

FRANKLIN RESOURCES INC
Form 10-Q
February 09, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2008

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 001-09318

FRANKLIN RESOURCES, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

Delaware
*(State or other jurisdiction of
incorporation or organization)*

13-2670991
*(I.R.S. Employer
Identification No.)*

One Franklin Parkway, San Mateo, CA
(Address of principal executive offices)

94403
(Zip Code)

(650) 312-2000
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Outstanding: 232,919,222 shares of common stock, par value \$0.10 per share, of Franklin Resources, Inc. as of January 31, 2009.

PART I FINANCIAL INFORMATION**Item 1. Financial Statements.****FRANKLIN RESOURCES, INC.****Condensed Consolidated Statements of Income****Unaudited**

<i>(in thousands, except per share data)</i>	Three Months Ended December 31,	
	2008	2007
Operating Revenues		
Investment management fees	\$ 600,274	\$ 1,020,315
Underwriting and distribution fees	304,929	573,796
Shareholder servicing fees	66,342	73,175
Consolidated sponsored investment products income, net	1,886	2,904
Other, net	(4,101)	15,401
Total operating revenues	969,330	1,685,591
Operating Expenses		
Underwriting and distribution	289,529	552,590
Compensation and benefits	244,063	280,290
Information systems, technology and occupancy	68,598	79,617
Advertising and promotion	24,227	46,644
Amortization of deferred sales commissions	36,612	44,551
Other	37,937	46,170
Total operating expenses	700,966	1,049,862
Operating Income	268,364	635,729
Other Income (Expenses)		
Consolidated sponsored investment products losses, net	(36,484)	(977)
Investment and other (losses) income, net	(45,009)	80,773
Interest expense	(1,200)	(6,045)
Other (expenses) income, net	(82,693)	73,751
Income before taxes	185,671	709,480
Taxes on income	64,771	191,164
Net Income	\$ 120,900	\$ 518,316
Earnings per Share		
Basic	\$ 0.52	\$ 2.15
Diluted	\$ 0.52	\$ 2.12
Dividends per Share	\$ 0.21	\$ 0.20

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN RESOURCES, INC.**Condensed Consolidated Balance Sheets****Unaudited**

<i>(in thousands)</i>	December 31, 2008	September 30, 2008
Assets		
Current Assets		
Cash and cash equivalents	\$ 2,453,127	\$ 2,314,818
Receivables	555,882	690,351
Investment securities, trading	395,417	356,408
Investment securities, available-for-sale	807,181	600,146
Other investments	281,245	836,657
Deferred taxes and other	57,421	51,252
Total current assets	4,550,273	4,849,632
Banking/Finance Assets		
Cash and cash equivalents	383,670	212,734
Loans held for sale	27,646	32,582
Loans receivable, net	352,913	371,647
Investment securities, trading	86,935	111,607
Investment securities, available-for-sale	352,525	320,910
Other	9,463	11,899
Total banking/finance assets	1,213,152	1,061,379
Non-Current Assets		
Investment securities, available-for-sale	143,863	155,295
Investments in equity method investees and other	345,714	328,247
Deferred sales commissions	159,949	187,807
Property and equipment, net	553,477	554,706
Goodwill	1,424,038	1,438,093
Other intangible assets, net	571,823	579,572
Other	25,063	21,789
Total non-current assets	3,223,927	3,265,509
Total Assets	\$ 8,987,352	\$ 9,176,520

[Table continued on next page]

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN RESOURCES, INC.

Condensed Consolidated Balance Sheets

Unaudited

[Table continued from previous page]

<i>(in thousands, except share data)</i>	December 31, 2008	September 30, 2008
Liabilities and Stockholders Equity		
Current Liabilities		
Compensation and benefits	\$ 135,355	\$ 307,223
Commercial paper	36,176	13,287
Accounts payable and accrued expenses	224,329	289,985
Commissions	168,111	230,028
Income taxes	56,665	66,032
Other	26,535	29,335
Total current liabilities	647,171	935,890
Banking/Finance Liabilities		
Deposits	776,606	570,279
Variable funding notes		28,551
Federal Home Loan Bank advances	117,000	109,000
Other	27,892	44,743
Total banking/finance liabilities	921,498	752,573
Non-Current Liabilities		
Long-term debt	105,102	118,433
Deferred taxes	144,592	146,489
Other	75,712	71,609
Total non-current liabilities	325,406	336,531
Total liabilities	1,894,075	2,024,994
Commitments and Contingencies (Note 11)		
Minority Interest	55,031	77,162
Stockholders Equity		
Preferred stock, \$1.00 par value, 1,000,000 shares authorized; none issued		
Common stock, \$0.10 par value, 1,000,000,000 shares authorized; 232,918,223 and 232,777,979 shares issued and outstanding, at December 31, 2008 and September 30, 2008	23,292	23,278
Capital in excess of par value		
Retained earnings	7,098,431	7,044,732
Accumulated other comprehensive (loss) income	(83,477)	6,354
Total stockholders equity	7,038,246	7,074,364
Total Liabilities and Stockholders Equity	\$ 8,987,352	\$ 9,176,520

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN RESOURCES, INC.

Condensed Consolidated Statements of Cash Flows

Unaudited

<i>(in thousands)</i>	Three Months Ended December 31,	
	2008	2007
Net Income	\$ 120,900	\$ 518,316
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	46,680	52,284
Stock-based compensation	18,719	16,299
Excess tax benefits from stock-based compensation arrangements	(3,012)	(26,600)
Net losses (gains) on sale of assets	12,064	(14,263)
Equity in net losses (income) of affiliated companies	25,460	(16,810)
Provision for loan losses	4,102	2,606
Other-than-temporary impairment of investments	33,849	158
Deferred taxes	(3,472)	3
Changes in operating assets and liabilities:		
Decrease in receivables, prepaid expenses and other	101,190	56,522
Payments on (originations of) loans held for sale, net	4,613	(139,057)
Increase in trading securities, net	(33,452)	(102,034)
Advances of deferred sales commissions	(17,303)	(31,058)
(Decrease) increase in income taxes payable	(3,093)	70,634
(Decrease) increase in commissions payable	(61,917)	12,314
Decrease in other liabilities	(38,715)	(37,446)
Decrease in accrued compensation and benefits	(164,668)	(157,860)
Net cash provided by operating activities	41,945	204,008
Purchase of investments	(473,937)	(481,446)
Liquidation of investments	671,543	233,430
Purchase of banking/finance investments	(39,692)	(49,190)
Liquidation of banking/finance investments	9,122	7,542
Decrease (increase) in loans receivable	14,320	(30,890)
Additions of property and equipment, net	(21,784)	(14,547)
Acquisitions of subsidiaries, net of cash acquired	533	
Net cash provided by (used in) investing activities	160,105	(335,101)
Increase in bank deposits	206,327	74,325
Exercise of common stock options	3,084	2,495
Dividends paid on common stock	(46,540)	(36,791)
Purchase of common stock	(40,678)	(780,508)
Excess tax benefits from stock-based compensation arrangements	3,012	26,600
Proceeds from issuance of debt	120,365	124,187
Payments on debt	(115,851)	(24,703)
Minority interest	22,352	51,571
Net cash provided by (used in) financing activities	152,071	(562,824)
Effect of exchange rate changes on cash and cash equivalents	(44,876)	(7,993)

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

Increase (decrease) in cash and cash equivalents	309,245	(701,910)
Cash and cash equivalents, beginning of period	2,527,552	3,584,183
Cash and Cash Equivalents, End of Period	\$ 2,836,797	\$ 2,882,273

[Table continued on next page]

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN RESOURCES, INC.**Condensed Consolidated Statements of Cash Flows****Unaudited**

[Table continued from previous page]

<i>(in thousands)</i>	Three Months Ended December 31,	
	2008	2007
Components of Cash and Cash Equivalents		
Cash and cash equivalents, beginning of period:		
Current assets	\$ 2,314,818	\$ 3,304,495
Banking/finance assets	212,734	279,688
Total	\$ 2,527,552	\$ 3,584,183
Cash and cash equivalents, end of period:		
Current assets	\$ 2,453,127	\$ 2,573,250
Banking/finance assets	383,670	309,023
Total	\$ 2,836,797	\$ 2,882,273
Supplemental Disclosure of Non-Cash Information		
Change in assets related to the net deconsolidation of certain sponsored investment products	\$ (85,196)	\$ (111,114)
Change in liabilities related to the net deconsolidation of certain sponsored investment products	(51,685)	(47,147)
Supplemental Disclosure of Cash Flow Information		
Cash paid for income taxes	\$ 64,265	\$ 97,283
Cash paid for interest	3,035	15,593

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN RESOURCES, INC.

Notes to Condensed Consolidated Financial Statements

December 31, 2008

(Unaudited)

Note 1 - Basis of Presentation

The unaudited interim financial statements of Franklin Resources, Inc. and its consolidated subsidiaries (collectively, the Company) included herein have been prepared by the Company in accordance with the instructions to Form 10-Q and the rules and regulations of the U.S. Securities and Exchange Commission (the SEC). Under these rules and regulations, some information and footnote disclosures normally included in financial statements prepared under accounting principles generally accepted in the United States of America (U.S. GAAP) have been shortened or omitted. Management believes that all adjustments necessary for a fair statement of the financial position and the results of operations for the periods shown have been made. All adjustments are normal and recurring. These financial statements should be read together with the Company's audited financial statements included in its Form 10-K for the fiscal year ended September 30, 2008 (fiscal year 2008). Certain amounts for the comparative prior fiscal year periods have been reclassified to conform to the financial presentation for and at the period ended December 31, 2008.

Note 2 - New Accounting Standards

The Company adopted the following accounting standards during the three months ended December 31, 2008. There were no significant updates to recently issued accounting standards not yet adopted by the Company as disclosed in its Form 10-K for fiscal year 2008.

In January 2009, the Financial Accounting Standards Board (the FASB) issued FASB Staff Position (FSP) EITF 99-20-1, Amendments to the Impairment Guidance of Emerging Issues Task Force (EITF) Issue No. 99-20 (FSP EITF 99-20-1). FSP EITF 99-20-1 amends the impairment guidance of EITF Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets to align it with the impairment guidance of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities. Both standards now require that management consider the probability that the holder of an asset will be unable to collect all amounts due when assessing assumptions about future cash flows for evaluations of assets for other-than-temporary impairment. FSP EITF 99-20-1 is effective for interim and annual reporting periods ending after December 15, 2008. The adoption of FSP EITF 99-20-1 did not have a material impact on the Company's consolidated financial statements.

In December 2008, the FASB issued FSP FAS 140-4 and FIN 46(R)-8, Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities (FSP FAS 140-4 and FIN 46R-8). FSP FAS 140-4 and FIN 46R-8 amends Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities as amended (SFAS 140) and FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities (FIN 46R) to require enhanced disclosures by public entities about transfers of financial assets and interests in variable interest entities, and provide users of the financial statements with greater transparency about a transferor's continuing involvement with transferred financial assets and an enterprise's involvement with variable interest entities. The disclosures required by FSP FAS 140-4 and FIN 46R-8 are effective for interim and annual reporting periods ending after December 15, 2008. The Company adopted FSP FAS 140-4 and FIN 46R-8 and has included the enhanced disclosures in Note 8 Securitization of Loans Held for Sale and Note 11 Commitments and Contingencies to its consolidated financial statements.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162). SFAS 162 identifies a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. GAAP for nongovernmental entities. SFAS 162 became effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The adoption of SFAS 162 had no impact on the Company's consolidated financial statements.

In June 2007, the FASB ratified the consensus reached by the EITF in EITF Issue No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards (EITF 06-11). EITF 06-11 requires that the realized income tax benefit from dividends and dividend equivalents that are charged to retained earnings and paid to employees for equity classified nonvested equity shares, nonvested equity share units, and outstanding equity share options be recorded as an increase to capital in excess of par value. EITF 06-11 applies prospectively to the income tax benefits on dividends declared in fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. The adoption of EITF 06-11 on October 1, 2008 had no impact on the Company's consolidated financial statements.

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 permits entities to irrevocably elect fair value as the measurement method for certain financial assets and liabilities, with changes in fair value recognized in earnings as they occur. SFAS 159 provides the fair

value option election on an instrument by instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. The difference between carrying value and fair value at the election date should be recorded as a cumulative effective adjustment to opening retained earnings. SFAS 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. The Company adopted SFAS 159 on October 1, 2008 without electing to apply the fair value option to any eligible assets or liabilities existing on its consolidated balance sheet as of October 1, 2008, or for any new eligible assets or liabilities recognized subsequent to October 1, 2008. Therefore, the adoption of SFAS 159 did not have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 does not require new fair value measurements, but provides guidance on how to measure fair value by establishing a fair value hierarchy used to classify the source of the information. SFAS 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FSP FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13, which amends SFAS 157 to exclude FASB Statement No. 13, Accounting for Leases (SFAS 13), and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under SFAS 13 from the scope of SFAS 157, and issued FSP FAS 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS 157 for nonfinancial assets and liabilities, except for items recognized or disclosed at fair value on an annual or more frequent basis, until fiscal years beginning after November 15, 2008. In October 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active, which clarifies the application of SFAS 157 for determining the fair value of a financial asset when the market for that asset is not active. The Company adopted SFAS 157 and related interpretations on October 1, 2008 for its financial assets and liabilities measured and reported at fair value and included the required disclosures in Note 7 Fair Value Measurements. The adoption of SFAS 157 did not have a material impact on the Company's consolidated financial statements. The adoption of SFAS 157 for nonfinancial assets and liabilities recognized or disclosed at fair value on a non-recurring basis is not expected to have a material impact on its consolidated financial statements.

Note 3 - Comprehensive Income

The components of comprehensive income were as follows:

<i>(in thousands)</i>	Three Months Ended	
	December 31,	
	2008	2007
Net income	\$ 120,900	\$ 518,316
Net unrealized losses on investments, net of tax	(7,832)	(26,055)
Currency translation adjustments	(81,999)	(10,836)
Other		(58)
Comprehensive Income	\$ 31,069	\$ 481,367

Note 4 - Earnings per Share

Basic earnings per share is computed on the basis of the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is computed on the basis of the weighted-average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. The components of basic and diluted earnings per share were as follows:

<i>(in thousands, except per share data)</i>	Three Months Ended December 31,	
	2008	2007
Net Income	\$ 120,900	\$ 518,316
Weighted-average shares outstanding - basic	231,626	241,585
Common stock options, nonvested stock awards and nonvested stock unit awards	1,062	2,562
Weighted-Average Shares Outstanding - Diluted	232,688	244,147

Earnings per Share

Basic	\$ 0.52	\$ 2.15
Diluted	\$ 0.52	\$ 2.12

For the three months ended December 31, 2008 and 2007, the Company excluded approximately 1,951.0 thousand and 7.8 thousand nonvested shares related to grants of stock awards and stock unit awards from the computation of diluted earnings per share because their effect would have been anti-dilutive.

Note 5 - Cash and Cash Equivalents

The Company discloses cash and cash equivalents as separate components of current assets and banking/finance assets in the condensed consolidated balance sheets. Cash and cash equivalents consisted of the following:

<i>(in thousands)</i>	December 31, 2008	September 30, 2008
Cash on hand and demand deposits with banks	\$ 658,606	\$ 579,361
Federal funds sold	1,998	134,759
Sponsored money market funds	1,158,841	1,076,966
Time deposits and other	1,017,352	736,466
Total	\$ 2,836,797	\$ 2,527,552

Federal Reserve Board regulations require certain of the Company's banking subsidiaries to maintain reserve and clearing balances on deposits with the Federal Reserve Banks. The required reserve balance was \$7.0 million at December 31, 2008 and \$6.4 million at September 30, 2008. The required clearing balance was \$1.2 million at December 31, 2008 and September 30, 2008.

The Company maintains cash and cash equivalents with financial institutions in various countries, limits the amount of credit exposure with any given financial institution and conducts ongoing evaluations of the creditworthiness of the financial institutions with which it does business.

Note 6 - Investments

Investments consisted of the following:

<i>(in thousands)</i>	December 31, 2008	September 30, 2008
Current		
Investment securities, trading	\$ 395,417	\$ 356,408
Investment securities, available-for-sale		
Sponsored investment products	764,794	591,562
Securities of U.S. states and political subdivisions	7,110	5,104
Securities of U.S. Treasury and federal agencies	25,809	2,799
Other equity and debt securities ¹	9,468	681
Total investment securities, available-for-sale	807,181	600,146
Other investments ²	281,245	836,657
Total Current	\$ 1,483,843	\$ 1,793,211
Banking/Finance		
Investment securities, trading	\$ 86,935	\$ 111,607
Investment securities, available-for-sale		
U.S. government-sponsored enterprise obligations ³	337,614	315,683
Securities of U.S. states and political subdivisions	989	1,125
Securities of U.S. Treasury and federal agencies	3,647	3,760
Other equity and debt securities ¹	10,275	342
Total investment securities, available-for-sale	352,525	320,910
Total Banking/Finance	\$ 439,460	\$ 432,517
Non-Current		
Investment securities, available-for-sale		
Sponsored investment products	\$ 27,360	\$ 28,089
Securities of U.S. states and political subdivisions	108,632	119,031
Securities of U.S. Treasury and federal agencies	634	625
Other equity and debt securities ¹	7,237	7,550
Total investment securities, available-for-sale	143,863	155,295
Investments in equity method investees and other	345,714	328,247
Total Non-Current	\$ 489,577	\$ 483,542

¹ Other equity and debt securities include equity securities, corporate debt securities, and other securities with a determinable fair value that are classified as available-for-sale securities.

² Other investments consist of time deposits with financial institutions having maturities greater than three months but less than one year from the date of purchase.

³ U.S. government-sponsored enterprise obligations include mortgage-backed securities and debentures.

At December 31, 2008 and September 30, 2008, current investment securities, trading included \$256.5 million and \$294.6 million of investments held by sponsored investment products that were consolidated in the Company's condensed financial statements.

At December 31, 2008 and September 30, 2008, banking/finance segment investment securities with aggregate carrying amounts of \$316.2 million and \$294.1 million were pledged as collateral for the ability to borrow from various government agencies (see Note 10 - Debt). In addition, investment management segment securities with aggregate carrying amounts of \$7.0 million and \$8.3 million were pledged as

collateral at December 31, 2008 and September 30, 2008.

A summary of the gross unrealized gains and losses relating to investment securities, available-for-sale is as follows:

<i>(in thousands)</i> as of December 31, 2008	Cost Basis	Gross Unrealized		Fair Value
		Gains	Losses	
Sponsored investment products	\$ 839,003	\$ 25,067	\$ (71,916)	\$ 792,154
U.S. government-sponsored enterprise obligations	336,947	5,722	(5,055)	337,614
Securities of U.S. states and political subdivisions	118,246	1,508	(3,023)	116,731
Securities of U.S. Treasury and federal agencies	30,069	83	(62)	30,090
Other equity and debt securities	25,092	1,983	(95)	26,980
Total	\$ 1,349,357	\$ 34,363	\$ (80,151)	\$ 1,303,569

<i>(in thousands)</i> as of September 30, 2008	Cost Basis	Gross Unrealized		Fair Value
		Gains	Losses	
Sponsored investment products	\$ 650,873	\$ 12,465	\$ (43,687)	\$ 619,651
U.S. government-sponsored enterprise obligations	315,969	2,705	(2,991)	315,683
Securities of U.S. states and political subdivisions	126,583	401	(1,724)	125,260
Securities of U.S. Treasury and federal agencies	7,092	109	(17)	7,184
Other equity and debt securities	7,882	906	(215)	8,573
Total	\$ 1,108,399	\$ 16,586	\$ (48,634)	\$ 1,076,351

The changes in net unrealized gains (losses) on investment securities include realization of net gains (losses) on the sale of investment securities, available-for-sale of \$(12.3) million and \$14.1 million during the three months ended December 31, 2008 and 2007. The tax effect of the change in unrealized gains (losses) on investment securities included in other comprehensive income was \$5.8 million and \$(3.4) million during the three months ended December 31, 2008 and 2007.

The Company evaluates investments for other-than-temporary impairment in value on a periodic basis when the cost of an investment exceeds its fair value. The Company considers many factors, including the severity and duration of the decline in the fair value below cost, the intent and ability of the Company to hold the security for a period of time sufficient for an anticipated recovery in fair value, and the financial condition and specific events related to the issuer. During the three months ended December 31, 2008 and 2007, the Company recognized \$33.8 million and \$0.2 million of other-than-temporary impairment in the value of certain investments primarily related to sponsored investment products.

The Company recognized net losses on trading investment securities that were still held at December 31, 2008 and 2007 in the amounts of \$62.4 million and \$0.7 million.

Note 7 - Fair Value Measurements

On October 1, 2008, the Company adopted SFAS 157, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). SFAS 157 also establishes a three-level fair value hierarchy that prioritizes the inputs for the valuation techniques used to measure fair value based on whether the inputs to those valuation techniques are observable or unobservable.

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

The three levels of fair value hierarchy established by SFAS 157 are set forth below. Our assessment of the hierarchy level of the assets or liabilities measured at fair value is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

- Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 Observable inputs other than Level 1 quoted prices, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs other than quoted prices that are observable or corroborated by observable market data. Level 2 quoted prices are obtained from independent third-party brokers or dealers, including prices derived from model-based valuation techniques for which the significant assumptions are observable in the market or corroborated by observable market data.
- Level 3 Unobservable inputs that are supported by little or no market activity. Level 3 valuations are derived primarily from model-based valuation techniques in which one or more significant inputs are unobservable in the market. These inputs require significant management judgment and reflect the Company's estimation of assumptions that market participants would use in pricing the asset or liability.

The Company records substantially all of its investments at fair value or amounts that approximate fair value. Trading securities, securities available-for-sale, and derivatives are financial instruments recorded at fair value on a recurring basis.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis.

(in thousands)

as of December 31, 2008	Level 1	Level 2	Level 3	Total
Current Assets				
Investment securities, trading	\$ 273,580	\$ 118,648	\$ 3,189	\$ 395,417
Investment securities, available-for-sale	774,262	32,919		807,181
Banking/Finance Assets				
Investment securities, trading		69,453	17,482	86,935
Investment securities, available-for-sale		352,525		352,525
Non-Current Assets				
Investment securities, available-for-sale	22,441	109,266	12,156	143,863
Total Assets Measured at Fair Value	\$ 1,070,283	\$ 682,811	\$ 32,827	\$ 1,785,921
Current Liabilities				
Forward foreign currency exchange contracts	\$	\$ 3,116	\$	\$ 3,116
Banking/Finance Liabilities				
Interest-rate swap agreements		120		120
Total Liabilities Measured at Fair Value	\$	\$ 3,236	\$	\$ 3,236

The following is a description of the significant assets measured at fair value, the fair value methodologies used, and the fair value hierarchy level.

Investment Securities, Trading consist primarily of securities held by consolidated sponsored investment products and retained subordinated securities and the interest-only strip receivable from securitization transactions. The fair value of securities held by consolidated sponsored investment products is primarily determined using quoted market prices, or independent third-party broker or dealer price quotes. These securities are primarily classified as Level 1 or Level 2. The fair value of retained subordinated securities from securitization transactions is determined using independent third-party broker or dealer price quotes, and these securities are currently classified as Level 2. The broker or dealer price quotes are evaluated for reasonableness based upon the performance of the underlying loans and comparable transaction pricing in the securitization market. The fair value of the interest-only strip receivable currently is determined using unobservable inputs and classified as Level 3, and is more fully described below.

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

Investment Securities, Available-for-Sale consist primarily of non-consolidated sponsored investment products and debt securities including U.S. government-sponsored enterprise obligations, securities of U.S. states and political subdivisions, and

securities of the U.S. Treasury and federal agencies. The fair value of non-consolidated sponsored investment products is generally determined based on the exchange listed net asset values of the sponsored investment products, and they are classified as Level 1. The fair value of the debt securities is determined using quoted market prices or independent third-party broker or dealer price quotes, which are evaluated for reasonableness, and they are generally classified as Level 2.

At December 31, 2008, Level 3 assets represented approximately 3.3% of total assets measured at fair value, and Level 3 liabilities measured at fair value were insignificant. There were immaterial transfers into Level 3 during the three months ended December 31, 2008. The following is a description of the Level 3 assets measured at fair value and the fair value methodologies used.

Interest-only strip receivable. The interest-only strip receivable, which is classified as a trading investment security, is backed by prime, non-prime and sub-prime automobile loans issued from March 1999 to April 2008. The fair value of the interest-only strip receivable is estimated using discounted cash flow analyses. Key inputs to the analysis include the excess cash flow discount rate, cumulative life loss rate, expected weighted-average life and prepayment speed assumption. The Company develops its key inputs using actual portfolio experience and recent market activity for similar transactions. The interest-only strip receivable is currently classified as Level 3 as at least one of the significant inputs used in the fair valuation is not observable because recent economic events have significantly reduced the number of comparable securitization transactions. During the three months ended December 31, 2008, the Company recognized a \$17.7 million write-down to the interest-only strip receivable primarily as a result of an increase in the excess cash flow discount rate from 19.8% at September 30, 2008 to 36.4% at December 31, 2008 to reflect the liquidity premium in the market. The key assumptions and the sensitivity of the fair value of the interest-only strip receivable to an immediate adverse change in those assumptions are shown in Note 8 – Securitization of Loans Held for Sale.

Securities held by consolidated sponsored investment products are classified as trading investment securities. Consolidated sponsored investment products may hold securities that are classified as Level 3 because their fair value is determined using unobservable inputs. Fair value of these securities is determined using valuation methods as appropriate for each security type such as model-based valuations or prices of similar securities adjusted for illiquidity and credit risk factors.

Collateralized debt obligations (CDOs), which are classified as available-for-sale securities, are highly illiquid, and observable inputs are currently not available. The fair value of CDOs are derived from market-standard models to estimate the cash flows using key inputs which include discount rates for each credit rating, collateral type, and other relevant contractual features. CDOs are classified as Level 3 because at least one of the significant inputs used in the fair valuation is not observable.

Automobile loans held for sale. The fair value of automobile loans held for sale generally is estimated based on the whole loan market price that would be received if the loans were sold in their current condition, which may include adjustments based on the composition of the loan portfolio and liquidity factors. As a result of the recent economic events, observable whole loan prices for comparable portfolios of automobile loans sold have not been readily available. Therefore, the fair value currently is determined by using discounted cash flow analyses with estimated discount rates for loans with similar terms and collateral. Accordingly, automobile loans held for sale currently are classified as Level 3.

While the Company believes the valuation methods described above are appropriate, the use of different methodologies or assumptions to determine the fair value could result in a different estimate of fair value at the reporting date.

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

The changes in Level 3 assets measured at fair value on a recurring basis for the three months ended December 31, 2008 were as follows.

<i>(in thousands)</i>	Securities Held by Consolidated Sponsored Investment Products	Interest- Only Strip Receivable	Other¹	Total
At October 1, 2008	\$ 4,089	\$ 29,782	\$ 12,112	\$ 45,983
Total realized and unrealized gains (losses):				
Included in other, net revenue		(17,703)		(17,703)
Included in consolidated sponsored investment products losses, net	(960)			(960)
Included in other comprehensive income			137	137
Purchases, sales, and settlements, net	3	5,403	(93)	5,313
Transfers into Level 3	57			57
At December 31, 2008	\$ 3,189	\$ 17,482	\$ 12,156	\$ 32,827
Change in unrealized losses included in net income relating to assets still held at December 31, 2008	\$ (962) ²	\$ (17,703) ³	\$	\$ (18,665)

¹ Other includes collateralized debt obligations and equity securities.

² Included in consolidated sponsored investment products losses, net.

³ Included in other, net revenue.

The Company also may be required to measure certain assets or liabilities at fair value on a nonrecurring basis. These adjustments to fair value generally result from the application of lower of cost or fair value accounting for automobile loans held for sale or write-downs of individual assets. At December 31, 2008, all automobile loans held for sale were measured at fair value and classified within Level 3 of the fair value hierarchy. The fair value of these loans was \$27.6 million, and the adjustment to the fair value of these loans recorded as a loss during the three months ended December 31, 2008 was de minimus.

Note 8 - Securitization of Loans Held for Sale

From time to time, the Company enters into automobile loan securitization transactions with securitization trusts structured as qualified special purpose entities (the securitization trusts), which then issue asset-backed securities to private investors. The Company records these transactions as sales. The securitization transactions are comprised of prime, non-prime and sub-prime contracts for retail installment sales that are secured by new and used automobiles purchased from motor vehicle dealers. The Company purchases the sale contracts in the ordinary course of business.

When the Company sells automobile loans in a securitization transaction, it retains a residual interest, which is an interest-only strip receivable. The interest-only strip receivable represents the Company's contractual right to receive interest from the pool of securitized loans after the payment of required amounts to holders of the asset-backed securities and certain other costs associated with the securitization. The interest-only strip receivable is generally fully realizable and subject to limited recourse provisions. The Company may also retain subordinated securities from securitization transactions, which are senior to the interest-only strip receivable. The retained interests in securitized assets, including the interest-only strip receivable and the retained subordinated securities, are recognized as banking/finance trading securities in the condensed consolidated balance sheets. Changes in the fair value of the retained interests are recognized currently in earnings.

Certain automobile loans to be sold in securitization transactions were held by special purpose statutory Delaware trusts (the trusts) that were organized to hold a portion of the Company's loans held for sale and issue notes under variable funding note warehouse credit facilities. The variable funding notes issued under these facilities were secured by cash and a pool of automobile loans that were expected to meet certain eligibility requirements. Directly and through the trusts, which were consolidated in the Company's financial statements, the Company entered into interest-rate swap agreements, accounted for as freestanding derivatives, intended to mitigate the interest rate risk between the fixed interest rate on the pool of automobile loans and the floating interest rate paid under the variable funding note warehouse credit facilities until the securitization and sale of the related loans. The Company terminated the trusts, the warehouse credit facilities and the related swap agreements in November 2008 and does not currently intend to replace them.

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

There were no automobile loan securitization transactions during the three months ended December 31, 2008 and 2007. The securitization transactions in which the Company entered into through September 30, 2008 were consistent in all material respects. As a result of a securitization transaction that the Company entered into in June 2008, it retained the subordinated securities in addition to the interest-only strip receivable. These retained subordinated securities had credit ratings from Standard & Poor's ranging from AA to BBB at December 31, 2008.

The Company determines the fair value of the retained interests in securitized assets at the date of securitization and at each period-end. The fair value of the retained subordinated securities is determined using independent third-party broker or dealer price quotes, which are evaluated for reasonableness based upon the performance of the underlying loans and comparable transaction pricing in the securitization market. The fair value of the interest-only strip receivable is estimated using discounted cash flow analyses. Key inputs to the analysis include the excess cash flow discount rate, cumulative life loss rate, expected weighted-average life and prepayment speed assumption. The Company develops its key inputs using actual portfolio experience and recent market activity for similar transactions. The Company increased the excess cash flow discount rate relating to the interest-only strip receivable from 19.8% at September 30, 2008 to 36.4% at December 31, 2008 to reflect the liquidity premium in the market. The Company also increased the cumulative life loss rate assumption ranging from 2.1%-5.7% at September 30, 2008 to 2.2%-7.8% at December 31, 2008 to reflect an increase in experienced and expected losses. This resulted in an increase in the weighted-average assumption for the cumulative life loss rate from 4.2% at September 30, 2008 to 5.7% at December 31, 2008.

The following table shows the sensitivity of the retained interests to hypothetical adverse changes in the key economic assumptions used to measure fair value:

<i>(dollar amounts in thousands)</i>	December 31, 2008	September 30, 2008
<i>Fair value of retained interests</i>		
Retained subordinated securities	\$ 69,453	\$ 81,826
Interest-only strip receivable	17,482	29,781
 Total	 \$ 86,935	 \$ 111,607
<i>Excess cash flow discount rate (annual rate)</i>		
	10.7%-36.4%	9.6%-19.8%
Impact on fair value of 10% adverse change	\$ (4,676)	\$ (3,865)
Impact on fair value of 20% adverse change	(9,319)	(7,713)
<i>Expected weighted-average life (years)</i>		
	2.6	2.7
Impact on fair value of 10% adverse change	\$ (476)	\$ (1,645)
Impact on fair value of 20% adverse change	(983)	(3,054)
<i>Cumulative life loss rate</i>		
	5.7%	4.2%
Impact on fair value of 10% adverse change	\$ (2,159)	\$ (1,754)
Impact on fair value of 20% adverse change	(3,202)	(3,215)
<i>Prepayment speed (average monthly rate)</i>		
	1.5%	1.5%
Impact on fair value of 10% adverse change	\$ (476)	\$ (1,645)
Impact on fair value of 20% adverse change	(983)	(3,054)

Actual future market conditions may differ materially. Accordingly, this sensitivity analysis should not be considered the Company's projection of future events or losses.

The Company retains servicing responsibilities for automobile loan securitizations and receives annual servicing fees ranging from 1% to 2% of the loans securitized for services that it provides to the securitization trusts. The servicing fees are recognized in other, net revenues in the consolidated statements of income. The Company does not recognize a servicing asset or liability under the provisions of SFAS 140, because the benefits of servicing are just adequate to compensate for its servicing responsibilities as the servicing fees are consistent with current market rates that would be charged to compensate a substitute servicer for providing these services.

The following table is a summary of cash flows received from and paid to the securitization trusts.

<i>(in thousands)</i>	Three Months Ended December 31,	
	2008	2007
Servicing fees received	\$ 3,786	\$ 3,376
Cash flows received related to retained subordinated securities	1,698	
Cash flows received related to interest-only strips	1,470	3,701
Purchase of loans from the securitization trusts		(20,490)

Amounts payable to the trustee related to loan principal and interest collected on behalf of the securitization trusts of \$24.0 million at December 31, 2008 and \$35.6 million at September 30, 2008 were included in other banking/finance liabilities in the condensed consolidated

balance sheets.

Credit enhancements for the securitization trusts require the Company to maintain a certain level of cash on deposit. At December 31, 2008 and September 30, 2008, the amounts of cash on deposit were \$24.5 million and \$23.2 million and their discounted values were recognized as part of the interest-only strip receivable in banking/finance trading securities in the condensed consolidated balance sheets.

The Company also provides guarantees to cover shortfalls for the securitization trusts in amounts due to the holders of the asset-backed securities if the shortfalls exceed cash on deposit. At December 31, 2008 and September 30, 2008, the maximum potential amounts of future payments related to these guarantees were \$41.8 million and \$48.2 million. The fair value of the guarantees was recognized as banking/finance liabilities in the condensed consolidated balance sheets and was not significant. In February 2009, the Company increased the amount of cash on deposit by \$31.9 million as a letter of credit provider for the securitization trusts no longer met an eligibility requirement of the credit enhancements. As a result, the maximum potential amounts of future payments related to the guarantees were reduced by the same amount.

During the three months ended December 31, 2008 and 2007, the Company did not provide financial or other support to the securitization trusts or the holders of the asset-backed securities.

The original amount of loans serviced for the securitization trusts that were still in existence at December 31, 2008 and September 30, 2008 totaled \$1.8 billion. At December 31, 2008 and September 30, 2008, the securitization trusts had 54,868 and 58,322 loans outstanding, and their weighted-average annualized interest rate was 10.4% and 10.5%. Net charge-offs on the securitized loans held by the securitization trusts were \$11.7 million and \$6.4 million for the three months ended December 31, 2008 and 2007.

The following table shows details of the loans serviced by the Company that were held by the securitization trusts.

<i>(dollar amounts in thousands)</i>	December 31, 2008	September 30, 2008
Principal amount of loans	\$ 775,648	\$ 851,810
Principal amount of loans 30 days or more past due	40,985	34,535
Credit quality as a percentage of aggregate outstanding principal balance		
Prime	47.4%	47.6%
Non-prime	50.1%	49.9%
Sub-prime	2.5%	2.5%

Note 9 - Goodwill and Other Intangible Assets

Goodwill and other intangible assets have been assigned to one reporting unit, the investment management and related services operating segment. The changes in the carrying values of goodwill and gross intangible assets were as follows:

<i>(in thousands)</i>	Goodwill	Amortized Intangible Assets	Non-amortized Intangible Assets
Balance at October 1, 2008	\$ 1,438,093	\$ 200,983	\$ 508,909
Foreign currency movements	(14,055)	(937)	(4,801)
Balance at December 31, 2008	\$ 1,424,038	\$ 200,046	\$ 504,108

Certain of the goodwill and intangible assets are denominated in currencies other than the U.S. dollar; therefore, their gross and net carrying amounts are subject to foreign currency movements.

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

Intangible assets as of December 31, 2008 and September 30, 2008 were as follows:

(in thousands)

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
as of December 31, 2008			
Amortized intangible assets			
Customer base	\$ 165,033	\$ (101,922)	\$ 63,111
Other	35,013	(30,409)	4,604
	200,046	(132,331)	67,715
Non-amortized intangible assets			
Management contracts	504,108		504,108
Total	\$ 704,154	\$ (132,331)	\$ 571,823

(in thousands)

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
as of September 30, 2008			
Amortized intangible assets			
Customer base	\$ 165,953	\$ (100,301)	\$ 65,652
Other	35,030	(30,019)	5,011
	200,983	(130,320)	70,663
Non-amortized intangible assets			
Management contracts	508,909		508,909
Total	\$ 709,892	\$ (130,320)	\$ 579,572

The Company completed its most recent annual impairment tests of goodwill and indefinite-lived intangible assets during the quarter ended December 31, 2008, under the guidance of FASB Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, and determined that there was no impairment in the value of these assets as of October 1, 2008. No impairment in the value of goodwill and indefinite-lived intangible assets was recognized during fiscal year 2008. No impairment in the value of intangible assets subject to amortization was recognized during the three months ended December 31, 2008 and 2007 as our estimate of the undiscounted expected cash flows from these assets exceeded the asset carrying values.

Amortization expense related to definite-lived intangible assets was \$2.6 million and \$2.7 million for the three months ended December 31, 2008 and 2007. The estimated remaining amortization expense related to definite-lived intangible assets as of December 31, 2008 was as follows:

(in thousands)

For the fiscal years ending September 30,	
2009 (remaining nine months)	\$ 7,764
2010	10,352
2011	10,330
2012	8,866

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

2013	8,722
Thereafter	21,681
Total	\$ 67,715

Note 10 - Debt

Outstanding debt consisted of the following:

<i>(in thousands)</i>	December 31, 2008	September 30, 2008
Current		
Commercial paper	\$ 36,176	\$ 13,287
Banking/Finance		
Variable funding notes		28,551
Federal Home Loan Bank advances	117,000	109,000
	117,000	137,551
Non-Current		
Long-term debt	105,102	118,433
Total Debt	\$ 258,278	\$ 269,271

At December 31, 2008, current debt consisted of commercial paper with a total face value of \$36.2 million that was issued at a weighted-average annualized interest rate of 0.65% and matured in January 2009.

The banking/finance segment has financed its automobile lending business primarily through securitizations, Federal Home Loan Bank advances (FHLB advances) and the issuance of variable funding notes under one-year revolving variable funding note warehouse credit facilities. The Company terminated the warehouse credit facilities in November 2008 and does not currently intend to replace them. The variable funding notes issued under these facilities were secured by cash and a pool of automobile loans that met certain eligibility requirements (see Note 8 Securitization of Loans Held for Sale).

At December 31, 2008, the banking/finance segment had \$117.0 million of total outstanding FHLB advances. Approximately \$69.0 million of these advances mature by December 31, 2009, while the remaining \$48.0 million mature from January 2010 through December 2038. These advances had a weighted-average interest rate of 1.76% at December 31, 2008 and are subject to collateralization requirements.

Long-term debt primarily relates to deferred commission liabilities recognized in relation to deferred commission assets (DCA) generated in the United States that were originally financed through a sale of related future revenue to Lightning Finance Company Limited (LFL), a company in which the Company holds a 49% ownership interest. In December 2005, LFL transferred substantially all of its rights to this future revenue to Lightning Asset Finance Limited (LAFL), an Irish special purpose vehicle formed in December 2005, in which the Company also holds a 49% ownership interest. The holder of the 51% ownership interests in both LFL and LAFL is a subsidiary of an international banking institution, which is not affiliated with the Company. Due to its significant interest in LAFL, the Company continues to carry on its balance sheet the DCA and the financing liability related to the future revenue originally sold to LFL by Franklin/Templeton Distributors, Inc. until these assets are amortized or sold by LAFL.

At December 31, 2008, the Company had \$420.0 million in short-term revolving credit available under a five-year credit agreement with certain banks and financial institutions expiring on June 9, 2010, \$463.8 million of short-term commercial paper remaining available for issuance under an uncommitted \$500.0 million private placement program, and \$12.3 million available in uncommitted short-term bank lines of credit. The revolving credit facility supports certain of the Company's commercial paper borrowing arrangements and is subject to various financial covenants, including, but not limited to, minimum requirements related to its interest coverage ratio and maintenance of working capital as well as limitations on its capitalization ratio, indebtedness, investments and liens. Interest rates on loans under the revolving credit facility are determined at the time of issuance and depend on the type of loan issued. As of December 31, 2008, there were no amounts outstanding under the revolving credit facility and the Company was in compliance with the financial covenants related to this facility. In addition, at December 31, 2008, the banking/finance segment had \$212.0 million available in uncommitted short-term bank lines of credit under the Federal Reserve Funds system, \$203.0 million available in secured Federal Reserve Bank short-term discount window and \$15.0 million available in secured Federal Home Loan Bank short-term borrowing capacity (see Note 6 Investments).

Note 11 - Commitments and Contingencies

Guarantees

The Company is obligated to cover shortfalls for the automobile loan securitization trusts in amounts due to the holders of the asset-backed securities up to certain levels (see Note 8 - Securitization of Loans Held for Sale).

At December 31, 2008, the banking/finance segment had issued financial standby letters of credit totaling \$6.9 million which beneficiaries would be able to draw upon in the event of non-performance by its customers, primarily in relation to lease and lien obligations of these banking customers. These standby letters of credit were secured by marketable securities with a fair value of \$9.8 million as of December 31, 2008.

Legal Proceedings

As previously reported, the Company and certain of its subsidiaries, and in some instances, certain of the Franklin Templeton mutual funds (the Funds), current and former officers, employees, and Company and/or Fund directors have been named in multiple lawsuits in various United States federal courts, alleging violations of federal securities and state laws. Specifically, the lawsuits claim breach of duty with respect to alleged arrangements to permit market timing and/or late trading activity, or breach of duty with respect to the valuation of the portfolio securities of certain Templeton Funds managed by certain of the Company's subsidiaries, allegedly resulting in market timing activity. The majority of these lawsuits duplicate, in whole or in part, the allegations asserted in the February 4, 2004 Massachusetts Administrative Complaint concerning one instance of market timing and the SEC's findings regarding market timing in its August 2, 2004 order, both of which matters were previously reported. The lawsuits are styled as class actions, or derivative actions on behalf of either the named Funds or the Company, and seek, among other relief, monetary damages, restitution, removal of Fund trustees, directors, advisers, administrators, and distributors, rescission of management contracts and distribution plans under Rule 12b-1 promulgated under the Investment Company Act of 1940 (Rule 12b-1), and/or attorneys' fees and costs.

In 2003 and 2004, more than 400 similar lawsuits against at least 19 different mutual fund companies were filed in federal district courts throughout the country. Because these cases involve common questions of fact, on February 20, 2004, the Judicial Panel on Multidistrict Litigation (the Judicial Panel) ordered the creation of a multidistrict litigation in the United States District Court for the District of Maryland, titled *In re Mutual Funds Investment Litigation* (the MDL). The Judicial Panel then transferred similar cases from different districts to the MDL for coordinated or consolidated pretrial proceedings.

The following market timing lawsuits are pending against the Company and certain of its subsidiaries (and in some instances, continue to name certain current Company and/or Fund directors and Company officers, as well as a former employee) and have been transferred to the MDL:

Kenerley v. Templeton Funds, Inc., et al., Case No. 03-770 GPM, filed on November 19, 2003 in the United States District Court for the Southern District of Illinois; Cullen v. Templeton Growth Fund, Inc., et al., Case No. 03-859 MJR, filed on December 16, 2003 in the United States District Court for the Southern District of Illinois and transferred to the United States District Court for the Southern District of Florida on March 29, 2004; Jaffe v. Franklin AGE High Income Fund, et al., Case No. CV-S-04-0146-PMP-RJJ, filed on February 6, 2004 in the United States District Court for the District of Nevada; Lum v. Franklin Resources, Inc., et al., Case No. C 04 0583 JSW, filed on February 11, 2004 in the United States District Court for the Northern District of California; Fischbein v. Franklin AGE High Income Fund, et al., Case No. C 04 0584 JSW, filed on February 11, 2004 in the United States District Court for the Northern District of California; Beer v. Franklin AGE High Income Fund, et al., Case No. 8:04-CV-249-T-26 MAP, filed on February 11, 2004 in the United States District Court for the Middle District of Florida; Bennett v. Franklin Resources, Inc., et al., Case No. CV-S-04-0154-HDM-RJJ, filed on February 12, 2004 in the United States District Court for the District of Nevada; Dukes v. Franklin AGE High Income Fund, et al., Case No. C 04 0598 MJJ, filed on February 12, 2004 in the United States District Court for the Northern District of California; McAlvey v. Franklin Resources, Inc., et al., Case No. C 04 0628 PJH, filed on February 13, 2004 in the United States District Court for the Northern District of California; Alexander v. Franklin AGE High Income Fund, et al., Case No. C 04 0639 SC, filed on February 17, 2004 in the United States District Court for the Northern District of California; Hugh Sharkey IRA/RO v. Franklin Resources, Inc., et al., Case No. 04 CV 1330, filed on February 18, 2004 in the United States District Court for the Southern District of New York; D'Alliessi v. Franklin AGE High Income Fund, et al., Case No. C 04 0865 SC, filed on March 3, 2004 in the United States District Court for the Northern District of California; Marcus v. Franklin Resources, Inc., et al., Case No. C 04 0901 JL, filed on March 5, 2004 in the United States District Court for the Northern District of California; Banner v. Franklin Resources, Inc., et al., Case No. C 04 0902 JL, filed on March 5, 2004 in the United States District Court for the Northern District of California; Denenberg v. Franklin Resources, Inc., et al., Case No. C 04 0984 EMC, filed on March 10, 2004 in the United States District Court for the Northern District of California; and Hertz v. Burns, et al., Case No. 04 CV 02489, filed on March 30, 2004 in the United States District Court for the Southern District of New York.

Plaintiffs in the MDL filed consolidated amended complaints on September 29, 2004. On February 25, 2005, defendants, including the Company, certain of its subsidiaries and the named Funds and individual defendants, filed motions to dismiss those

amended complaints (collectively the Company's motions). On June 26, 2008, the court issued its order granting in part and denying in part the Company's motion to dismiss the consolidated amended class action complaint. In its order, the court dismissed certain claims, while allowing others to remain, and dismissed all class action claims against the named Funds. Pursuant to stipulation, the court also dismissed all claims against certain individual defendants, including the independent directors to the named Funds, and a former Company executive. The Company's motion to dismiss the consolidated fund derivative action remains under submission with the court.

In addition, as previously reported, Franklin Templeton Investments Corp. (FTIC), a subsidiary of the Company and the investment manager of Franklin Templeton's Canadian mutual funds, is named (along with several other non-Franklin affiliated investment manager defendants) in two market-timing lawsuits in Canada that are styled as class actions. The lawsuits contain allegations similar or identical to allegations asserted by the Ontario Securities Commission in its March 3, 2005 order concerning market-timing activities by three institutional investors in certain Canadian mutual funds managed by FTIC between February 1999 and February 2003, as previously reported. The lawsuits seek, among other relief, monetary damages, punitive damages, an order barring any increase in management fees for a period of two years following judgment, and/or attorneys' fees and costs, as follows: Huneault v. AGF Funds, Inc., et al., Case No. 500-06-000256-046, filed on October 25, 2004 in the Superior Court for the Province of Quebec, District of Montreal; and Fischer, et al. v. IG Investment Management Ltd., et al. Case No. 06-CV-307599CP, filed on March 9, 2006 in the Ontario Superior Court of Justice.

Plaintiffs in the Fischer lawsuit served defendants with a motion for authorization to institute a class action in July 2007. Defendants filed their evidence in opposition to that motion on September 29, 2008.

Management strongly believes that the claims made in each of the unresolved lawsuits identified above are without merit and intends to defend against them vigorously. The Company cannot predict with certainty, however, the eventual outcome of those lawsuits, nor whether they will have a material negative impact on the Company.

The Company is from time to time involved in litigation relating to claims arising in the normal course of business. Management is of the opinion that the ultimate resolution of such claims will not materially affect the Company's business, financial position, and results of operations. In management's opinion, an adequate accrual has been made as of December 31, 2008 to provide for any probable losses that may arise from these matters for which the Company could reasonably estimate an amount.

Variable Interest Entities

The Company's variable interest entities (VIEs) primarily include certain sponsored investment products and certain other investment products (collectively, investment products). The Company's variable interests generally include its equity ownership interest in the investment products, and its investment management and related services fees received from sponsored investment products.

Total assets under management of investment products in which the Company held a variable interest, but was not the primary beneficiary were approximately \$28.0 billion at December 31, 2008. The carrying values of the Company's equity ownership interest and investment management and related service fees receivable for investment products in the Company's condensed consolidated balance sheet at December 31, 2008 are set forth below. These amounts represent the Company's maximum exposure to loss.

(in thousands)

Current Assets	
Receivables	\$ 40,618
Investment securities, trading	88,633
Investment securities, available-for-sale	122,252
Total Current	\$ 251,503
Non-Current Assets	
Investment securities, available-for-sale	\$ 21,454
Investments in equity method investees and other	276,123
Total Non-Current	\$ 297,577

While the Company has no contractual obligation to do so, it routinely participates in financing the initial launch of its sponsored investment products. The Company also may voluntarily elect to provide its sponsored investment products with additional direct or indirect financial support based on its business objectives. During October and November 2008 the Company invested \$140.0 million in shares of one of its funds

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

in India in response to unprecedented levels of fund redemptions. By December 2008 the fund's liquidity position had improved and the Company redeemed \$50.0 million of its investment. The Company currently expects to redeem the balance of its investment, which is classified as investment securities, trading in the table above, in March 2009.

The Company's other VIEs include limited liability partnerships, limited liability companies, and joint ventures. The Company's variable interest generally comprises its equity ownership interest. These investments are recognized as investments in equity method investees because the Company is not the primary beneficiary. The investment carrying values in the Company's condensed consolidated balance sheet related to these VIEs was \$69.2 million at December 31, 2008. This amount represents the Company's maximum exposure to loss. The Company has not provided financial or other support to its other VIEs during the three months ended December 31, 2008.

The other VIEs include LFL and LAFL, in which the Company has a 49% ownership interest. At December 31, 2008, LFL had approximately \$2.5 million in total assets and the Company's maximum exposure to loss related to LFL was limited to the carrying value of its investment totaling approximately \$1.2 million. At December 31, 2008, LAFL had approximately \$183.8 million in total assets and the Company's maximum exposure to loss related to LAFL totaled approximately \$90.9 million. The maximum exposure to loss related to LAFL is limited to the carrying value of the Company's investment and 49% of the liabilities of LAFL. The Company recognized pre-tax losses of approximately \$0.8 million for its share of LFL's and LAFL's net losses for the three months ended December 31, 2008. Due to its significant interest in LAFL, the Company continues to carry on its balance sheet the DCA generated in the United States and the financing liability related to the future revenue originally sold to LFL and transferred to LAFL by Franklin/Templeton Distributors, Inc. until these assets are amortized or sold by LAFL. At December 31, 2008 the DCA and liability amounts were both \$104.9 million. Neither the Company nor its distribution subsidiaries retain any direct ownership interest in the future revenue sold, and, therefore, the future revenue is not available to satisfy claims of its creditors or those of its distribution subsidiaries.

Other Commitments and Contingencies

At December 31, 2008, the banking/finance segment had commitments to extend credit in an aggregate principal amount of \$169.4 million, primarily under credit card lines.

The Company in its role as agent or trustee facilitates the settlement of investor share purchase, redemption, and other transactions with affiliated mutual funds. The Company is appointed by the affiliated mutual funds as agent or trustee to manage, on behalf of the affiliated mutual funds, bank deposit accounts that contain only (i) cash remitted by investors to the affiliated mutual funds for the direct purchase of fund shares, or (ii) cash remitted by the affiliated mutual funds for direct delivery to the investors for either the proceeds of fund shares liquidated at the investors' direction, or dividends and capital gains earned on fund shares. As of December 31, 2008 and September 30, 2008, cash of approximately \$125.1 million and \$185.7 million was held off-balance sheet in agency or trust for investors and the affiliated mutual funds.

At December 31, 2008, there were no changes in other commitments and contingencies that would have a material effect on commitments and contingencies reported in the Company's Form 10-K for fiscal year 2008.

Note 12 - Stock-Based Compensation

The Company's stock-based compensation plans include the Amended and Restated Annual Incentive Plan (the "AIP") and the 2002 Universal Stock Incentive Plan, as amended and restated (the "USIP"). Under the terms of the AIP, eligible employees may receive cash, equity awards, and/or cash-settled equity awards generally based on the performance of Franklin Templeton Investments, its funds, and the individual employee. The USIP provides for the issuance of up to 30.0 million shares of the Company's common stock for various stock-related awards to officers, directors, and employees. At December 31, 2008, approximately 4.1 million shares were available for grant under the USIP. In addition to stock awards and stock unit awards, the Company may award options and other forms of stock-based compensation to officers, directors, and employees under the USIP. The Compensation Committee of the Board of Directors determines the terms and conditions of awards under the AIP and the USIP. Compensation expense for these plans is recognized in accordance with FASB Statement of Financial Accounting Standards No 123 (revised 2004), Share-Based Payment ("SFAS 123R").

Stock Options

The following table summarizes stock option activity:

<i>(in thousands, except weighted-average exercise price)</i>	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at September 30, 2008	3,381	\$ 37.84	3.6	\$ 170,031
Exercised	(44)	36.34	2.8	
Cancelled/expired	(32)	36.19	3.4	
Outstanding and Exercisable at December 31, 2008	3,305	\$ 37.88	3.4	\$ 85,591

Stock option awards outstanding under the USIP generally have been granted at prices that are either equal to or above the market value of the underlying common stock on the date of grant, generally vest over three years and expire no later than ten years after the grant date. No stock option awards have been granted under the USIP since November 2004. All stock options were fully vested and all related compensation cost was recognized prior to fiscal year 2008.

Stock Awards and Stock Unit Awards

The fair value of stock awards and stock unit awards granted under the USIP is estimated on the date of grant based on the market price of the underlying shares of common stock and is amortized to compensation expense on a straight-line basis over the related vesting period, which is generally three to four years. The total number of stock awards and stock unit awards expected to vest is adjusted for estimated forfeitures.

Total unrecognized compensation cost related to nonvested stock awards and stock unit awards, net of estimated forfeitures, was \$127.0 million at December 31, 2008. This cost is expected to be recognized over a remaining weighted-average vesting period of 2.0 years.

The following is a summary of nonvested stock award and stock unit award activity:

<i>(shares in thousands)</i>	Shares	Weighted-Average Grant-Date Fair Value
Nonvested balance at September 30, 2008	919	\$116.12
Granted	996	68.67
Forfeited/cancelled	(24)	105.14
Nonvested Balance at December 31, 2008	1,891	\$ 91.26

The stock awards generally entitle holders to the right to sell their shares of common stock once the awards vest. Stock unit awards generally entitle holders to receive the underlying shares of common stock once the awards vest. In addition, certain performance-based stock awards were granted to the Chief Executive Officer. The total number of shares ultimately received by the Chief Executive Officer depends on the Company's performance against specified performance goals and is subject to vesting provisions. At December 31, 2008, the balance of nonvested shares granted to the Chief Executive Officer and subject to vesting upon the achievement of prior years' performance goals, set or determined in prior years, was 12.3 thousand and had a weighted-average grant-date fair value of \$121.76 per share.

Employee Stock Investment Plan

The amended and restated Franklin Resources, Inc. 1998 Employee Stock Investment Plan (the "ESIP"), allows eligible participants to buy shares of the Company's common stock at a discount of its market value on defined dates. The Compensation Committee and the Board of Directors determine the terms and conditions of awards under the ESIP. No shares were issued under the ESIP during the three months ended December 31, 2008. At December 31, 2008, approximately 3.6 million shares were reserved for future issuance under this plan.

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

Effective August 1, 2008, the terms of the ESIP were amended to allow eligible participants to buy shares of the Company's common stock at 85% of its market value on defined dates and the Company's discretionary match was discontinued.

All Stock-Based Plan Arrangements

Total stock-based compensation costs of \$18.7 million and \$16.3 million were recognized in the condensed consolidated statements of income for the three months ended December 31, 2008 and 2007.

Cash received from stock option exercises for the three months ended December 31, 2008 and 2007 was \$3.1 million and \$2.5 million. The income tax benefits from all stock-based arrangements totaled \$2.3 million and \$31.9 million for the three months ended December 31, 2008 and 2007. These amounts included \$3.4 million and \$16.6 million of the income tax benefits from stock option exercises.

The Company generally does not repurchase shares upon share option exercise or vesting of stock awards and stock unit awards. However, in order to pay taxes due in connection with the vesting of employee and executive officer stock awards and stock unit awards under the USIP and in connection with matching grants under the ESIP, shares are repurchased using a net stock issuance method.

Note 13 - Common Stock Repurchases

During the three months ended December 31, 2008, the Company repurchased 0.7 million shares of its common stock at a cost of \$40.7 million. The common stock repurchases made as of December 31, 2008 reduced capital in excess of par value to nil and the excess amount was recognized as a reduction to retained earnings. At December 31, 2008, approximately 4.4 million shares of common stock remained available for repurchase under the stock repurchase program. During the three months ended December 31, 2007, the Company repurchased 6.5 million shares of common stock at a cost of \$780.5 million. The stock repurchase program is not subject to an expiration date.

Note 14 - Segment Information

The Company bases its operating segment selection process primarily on services offered. The Company derives the majority of its operating revenues and net income from providing investment management and related services to its retail mutual funds, and to institutional, high net-worth and separately-managed accounts and other investment products. This is the Company's primary business activity and operating segment. The Company's sponsored investment products and investment management and related services are distributed or marketed to the public globally under six distinct brand names: Franklin, Templeton, Mutual Series, Bissett, Fiduciary Trust and Darby.

The Company's secondary business and operating segment is banking/finance. The banking/finance segment offers selected retail banking and consumer lending services and private banking services to high net-worth clients. Consumer lending and retail banking activities include automobile lending services related to the purchase, securitization, and servicing of retail installment sales contracts originated by independent automobile dealerships, consumer credit and debit cards, real estate equity lines, home equity/mortgage lending, and other consumer lending.

Financial information for the two operating segments is presented in the table below. Inter-segment transactions are immaterial and excluded from segment income (losses) and assets. Operating revenues of the banking/finance segment are reported net of interest expense and the provision for loan losses.

<i>(in thousands)</i>	Investment Management and Related Services			Banking/ Finance	Totals
as of and for the three months ended December 31, 2008					
Assets	\$ 7,774,200	\$ 1,213,152			\$ 8,987,352
Operating revenues	975,959	(6,629)			969,330
Income (losses) before taxes	219,831	(34,160)			185,671
for the three months ended December 31, 2007					
Operating revenues	\$ 1,672,718	\$ 12,873			\$ 1,685,591
Income before taxes	704,657	4,823			709,480
as of September 30, 2008					
Assets	\$ 8,115,141	\$ 1,061,379			\$ 9,176,520

Operating revenues of the banking/finance segment included above were as follows:

<i>(in thousands)</i>	Three Months Ended December 31,	
	2008	2007
Interest and fees on loans	\$ 6,053	\$ 15,653
Interest and dividends on investment securities	6,976	5,436
Total interest income	13,029	21,089
Interest on deposits	(1,758)	(3,099)
Interest on short-term debt	(771)	(7,527)
Interest on long-term debt	(410)	
Total interest expense	(2,939)	(10,626)
Net interest income	10,090	10,463
Unrealized losses on trading investments, net	(17,703)	(334)
Other income	5,086	5,350
Provision for loan losses	(4,102)	(2,606)
Total	\$ (6,629)	\$ 12,873

The investment management and related services segment incurs substantially all of the Company's depreciation and amortization costs and expenditures on long-lived assets.

Note 15 - Banking Regulatory Ratios

The Company is a bank holding company and a financial holding company subject to various regulatory capital requirements administered by federal banking agencies, including the Federal Reserve Board. Failure to meet minimum capital requirements can result in certain mandatory, and possibly additional, discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial statements. The Company must meet specific capital adequacy guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require us to maintain a minimum Tier 1 capital and Tier 1 leverage ratio (as defined in the regulations), as well as minimum Tier 1 and Total risk-based capital ratios (as defined in the regulations). Based on the calculations as of December 31, 2008 and September 30, 2008, the Company exceeded the applicable capital adequacy requirements as listed below.

<i>(dollar amounts in thousands)</i>	December 31, 2008	September 30, 2008	Capital Adequacy Minimum
Tier 1 capital	\$ 5,093,201	\$ 5,108,763	N/A
Total risk-based capital	5,102,198	5,115,055	N/A
Tier 1 leverage ratio	73%	71%	4%
Tier 1 risk-based capital ratio	100%	101%	4%
Total risk-based capital ratio	100%	101%	8%

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.
Forward-Looking Statements**

In this section, we discuss and analyze the results of operations and financial condition of the Company and its subsidiaries. In addition to historical information, we also make statements relating to the future, called forward-looking statements, which are provided under the safe harbor protection of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are generally written in the future tense and/or are preceded by words such as will, may, could, expect, believe, anticipate, intend, or other similar words. Moreover, statements that speculate about future events are forward-looking statements. These forward-looking statements involve a number of known and unknown risks, uncertainties and other important factors that could cause the actual results and outcomes to differ materially from any future results or outcomes expressed or implied by such forward-looking statements. You should carefully review the Risk Factors section set forth below and in any more recent filings with the SEC, each of which describes these risks, uncertainties and other important factors in more detail. While forward-looking statements are our best prediction at the time that they are made, you should not rely on them. If a circumstance occurs after the date of this Form 10-Q that causes any of our forward-looking statements to be inaccurate, we do not have an obligation, and we undertake no obligation, to announce publicly the change to our expectations, or to make any revisions to our forward-looking statements, unless required by law.

The following discussion should be read in conjunction with our Form 10-K for the fiscal year ended September 30, 2008 filed with the SEC, and the condensed consolidated financial statements and notes thereto included elsewhere in this Form 10-Q.

Overview

We are a global investment management company and derive the majority of our operating revenues and net income from providing investment management and related services to our retail mutual funds, and to institutional, high net-worth, and separately-managed accounts and other investment products. Our services include fund administration, shareholder services, transfer agency, underwriting, distribution, custodial, trustee and other fiduciary services. Our sponsored investment products and investment management and related services are distributed or marketed to the public globally under six distinct brand names: Franklin, Templeton, Mutual Series, Bissett, Fiduciary Trust and Darby.

We offer a broad range of sponsored investment products under equity, hybrid, fixed-income and money market categories that meet a wide variety of specific investment needs of individual and institutional investors.

The level of our revenues depends largely on the level and relative mix of assets under management. As noted in the Risk Factors section set forth below, the amount and mix of our assets under management are subject to significant fluctuations and could negatively impact our revenues and income. To a lesser degree, our revenues also depend on the level of mutual fund sales and the number of mutual fund shareholder accounts. The fees charged for our services are based on contracts with our sponsored investment products or our clients. These arrangements could change in the future.

Our secondary business is banking/finance. Our banking/finance group offers retail banking and consumer lending services and private banking services to high net-worth clients. Our consumer lending and retail banking activities include automobile lending related to the purchase, securitization, and servicing of retail installment sales contracts originated by independent automobile dealerships, consumer credit and debit cards, real estate equity lines, and home equity/mortgage lending.

During the three months ended December 31, 2008, the ongoing global financial crisis worsened and the economy deteriorated into a recession. The turmoil in the global financial markets, evidenced by a 22% decrease in both the MSCI World and S&P 500 indexes during the quarter, has impacted the entire asset management industry. The unprecedented downturn in the markets has significantly affected our assets under management, fee revenues and non-operating income, all of which decreased sharply during the quarter. We expect that the market conditions will continue to put pressure on our financial results throughout fiscal year 2009.

Our total assets under management at December 31, 2008 were \$416.2 billion, 35% lower than they were at December 31, 2007 and 18% below the level at September 30, 2008. Market depreciation of \$71.0 billion during the first quarter accounted for 78% of the quarterly decrease. Sales activity continued to slow and redemptions remained at elevated levels during the quarter as investor demand continued to shift to lower risk investments, resulting in negative net flows of \$18.2 billion. Simple monthly average assets under management for the quarter decreased 33% from the same period in the prior fiscal year and 21% from the prior quarter.

We have taken steps to manage our business and our cost structure to respond to the market conditions and resulting decrease in revenue, including reducing expenditures in areas such as travel and entertainment, advertising, and contractor and professional fees, and deferring non-business critical initiatives and hiring. In addition, we deferred the launch of new investment products and merged products that have not met their growth objectives. We also announced a reduction in our workforce of approximately 2% during the quarter and an additional 4% in January 2009, and did not provide annual merit salary increases. We are continuing to assess and implement cost reduction measures as we adapt to the unprecedented changes affecting our industry.

Challenging market conditions continued to persist as of the beginning of calendar year 2009 and remain in the forecast for the foreseeable future. As we confront the challenges of this economic environment, we expect to continue to focus on the investment performance of our sponsored investment products and to provide high quality customer service to our clients. While we are focused on reducing costs, we will also seek to attract, retain and develop employees and invest strategically in systems and technology that will provide secure, stable environments and economies of scale. We will continue to protect and further our brand recognition while developing and maintaining broker/dealer and client relationships. The success of these and other strategies may be influenced by the factors discussed in the Risk Factors section set forth below.

RESULTS OF OPERATIONS

	Three Months Ended		Percent Change
	December 31,		
	2008	2007	
<i>(dollar amounts in millions, except per share data)</i>			
Operating Income	\$ 268.4	\$ 635.7	(58)%
Net Income	120.9	518.3	(77)%
Earnings Per Share			
Basic	\$ 0.52	\$ 2.15	(76)%
Diluted	0.52	2.12	(75)%
Operating Margin ¹	28%	38%	

¹ Defined as operating income divided by total operating revenues.

Operating income decreased 58% during the three months ended December 31, 2008 as compared to the same period in the prior year. Adverse market conditions led to a 42% decrease in operating revenues as we experienced a 33% decrease in our simple monthly average assets under management and a higher proportion of fixed-income assets under management. As described above, we have taken actions to reduce our operating expenses in response to the market conditions and resulting revenue decreases, contributing to a 33% operating expense decrease as compared to the same period in the prior fiscal year.

Net income decreased 77% for the three months ended December 31, 2008, resulting from a \$367.3 million decline in operating income and a \$156.4 million decline in non-operating income. Other income (expenses), net was significantly impacted by lower investment valuations during the quarter, resulting in losses of \$82.7 million as compared to income of \$73.8 million in the same period in the prior fiscal year. Decreased fair values of the underlying securities in our consolidated sponsored investment products and in our other trading investments, other-than-temporary impairments and realized losses from our available-for-sale investments, and losses from equity method investees were the primary causes of the non-operating losses.

ASSETS UNDER MANAGEMENT

Assets under management by investment objective were as follows:

<i>(dollar amounts in billions)</i>	December 31, 2008	December 31, 2007	Percent Change
Equity			
Global/international	\$ 142.6	\$ 286.1	(50)%
Domestic (U.S.)	55.2	95.8	(42)%
Total equity	197.8	381.9	(48)%
Hybrid	78.8	116.4	(32)%
Fixed-Income			
Tax-free	56.1	59.3	(5)%
Taxable			
Global/international	45.9	48.3	(5)%
Domestic (U.S.)	29.8	31.5	(5)%
Total fixed-income	131.8	139.1	(5)%
Money Market	7.8	6.3	24%
Total	\$ 416.2	\$ 643.7	(35)%
Simple Monthly Average for the Three-Month Period¹	\$ 438.7	\$ 651.5	(33)%

¹ Investment management fees from approximately 51% of our assets under management at December 31, 2008 were calculated using daily average assets under management.

Assets under management at December 31, 2008 were 35% lower than they were at December 31, 2007, primarily due to market depreciation of \$191.2 billion and negative net flows of \$31.7 billion during the twelve month period. The reductions occurred predominantly in equity products as market volatility led to significant valuation decreases and a shift in investor demand to lower risk investments. Simple monthly average assets under management, which are generally more indicative of trends in revenue for providing investment management and fund administration services than the year over year change in ending assets under management, decreased 33% during the year.

The simple monthly average mix of assets under management is shown below. The change in mix for the three months ended December 31, 2008 as compared to the same period in the prior fiscal year reflects an investor shift to lower risk investments during the prior twelve months.

	Three Months Ended December 31,	
	2008	2007
Equity	49%	60%
Hybrid	19%	18%
Fixed-income	30%	21%
Money market	2%	1%
Total	100%	100%

Assets under management by sales region were as follows:

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

<i>(dollar amounts in billions)</i>	December 31, 2008	Percent of Total	December 31, 2007	Percent of Total
United States	\$ 313.8	75%	\$ 462.2	72%
Europe ¹	41.2	10%	77.8	12%
Asia-Pacific ²	35.9	9%	55.9	9%
Canada	25.3	6%	47.8	7%
Total	\$ 416.2	100%	\$ 643.7	100%

¹ Europe sales region includes Middle East and Africa.

² Asia-Pacific sales region includes Latin America.

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

As shown in the table above, approximately 75% of our assets under management at December 31, 2008 originated from our U.S. sales region. In addition, approximately 69% of our operating revenues originated from our U.S. operations in the three months ended December 31, 2008. Due to the global nature of our business operations, investment management and related services may be performed in locations unrelated to the sales region.

Components of the change in our assets under management were as follows:

<i>(dollar amounts in billions)</i>	Three Months Ended		Percent Change
	December 31, 2008	December 31, 2007	
Beginning assets under management	\$ 507.3	\$ 645.9	(21)%
Sales	30.2	50.5	(40)%
Redemptions	(48.4)	(45.9)	5%
Net new flows	(18.2)	4.6	NM
Reinvested distributions	7.1	19.5	(64)%
Net flows	(11.1)	24.1	NM
Distributions	(9.0)	(23.1)	(61)%
Depreciation and other	(71.0)	(3.2)	NM
Ending Assets Under Management	\$ 416.2	\$ 643.7	(35)%

Assets under management decreased during the quarter ended December 31, 2008 as the ongoing market downturn worsened and asset values eroded, resulting in \$71.0 billion of depreciation in our products. Sales activity continued to slow and redemptions remained at elevated levels during the quarter, resulting in negative net flows of \$18.2 billion. The market depreciation and net outflows predominantly resulted from our equity products. During the more favorable market period of the three months ended December 31, 2007, our products experienced growth in net new flows.

Investment Management Fee Rate

For the three months ended December 31, 2008, our effective investment management fee rate (investment management fees divided by simple monthly average assets under management) decreased to 0.547% from 0.626% for the three months ended December 31, 2007. The decrease was primarily due to a shift in the mix of assets under management from equity products towards fixed-income products. This shift mainly resulted from depreciation and net outflows of equity products during the quarter. Generally, investment management fees earned on equity products are higher than fees earned on fixed-income products.

OPERATING REVENUES

The table below presents the percentage change in each revenue category and the percentage of total operating revenues represented by each revenue category.

<i>(dollar amounts in millions)</i>	Three Months Ended		Percent Change
	December 31, 2008	December 31, 2007	
Investment management fees	\$ 600.3	\$ 1,020.3	(41)%
Underwriting and distribution fees	304.9	573.8	(47)%
Shareholder servicing fees	66.3	73.2	(9)%
Consolidated sponsored investment products income, net	1.9	2.9	(34)%
Other, net	(4.1)	15.4	NM
Total Operating Revenues	\$ 969.3	\$ 1,685.6	(42)%

Investment Management Fees

Edgar Filing: FRANKLIN RESOURCES INC - Form 10-Q

Investment management fees are generally calculated under contractual arrangements with our sponsored investment products as a percentage of the market value of assets under management. Annual rates vary by investment objective and type of services provided.

Investment management fees decreased for the three months ended December 31, 2008 primarily due to a 33% decrease in simple monthly average assets under management. The decrease was also impacted by a lower effective management fee rate for the quarter, resulting from a higher mix of fixed-income assets, which generally carry lower investment management fees. The lower level of assets under management at period end will lead to further reductions in management fees in future periods, which will also be affected by future changes in asset flows and mix.

Underwriting and Distribution Fees

We earn underwriting fees from the sale of certain classes of sponsored investment products on which investors pay a sales commission at the time of purchase. Sales commissions are reduced or eliminated on some share classes and for some sale transactions depending upon the amount invested and the type of investor. Therefore, underwriting fees will change with the overall level of gross sales, the size of individual transactions, and the relative mix of sales between different share classes and types of investors.

Globally, our mutual funds and certain other products generally pay us distribution fees in return for sales, marketing and distribution efforts on their behalf. Specifically, the majority of U.S.-registered mutual funds, with the exception of certain of our money market mutual funds, have adopted distribution plans (the Plans) under Rule 12b-1 promulgated under the Investment Company Act of 1940, as amended (Rule 12b-1). The Plans permit the mutual funds to bear certain expenses relating to the distribution of their shares, such as expenses for marketing, advertising, printing and sales promotion, subject to the Plans' limitations on amounts. The individual Plans set a percentage limit for Rule 12b-1 expenses based on average daily net assets under management of the mutual fund. Similar arrangements exist for the distribution of our non-U.S. funds and where, generally, the distributor of the funds in the local market arranges for and pays commissions.

We pay a significant portion of underwriting and distribution fees to the financial advisers and other intermediaries who sell our sponsored investment products to the public on our behalf. See the description of underwriting and distribution expenses below.

Underwriting and distribution fees decreased for the three months ended December 31, 2008. Underwriting fees decreased 58% primarily due to a 40% decrease in commissionable sales combined with a shift in sales from equity products to fixed-income products, which typically generate lower underwriting fees. Distribution fees decreased 41% primarily due to a 33% decrease in simple monthly average assets under management and a shift in simple monthly average mix of assets under management from equity products to fixed-income products. Distribution fees are generally higher for equity products, as compared to fixed-income products.

Shareholder Servicing Fees

Shareholder servicing fees are generally fixed charges per shareholder account that vary with the particular type of fund and the service being rendered. In some instances, sponsored investment products are charged these fees based on the level of assets under management. We receive fees as compensation for providing transfer agency services, which include providing customer statements, transaction processing, customer service and tax reporting. In the United States, transfer agency service agreements provide that accounts closed in a calendar year generally remain billable at a reduced rate through the second quarter of the following calendar year. In Canada, such agreements provide that accounts closed in the calendar year remain billable for four months after the end of the calendar year. Accordingly, the level of fees will vary with the growth in new accounts and the level of closed accounts that remain billable.

Shareholder servicing fees decreased for the three months ended December 31, 2008, primarily due to a 1% decrease in simple monthly average billable shareholder accounts, an increase in the percentage of closed accounts and an unfavorable currency impact. The accounts decrease was predominantly related to shareholder accounts originated in Canada and the United States, which are generally billable at higher rates than in other markets.

Consolidated Sponsored Investment Products Income, Net

Consolidated sponsored investment products income, net reflects the net investment income, including dividend and interest income, of sponsored investment products that we consolidate in our financial statements.

Consolidated sponsored investment products income, net decreased for the three months ended December 31, 2008. The decrease reflects lower investment performance and net asset balances of the specific sponsored investment products that we consolidated during each period.

Other, Net

Other, net revenue primarily consists of revenues from the banking/finance segment as well as income from custody services. Banking/finance revenues include interest income on loans, servicing income, and realized and unrealized gains (losses) on an interest-only strip receivable from securitization transactions, and are reduced by interest expense and the provision for loan losses.

Other, net revenue decreased for the three months ended December 31, 2008, primarily due to a \$17.7 million decline in the fair value of the interest-only strip receivable.

OPERATING EXPENSES

The table below presents the percentage change in each expense category and the percentage of total operating expenses represented by each expense category.

<i>(dollar amounts in millions)</i>	Three Months Ended		Percent Change
	December 31, 2008	2007	
Underwriting and distribution	\$ 289.5	\$ 552.6	(48)%
Compensation and benefits	244.1	280.3	(13)%
Information systems, technology and occupancy	68.6	79.6	(14)%
Advertising and promotion	24.2	46.6	(48)%
Amortization of deferred sales commissions	36.6	44.6	(18)%
Other	38.0	46.2	(18)%
Total Operating Expenses	\$ 701.0	\$ 1,049.9	(33)%

Underwriting and Distribution

Underwriting and distribution expenses include payments to financial advisers and other third parties for providing sales, marketing and distribution services to investors in our sponsored investment products. The decrease in underwriting and distribution expenses for the three months ended December 31, 2008 was consistent with the 47% decrease in underwriting and distribution revenues during the quarter.

Compensation and Benefits

Compensation and benefit expenses decreased for the three months ended December 31, 2008, primarily due to a \$25.3 million decrease in variable compensation. Also contributing to the decrease was a \$22.1 million decline in salaries, wages and benefits mainly resulting from lower staffing levels, a favorable currency impact and lower market-based compensation costs. These decreases were partially offset by \$11.2 million of severance costs related to the 2% reduction in our global workforce announced in October 2008.

The decreased expenses during the quarter reflect in part some of the actions we have taken to contain costs, including reducing variable compensation and not providing annual merit salary increases. Our number of employees decreased to approximately 8,600 at December 31, 2008, from approximately 8,900 at December 31, 2007. During January 2009, we announced a further reduction in our global workforce of approximately 4% and expect to recognize related severance costs of approximately \$13.0 million during the second quarter.

We continue to place a high emphasis on our pay for performance philosophy. As such, any changes in the underlying performance of our sponsored investment products or changes in the composition of our incentive compensation offerings could have an impact on compensation and benefit expenses going forward. However, in order to attract and retain talented individuals, our level of compensation and benefit expenses may increase more quickly or decrease more slowly than our revenue.

Information Systems, Technology and Occupancy

Information systems, technology and occupancy costs decreased for the three months ended December 31, 2008, primarily due to lower costs incurred for external data services, technology consulting, and occupancy. The lower costs resulted in part from our cost reduction efforts to defer non-business critical initiatives and to reduce expenditures for contractors and professional fees.

Details of capitalized information systems and technology costs, which exclude occupancy costs, are shown below.

<i>(in millions)</i>	Three Months Ended December 31,	
	2008	2007
Net carrying amount at beginning of period	\$ 66.5	\$ 61.6
Additions during period, net of disposals and other adjustments	15.3	8.4
Amortization during period	(7.9)	(6.6)
Net Carrying Amount at End of Period	\$ 73.9	\$ 63.4

Advertising and Promotion

Advertising and promotion expense decreased for the three months ended December 31, 2008, primarily due to a \$12.8 million decrease in marketing support payments to intermediaries, resulting from lower product sales and assets under management. Also contributing to the decrease were lower advertising, travel, sales promotions and printing costs primarily as a result of our global cost reduction initiatives.

We are committed to investing in advertising and promotion in response to changing business conditions, and to advance our products where we see continued or potential new growth opportunities. As a result of potential changes in our strategic marketing campaigns, the level of advertising and promotion expenditures may increase more rapidly, or decrease more slowly, than our revenues.

Amortization of Deferred Sales Commissions

Certain fund share classes sold globally, including Class C and Class R shares marketed in the United States, are sold without a front-end sales charge to shareholders, although our distribution subsidiaries pay an up-front commission to financial intermediaries on these sales. In addition, certain share classes, such as Class A shares sold in the United States, are sold without a front-end sales charge to shareholders when minimum investment criteria are met, although our distribution subsidiaries pay an up-front commission to financial intermediaries on these sales. We defer all up-front commissions paid by our distribution subsidiaries and amortize them over the periods in which commissions are generally recovered from distribution and service fee revenues and contingent sales charges received from shareholders of the funds upon redemption of their shares. We evaluate deferred commission assets (DCA) for recoverability on a periodic basis using undiscounted expected cash flows from the shares of mutual funds sold without a front-end sales charge.

The U.S. funds that had offered Class B shares and carried a deferred sales charge arrangement ceased offering these shares to new investors and existing shareholders at the end of fiscal year 2005. Existing Class B shareholders may continue to exchange shares into Class B shares of different funds and they may also continue to reinvest dividends on Class B shares in additional Class B shares. Historically, Class B and certain of our Class C DCA arising from our U.S., Canadian and European operations have been financed through sales of related future revenue or other arrangements with Lightning Finance Company Limited (LFL), a company registered in Ireland in which we hold a 49% ownership interest. In December 2005, LFL transferred substantially all of its rights to this future revenue to Lightning Asset Finance Limited (LAFL), an Irish special purpose vehicle formed for this sole purpose, in which we also hold a 49% ownership interest. The holder of the 51% ownership interests in both LFL and LAFL is a subsidiary of an international banking institution which is not affiliated with us. As of December 2005, our DCA have not been financed by LAFL.

Under the U.S. financing arrangements, the funds contracted with our U.S. distributor, which in turn contracted with LFL. As a result of our significant interest in both LFL and LAFL we continue to carry the DCA generated in the United States on our condensed consolidated balance sheets until these assets are amortized or sold by LAFL. Neither we nor our distribution subsidiaries retain any direct ownership interest in the

future revenue sold, and, therefore, the future revenue is not available to

satisfy claims of our creditors or those of our distribution subsidiaries. In contrast to the U.S. arrangements, the arrangements outside the United States are, in most cases, direct agreements with our Canadian and European sponsored investment products, and, as a result, we do not record DCA from these sources in our consolidated financial statements.

Amortization of deferred sales commissions decreased for the three months ended December 31, 2008 mainly due to lower product sales with up-front commissions, primarily related to U.S. and Canadian funds.