when we ultimately can and decide to liquidate seed capital.

The other thing we have seen on that line item has been write downs on some of the CLO products that we've had. And as you know, those are unrealized losses. So it is market -- it is model driven, not market driven. We had about a \$1 million of CLO as well this quarter. Markets have largely stabilized and default rates don't seem to be dramatically moving. So that's why we

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haven't seen anything. Again, the only way you see gains there is through, ultimately, when the CLOs come to fruition. So again, that's sort of sporadic based on when they mature. And then the final thing we will see sometimes in that line item is gains and losses due to foreign exchange which, again, is something that you can generally look at FX and you will see what happens there.

Craig Siegenthaler - *Credit Suisse - Analyst*

So there's no pure equity and bond funds that are sensitive quarterly to mark? All of the gains and losses seem to be realized ,and that is either OTTI on the way down or a sale on the way up. Is that correct?

Loren Starr - *Invesco Ltd. - CFO*

Yes, that is largely the right way to think about it other than foreign exchange.

Craig Siegenthaler - *Credit Suisse - Analyst*

Okay. Great. Thanks for taking my questions.

Loren Starr - *Invesco Ltd. - CFO*

Sure. No problem.

Operator

The next question comes from William Katz of Buckingham Research. Your line is open.

William Katz - *Buckingham Research - Analyst*

Thank you. Good morning. I just want to come back to the discussion on margins for a moment. When you think about the margin in your discussion on comp increase or expenses overall, your margin is greatly benefited by the impact of FX. If you were to strip that out, you had good margin improvement but not as stout as maybe the optics would suggest. When you talk about your comfort with margin, are you looking at margin FX, or inclusive when you talk about the outlook for expense growth?

Martin Flanagan - *Invesco Ltd. - President, CEO*

Loren, you want to --

Loren Starr - *Invesco Ltd. - CFO*

Yes. We look at it ,obviously, in the US dollar basis. The foreign exchange element is we have foreign plans that pay in foreign dollars and we bring those back. So it is hedging the revenues coming in. When we think about margin, we talk about margins, we are largely talking about the US dollar equivalent to margin. We are not bringing it back into a sterling basis or Canadian basis.

I think what you will see, though, is that foreign exchange won't necessarily impact the way we think about compensating -- changing variable compensation, US dollar compensation. The only thing that you will have is the foreign base plans will, if

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assets are growing and performance is good, you will see those plans increase, and we just bring those back in terms of their dollar equivalents, but there isn't -- So I guess the point is that each of the plans are in the own foreign currency. Our total variable compensation is really an aggregation of all of these various plans and these different foreign currencies. So we are not really focused on a US dollar variable compensation number.

William Katz - *Buckingham Research - Analyst*

Okay. Second question is, Marty, if you want to chime in, curious on your perspective coming at the Black Rock BGI transaction from a different way. Do you view the transaction as it further legitimizes what you have been doing in terms of Power Shares, or could there be any concern now that you have a very large competitor with a pretty formidable distribution story that might be able to potentially take market share away from Power Shares otherwise?

Martin Flanagan - *Invesco Ltd. - President, CEO*

I think the answer to both questions is yes, right. I mean, the fact is it does legitimize what we are trying to do, recognize the share sizes, something very different than what we have. But there's not going to be only one provider. That's just not going to be the case. And so our fundamental focus is clients backwards in and having good investment performance, and the relative range of product to match off against the different channels and clients is very, very important. And we think we are getting pretty close to achieving that.

Always room for improvement, as I keep saying, but again, I think it's on balance, that transaction is a good one for us. It really solidifies our -- confirms the thought process we have been on as an organization. It is also consistent with what we saw coming in the advice channel in particular. So again, we feel good about the prospects, and that is -- Larry is a talented guy and it is a talented firm and they're going to be an important player, continue to be. No question about it.

William Katz - *Buckingham Research - Analyst*

If I could ask one follow up on that, there has been a lot of controversy on whether or not the ETF platforms can make any significant inroads into the institutional channel, particularly 401K. How do you sort of see that and does that type of transaction, does accelerate that process in saying it's maybe more real time?

Martin Flanagan - *Invesco Ltd. - President, CEO*

The reality will be in time 401Ks will -- ETFs will find their way into the 401K channel, but it is more practical barriers than conceptual barriers in the way. It is sort of the processing, and you don't want participants to churn and et cetera, et cetera. So there's some real plan type design things and systems things that are in the way of it. In our opinion, they will get solved over time. And I'm sorry, Bill, what was the second part of the question?

William Katz - *Buckingham Research - Analyst*

I was just curious. You answered the question. Thanks very much.

Martin Flanagan - *Invesco Ltd. - President, CEO*

Okay. Good. Thank you.

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Operator

The next question is from Mike Carrier from Deutsche bank.

Mike Carrier - *Deutsche Bank - Analyst*

Thanks, guys.

Martin Flanagan - *Invesco Ltd. - President, CEO*

Hi, Mike.

Mike Carrier - *Deutsche Bank - Analyst*

I guess on the strategic side of the equation, if you look at during the quarter you had the Chinese equity fund in Japan. Is anything else in the pipe, or do you see increasing demand on the international front to launch new products, whether it is in Europe or in Asia?

Martin Flanagan - *Invesco Ltd. - President, CEO*

Let me take a crack at it and Loren can pitch in. It is the right question to ask. The answer we can't answer to your satisfaction just from the public disclosure forward-looking type things. Again, I think the reason we highlighted those couple of things and the flows around the world is to give you a sense that there is a growing appetite by investors to come back into the market place. And we highlighted the China security launch in Japan in particular, as the sort of cross border appetite into equity exposures.

So, if the markets stay, as I said earlier, some semblance order of where we are, I think you are going to continue to see some growth in the marketplace. But again, I know that's not a specific answer to your specific question. But, Loren, would you add to it any more?

Loren Starr - *Invesco Ltd. - CFO*

Yes, I think all I can say is sort of piling on to that, probably more so than we have ever seen before, the ability to take our different investment disciplines and sort of bring them to different markets is work that's under way for the retail platforms as well as the institutional platforms. So different geography, real estate going to Australia. The pipeline, the things we are looking at right now, are all related to that coming to fruition.

I think the other thing, just anecdotally, is in terms of our joint venture with China, we think that there's opportunities to begin to launch new products in China again. So we are looking forward to seeing that being a this year type type of event. Again, nothing specific I would like to point out other than there are more than we have in the past seen the opportunities to Invesco to the regions.

Martin Flanagan - *Invesco Ltd. - President, CEO*

And maybe I will add one more point sort of along those lines. If you look out, there's going to be probably the next couple of years, real opportunity up and down the spectrum and to loans and to direct real estate. And so when we look at the PPIP program, we think it is a great program and it's going to do what the Government wanted it to do. For us, it was a broader response to that market. We don't -- that was on the legacy security side. We look at the opportunity from securities to hold on



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to direct real estate, and people managing that, and we have fixed income managing legacy securities, real estate would manage the direct real estate, Wilbur Ross's team would do all of the distressed. And we think it is the combination of that skill, we think, is going to really have a real opportunity over the next few years to participate, in really the healing and the coming together of the full spectrum around mortgage through real estate.

Mike Carrier - Deutsche Bank - Analyst

Okay. Thanks. And then just the one on the expenses, that line, you just mentioned the noncash charge next quarter. Can you just give maybe roughly what the -- I guess the outlook meaning for the impact from that charge, like if it is going to be, like on a quarterly basis, if it will be lower by X amount?

Loren Starr - Invesco Ltd. - CFO

Yes, so I mentioned that there's roughly a \$10 million noncash charge to take place in the third quarter. I think, as I mentioned, there's going to be offsets through the course of the year. I don't think you are going to see the full impact of the \$10 million because it will be largely offset by some of the benefits of what I said. So I don't want to get into too specific, but certainly it is not going to be the full impact. Probably better to think about roughly half of the impact for Q3 on a net basis, and then net positive offset in the fourth quarter.

Mike Carrier - Deutsche Bank - Analyst

Okay. Thanks, guys.

Operator

The next question comes from Robert Lee of KBW. Your line is open.

Robert Lee - KBW - Analyst

Thanks. Good morning, everyone.

Martin Flanagan - Invesco Ltd. - President, CEO

Hey, Robert.

Robert Lee - KBW - Analyst

First question, of the -- can you maybe just update us on the \$800 odd million of cash, how much of that is actually available and is not held for regulatory purposes or otherwise offshore.

Loren Starr - Invesco Ltd. - CFO

Sure. So the \$817 million of cash, there's about, I think \$305 million is in the European subgroup. So the rest is largely available for use.

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Robert Lee - KBW - Analyst

Okay. And maybe a question for Marty, in the fixed income business, I just want to make sure I am understanding it correctly. Meaning, you clearly are excited about the opportunity to see the A/R performance is good.

Martin Flanagan - Invesco Ltd. - President, CEO

Right.

Robert Lee - KBW - Analyst

One of the things that some times for me is a little less clear is how you feel about your kind of retail fixed income capabilities. Certainly, you've seen pretty consistent, solid flows into municipal funds and, certainly, fixed income generally has been pretty positive in the retail world. Do you feel like you are as well positioned there. Is that a place you have to work on some?

Martin Flanagan - Invesco Ltd. - President, CEO

Thanks for the question. The answer is no, we weren't. That's the fundamental answer, and it is really what we have seen over the last handful of years of creating sort of a single fixed income capability. And they are the ones managing the retail products, and some of the retail funds have some legacy performance which was not strong as we -- as you would wish. But the team that's managing it now is really strong. And you can see it in the more recent performance. So you do have that lag effect. You are right on mark, but if you look at the capability, it has been a good team with good performance. So we are undershooting our weight, and we do think that just the -- some of the recognition of the fixed income group is really more recently important for that, and it will flow over into the retail side of the business. But you are asking the right question.

Robert Lee - KBW - Analyst

Okay. And maybe a follow up on Power Share. Is it possible to maybe drill down a little bit, if we think of the quarter just ended, how much relatively speaking did Power Shares contribute to that? And maybe are you seeing demand, at least that Power Share is reasonably broad based? Is it since it is being driven by one or two -- I guess you always have one or two that drive a lot of flows. But anything -- what I am trying to drive at is it being driven by pushing it through the retail distribution or is it being driven right now more because maybe there's institutional investors trying to express a view on water or something?

Martin Flanagan - Invesco Ltd. - President, CEO

So let me answer the broader question and Loren can talk more about the specifics. Where we see the future of it, you are always going to have the people seeking exposure, whether it is portfolio managers wanting to use ETFs to seek exposure, that type of thing. But it has really been for us a multiyear effort to how do you introduce ETFs into the advice retail channel. And we think we are well underway in figuring out how to do it, and we have been doing very good things, and I think the response has been strong. It doesn't happen over night, and I think the earlier question about where is the acceptance in the channel, it has really been the last three, six, nine months. All of the sudden, you see people's intention to use ETFs in the retail channel go up. Now, it is also matters that the advice channel open up that ability for the FAs to use it. So all of these dynamics are coming together right now, and I think it is a multi-quarter, multi-year event before you will see it be as broad as really the underlying question that you are asking. That is my opinion.

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Loren Starr - *Invesco Ltd. - CFO*

Just in terms of flows and contribution, I mean the Power Share flows increased about 36% quarter-over-quarter, net flows about 33% quarter-over-quarter. They accounted for about \$0.8 billion of net sales in Q2. So again, very strong contributor and, again, in terms of thinking about the profitability of the business, roughly in line with mutual fund margins, their net revenue yield is about 50 basis points. So you can do the math.

Robert Lee - *KBW - Analyst*

All right. Great. Maybe just one follow up, if I could. Marty, I'm curious, you've had one -- you've had the retail brokerage industry, I think, come out and say they're willing to live by having to accept a fiduciary standard as opposed to what they operate under now. Do you at all see that impacting the kinds of mutual funds or products that get sold or whether it is fees become more important or something else. Do you think it really changes the landscape for the industry?

Martin Flanagan - *Invesco Ltd. - President, CEO*

You are asking the right question. Everybody has, but I do think the truth of the matter is the advice channel has evolved quite strongly over the last, I don't know, five or ten years. And I think they actually do a very good fiduciary job. And let me go through, and you can counter this, I mean, the fundamental fact to be in somebody's channel, you really go through an enormous due diligence process around philosophy, process, et cetera, et cetera, quality of the team. That wasn't the case 15 years ago.

So it is really a team by team analysis into their channel and also the vehicle. And part of that, obviously, is not just relative -- it's they analyze your performance, was it for the right reasons, wrong reasons. They look at fees. And so all the things, they have, in my opinion, been acting very strongly as fiduciaries. I don't know the specifics that will be added to it, but I would say many of the very good firms that we all think of and work with, I think do a very, very good job of it. I think that the days of selling hot products is over and, quite frankly, has largely been over. So that would be my general view. But again, I think it will be the specifics that we'll all have to pay attention to.

Robert Lee - *KBW - Analyst*

Okay. Great. Thanks, guys.

Martin Flanagan - *Invesco Ltd. - President, CEO*

Thanks.

Operator

The next question comes from Jeff Hopson of Stifel. Your line is open.

Jeff Hopson - *Stifel Nicolaus & Company - Analyst*

Okay. Thank you. Can you comment a little more on continental Europe and Asia, the flows were modest, even though within the numbers you had some positive events. So what is kind of the outlook there in terms of the environment, and then you in particular, and then maybe comment on Canada as well.

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Martin Flanagan - *Invesco Ltd. - President, CEO*

Let me take a couple of the broader comments and the, Loren, why don't you chime in. So, just generally around the globe. Asia as an industry is picking up. Europe is starting to. But remember, what we have all seen in Europe the last couple of years, mutual funds became a source of funds in Italy comes to my mind, where the mutual fund industry was just absolutely net redemptions, and they were being -- it was really the structured products that really had overwhelmed the mutual fund industry. So there's the structural element that overwhelmed, and we think there will probably a movement back towards mutual funds over the next period of time. That is our general sense.

In Canada, for us, the effort has been broadening the platform in Canada, broader set of investment capabilities, the core has been Trimark which has been a very concentrated discipline which, again, you get relative swings in the performance based on the concentrated portfolios where its performance is strengthening again. But again, it is that relativeness that we know as a business ultimately hurts you. But it is a great investment management discipline. So the way for us more broadly to have less volatility is to have a broader product line up in Canada. So Loren, would you add to that?

Loren Starr - *Invesco Ltd. - CFO*

Yes. I think just in terms of continental Europe. We have actually seen sort of a fairly marked improvement versus the first quarter. We've had great momentum in some of our fixed income products, European corporate bond for an example, and I think industry gross sales in continental Europe in Q2 improved 18% versus Q1. So we are definitely participating in that. And I think in terms of our ranking, we are definitely in the top, top five, six. I don't know the exact numbers, but we have certainly improved in terms of our overall participation in those flows. So we are hopeful to see continued positive trend in continental Europe and we would like to continue to see ourselves participate in that.

In Asia, we believe that there is great strength and performance in terms of what we have to offer China and Hong Kong being a big piece in that, but then also seeing strength in Australia and other places. So again, the positioning is such that we feel good about the flow picture in Asia Pacific and continental Europe, and we think it's one that's generally improving versus what we have seen in the first quarter and continues to improve versus the second quarter.

Jeff Hopson - *Stifel Nicolaus & Company - Analyst*

Okay. Great. Thank you.

Operator

The next question comes from Keith Walsh of Citi. Your line is open.

Keith Walsh - *Citi - Analyst*

Good morning, everybody. First question, just on the money market business, I look at all of your competitors out there, seeing large out flows on that product line and you guys are growing it. What's going on there and I have a couple of others. Thanks.

Martin Flanagan - *Invesco Ltd. - President, CEO*

Let me start on that and, again, I think a number here have heard me speak of this in the past. The teams have done a heck of a job and if you go through how they performed over the last period of time, they're very focused on and have been for decades, not one or two years, safety, liquidity and yield. That has been sort of the mantra that they have managed to because they understand what the product is for, and it is not a yield seeking product. It is, again, just net priority that I laid out. And during

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that very, very difficult time, that's what they delivered and there were no securities in the portfolio, they're actually downgraded. So to say nothing of having SIBs or support agreements in place or the like. So it's really the stability of the firm, the stability of the way they have managed the product that has served them very, very well. And I think that's indicative of what you are seeing with net inflows in a quarter when the overall money fund industry was out. So that's why we think we are seeing what we are seeing.

Keith Walsh - Citi - Analyst

Okay. And then just with the \$460 million of equity raised in May, just remind us what's left specifically of that, and is the remainder going to be used to support PPIP, and I have one further.

Loren Starr - Invesco Ltd. - CFO

Of the \$460 million, we netted after fees about \$440 million. We have used \$100 million of that to tender for the debt. And so we are left with \$340 million. Of that \$340 million, we had expected somewhere in the order of magnitude of \$100 million, possibly to go into new product launches between the mortgage REIT which we put \$30 million into that product, the PPIP related products, and ultimately hopefully, a Fund V product, among some others. So you probably have about \$240 million X that, and then -- so, again this is a multi, has many different possibilities of being used. Acquisitions is, yet another thing that continues to show opportunities in the marketplace, and so we could certainly use some of the residual cash to do acquisitions if it made strategic sense and financial sense. But, of course, that would be on the small side if that was all we were using.

Keith Walsh - Citi - Analyst

Great, and then last question for Marty. Since you took this job a few years ago, a lot has improved. Where are we in regards to -- what inning of the ball game are we in here? What are some of the guideposts that we should look far as far as what you still need to accomplish at this organization? Thanks.

Martin Flanagan - Invesco Ltd. - President, CEO

What a question to wrap up on. I think the organization has done a heck of a job. I think there's people, a very, very talented organization that's very focused on the elements that we laid out, first and foremost, an investment management organization with consistent good long-term performance, and do a good job for clients and run a good business.

I think we are operating well along those paths, and the reality is it is competitive marketplace, clients are always wanting you to do a better job for them. So the game is never over. And using the baseball analogy, I don't know that you ever get past the sixth inning, so let's say we're in the sixth inning and I say that from a standpoint of you just always have to be focused on improving the business and that's what we are doing.

So, again each time when we come back to investors and shareholders, we will tell you about where we are focused on doing a better job.

Keith Walsh - Citi - Analyst

Great. Thanks.

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Martin Flanagan - *Invesco Ltd. - President, CEO*

If I can, thanks on behalf of Loren and myself, thank you for your time. It has been a good call. We appreciate the questions, and we are going to put our heads back down and get back to work and we will be talking to everybody very, very shortly. So thank you very much.

Operator

Ladies and gentlemen, this concludes today's earnings call.

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