

WADDELL & REED FINANCIAL INC  
Form 10-K  
February 27, 2013

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

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**FORM 10-K**

**ý Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the fiscal year ended December 31, 2012**

**OR**

**o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**Commission file number 001-13913**

**WADDELL & REED FINANCIAL, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

51-0261715  
(I.R.S. Employer  
Identification No.)

6300 Lamar Avenue  
Overland Park, Kansas 66202  
913-236-2000

(Address, including zip code, and telephone number of Registrant's principal executive offices)

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**SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT**

**Title of each class**  
Class A Common Stock, \$.01 par value

**Name of each exchange on which registered**  
New York Stock Exchange

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**SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:**

**None**  
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ☒ NO ☐

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ☐ NO ☒.

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. ( ☐ )

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

|                         |                                  |                           |                       |
|-------------------------|----------------------------------|---------------------------|-----------------------|
| Large accelerated Filer | <input checked="" type="radio"/> | Accelerated Filer         | <input type="radio"/> |
| Non-accelerated Filer   | <input type="radio"/>            | Smaller Reporting Company | <input type="radio"/> |

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common stock equity held by non-affiliates (*i.e.* persons other than officers, directors and stockholders holding greater than 5% of the registrant's common stock) based on the closing sale price on June 30, 2012 was \$2.32 billion.

Shares outstanding of each of the registrant's classes of common stock as of February 15, 2013 Class A common stock, \$.01 par value: 85,595,304

### DOCUMENTS INCORPORATED BY REFERENCE

In Part III of this Form 10-K, portions of the definitive proxy statement for the 2013 Annual Meeting of Stockholders to be held April 17, 2013.

Index of Exhibits (Pages 84 through 88)  
Total Number of Pages Included Are 88

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**PART I**

**ITEM 1. Business**

**General**

Waddell & Reed Financial, Inc. (hereinafter referred to as the "Company," "we," "our" or "us") is a corporation, incorporated in the state of Delaware in 1981, that conducts business through its subsidiaries. Founded in 1937, we are one of the oldest mutual fund complexes in the United States, having introduced the Waddell & Reed Advisors Group of Mutual Funds (the "Advisors Funds") in 1940. Over time we added additional mutual fund families: Ivy Funds (the "Ivy Funds"), Ivy Funds Variable Insurance Portfolios ("Ivy Funds VIP") and InvestEd Portfolios, our 529 college savings plan ("InvestEd"). As of December 31, 2012, we had \$96.4 billion in assets under management.

We derive our revenues from providing investment management, investment product underwriting and distribution, and shareholder services administration to mutual funds and institutional and separately managed accounts. Investment management fees are based on the amount of average assets under management and are affected by sales levels, financial market conditions, redemptions and the composition of assets. Our underwriting and distribution revenues consist of commissions derived from sales of investment and insurance products, Rule 12b-1 asset-based service and distribution fees, distribution fees on certain variable products, fees earned on fee-based asset allocation products, and related advisory services. The products sold have various commission structures and the revenues received from those sales vary based on the type and amount sold. Shareholder service fees revenue includes transfer agency fees, custodian fees from retirement plan accounts, and portfolio accounting and administration fees, and is earned based on assets under management or number of client accounts.

We operate our business through three distinct distribution channels. Our retail products are distributed through third-parties such as other broker/dealers, registered investment advisors and various retirement platforms, (collectively, the "Wholesale channel") or through our sales force of independent financial advisors (the "Advisors channel") We also market our investment advisory services to institutional investors, either directly or through consultants (the "Institutional channel").

Our Wholesale channel efforts include retail fund distribution through broker/dealers (the largest method of distributing mutual funds for the industry), registered investment advisors (fee-based financial advisors who generally sell mutual funds through financial supermarkets) and retirement and insurance platforms. Assets under management in this channel were \$48.9 billion at the end of 2012.

In the Advisors channel, our sales force focuses its efforts primarily on financial planning, serving primarily middle class and mass affluent clients. We compete with smaller broker/dealers and independent financial advisors, as well as a span of other financial service providers. Assets under management in this channel were \$35.7 billion at December 31, 2012.

Through our Institutional channel, we manage assets in a variety of investment styles for a variety of types of institutions. The largest client type is funds that hire us to act as subadvisor; they are typically distributors who lack scale or the track record to manage internally, or choose to market multi-manager styles. Assets under management in the Institutional channel were \$11.8 billion at December 31, 2012.

**Organization**

We operate our investment advisory business through our subsidiary companies, primarily Waddell & Reed Investment Management Company ("WRIMCO"), a registered investment adviser and Ivy Investment Management Company ("IICO"), the registered investment adviser for Ivy Funds.

Our underwriting and distribution business operates through two broker/dealers: Waddell & Reed, Inc. ("W&R") and Ivy Funds Distributor, Inc. ("IFDI"). W&R is a registered broker/dealer and investment adviser that acts primarily as the national distributor and underwriter for shares of the Advisors

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Funds, other mutual funds and a distributor of variable annuities and other insurance products issued by our business partners. In addition, W&R is the ninth largest distributor of our Ivy Funds. IFDI is the distributor and underwriter for the Ivy Funds.

During 2012, the Company committed to a plan to sell its Legend group of subsidiaries ("Legend"), and on October 29, 2012 the Company signed a definitive agreement to execute the transaction. The sale closed effective January 1, 2013. Legend is a mutual fund distribution and retirement planning subsidiary based in Palm Beach Gardens, Florida. Through its network of financial advisors, Legend primarily serves employees of school districts and other not-for-profit organizations. Legend Advisory Corporation, the registered investment adviser for the Legend group, and Legend Equities Corporation, a registered broker/dealer ("LEC"), were among the subsidiaries sold.

Waddell & Reed Services Company ("WRSCO") provides transfer agency and accounting services to the Advisors Funds, Ivy Funds, Ivy Funds VIP and InvestEd. W&R, WRIMCO, WRSCO, IICO and IFDI are hereafter collectively referred to as the "Company," "we," "us" or "our" unless the context requires otherwise.

**Investment Management Operations**

Our investment advisory business provides one of our largest sources of revenues and profits. We earn investment management fee revenues by providing investment advisory and management services pursuant to investment management agreements with each fund within the Advisors Funds family, the Ivy Funds family, the Ivy Funds VIP family, and InvestEd (collectively, the "Funds"). While the specific terms of the agreements vary, the basic terms are similar. The agreements provide that we render overall investment management services to each of the Funds, subject to the oversight of each Fund's board of trustees and in accordance with each Fund's investment objectives and policies. The agreements permit us to enter into separate agreements for shareholder services or accounting services with each respective Fund.

Each Fund's board of trustees, including a majority of the trustees who are not "interested persons" of the Fund or the Company within the meaning of the Investment Company Act of 1940, as amended (the "ICA") ("disinterested members") and the Fund's shareholders must approve the investment management agreement between the respective Fund and the Company. These agreements may continue in effect from year to year if specifically approved at least annually by (i) the Fund's board, including a majority of the disinterested members, or (ii) the vote of a majority of both the shareholders of the Fund and the disinterested members of each Fund's board, each vote being cast in person at a meeting called for such purpose. Each agreement automatically terminates in the event of its assignment, as defined by the ICA or the Investment Advisers Act of 1940, as amended (the "Advisers Act"), and may be terminated without penalty by any Fund by giving us 60 days' written notice if the termination has been approved by a majority of the Fund's trustees or the Fund's shareholders. We may terminate an investment management agreement without penalty on 120 days' written notice.

In addition to performing investment management services for the Funds, we act as an investment adviser for institutional and other private investors and we provide subadvisory services to other investment companies. Such services are provided pursuant to various written agreements and our fees are generally based on a percentage of assets under management.

Our investment management team meets every morning in a collaborative setting that fosters idea sharing, yet reinforces individual accountability. Through all market cycles, we remain dedicated to the following investment principles:

Rigorous fundamental research    an enduring investment culture that dedicates itself to analyzing companies on our own rather than relying exclusively on widely available research produced by others.

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Collaboration and accountability a balance of collaboration and individual accountability, which ensures the sharing and analysis of investment ideas among investment professionals while empowering portfolio managers to shape their portfolios individually.

Focus on growing and protecting investors' assets a sound approach that seeks to capture asset appreciation when market conditions are favorable and strives to manage risk during difficult market periods.

These three principles shape our investment philosophy and money management approach. Over seven decades, our investment organization has delivered consistently competitive investment performance. Through bull and bear markets, our investment professionals have not strayed from what works a time-tested investment process and fundamental research. We believe investors turn to us because they appreciate that our investment approach continues to identify and create opportunities for wealth creation.

Our investment management team comprises 79 professionals including 32 portfolio managers who average 21 years of industry experience and 15 years of tenure with our firm. We have significant experience in virtually all major asset classes, several specialized asset classes and a range of investment styles. At December 31, 2012, over 75% of the Company's \$96.4 billion in assets under management were invested in equities, of which 72% was domestic and 28% was international. In recent years, we have supported growth of international investments by adding investment professionals native to countries that we consider emerging markets. They, along with other members of the investment team, focus on understanding foreign markets and capturing investment opportunities. Our investment management team also includes subadvisors who bring similar investment philosophies and additional expertise in specific asset classes.

**Investment Management Products**

Our mutual fund families offer a wide variety of investment options. We are the exclusive underwriter and distributor of 81 registered open-end mutual fund portfolios in the Advisors Funds, Ivy Funds, Ivy Funds VIP and InvestEd. The Advisors Funds, variable products offering the Ivy Funds VIP, and InvestEd are offered primarily through our financial advisors; in some circumstances, certain of these funds are also offered through the Wholesale channel. The Ivy Funds are offered through both our Wholesale channel and Advisors channel. The Funds' assets under management are included in either our Wholesale channel or our Advisors channel depending on which channel marketed the client account or is the broker of record.

We added one fund to our product line in 2012. We launched the Ivy Global Equity Income fund for investors interested in generating a reasonable level of current income given current market conditions. The fund focuses on equity securities issued by companies located largely in developed markets, of any size. Under normal circumstances, the fund invests at least 80% of its net assets in equity securities. For this purpose, equity securities consist primarily of dividend-paying common stocks across the globe. The fund also may invest in preferred stock, convertible securities, or other instruments whose price is linked to the value of common stock. The fund may invest in U.S. and non-U.S. issuers. Although the fund primarily invests in large cap companies, it may invest in companies of any size.

Additionally, in 2012, the Ivy International Balanced fund was renamed the Ivy Global Income Allocation fund. This fund seeks to provide total return through a combination of current income and capital appreciation. The fund invests principally in equity and debt securities issued by companies and governments of any size and under normal market conditions, invests primarily in income-producing securities across the globe. The fund may invest in U.S. and non-U.S. issuers. In an attempt to enhance return, the fund may also invest, to a lesser extent, in securities not currently providing income or in companies and governments in countries with new or comparatively undeveloped and emerging economies.

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**Other Products**

In our Advisors channel, we distribute various business partners' variable annuity products, which offer the Ivy Funds VIP as an investment vehicle. We also offer our Advisors channel customers retirement and life insurance products underwritten by our business partners. Through our insurance agency subsidiaries, our financial advisors also sell life insurance and disability products underwritten by various carriers.

In addition, we offer our Advisors channel customers fee-based asset allocation investment advisory products, including Managed Allocation Portfolio ("MAP"), MAPPlus and Strategic Portfolio Allocation ("SPA"), which utilize our Funds. As of December 31, 2012, clients had \$8.2 billion invested in our MAP, MAPPlus and SPA products. These assets are included in our mutual fund assets under management.

**Distribution Channels**

We distribute our investment products through the Wholesale, Advisors and Institutional channels.

*Wholesale Channel*

Our Wholesale channel generates sales through various third-party distribution outlets. Our assets under management in the Wholesale channel were \$48.9 billion at December 31, 2012, including \$2.6 billion in assets subadvised by other managers.

Our team of 50 external wholesalers lead our wholesaling efforts, which focus principally on distributing the Ivy Funds through three segments: broker/dealers (the largest method of distributing mutual funds for the industry and for us), retirement platforms (401(k) platforms using multiple managers) and registered investment advisors (fee-based financial advisors who generally sell mutual funds through financial supermarkets).

During 2012, our Ivy Asset Strategy fund continued to play a lead role in the Wholesale channel's results, comprising 32% of the channel's gross sales and 27% of total assets under management as of December 31, 2012. While we recognize the past success of this fund, we are also aware of the concentration risks to our revenue streams created by the size of this fund, despite its flexible mandate. Our compensation program for wholesalers encourages the sales of other products with track records of strong performance. Over the past three years, our wholesalers successfully marketed additional products to their financial advisor clients, which resulted in Wholesale channel sales for the Ivy Asset Strategy fund decreasing from 60% in 2010 to 32% in 2012. We plan to continue to stress diversification of sales as we enter 2013.

*Advisors Channel*

Assets under management in the Advisors channel were \$35.7 billion at December 31, 2012. Historically, our advisors have sold investment products primarily to middle income and mass affluent individuals, families and businesses across the country in geographic markets of all sizes. We assist clients on a wide range of financial issues with a significant focus on helping them plan, generally, for long-term investments such as retirement and education and offer one-on-one consultations that emphasize long-term relationships through continued service. As a result of this approach, this channel has developed a loyal customer base with clients maintaining their accounts significantly longer than the industry average. Over the past several years, we have expanded our Choice brokerage platform technology and offerings, which should allow us to competitively recruit experienced advisors.

As of December 31, 2012, our sales force consisted of 1,763 financial advisors who operate out of 165 offices located throughout the United States and 263 individual advisor offices. We believe, based on industry data, that our financial advisors are currently one of the largest sales forces in the United States selling primarily mutual funds, and that W&R, our broker/dealer subsidiary, ranks among the largest

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independent broker/dealers. As of December 31, 2012, our Advisors channel had approximately 484 thousand mutual fund customers.

Over the past several years, we have instituted more stringent production requirements for our sales force, which has resulted in a steady decline in our number of advisors. However, gross sales have not declined, and this channel produced 12% more in 2012 with 13% fewer advisors, on average, compared to 2010. This headcount decline leveled off during 2012. We utilize gross revenue per advisor to measure advisor productivity. For purposes of this measure, gross revenue consists of front-end load sales and distribution fee revenues, as would be received from an underwriter, from sales of both our Funds and other mutual funds. It also includes fee revenues from our asset allocation products and financial plans, and commission revenues earned on insurance products. Gross revenue per advisor was \$168 thousand, \$156 thousand and \$119 thousand for the years ended December 31, 2012, 2011 and 2010, respectively.

### *Institutional Channel*

Through this channel, we manage assets in a variety of investment styles for a variety of institutions. The largest client type is other asset managers that hire us to act as subadvisor; they are typically distributors who lack scale or the track record to manage internally, or choose to market multi-manager styles. Our diverse client list also includes corporations, foundations, endowments, Taft-Hartley plans and public funds, including defined benefit plans and defined contribution plans. Over time, the Institutional channel has been successful in developing subadvisory relationships. As of December 31, 2012, this type of business comprised more than 65% of the Institutional channel's assets, which management views as a positive development as it believes this type of business has better growth potential than the defined benefit business. Assets under management in the Institutional channel were \$11.8 billion at December 31, 2012.

### **Service Agreements**

We earn service fee revenues by providing various services to the Funds and their shareholders. Pursuant to the shareholder servicing agreements, we perform shareholder servicing functions for which the Funds pay us a monthly fee, including: maintaining shareholder accounts; issuing, transferring and redeeming shares; distributing dividends and paying redemptions; furnishing information related to the Funds; and handling shareholder inquiries. Pursuant to the accounting service agreements, we provide the Funds with bookkeeping and accounting services and assistance for which the Funds pay us a monthly fee, including: maintaining the Funds' records; pricing Fund shares; and preparing prospectuses for existing shareholders, proxy statements and certain other shareholder reports.

Agreements with the Funds may be adopted or amended with the approval of the disinterested members of each Fund's board of trustees and have annually renewable terms of one year.

### **Competition**

The financial services industry is a highly competitive global industry. According to the ICI, at the end of 2012 there were more than 8,700 open-end investment companies of varying sizes, investment policies and objectives whose shares are being offered to the public in the United States alone. Factors affecting our business include brand recognition, business reputation, investment performance, quality of service and the continuity of both client relationships and assets under management. A majority of mutual fund sales go to funds that are highly rated by a small number of well-known ranking services that focus on investment performance. Competition is based on distribution methods, the type and quality of shareholder services, the success of marketing efforts, and the ability to develop investment products for certain market segments to meet the changing needs of investors and to achieve competitive investment management performance.

We compete with hundreds of other mutual fund management, distribution and service companies that distribute their fund shares through a variety of methods, including affiliated and unaffiliated sales



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forces, broker/dealers and direct sales to the public of shares offered at a low or no sales charge. Many larger mutual fund complexes have significant advertising budgets and established relationships with brokerage houses with large distribution networks, which enable these fund complexes to reach broad client bases. Many investment management firms offer services and products similar to ours, as well as other independent financial advisors. We also compete with brokerage and investment banking firms, insurance companies, commercial banks and other financial institutions and businesses offering other financial products in all aspects of their businesses. Although no single company or group of companies consistently dominates the mutual fund management and services industry, many are larger than us, have greater resources and offer a wider array of financial services and products. We believe that competition in the mutual fund industry will increase as a result of increased flexibility afforded to banks and other financial institutions to sponsor mutual funds and distribute mutual fund shares. Additionally, barriers to entry into the investment management business are relatively few, and thus, we face a potentially growing number of competitors, especially during periods of strong financial and economic markets.

The distribution of mutual funds and other investment products has undergone significant developments in recent years, which has intensified the competitive environment in which we operate. These developments include the introduction of new products, increasingly complex distribution systems with multiple classes of shares, the development of internet websites providing investors with the ability to invest on-line, the introduction of sophisticated technological platforms used by financial advisors to sell and service mutual funds for their clients, the introduction of separately managed accounts previously available only to institutional investors to individuals, and growth in the number of mutual funds offered.

We believe we effectively compete across multiple dimensions of the asset management and broker/dealer businesses. First, we market our products, primarily the Ivy Funds family, to unaffiliated broker/dealers and advisors and compete against other asset managers offering mutual fund products. This distribution method allows us to move beyond proprietary distribution and increases our potential pool of clients. Competition is based on sales techniques, personal relationships and skills, and the quality of financial planning products and services offered. We compete against asset managers that are both larger and smaller than our firm, but we believe that the breadth and depth of our products position us to compete in this environment. Second, our proprietary broker/dealer consists of a sales force of independent contractors affiliated with our company who have access to our proprietary financial products. We believe our business model targets customers seeking personal assistance from financial advisors or planners where the primary competition is companies distributing products through financial advisors. Our financial advisors compete primarily with large and small broker/dealers, independent financial advisors, registered investment advisors and insurance representatives. The market for financial advice is extremely broad and fragmented. Finally, we compete in the institutional marketplace, working with consultants who select asset managers for various opportunities, as well as working directly with plan sponsors, foundations, endowments and other asset managers who hire subadvisors. In this marketplace, we compete with a broad range of asset managers.

We also face competition in attracting and retaining qualified financial advisors and employees. To maximize our ability to compete effectively in our business, we offer competitive compensation.

**Regulation**

The securities industry is subject to extensive regulation and virtually all aspects of our business are subject to various federal and state laws and regulations. These laws and regulations are primarily intended to protect investment advisory clients and shareholders of registered investment companies. Under such laws and regulations, agencies and organizations that regulate investment advisers, broker/dealers, and transfer agents like us have broad administrative powers, including the power to limit, restrict or prohibit an investment adviser, broker/dealer or transfer agent from carrying on its business in the event that it fails to comply with applicable laws and regulations. In such event, the possible sanctions that may be imposed include, but are not limited to, the suspension of individual employees or agents, limitations on engaging in

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certain lines of business for specified periods of time, censures, fines and the revocation of investment adviser and other registrations.

The Securities and Exchange Commission (the "SEC") is the federal agency responsible for the administration of federal securities laws. Certain of our subsidiaries are registered with the SEC as investment advisers under the Advisers Act, which imposes numerous obligations on registered investment advisers including, among other things, fiduciary duties, record-keeping and reporting requirements, operational requirements and disclosure obligations, as well as general anti-fraud prohibitions. Investment advisers are subject to periodic examination by the SEC, and the SEC is authorized to institute proceedings and impose sanctions for violations of the Advisers Act, ranging from censure to termination of an investment adviser's registration.

Our Funds are registered as investment companies with the SEC under the ICA, and various filings are made with states under applicable state rules and regulations. The ICA regulates the relationship between a mutual fund and its investment adviser and prohibits or severely restricts principal transactions and joint transactions. Various regulations cover certain investment strategies that may be used by the Funds for hedging and/or speculative purposes. To the extent the Funds purchase futures contracts, options on futures contracts and foreign currency contracts, they are subject to the commodities and futures regulations of the Commodity Futures Trading Commission.

We derive a large portion of our revenues from investment management agreements. Under the Advisers Act, our investment management agreements terminate automatically if assigned without the client's consent. Under the ICA, investment advisory agreements with registered investment companies, such as the Funds, terminate automatically upon assignment. The term "assignment" is broadly defined and includes direct assignments, as well as assignments that may be deemed to occur, under certain circumstances, upon the transfer, directly or indirectly, of a controlling interest in the Company.

The Company is also subject to federal and state laws affecting corporate governance, including the Sarbanes-Oxley Act of 2002 ("S-OX"), as well as rules adopted by the SEC. In 2004, we implemented compliance with Section 404 of S-OX. Our related report on internal controls over financial reporting for 2012 is included in Part I, Item 9A.

As a publicly traded company, we are also subject to the rules of the New York Stock Exchange (the "NYSE"), the exchange on which our stock is listed, including the corporate governance listing standards approved by the SEC.

Two of our subsidiaries, W&R and IFDI, are registered as broker/dealers with the SEC and the states. A third broker/dealer subsidiary, LEC, was sold effective January 1, 2013. Much of the broker/dealer regulation has been delegated by the SEC to self-regulatory organizations, principally the Municipal Securities Rulemaking Board and the Financial Industry Regulatory Authority ("FINRA"), which is the primary regulator of our broker/dealer activities. These self-regulatory organizations adopt rules (subject to approval by the SEC) that govern the industry and conduct periodic examinations of our operations over which they have jurisdiction. Securities firms are also subject to regulation by state securities administrators in those states in which they conduct business. Broker/dealers are subject to regulations that cover all aspects of the securities business, including sales practices, market making and trading among broker/dealers, the use and safekeeping of clients' funds and securities, capital structure, record-keeping, and the conduct of directors, officers and employees. Violation of applicable regulations can result in the revocation of broker/dealer licenses, the imposition of censures or fines, and the suspension or expulsion of a firm, its officers or employees.

W&R, LEC and IFDI are each subject to certain net capital requirements pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Uniform Net Capital Rule 15c3-1 of the Exchange Act (the "Net Capital Rule") specifies the minimum level of net capital a registered broker/dealer must maintain and also requires that part of its assets be kept in a relatively liquid form. The Net

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Capital Rule is designed to ensure the financial soundness and liquidity of broker/dealers. Any failure to maintain the required minimum net capital may subject us to suspension or revocation of our registration or other limitations on our activity by the SEC, and suspension or expulsion by FINRA or other regulatory bodies, and ultimately could require the broker/dealer's liquidation. The maintenance of minimum net capital requirements may also limit our ability to pay dividends. As of December 31, 2012, 2011 and 2010, net capital for W&R, LEC and IFDI exceeded all minimum requirements.

Pursuant to the requirements of the Securities Investor Protection Act of 1970, W&R is a member of the Securities Investor Protection Corporation (the "SIPC"). IFDI is not a member of the SIPC. The SIPC provides protection against lost, stolen or missing securities (but not loss in value due to a rise or fall in market prices) for clients in the event of the failure of a broker/dealer. Accounts are protected up to \$500,000 per client with a limit of \$100,000 for cash balances. However, since the Funds, and not our broker/dealer subsidiaries, maintain customer accounts, SIPC protection would not cover mutual fund shareholders whose accounts are maintained directly with the Funds.

Title III of the USA PATRIOT Act, the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001, imposes significant anti-money laundering requirements on all financial institutions, including domestic banks and domestic operations of foreign banks, broker/dealers, futures commission merchants and investment companies.

Our businesses may be materially affected not only by regulations applicable to us as an investment adviser, broker/dealer or transfer agent, but also by law and regulations of general application. For example, the volume of our principal investment advisory business in a given time period could be affected by, among other things, existing and proposed tax legislation and other governmental regulations and policies (including the interest rate policies of the Federal Reserve Board), and changes in the interpretation or enforcement of existing laws and rules that affect the business and financial communities.

### **Intellectual Property**

We regard our names as material to our business, and have registered certain service marks associated with our business with the United States Patent and Trademark Office.

### **Employees**

At December 31, 2012 we had 1,656 full-time employees, consisting of 1,163 home office employees, 123 Legend employees and 370 employees responsible for advisor field supervision and administration.

### **Available Information**

We file reports, proxy statements, and other information with the SEC, copies of which can be obtained from the SEC's Public Reference Room at 100 F Street NE, Room 1580, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-732-0330.

Reports we file electronically with the SEC via the SEC's Electronic Data Gathering, Analysis and Retrieval system ("EDGAR") may be accessed through the internet. The SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, at [www.sec.gov](http://www.sec.gov). The Company makes available free of charge our proxy statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports under the "Reports & SEC Filings" menu on the "Investor Relations" section of our internet website at [www.waddell.com](http://www.waddell.com) as soon as it is reasonably practical after such filing has been made with the SEC.

Also available on the "Corporate Governance" page in the "Our Firm" dropdown menu is information on corporate governance. Stockholders can view our Corporate Code of Business Conduct and Ethics (the "Code of Ethics"), which applies to directors, officers and all employees of the Company,

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our Corporate Governance Guidelines, and the charters of key committees (including the Audit, Compensation, and Nominating and Corporate Governance Committees). Printed copies of these documents are available to any stockholder upon request by calling the investor relations department at 1-800-532-2757. Any future amendments to or waivers of the Code of Ethics will be posted to our website, as required.

**ITEM 1A. Risk Factors**

***Our Financial Advisors Are Classified As Independent Contractors, And Changes To Their Classification May Increase Our Operating Expenses.*** From time to time, various legislative or regulatory proposals are introduced at the federal or state levels to change the status of independent contractors' classification to employees for either employment tax purposes (withholding, social security, Medicare and unemployment taxes) or other benefits available to employees. Currently, most individuals are classified as employees or independent contractors for employment tax purposes based on 20 "common law" factors, rather than any definition found in the Internal Revenue Code or Treasury regulations. We classify the majority of our financial advisors as independent contractors for all purposes, including employment tax and employee benefit purposes. There can be no assurance that legislative, judicial or regulatory (including tax) authorities will not introduce proposals or assert interpretations of existing rules and regulations that would change the independent contractor/employee classification of those financial advisors currently doing business with us. The costs associated with potential changes, if any, with respect to these independent contractor classifications could have a material adverse effect on the Company, including our results of operations and financial condition. See Part I, Item 3. "Legal Proceedings."

***Our Business Is Subject To Substantial Risk From Litigation, Regulatory Investigations And Potential Securities Laws Liability.*** Many aspects of our business involve substantial risks of litigation, regulatory investigations and/or arbitration, and from time to time, we are involved in various legal proceedings in the course of operating our business. The Company is exposed to liability under federal and state securities laws, other federal and state laws and court decisions, as well as rules and regulations promulgated by the SEC, FINRA and other regulatory bodies. We, our subsidiaries, and/or certain of our past and present officers, have been named as parties in legal actions, regulatory investigations and proceedings, and securities arbitrations in the past and have been subject to claims alleging violation of such laws, rules and regulations, which have resulted in the payment of fines and settlements. An adverse resolution of any lawsuit, legal or regulatory proceeding or claim against us could result in substantial costs or reputational harm to the Company, and have a material adverse effect on the Company's business, financial condition or results of operations, which, in turn, may negatively affect the market price of our common stock and our ability to pay dividends. In addition to these financial costs and risks, the defense of litigation or arbitration may divert resources and management's attention from operations. See Part I, Item 3. "Legal Proceedings."

***An Increasing Percentage Of Our Assets Under Management Are Distributed Through Our Wholesale Channel, Which Has Higher Redemption Rates Than Our Traditional Advisors Channel.*** In recent years, we have focused on expanding distribution efforts relating to our Wholesale channel. The percentage of our assets under management in the Wholesale channel has increased from 10% at December 31, 2003 to 51% at December 31, 2012, and the percentage of our total sales represented by the Wholesale channel has increased from 17% for the year ended December 31, 2003 to 70% for the year ended December 31, 2012. The success of sales in our Wholesale channel depends upon our maintaining strong relationships with institutional accounts, certain strategic partners and our third party distributors. Many of those distribution sources also offer investors competing funds that are internally or externally managed, which could limit the distribution of our products. The loss of any of these distribution channels and the inability to continue to access new distribution channels could decrease our assets under management and adversely affect our results of operations and growth. There are no assurances that these channels and their client bases will continue to be accessible to us. The loss or diminution of the level of business we do with those providers could have a material adverse effect on our business, especially with the high concentration of assets in

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certain funds in this channel, namely the Ivy Asset Strategy fund. Compared to the industry average redemption rate of 24.5% and 27.0% for the years ended December 31, 2012 and 2011, respectively, the Wholesale channel had redemption rates of 30.2% and 29.5% for the years ended December 31, 2012 and 2011, respectively. Redemption rates were 9.9% and 10.0% for our Advisors channel in the same periods, reflecting the higher rate of transferability of investment assets in the Wholesale channel.

***There May Be An Adverse Effect On Our Revenues And Earnings If Our Investors Redeem The Assets We Manage On Short Notice.*** Mutual fund investors may redeem their investments in our mutual funds at any time without any prior notice. Additionally, our investment management agreements with institutions and other non-mutual fund accounts are generally terminable upon relatively short notice. Investors can terminate their relationship with us, reduce their aggregate amount of assets under management, or shift their funds to other types of accounts with different rate structures for any number of reasons, including investment performance, changes in prevailing interest rates and financial market performance. The ability of our investors to accomplish this on short notice has increased materially due to the growth of assets in our Wholesale channel, and with the high concentration of assets in certain funds in this channel, including the Ivy Asset Strategy fund. The decrease in revenues that could result from any such event could have a material adverse effect on our business and earnings.

***There Is No Assurance That New Information Systems Will Be Implemented Successfully.*** A number of the Company's key information technology systems were developed solely to handle the Company's particular information technology infrastructure. The Company is in the process of evaluating and implementing new information technology and systems that it believes could facilitate and improve our core businesses and our productivity. There can be no assurance that the Company will be successful in implementing the new information technology and systems or that their implementation will be completed in a timely or cost effective manner. Failure to implement or maintain adequate information technology infrastructure could impede our ability to support business growth.

***Regulatory Risk Is Substantial In Our Business And Non-Compliance With Regulations, Or Changes In Regulations, Could Have A Significant Impact On The Conduct Of Our Business And Our Prospects, Revenues And Earnings.*** Our investment advisory and broker/dealer businesses are heavily regulated, primarily at the federal level. Non-compliance with applicable laws or regulations could result in sanctions being levied against us, including fines and censures, suspension or expulsion from a certain jurisdiction or market, or the revocation of licenses. Non-compliance with applicable laws or regulations could also adversely affect our reputation, prospects, revenues and earnings. In addition, changes in current legal, regulatory, accounting, tax or compliance requirements or in governmental policies could adversely affect our operations, revenues and earnings by, among other things, increasing expenses and reducing investor interest in certain products we offer. Distribution fees paid to mutual fund distributors in accordance with Rule 12b-1 promulgated under the Investment Company Act of 1940, as amended ("Rule 12b-1") are an important element of the distribution of the mutual funds we manage. The SEC has proposed replacing Rule 12b-1 with a new regulation that would significantly change current fund distribution practices in the industry. If this proposed regulation is adopted, it may have a material impact on the compensation we pay to distributors for distributing the mutual funds we manage and/or our ability to recover expenses related to the distribution of our funds, and thus could materially impact our revenue and net income. Additionally, our profitability could be affected by rules and regulations that impact the business and financial communities generally, including changes to the laws governing state and federal taxation.

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***Our Revenues, Earnings And Prospects Could Be Adversely Affected If The Securities Markets Decline.*** Our results of operations are affected by certain economic factors, including the level of the securities markets. The on-going existence of adverse market conditions, which is particularly material to us due to our high concentration of assets under management in the United States domestic stock market, and lack of investor confidence could result in investors further withdrawing from the markets or decreasing their rate of investment, either of which could adversely affect our revenues, earnings and growth prospects to a greater extent. Because our revenues are, to a large extent, investment management fees that are based on the value of assets under management, a decline in the value of these assets adversely affects our revenues and earnings. Our growth is dependent to a significant degree upon our ability to attract and retain mutual fund assets, and, in an adverse economic environment, this may prove more difficult. Our growth rate has varied from year to year and there can be no assurance that the average growth rates sustained in recent years will continue. Declines in the securities markets could significantly reduce future revenues and earnings. In addition, a decline in the market value of these assets could cause our clients to withdraw funds in favor of investments they perceive as offering greater opportunity or lower risk, which could also negatively impact our revenues and earnings. The combination of adverse markets reducing sales and investment management fees could compound on each other and materially affect earnings.

***There May Be Adverse Effects On Our Revenues And Earnings If Our Funds' Performance Declines.*** Success in the investment management and mutual fund businesses is dependent on the investment performance of client accounts relative to market conditions and the performance of competing funds. Good relative performance stimulates sales of the Funds' shares and tends to keep redemptions low. Sales of the Funds' shares in turn generate higher management fees and distribution revenues. Good relative performance also attracts institutional and separate accounts. Conversely, poor relative performance results in decreased sales, increased redemptions of the Funds' shares and the loss of institutional and separate accounts, resulting in decreases in revenues. Failure of our Funds to perform well could, therefore, have a material adverse effect on our revenues and earnings.

***Our Ability To Hire And Retain Senior Executive Management And Other Key Personnel Is Significant To Our Success And Growth.*** Our continued success depends to a substantial degree on our ability to attract and retain qualified senior executive management and other key personnel to conduct our broker/dealer, fund management and investment advisory businesses. The market for qualified fund managers, investment analysts, financial advisors and wholesalers is extremely competitive. Additionally, we are dependent on our financial advisors and select wholesale distributors to sell our mutual funds and other investment products. Our growth prospects will be directly affected by the quality, quantity and productivity of financial advisors and wholesalers we are able to successfully recruit and retain. There can be no assurances that we will be successful in our efforts to recruit and retain the required personnel.

***We Have Substantial Intangibles On Our Balance Sheet, And Any Impairment Of Our Intangibles Could Adversely Affect Our Results of Operations And Financial Position.*** At December 31, 2012, our total assets were approximately \$1.2 billion, of which approximately \$162.0 million, or 14%, consisted of goodwill and identifiable intangible assets. We complete an ongoing review of goodwill and intangible assets for impairment on an annual basis or more frequently whenever events or a change in circumstances warrant. Important factors in determining whether an impairment of goodwill or intangible assets might exist include significant continued underperformance compared to peers, the likelihood of termination or non-renewal of a mutual fund advisory or subadvisory contract or substantial changes in revenues earned from such contracts, significant changes in our business and products, material and ongoing negative industry or economic trends, or other factors specific to each asset or subsidiary being tested. Because of the significance of goodwill and other intangibles to our consolidated balance sheets, the annual impairment analysis is critical. Any changes in key assumptions about our business and our prospects, or changes in market conditions or other externalities, could result in an impairment charge. Any such charge could have a material effect on our results of operations and financial position.

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***There May Be Adverse Effects On Our Business And Earnings Upon The Termination Of, Or Failure To Renew, Certain Agreements.*** A majority of our revenues are derived from investment management agreements with the Funds that, as required by law, are terminable on 60 days' notice. Each investment management agreement must be approved and renewed annually by the disinterested members of each Fund's board of trustees or its shareholders, as required by law. Additionally, our investment management agreements provide for automatic termination in the event of assignment, which includes a change of control, without the consent of our clients and, in the case of the Funds, approval of the Funds' board of directors/trustees and shareholders to continue the agreements. There can be no assurances that our clients will consent to any assignment of our investment management agreements, or that those and other contracts will not be terminated or will be renewed on favorable terms, if at all, at their expiration and new agreements may not be available. See "Business Distribution Channels Wholesale Channel, Institutional Channel." The decrease in revenues that could result from any such event could have a material adverse effect on our business and earnings.

***A Failure In Or Breach Of Our Operational Or Security Systems Or Our Technology Infrastructure, Or Those Of Third Parties, Could Result In A Material Adverse Effect On Our Business, Reputation, Cash Flows and Results Of Operations.*** We are highly dependent upon the use of various proprietary and third-party software applications and other technology systems to operate our business. As part of our normal operations, we process a large number of transactions on a daily basis and maintain and transmit confidential client and employee information, the safety and security of which is dependent upon the effectiveness of our information security policies, procedures and capabilities to protect such systems and the data that reside on or are transmitted through them.

Although we take protective measures and endeavor to modify these protective measures as circumstances warrant, technology is subject to rapid change and the nature of the threats continue to evolve. As a result, our operating and technology systems, software and networks may fail to operate properly or become disabled, or may be vulnerable to unauthorized access, inadvertent disclosure, loss or destruction of data (including confidential client information), computer viruses or other malicious code, cyber attacks and other events that could materially damage our operations, have an adverse security impact, or cause the disclosure or modification of sensitive or confidential information. Most of the software applications that we use in our business are licensed from, and supported, upgraded and maintained by, third-party vendors. A suspension or termination of certain of these licenses or the related support, upgrades and maintenance could cause temporary system delays or interruption. We also take precautions to password protect and/or encrypt our laptops and other mobile electronic hardware. If such hardware is stolen, misplaced or left unattended, it may become vulnerable to hacking or other unauthorized use, creating a possible security risk and resulting in potentially costly actions by us. Further, while we have in place a disaster recovery plan to address catastrophic and unpredictable events, there is no guarantee that this plan will be sufficient in responding to or ameliorating the effects of all disaster scenarios, and we may experience system delays and interruptions as a result of natural disasters, power failures, acts of war, and third-party failures.

The breach of our operational or technology systems, software and networks, or those of third parties, due to one or more of these events could cause interruptions, malfunctions or failures in our operations and/or the loss or inadvertent disclosure of confidential client information could result in substantial financial loss or costs, liability for stolen assets or information, breach of client contracts, client dissatisfaction and/or loss, regulatory actions, remediation costs to repair damage caused by the breach, additional security costs to mitigate against future incidents and litigation costs resulting from the incident. These events, and those discussed above, could have a material adverse effect on our business, reputation, results of operations, financial position, cash flow, revenues and income.

***Regulations Restricting The Use Of "Soft Dollars" Could Result In An Increase In Our Expenses.*** On behalf of our mutual fund and investment advisory clients, we make decisions to buy and sell securities for each portfolio, select broker/dealers to execute trades, and negotiate brokerage commission rates. In connection

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with these transactions, we may receive "soft dollar credits" from broker/dealers that we can use to defray certain of our expenses. If regulations are adopted eliminating the ability of asset managers to use "soft dollars," our operating expenses could increase.

***Fee Pressures Could Reduce Our Revenues And Profitability.*** There is a trend toward lower fees in some segments of the investment management business. In addition, the SEC has adopted rules that are designed to improve mutual fund corporate governance, which could result in further downward pressure on investment advisory fees in the mutual fund industry. Accordingly, there can be no assurance that we will be able to maintain our current fee structure. Fee reductions on existing or future new business could have an adverse impact on our revenues and profitability.

***We Could Experience Adverse Effects On Our Revenues, Profits And Market Share Due To Strong Competition From Numerous And Sometimes Larger Companies.*** We compete with stock brokerage firms, mutual fund companies, investment banking firms, insurance companies, banks, internet investment sites, and other financial institutions and individual registered investment advisers. Many of these companies not only offer mutual fund investments and services, but also offer an ever-increasing number of other financial products and services. Many of our competitors have more products and product lines, services and brand recognition and may also have substantially greater assets under management. Many larger mutual fund complexes have developed more extensive relationships with brokerage houses with large distribution networks, which may enable those fund complexes to reach broader client bases. In recent years, there has been a trend of consolidation in the mutual fund industry resulting in stronger competitors with greater financial resources than us. There has also been a trend toward online internet financial services. If existing or potential customers decide to invest with our competitors instead of with us, our market share, revenues and income could decline.

***The Terms Of Our Credit Facility And Senior Unsecured Notes Impose Restrictions On Our Operations That May Adversely Impact Our Prospects And The Operations Of Our Business.*** There are no assurances that we will be able to raise additional capital if needed, which could negatively impact our liquidity, prospects and operations. We have entered into a 3-year revolving credit facility with various lenders providing for total loans of \$125.0 million. Under this facility, the lenders may, at their option upon our request, expand the facility to \$200.0 million. At February 15, 2013, there was no balance outstanding under the revolving credit facility. We also entered into a note purchase agreement with various purchasers for the sale and issuance of \$190.0 million of unsecured senior notes comprised of \$95 million of 5.0% senior notes, series A, due 2018 and \$95 million of 5.75% senior notes, series B, due 2021, all of which were issued on January 13, 2011. The terms and conditions of our revolving credit facility and note purchase agreement impose restrictions that affect, among other things, our ability to incur additional debt, make capital expenditures and acquisitions, merge, sell assets, pay dividends and create or incur liens. Our ability to comply with the financial covenants set forth in our credit facility and note purchase agreement could be affected by events beyond our control, and there can be no assurance that we will achieve operating results that will comply with such terms and conditions, a breach of which could result in a default under our credit facility and note purchase agreement. In the event of a default under the credit facility and/or note purchase agreement, the banks could elect to declare the outstanding principal amount of our credit facility, all interest thereon, and all other amounts payable under our credit facility to be immediately due and payable, and the Company's obligations under the senior unsecured notes could be accelerated and become due and payable, including any make-whole amount, respectively.

Our ability to meet our cash needs and satisfy our debt obligations will depend upon our future operating performance, asset values, the perception of our creditworthiness and, indirectly, the market value of our stock. These factors will be affected by prevailing economic, financial and business conditions and other circumstances, some of which are beyond our control. We anticipate that any funds generated by the issuance of our senior unsecured notes and any borrowings from our existing credit facility and/or cash provided by operating activities will provide sufficient funds to finance our business plans, meet our operating expenses and service our debt obligations as they become due. However, in the event that we



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require additional capital, there can be no assurance that we will be able to raise such capital when needed or on satisfactory terms, if at all, and there can be no assurance that we will be able to renew or refinance our credit facility or senior unsecured notes upon their maturity or on favorable terms. If we are unable to raise capital or obtain financing, we may be forced to incur unanticipated costs or revise our business plan.

***Potential Misuse Of Funds And Information In The Possession Of Our Employees And/Or Advisors Could Result In Liability To Our Clients, Subject Us To Regulatory Sanctions Or Otherwise Adversely Affect Our Revenues and Profitability.*** Our business is based on the trust and confidence of our clients, for whom our financial advisors handle a significant amount of funds, as well as financial and personal information. Although we have implemented a system of internal controls to minimize the risk of fraudulent taking or misuse of funds and information, there can be no assurance that our controls will be adequate or that a taking or misuse by our employees or financial advisors can be prevented. We could be liable in the event of a taking or misuse by our employees or financial advisors and we could also be subject to regulatory sanctions. Although we believe that we have adequately insured against these risks, there can be no assurance that our insurance will be maintained or that it will be adequate to meet any liability. Any damage to the trust and confidence placed in us by our clients may cause assets under management to decline, which could adversely affect our revenues, financial condition, results of operations and business prospects.

***Our Stockholders Rights Plan Could Deter Takeover Attempts, Which Some Of Our Stockholders May Believe To Be In Their Best Interest.*** Under certain conditions, the rights under our stockholders rights plan entitle the holders of such rights to receive shares of our common stock having a value equal to two times the exercise price of the right. The rights are attached to each share of our outstanding common stock and generally are exercisable only if a person or group acquires 15% or more of the voting power represented by our common stock. Our stockholders rights plan could impede the completion of a merger, tender offer, or other takeover attempt even though some or a majority of our stockholders might believe that a merger, tender offer or takeover is in their best interests, and even if such a transaction could result in our stockholders receiving a premium for their shares of our stock over the then current market price of our stock.

***Provisions Of Our Organizational Documents Could Deter Takeover Attempts, Which Some Of Our Stockholders May Believe To Be In Their Best Interest.*** Under our Restated Certificate of Incorporation, our Board of Directors has the authority, without action by our stockholders, to fix certain terms and issue shares of our Preferred Stock, par value \$1.00 per share. Actions of our Board of Directors pursuant to this authority may have the effect of delaying, deterring or preventing a change in control of the Company. Other provisions in our Restated Certificate of Incorporation and in our Amended and Restated Bylaws impose procedural and other requirements that could be deemed to have anti-takeover effects, including replacing incumbent directors. Our Board of Directors is divided into three classes, each of which is to serve for a staggered three-year term after the initial classification and election, and incumbent directors may not be removed without cause, all of which may make it more difficult for a third party to gain control of our Board of Directors. In addition, as a Delaware corporation we are subject to section 203 of the Delaware General Corporation Law. With certain exceptions, section 203 imposes restrictions on mergers and other business combinations between us and any holder of 15% or more of our voting stock.

***Our Holding Company Structure Results In Structural Subordination And May Affect Our Ability To Fund Our Operations And Make Payments On Our Debt.*** We are a holding company and, accordingly, substantially all of our operations are conducted through our subsidiaries. As a result, our cash flow and our ability to service our debt, including \$190.0 million of our senior notes, are dependent upon the earnings of our subsidiaries and the distribution of earnings, loans or other payments by our subsidiaries to us. Our subsidiaries are separate and distinct legal entities and have no obligation to pay any amounts due on our debt or provide us with funds for our payment obligations, whether by dividends, distributions, loans or other payments. In addition, any payment of dividends, distributions, loans or advances to us by our subsidiaries could be subject to statutory or contractual restrictions. Payments to us by our subsidiaries will also be contingent upon our subsidiaries' earnings and business considerations. Our right to receive any

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assets of any of our subsidiaries upon their liquidation or reorganization, and therefore the right of the holders of our debt to participate in those assets, would be effectively subordinated to the claims of those subsidiaries' creditors, including trade creditors. In addition, even if we were a creditor of any of our subsidiaries, our rights as a creditor would be effectively subordinate to any security interest in the assets of our subsidiaries and any indebtedness of our subsidiaries senior to that held by us.

***There Are No Assurances That We Will Pay Future Dividends, Which Could Adversely Affect Our Stock Price.*** The Waddell & Reed Financial, Inc. Board of Directors (the "Board of Directors") currently intends to continue to declare quarterly dividends on our Class A common stock (our "common stock"); however, the declaration and payment of dividends is subject to the discretion of our Board of Directors. Any determination as to the payment of dividends, as well as the level of such dividends, will depend on, among other things, general economic and business conditions, our strategic plans, our financial results and condition, and contractual, legal, and regulatory restrictions on the payment of dividends by us or our subsidiaries. We are a holding company and, as such, our ability to pay dividends is subject to the ability of our subsidiaries to provide us with cash. There can be no assurance that the current quarterly dividend level will be maintained or that we will pay any dividends in any future period(s). Any change in the level of our dividends or the suspension of the payment thereof could adversely affect our stock price.

**ITEM 1B. Unresolved Staff Comments**

None.

**ITEM 2. Properties**

We own two buildings in the vicinity of buildings currently leased by our home offices: a 50,000 square foot building located in Overland Park, KS and a 45,000 square foot building located in Mission, KS. Existing home office lease agreements cover approximately 310,000 square feet for Waddell & Reed located in Overland Park, Kansas, 38,000 square feet for our disaster recovery facility and 39,000 square feet for Legend located in Palm Beach Gardens, Florida. The lease agreement for Legend was assumed by the purchaser, effective January 1, 2013. An additional lease covers office space of 41,000 square feet in Boca Raton, Florida. This space has been sublet and the lease agreement ends March 31, 2013. In addition, we lease office space for sales management, which is available to our financial advisors for use, in various locations throughout the United States totaling approximately 661,000 square feet. In the opinion of management, the office space owned and leased by the Company is adequate for existing operating needs.

**ITEM 3. Legal Proceedings**

The Company is involved from time to time in various legal proceedings, regulatory investigations and claims incident to the normal conduct of business, which may include proceedings that are specific to us and others generally applicable to business practices within the industries in which we operate. A substantial legal liability or a significant regulatory action against us could have an adverse effect on our business, financial condition and on the results of operations in a particular quarter or year.

The Company accrues an undiscounted liability for those contingencies where the incurrence of a loss is probable, and the amount can be reasonably estimated. These amounts are not reduced by amounts that may be recovered under insurance or claims against third parties, but undiscounted receivables from insurers or other third parties may be accrued separately. The Company regularly revises such accruals in light of new information. For contingencies where an unfavorable outcome is reasonably possible and that are significant, the Company discloses the nature of the contingency and, where feasible, an estimate of the possible loss. For purposes of our litigation contingency disclosures, "significant" includes material matters as well as other items that management believes should be disclosed. Management judgment is required related to contingent liabilities and the outcome of litigation because both are difficult to predict.

*Michael E. Taylor, Kenneth B. Young, individuals, on behalf of themselves individually and on behalf of others similarly situated v. Waddell & Reed, Inc., a Delaware Corporation; and DOES 1 through 10 inclusive; Case No. 09-CV-2909 DMS WVG; in the United States District Court for the Southern District of California.*

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In this action filed December 28, 2009, the Company was sued in an individual action, class action and Fair Labor Standards Act ("FLSA") nationwide collective action by two former advisors asserting misclassification of financial advisors as independent contractors instead of employees. Plaintiffs, on behalf of themselves and a purported class of Waddell & Reed, Inc. financial advisors, assert claims under the FLSA for minimum wages and overtime wages, and under California Labor Code Statutes for timely payment of wages, minimum wages, overtime compensation, meal periods, reimbursement of losses and business expenses and itemized wage statements and a claim for Unfair Business Practices under §17200 of the California Business & Professions Code. Plaintiffs seek declaratory and injunctive relief and monetary damages.

Plaintiffs moved for conditional collective action certification under the FLSA. The Company opposed this motion and additionally moved for summary judgment on Plaintiffs' individual FLSA claims. The Court issued an order on January 3, 2012 granting the Company's summary judgment motions, holding that Plaintiffs' individual FLSA claims fail as a matter of law, and denying Plaintiffs' motion for conditional collective action certification under the FLSA as moot. This ruling effectively removes all nationwide FLSA claims from the case.

Subsequently, the Company moved for summary judgment on Plaintiffs' individual California claims. The Court issued an order on August 20, 2012 granting the Company's summary judgment motions, holding that Plaintiffs' individual California claims fail as a matter of law. This order effectively dismissed Plaintiffs from the case, both individually and as putative class representatives.

However, in its August 20, 2012 order, the Court also granted Plaintiffs' motion to add a new individual and putative class representative to the action, effectively replacing the originally named Plaintiffs. The newly named Plaintiff continued to pursue the California claims referenced above on behalf of the putative class, as well as newly added representative derivative claims under the California Private Attorney General Act.

The Company moved for summary judgment, asking the Court to dismiss the newly named Plaintiff's individual claims. The arguments made in support of this request were the same as those that prevailed in the Taylor and Young motions for summary judgment. On February 1, 2013, the Court issued an order granting the Company's summary judgment motion. This ruling effectively dismisses all remaining claims in the case in their entirety, pending appeal. No appeal has yet been filed. The Company intends to continue to vigorously defend the matter at appeal, if any.

**ITEM 4. Submission of Matters to a Vote of Security Holders**

During the fourth quarter of the fiscal year covered by this report, no matter was submitted to a vote of the Company's security holders, through the solicitation of proxies or otherwise.

Table of Contents**PART II****ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our Class A common stock ("common stock") is traded on the NYSE under the ticker symbol "WDR." The following table sets forth, for the periods indicated, the high and low sale prices of our common stock, as reported by the NYSE, as well as the cash dividends declared for these time periods:

| Quarter | 2012     |          |                           | 2011     |          |                           |
|---------|----------|----------|---------------------------|----------|----------|---------------------------|
|         | High     | Low      | Dividends<br>Per<br>Share | High     | Low      | Dividends<br>Per<br>Share |
| 1       | \$ 33.58 | \$ 24.40 | \$ 0.25                   | \$ 42.20 | \$ 34.54 | \$ 0.20                   |
| 2       | 33.53    | 26.55    | 0.25                      | 42.49    | 34.45    | 0.20                      |
| 3       | 34.04    | 27.02    | 0.25                      | 40.04    | 24.78    | 0.20                      |
| 4       | 35.77    | 30.91    | 1.28                      | 29.78    | 22.85    | 0.25                      |

The cash dividends declared during the fourth quarter of 2012 includes a special cash dividend on our common stock of \$1.00 per share that was paid on December 6, 2012.

Year-end closing prices of our common stock were \$34.82 and \$24.77 for 2012 and 2011, respectively. The closing price of our common stock on February 15, 2013 was \$42.73.

According to the records of our transfer agent, we had 3,001 holders of record of common stock as of February 15, 2013. We believe that a substantially larger number of beneficial stockholders hold such shares in depository or nominee form.

**Dividends**

The declaration of dividends is subject to the discretion of the Board of Directors. We intend, from time to time, to pay cash dividends on our common stock as our Board of Directors deems appropriate, after consideration of our operating results, financial condition, cash and capital requirements, compliance with covenants in our revolving credit facility, note purchase agreement and such other factors as the Board of Directors deems relevant. To the extent assets are used to meet minimum net capital requirements under the Net Capital Rule, they are not available for distribution to stockholders as dividends. See Part I, Item 1. "Business Regulation." We anticipate that quarterly dividends will continue to be paid.

**Common Stock Repurchases**

Our Board of Directors has authorized the repurchase of our common stock in the open market and/or private purchases. The acquired shares may be used for corporate purposes, including shares issued to employees in our stock-based compensation programs. During the year ended December 31, 2012, we repurchased 1,536,968 shares in the open market and privately at an aggregate cost, including commissions, of \$48.7 million, including 568,568 shares from related parties to cover their tax withholdings from the vesting of shares granted under our stock-based compensation programs. The aggregate cost of shares obtained from related parties during 2012 was \$19.1 million. The purchase price paid by us for private repurchases of our common stock from related parties is the closing market price on the purchase date.

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The following table sets forth certain information about the shares of common stock we repurchased during the fourth quarter of 2012.

| <b>Period</b>               | <b>Total Number<br/>of<br/>Shares<br/>Purchased<br/>(1)</b> | <b>Average<br/>Price Paid<br/>per Share</b> | <b>Total Number<br/>of<br/>Shares<br/>Purchased as<br/>Part of<br/>Publicly<br/>Announced<br/>Program</b> | <b>Maximum<br/>Number (or<br/>Approximate<br/>Dollar<br/>Value) of Shares<br/>That<br/>May Yet Be<br/>Purchased<br/>Under The<br/>Program</b> |
|-----------------------------|-------------------------------------------------------------|---------------------------------------------|-----------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------|
| October 1 - October 31      | 125,000                                                     | \$ 32.17                                    | 125,000                                                                                                   | n/a (1)                                                                                                                                       |
| November 1 -<br>November 30 | 53,285                                                      | 32.22                                       | 53,285                                                                                                    | n/a (1)                                                                                                                                       |
| December 1 -<br>December 31 | 199,963                                                     | 34.74                                       | 199,963                                                                                                   | n/a (1)                                                                                                                                       |
| Total                       | 378,248                                                     | \$ 33.54                                    | 378,248                                                                                                   |                                                                                                                                               |

(1)

On August 31, 1998, we announced that our Board of Directors approved a program to repurchase shares of our common stock on the open market. Under the repurchase program, we are authorized to repurchase, in any seven-day period, the greater of (i) 3% of our outstanding common stock or (ii) \$50 million of our common stock. We may repurchase our common stock through the New York Stock Exchange, other national or regional market systems, electronic communication networks or alternative trading systems. Our stock repurchase program does not have an expiration date or an aggregate maximum number or dollar value of shares that may be repurchased. Our Board of Directors reviewed and ratified the stock repurchase program in October 2012. During the fourth quarter of 2012, all stock repurchases were made pursuant to the repurchase program and 153,248 shares, reflected in the table above, were purchased in connection with funding employee income tax withholding obligations arising from the vesting of nonvested shares.

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**Total Return Performance**

**Comparison of Cumulative Total Return (1)**

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The above graph compares the cumulative total stockholder return on the Company's Class A common stock from December 31, 2007 through December 31, 2012, with the cumulative total return of the Standard & Poor's 500 Stock Index and the SNL Asset Manager Index. The SNL Asset Manager Index is a composite of 36 publicly traded asset management companies (including, among others, the companies in the peer group reviewed by the Compensation Committee for executive compensation purposes) prepared by SNL Financial, Charlottesville, Virginia. The graph assumes the investment of \$100 in the Company's Class A common stock and in each of the two indices on December 31, 2007 with all dividends being reinvested. The closing price of the Company's Class A common stock on December 31, 2007 (the last trading day of the year) was \$36.09 per share. The stock price performance on the graph is not necessarily indicative of future price performance.

| <i>Index</i>                   | <i>Period Ending</i> |          |          |          |          |          |
|--------------------------------|----------------------|----------|----------|----------|----------|----------|
|                                | 12/31/07             | 12/31/08 | 12/31/09 | 12/31/10 | 12/31/11 | 12/31/12 |
| Waddell & Reed Financial, Inc. | 100.00               | 44.46    | 90.61    | 107.45   | 77.53    | 115.11   |
| SNL Asset Manager              | 100.00               | 47.52    | 77.10    | 88.75    | 76.76    | 98.48    |
| S&P 500                        | 100.00               | 63.00    | 79.68    | 91.68    | 93.61    | 108.59   |

(1)

Cumulative total return assumes an initial investment of \$100 on December 31, 2007, with the reinvestment of all dividends through December 31, 2012.

Table of Contents**ITEM 6. Selected Financial Data**

The following table sets forth our selected consolidated financial and other data at the dates and for the periods indicated, and reflects continuing operations data. Selected financial data should be read in conjunction with, and is qualified in its entirety by, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our Consolidated Financial Statements and the Notes thereto appearing elsewhere in this report.

|                                                                    | <b>For the Year Ended December 31,</b>                                        |                  |                |                |                 |
|--------------------------------------------------------------------|-------------------------------------------------------------------------------|------------------|----------------|----------------|-----------------|
|                                                                    | <b>2012</b>                                                                   | <b>2011</b>      | <b>2010</b>    | <b>2009</b>    | <b>2008 (1)</b> |
|                                                                    | <b>(in thousands, except per share data and number of financial advisors)</b> |                  |                |                |                 |
| Revenues from:                                                     |                                                                               |                  |                |                |                 |
| Investment management fees                                         | \$ 549,231                                                                    | 530,599          | 457,538        | 354,593        | 399,863         |
| Underwriting and distribution fees                                 | 496,465                                                                       | 469,484          | 410,380        | 331,754        | 365,345         |
| Shareholder service fees                                           | 128,109                                                                       | 122,449          | 110,348        | 97,969         | 94,514          |
| <b>Total revenues</b>                                              | <b>1,173,805</b>                                                              | <b>1,122,532</b> | <b>978,266</b> | <b>784,316</b> | <b>859,722</b>  |
| Income from continuing operations                                  | 192,528                                                                       | 172,205          | 153,428        | 104,051        | 96,210          |
| Net income per share from continuing operations, basic and diluted | 2.25                                                                          | 2.01             | 1.79           | 1.22           | 1.12            |
| Dividends declared per common share                                | \$ 2.03                                                                       | 0.85             | 0.77           | 0.76           | 0.76            |
| Wholesale channel data:                                            |                                                                               |                  |                |                |                 |
| Sales (net of commissions)                                         | \$ 15,258,158                                                                 | 16,527,674       | 14,448,552     | 14,653,043     | 15,524,989      |
| Number of external wholesalers                                     | 50                                                                            | 51               | 46             | 34             | 35              |
| Advisor channel data:                                              |                                                                               |                  |                |                |                 |
| Sales (net of commissions)                                         | \$ 4,050,418                                                                  | 3,799,077        | 3,615,654      | 3,201,867      | 3,724,165       |
| Gross revenue per advisor                                          | 168.2                                                                         | 155.7            | 118.9          | 92.8           | 103.0           |
| Number of financial advisors (end of period)                       | 1,763                                                                         | 1,816            | 1,847          | 2,393          | 2,366           |
| Average number of financial advisors                               | 1,762                                                                         | 1,757            | 2,019          | 2,336          | 2,297           |
| Institutional channel sales                                        | \$ 2,501,643                                                                  | 3,413,748        | 3,588,260      | 1,703,470      | 2,358,104       |

|                                             | <b>As of December 31,</b> |             |             |             |             |
|---------------------------------------------|---------------------------|-------------|-------------|-------------|-------------|
|                                             | <b>2012</b>               | <b>2011</b> | <b>2010</b> | <b>2009</b> | <b>2008</b> |
|                                             | <b>(in millions)</b>      |             |             |             |             |
| Assets under management                     | \$ 96,365                 | 83,157      | 83,673      | 69,783      | 47,484      |
| Balance sheet data:                         |                           |             |             |             |             |
| Goodwill and identifiable intangible assets | 162.0                     | 162.0       | 162.0       | 162.0       | 162.0       |
| Total assets                                | 1,152.8                   | 1,082.4     | 976.9       | 983.4       | 775.4       |
| Long-term debt                              | 190.0                     | 190.0       | 190.0       | 200.0       | 200.0       |
| Total liabilities                           | 642.6                     | 558.8       | 519.8       | 614.3       | 455.3       |
| Stockholders' equity                        | 510.2                     | 523.6       | 457.1       | 369.1       | 320.1       |

(1)

Includes a pre-tax charge of \$16.5 million (\$10.5 million net of tax) for restructuring charges consisting primarily of severance costs associated with our voluntary separation program as well as costs associated with terminating various projects under development; a charge of \$7.2 million (not deductible for income tax purposes) to recognize the impairment of goodwill associated with Austin Calvert & Flavin, Inc., a subsidiary sold in 2009; additional amortization of our deferred sales commission asset of \$6.5 million (\$4.1 million net of tax) due to significant asset redemption activity and our review of the recoverability of our deferred sales commission asset; and a pre-tax charge of \$2.1 million (\$1.4 million net of tax) related to the settlement of miscellaneous litigation and other matters.

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**ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*This Item contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which reflect the current views and assumptions of management with respect to future events regarding our business and the industry in general. These forward-looking statements include all statements, other than statements of historical fact, regarding our financial position, business strategy and other plans and objectives for future operations, including statements with respect to revenues and earnings, the amount and composition of assets under management, distribution sources, expense levels, redemption rates and the financial markets and other conditions. These statements are generally identified by the use of words such as "may," "could," "should," "would," "believe," "anticipate," "forecast," "estimate," "expect," "intend," "plan," "project," "outlook," "will," "potential" and similar statements of a future or forward-looking nature. Readers are cautioned that any forward-looking information provided by or on behalf of the Company is not a guarantee of future performance. Certain important factors that could cause actual results to differ materially from our expectations are disclosed in the "Risk Factors" section of this Form 10-K, which include, without limitation, the adverse effect from a decline in securities markets or in the relative investment performance of our products, our inability to pay future dividends, the loss of existing distribution channels or the inability to access new ones, a reduction of the assets we manage on short notice, and adverse results of litigation and/or arbitration. All forward-looking statements speak only as of the date on which they are made and we undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

The following should be read in conjunction with the "Selected Financial Data" and our Consolidated Financial Statements and Notes thereto appearing elsewhere in this report.

**Executive Overview**

We are one of the oldest mutual fund and asset management firms in the country, with expertise in a broad range of investment styles and across a variety of market environments. Our earnings and cash flows are heavily dependent on financial market conditions. Significant increases or decreases in the various securities markets can have a material impact on our results of operations, financial condition and cash flows.

*Revenue Sources*

We derive our revenues from providing investment management, investment product underwriting and distribution, and shareholder services administration to mutual funds and institutional and separately managed accounts. Investment management fees are based on the amount of average assets under management and are affected by sales levels, financial market conditions, redemptions and the composition of assets. Our underwriting and distribution revenues consist of commissions derived from sales of investment and insurance products, Rule 12b-1 asset-based service and distribution fees, distribution fees on certain variable products, fees earned on fee-based asset allocation products, and related advisory services. The products sold have various commission structures and the revenues received from those sales vary based on the type and amount sold. Shareholder service fee revenue includes transfer agency fees, custodian fees from retirement plan accounts, portfolio accounting and administration fees, and is earned based on assets under management or number of client accounts.

*Expense Drivers*

Our major expenses are underwriting and distribution-related commissions, employee compensation, amortization of deferred sales commissions, subadvisory fee expenses and information technology expense.

*Our Distribution Channels*

One of our distinctive qualities is that we are a significant distributor of investment products. Our retail products are distributed through our Wholesale channel, which includes third-parties such as other broker/dealers, registered investment advisors and various retirement platforms or through our Advisors



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channel sales force of independent financial advisors. We also market our investment advisory services to institutional investors, either directly or through consultants, in our Institutional channel.

Our Wholesale Channel is our fastest growing distribution channel. Channel efforts are led by the solid performance record of the Ivy Funds family. We distribute retail mutual funds through broker/dealers, and registered investment advisors, and various retirement platforms through a team of external, internal and hybrid wholesalers as well as a team dedicated to national accounts.

The Ivy Funds maintain strong positions on many of the leading third-party distribution platforms, and we continue efforts to diversify our sales by offering other solid performing funds besides our flagship Ivy Asset Strategy fund to our partners. During 2012, we had nine funds exceed gross sales of \$250 million. Sales of products other than our Ivy Asset Strategy fund accounted for 68% of total sales during 2012 compared to 53% during 2011 and 40% for 2010. We expect the Wholesale Channel to be critical in driving our organic growth rate in the coming years.

Our Advisors channel sales force consists of 1,763 independent financial advisors spread throughout the United States, who carry out our mission of providing financial advice for retirement, education funding, estate planning and other financial needs for our clients. A distinguishing aspect of this channel is its industry low redemption rate, which can be attributed to the personal nature in which our advisors provide service to their clients.

Over the past three years, we have experienced a decline in our number of financial advisors; however, the decline was not unexpected as we continue to push for higher production from our advisors by increasing minimum production requirements for them to stay licensed with us. Our gross revenue production per advisor increased 41%, to \$168 thousand, and gross sales in the channel increased 12%, to \$4.1 billion, during the past two years, despite the 13% decrease in advisor headcount. This headcount decline leveled off during 2012. We continue to focus our recruiting efforts on bringing in experienced advisors.

Through our Institutional channel we manage assets in a variety of investment styles for a variety of types of institutions. The largest percentage of our clients hire us to act as subadvisor for their branded products; they are typically distributors who lack scale or the track record to manage internally, or choose to market multi-manager styles. This is the smallest of our three distribution channels but it has experienced positive gross sales and net flow trends over the past two years due to our growing subadvisory relationships. Our subadvisory relationships currently account for more than 65% of the channel's \$11.8 billion in assets at the end of 2012.

*Market Developments*

The financial markets experienced strong gains in 2012 despite ongoing uncertainty surrounding government policy and global economic growth. Retail investors were willing to accept minimal returns rather than expose themselves to the highly unpredictable equity market, which led to meaningful outflows of actively managed equity funds. Through this volatile year, the Company generated net flows of \$2.3 billion and maintained stable redemption rates compared to industry averages. Strong market appreciation combined with positive flows contributed to a 16% increase in assets under management compared to December 31, 2011, as we reached assets under management of \$96.4 billion at December 31, 2012.

*Sale of Legend*

During 2012, the Company committed to a plan to sell its Legend subsidiaries and on October 29, 2012 the Company signed a definitive agreement to execute the transaction. The sale closed effective January 1, 2013. Based on the value of the consideration the Company expected to receive upon closing, which is less than the carrying value of net assets to be sold, the Company recorded a non-cash impairment charge of \$42.4 million, which is reflected in income (loss) from discontinued operations on the statement

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of income. The consideration received was subject to working capital and regulatory capital adjustments through the closing date. The Company retained \$7.7 million of Legend's excess working capital as part of the agreement. The agreement also includes an earnout provision based on asset retention for a period of two years following the closing date.

The operational results of Legend have been presented as discontinued operations in the consolidated financial statements for all periods presented. Unless otherwise stated, references in Management's Discussion and Analysis of Financial Condition and Results of Operations refers to continuing operations.

*Operating Results*

The company ended the year with \$1.2 billion in revenues. The revenue increase of 5% relative to fiscal 2011 was reflective of an increase in our average managed assets and positive net flows. Average assets under management were \$91.7 billion in 2012 compared to \$87.1 billion in 2011.

Income from continuing operations increased 12% compared to 2011 while our operating margin improved slightly from 25.5% to 25.8%. We plan to continue our focus on cost controls during 2013.

Our balance sheet remains strong, as we ended the year with cash and investments of \$504.2 million, after payment of an \$85.4 million special dividend in December. At December 31, 2012, we had no borrowings outstanding under our three year revolving credit facility, which provides for initial borrowings of up to \$125.0 million and can be expanded to \$200.0 million.

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### Assets Under Management

Assets under management of \$96.4 billion on December 31, 2012 increased \$13.2 billion, or 16%, compared to \$83.2 billion reported a year ago. Market appreciation of \$10.9 billion across the complex, and net sales of \$1.4 billion generated by the Wholesale channel were the primary contributors to this increase.

#### *Change in Assets Under Management* (1)

|                                        | Wholesale<br>Channel | Advisors<br>Channel | Institutional<br>Channel | Total    |
|----------------------------------------|----------------------|---------------------|--------------------------|----------|
|                                        | (in millions)        |                     |                          |          |
| December 31, 2012                      |                      |                     |                          |          |
| Beginning Assets                       | \$ 40,954            | 31,709              | 10,494                   | 83,157   |
| Sales (net of commissions)             | 15,325               | 4,051               | 2,502                    | 21,878   |
| Redemptions                            | (13,896)             | (4,156)             | (2,760)                  | (20,812) |
| Net Sales                              | 1,429                | (105)               | (258)                    | 1,066    |
| Net Exchanges                          | 155                  | (158)               | -                        | (3)      |
| Reinvested Dividends and Capital Gains | 605                  | 454                 | 218                      | 1,277    |
| Net Flows                              | 2,189                | 191                 | (40)                     | 2,340    |
| Market Appreciation                    | 5,787                | 3,760               | 1,321                    | 10,868   |
| Ending Assets                          | \$ 48,930            | 35,660              | 11,775                   | 96,365   |
| December 31, 2011                      |                      |                     |                          |          |
| Beginning Assets                       | \$ 40,883            | 33,181              | 9,609                    | 83,673   |
| Sales (net of commissions)             | 16,594               | 3,800               | 3,413                    | 23,807   |
| Redemptions                            | (12,995)             | (4,047)             | (2,479)                  | (19,521) |
| Net Sales                              | 3,599                | (247)               | 934                      | 4,286    |
| Net Exchanges                          | 261                  | (262)               | -                        | (1)      |
| Reinvested Dividends and Capital Gains | 279                  | 353                 | 112                      | 744      |
| Net Flows                              | 4,139                | (156)               | 1,046                    | 5,029    |
| Market Depreciation                    | (4,068)              | (1,316)             | (161)                    | (5,545)  |
| Ending Assets                          | \$ 40,954            | 31,709              | 10,494                   | 83,157   |
| December 31, 2010                      |                      |                     |                          |          |
| Beginning Assets                       | \$ 32,818            | 29,474              | 7,491                    | 69,783   |
| Sales (net of commissions)             | 14,505               | 3,616               | 3,588                    | 21,709   |
| Redemptions                            | (10,560)             | (3,526)             | (2,874)                  | (16,960) |
| Net Sales                              | 3,945                | 90                  | 714                      | 4,749    |
| Net Exchanges                          | 190                  | (308)               | 116                      | (2)      |
| Reinvested Dividends and Capital Gains | 237                  | 338                 | 114                      | 689      |
| Net Flows                              | 4,372                | 120                 | 944                      | 5,436    |

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|                     |    |        |        |       |        |
|---------------------|----|--------|--------|-------|--------|
| Market Appreciation |    | 3,693  | 3,587  | 1,174 | 8,454  |
| Ending Assets       | \$ | 40,883 | 33,181 | 9,609 | 83,673 |

(1)

Includes all activity of the Funds and institutional and separate accounts, including money market funds and transactions at net asset value, accounts for which we receive no commissions.

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Average assets under management, which are generally more indicative of trends in revenue for providing investment management services than the year over year change in ending assets under management, increased by 5% compared to 2011.

**Average Assets Under Management**

|                                       | 2012      |                     | 2011    |                     | 2010    |                     |
|---------------------------------------|-----------|---------------------|---------|---------------------|---------|---------------------|
|                                       | Average   | Percentage of Total | Average | Percentage of Total | Average | Percentage of Total |
| (in millions, except percentage data) |           |                     |         |                     |         |                     |
| <b>Distribution Channel:</b>          |           |                     |         |                     |         |                     |
| Wholesale Channel                     |           |                     |         |                     |         |                     |
| Equity                                | \$ 37,924 | 83%                 | 39,387  | 91%                 | 32,805  | 92%                 |
| Fixed income                          | 7,684     | 17%                 | 3,684   | 8%                  | 2,385   | 7%                  |
| Money market                          | 191       | 0%                  | 320     | 1%                  | 284     | 1%                  |
| Total                                 | \$ 45,799 | 100%                | 43,391  | 100%                | 35,474  | 100%                |
| Advisors Channel                      |           |                     |         |                     |         |                     |
| Equity                                | \$ 24,227 | 70%                 | 24,477  | 73%                 | 22,430  | 74%                 |
| Fixed income                          | 8,933     | 26%                 | 7,629   | 23%                 | 6,614   | 22%                 |
| Money market                          | 1,318     | 4%                  | 1,203   | 4%                  | 1,288   | 4%                  |
| Total                                 | \$ 34,478 | 100%                | 33,309  | 100%                | 30,332  | 100%                |
| Institutional Channel                 |           |                     |         |                     |         |                     |
| Equity                                | \$ 10,630 | 93%                 | 9,627   | 93%                 | 7,467   | 91%                 |
| Fixed income                          | 784       | 7%                  | 780     | 7%                  | 732     | 9%                  |
| Money market                          | -         | -                   | -       | -                   | -       | -                   |
| Total                                 | \$ 11,414 | 100%                | 10,407  | 100%                | 8,199   | 100%                |
| <b>Total by Asset Class:</b>          |           |                     |         |                     |         |                     |
| Equity                                | \$ 72,781 | 84%                 | 73,491  | 84%                 | 62,702  | 85%                 |
| Fixed income                          | 17,401    | 14%                 | 12,093  | 14%                 | 9,731   | 13%                 |
| Money market                          | 1,509     | 2%                  | 1,523   | 2%                  | 1,572   | 2%                  |
| Total                                 | \$ 91,691 | 100%                | 87,107  | 100%                | 74,005  | 100%                |

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The following table summarizes our five largest mutual funds as of December 31, 2012 by ending assets under management and investment management fees for the last three years. The assets under management and management fees of our five largest mutual funds are presented as a percentage of our total assets under management and total management fees.

*Five Largest Mutual Funds by Ending Assets Under Management and Investment Management Fees*

|                                       | 2012      |                     | 2011   |                     | 2010   |                     |
|---------------------------------------|-----------|---------------------|--------|---------------------|--------|---------------------|
|                                       | Ending    | Percentage of Total | Ending | Percentage of Total | Ending | Percentage of Total |
| (in millions, except percentage data) |           |                     |        |                     |        |                     |
| <b>By Assets Under Management:</b>    |           |                     |        |                     |        |                     |
| Ivy Asset Strategy                    | \$ 25,981 | 27%                 | 23,642 | 28%                 | 25,106 | 30%                 |
| Ivy High Income                       | 7,228     | 8%                  | 3,197  | 4%                  | 1,694  | 2%                  |
| Advisors Asset Strategy               | 3,076     | 3%                  | 2,772  | 3%                  | 3,328  | 4%                  |
| Advisors Core Investment              | 3,067     | 3%                  | 2,724  | 3%                  | 2,888  | 3%                  |
| Ivy Mid Cap Growth                    | 2,777     | 3%                  | 1,500  | 2%                  | 543    | 1%                  |
| Total                                 | \$ 42,129 | 44%                 | 33,835 | 40%                 | 33,559 | 40%                 |

|                                        |            |     |         |     |         |     |
|----------------------------------------|------------|-----|---------|-----|---------|-----|
| (in thousands, except percentage data) |            |     |         |     |         |     |
| <b>By Management Fees:</b>             |            |     |         |     |         |     |
| Ivy Asset Strategy                     | \$ 142,701 | 26% | 146,649 | 28% | 123,638 | 27% |
| Ivy Global Natural Resources (1)       | 28,886     | 5%  | 46,324  | 9%  | 43,839  | 10% |
| Ivy High Income                        | 28,182     | 5%  | 12,843  | 2%  | 7,925   | 2%  |
| Advisors Asset Strategy                | 19,248     | 4%  | 20,465  | 4%  | 20,402  | 4%  |
| Advisors Science & Technology          | 19,007     | 3%  | 19,208  | 3%  | 18,379  | 4%  |
| Total                                  | \$ 238,024 | 43% | 245,489 | 46% | 214,183 | 47% |

- (1) For the years ended December 31, 2012, 2011 and 2010, we paid subadvisory fees of \$14.6 million, \$23.4 million and \$22.1 million, respectively.

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|                                                                    | For the Year Ended<br>December 31,     |         |         | Variance         |                  |
|--------------------------------------------------------------------|----------------------------------------|---------|---------|------------------|------------------|
|                                                                    | 2012                                   | 2011    | 2010    | 2012 vs.<br>2011 | 2011 vs.<br>2010 |
|                                                                    | (in thousands, except percentage data) |         |         |                  |                  |
| Income from continuing operations                                  | \$ 192,528                             | 172,205 | 153,428 | 12%              | 12%              |
| Net income per share from continuing operations, basic and diluted | \$ 2.25                                | 2.01    | 1.79    | 12%              | 12%              |
| Operating Margin                                                   | 26%                                    | 25%     | 25%     | 1%               | 0%               |

We reported income from continuing operations of \$192.5 million, or \$2.25 per diluted share, in 2012 compared to \$172.2 million, or \$2.01 per diluted share, in 2011 and \$153.4 million, or \$1.79 per diluted share, in 2010.

**Total Revenues**

Total revenues increased 5% in 2012 compared to 2011, attributable to an increase in average assets under management of 5%, partially offset by a decrease in gross sales of 8%, while total revenues increased 15% in 2011 compared to 2010, attributable to an increase in average assets under management of 18% and an increase in gross sales of 10%.

|                                    | For the Year Ended<br>December 31,     |           |         | Variance         |                  |
|------------------------------------|----------------------------------------|-----------|---------|------------------|------------------|
|                                    | 2012                                   | 2011      | 2010    | 2012 vs.<br>2011 | 2011 vs.<br>2010 |
|                                    | (in thousands, except percentage data) |           |         |                  |                  |
| Investment management fees         | \$ 549,231                             | 530,599   | 457,538 | 4%               | 16%              |
| Underwriting and distribution fees | 496,465                                | 469,484   | 410,380 | 6%               | 14%              |
| Shareholder service fees           | 128,109                                | 122,449   | 110,348 | 5%               | 11%              |
| Total revenues                     | \$ 1,173,805                           | 1,122,532 | 978,266 | 5%               | 15%              |

*Investment Management Fee Revenues*

Investment management fee revenues are earned for providing investment advisory services to the Funds and to institutional and separate accounts. Investment management fee revenues increased \$18.6 million, or 4%, in 2012 and increased \$73.1 million, or 16%, in 2011.

Revenues from investment management services provided to our retail mutual funds, which are distributed through the Wholesale, Advisors and Institutional channels, were \$506.1 million in 2012 and increased \$16.1 million, or 3%, compared to 2011, while the related retail average assets increased 5%. Investment management fee revenues increased less than the related retail average assets due to the effect of recording management fee waivers as an offset to investment management fees beginning in the third quarter of 2010. Of the total management fee waivers recorded in 2012 of \$8.7 million, \$5.5 million related to money market accounts. Revenues from investment management services provided to our retail mutual

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funds were \$490.0 million in 2011 and increased \$65.9 million, or 16%, compared to 2010, while the related retail average assets increased 17%. Retail sales were \$19.4 billion, \$20.4 billion and \$18.1 billion in 2012, 2011 and 2010, respectively.

Institutional and separate account revenues were \$43.2 million, \$40.6 million and \$33.4 million in 2012, 2011 and 2010, respectively. The increase in revenues in 2012 compared to 2011 was primarily attributable to a 10% increase in average assets while the increase in revenues in 2011 compared to 2010 was a result of a 27% increase in average assets.

In the Wholesale channel, long-term redemption rates were 30.2% in 2012, compared to 29.5% in 2011 and 29.3% in 2010. Long-term redemption rates (which exclude money market fund redemptions) in the Advisors channel were 9.9% in 2012 compared to 10.0% and 9.3% in 2011 and 2010, respectively. We expect the Advisors channel long-term redemption rate to remain lower than that of the Wholesale channel due to the personal and customized nature in which our financial advisors provide service to our clients.

The long-term redemption rate for our Institutional channel was 24.2% in 2012 compared to 23.8% in 2011 and 35.1% in 2010. Subadvisory and defined contribution pension business comprise more than 65% of the Institutional channel's assets as of December 31, 2012 and unlike defined benefit pension accounts, the active daily flows in or out of these accounts can result in an increase in contributions and withdrawals and impact the channel's redemption rate.

**Underwriting and Distribution**

We earn underwriting and distribution fee revenues primarily by distributing the Funds pursuant to an underwriting agreement with each Fund (except the Ivy Funds VIP as explained below) and, to a lesser extent, by distributing mutual funds offered by other unaffiliated companies. Pursuant to each agreement, we offer and sell the Funds' shares on a continuous basis (open-end funds) and pay certain costs associated with underwriting and distributing the Funds, including the costs of developing and producing sales literature and printing of prospectuses, which may be either partially or fully reimbursed by the Funds. The Funds are sold in various classes that are structured in ways that conform to industry standards (*i.e.*, "front-end load," "back-end load," "level-load" and institutional).

When a client purchases Class A shares (front-end load), the client pays an initial sales charge of up to 5.75% of the amount invested. The sales charge for Class A shares typically declines as the investment amount increases. In addition, investors may combine their purchases of all fund shares to qualify for a reduced sales charge. Class A shares purchased at net asset value are assessed a 1% contingent deferred sales charge ("CDSC") if the shares are redeemed within 12 months of purchase. When a client invests in an asset allocation product, Class A shares are purchased at net asset value. We do not charge an initial sales charge, but investors are assessed a CDSC upon early redemption of shares, up to 3% of the amount originally invested and declining to zero for investments held more than three years. When a client purchases Class B shares (back-end load), we do not charge an initial sales charge, but we do charge a CDSC upon early redemption of shares, up to 5% of the lesser of the current market net asset value or the purchase cost of the redeemed shares in the first year and declining to zero for shares held for more than six years. Class B shares convert to Class A shares after seven years. When a client purchases Class C shares (level-load), we do not charge an initial sales charge, but we do charge investors who redeem their Class C shares in the first year a CDSC of 1% of the current market net asset value or the purchase cost of the shares redeemed, whichever is less.

Under a Rule 12b-1 service plan, the Funds may charge a maximum fee of 0.25% of the average daily net assets under management for expenses paid to broker/dealers and other sales professionals in connection with providing ongoing services to the Funds' shareholders and/or maintaining the Funds' shareholder accounts, with the exception of the Funds' Class R shares, for which the maximum fee is 0.50%. The Funds' Class B and Class C shares may charge a maximum of 0.75% of the average daily net



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assets under management under a Rule 12b-1 distribution plan to broker/dealers and other sales professionals for their services in connection with distributing shares of that class. The Rule 12b-1 plans are subject to annual approval by the Funds' board of trustees, including a majority of the disinterested members, by votes cast in person at a meeting called for the purpose of voting on such approval. All Funds may terminate the service plan at any time with approval of fund trustees or portfolio shareholders (a majority of either) without penalty.

We offer asset allocation investment advisory products that utilize our Funds. These products offer clients a selection of traditional asset allocation models, as well as features such as systematic rebalancing and client and advisor participation in determining asset allocation across asset classes. We earn asset-based fees on our asset allocation investment advisory products.

We distribute variable products offering the Ivy Funds VIP as investment vehicles pursuant to general agency arrangements with our business partners and receive commissions, marketing allowances and other compensation as stipulated by such agreements. In connection with these arrangements, the Ivy Funds VIP are offered and sold on a continuous basis.

In addition to distributing variable products, we distribute a number of other insurance products through our insurance agency subsidiaries, including individual term life, group term life, whole life, accident and health, long-term care, Medicare supplement and disability insurance. We receive commissions and compensation from various underwriters for distributing these products. We are not an underwriter for any insurance policies.

### Underwriting and Distribution Fee Revenues and Expenses

The following tables illustrate our underwriting and distribution fee revenues and expenses segregated by distribution channel for the years ended December 31, 2012, 2011 and 2010:

|                                 | <b>Total</b>                                  |                |                | <b>2012 vs.</b> | <b>2011 vs.</b> |
|---------------------------------|-----------------------------------------------|----------------|----------------|-----------------|-----------------|
|                                 | <b>2012</b>                                   | <b>2011</b>    | <b>2010</b>    | <b>2011</b>     | <b>2010</b>     |
|                                 | <b>(in thousands, except percentage data)</b> |                |                |                 |                 |
| Revenue                         | \$ 496,465                                    | 469,484        | 410,380        | 6%              | 14%             |
| Expenses:                       |                                               |                |                |                 |                 |
| Direct                          | 444,854                                       | 428,447        | 372,537        | 4%              | 15%             |
| Indirect                        | 145,127                                       | 131,772        | 120,919        | 10%             | 9%              |
| <b>Total Expenses</b>           | <b>589,981</b>                                | <b>560,219</b> | <b>493,456</b> | <b>5%</b>       | <b>14%</b>      |
| Net Underwriting & Distribution | \$ (93,516)                                   | (90,735)       | (83,076)       | -3%             | -9%             |

|                                 | <b>Wholesale Channel</b> |                |                | <b>2012 vs.</b> | <b>2011 vs.</b> |
|---------------------------------|--------------------------|----------------|----------------|-----------------|-----------------|
|                                 | <b>2012</b>              | <b>2011</b>    | <b>2010</b>    | <b>2011</b>     | <b>2010</b>     |
| Revenue                         | \$ 178,700               | 179,407        | 158,273        | 0%              | 13%             |
| Expenses:                       |                          |                |                |                 |                 |
| Direct                          | 224,744                  | 224,089        | 195,379        | 0%              | 15%             |
| Indirect                        | 39,929                   | 34,358         | 33,188         | 16%             | 4%              |
| <b>Total Expenses</b>           | <b>264,673</b>           | <b>258,447</b> | <b>228,567</b> | <b>2%</b>       | <b>13%</b>      |
| Net Underwriting & Distribution | \$ (85,973)              | (79,040)       | (70,294)       | -9%             | -12%            |

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| Advisors Channel                   |            |          |          |                  |                  |
|------------------------------------|------------|----------|----------|------------------|------------------|
|                                    | 2012       | 2011     | 2010     | 2012 vs.<br>2011 | 2011 vs.<br>2010 |
| Revenue                            | \$ 317,765 | 290,077  | 252,107  | 10%              | 15%              |
| Expenses:                          |            |          |          |                  |                  |
| Direct                             | 220,110    | 204,358  | 177,158  | 8%               | 15%              |
| Indirect                           | 105,198    | 97,414   | 87,731   | 8%               | 11%              |
| Total Expenses                     | 325,308    | 301,772  | 264,889  | 8%               | 14%              |
| Net Underwriting &<br>Distribution | \$ (7,543) | (11,695) | (12,782) | 36%              | 9%               |

A significant portion of underwriting and distribution revenues are received from Rule 12b-1 asset-based distribution and service fees earned on both load and load-waived and deferred-load products sold by our financial advisors and third party intermediaries. Underwriting and distribution revenues also include asset-based fees earned on our asset allocation products and commissions earned on the sale of other insurance products. A portion of underwriting and distribution fee revenues in our Advisors channel are derived from sales commissions charged on front-end load products sold by our financial advisors, including mutual fund Class A shares (those sponsored by the Company and those underwritten by other non-proprietary mutual fund companies), variable annuities and financial planning fees. A significant amount of Wholesale mutual fund sales are load-waived.

We divide the costs of underwriting and distribution into two components direct costs and indirect costs. Direct selling costs fluctuate with sales volume, such as advisor commissions and commission overrides paid to field management, advisor incentive compensation, commissions paid to third parties and to our own wholesalers, and related overrides in our Wholesale channel. Direct selling costs also fluctuate with assets under management, such as Rule 12b-1 service and distribution fees paid to the same parties. Indirect selling costs are fixed costs that do not necessarily fluctuate with sales levels. Indirect costs include expenses incurred by our home office and field offices such as wholesaler salaries, marketing costs, promotion and distribution of our products through the Wholesale and Advisors channels; support and management of our financial advisors such as field office overhead, sales programs and technology infrastructure; and costs of managing and supporting our wholesale efforts through technology infrastructure and personnel. While the Institutional channel does have marketing expenses, those expenses are accounted for in compensation and related costs and general and administrative expense instead of underwriting and distribution because of the channel's integration with our investment management division, its relatively small size and the fact that there are no Rule 12b-1 fees, loads, CDSCs, or any other charges to separate account clients except investment management fees.

We recover certain of our underwriting and distribution costs through Rule 12b-1 service and distribution fees, which are paid by the Funds. All Rule 12b-1 service and distribution fee revenue received from the Funds is recorded on a gross basis.

Underwriting and distribution revenues earned in 2012 increased by \$27.0 million, or 6%, compared to 2011. During 2012, revenues from fee-based asset allocation products continued to be a meaningful contributor to revenues, increasing to 23% of underwriting and distribution revenues in 2012 compared to 18% in 2011. Assets grew from \$6.0 billion to \$8.2 billion year over year and revenues generated from these assets increased \$33.1 million. Technology fees collected from our advisors increased revenues \$3.0 million. Prior to the fourth quarter of 2011, these fees were netted in operating expenses. Increased Rule 12b-1 asset-based service and distribution fees of \$2.2 million resulted from the increase in average mutual fund assets under management. Offsetting these increases, revenues from variable annuity products

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sold in the Advisors channel decreased by \$10.5 million. Insurance-related revenues and revenues from financial plans each decreased \$1.1 million compared to 2011.

Underwriting and distribution revenues earned in 2011 increased by \$59.1 million, or 14%, compared to 2010. Revenues from fee-based asset allocation products increased \$33.3 million compared to 2010 as assets grew from \$4.5 billion to \$6.0 billion year over year. Rule 12b-1 asset-based service and distribution fees increased \$28.5 million compared to 2010 as a result of an increase in average mutual fund assets under management. Revenues from front-load product sales sold in the Advisors channel decreased by \$4.5 million; however, this overall decrease included an increase in variable annuity revenues of \$7.5 million. Insurance-related revenues decreased \$1.1 million compared to 2010.

Underwriting and distribution expenses in 2012 increased by \$29.8 million, or 5%, compared to 2011. Direct expenses in the Wholesale channel increased \$0.7 million compared to 2011 as a result of an increase in average wholesale assets under management, partially offset by lower sales volume year over year. We incurred higher dealer compensation paid to third party distributors and increased Rule 12b-1 asset-based service and distribution expenses, partially offset by lower wholesaler commissions. Direct expenses in the Advisors channel increased \$15.8 million, or 8% due to increased commissions related to the sale of fee-based asset allocation products of \$25.1 million, partially offset by lower commissions on variable annuity products of \$6.1 million. Expenses related to financial plans and insurance products decreased \$1.0 million and \$0.5 million, respectively. Indirect expenses increased a total of \$13.4 million compared to 2011. The indirect expenses increase of \$5.6 million in the Wholesale channel was due to increased marketing costs and employee compensation and benefits expenses. The increase in indirect expenses in the Advisors channel of \$7.8 million was due to costs associated with our electronic books and records conversion project and increased employee compensation and benefits expenses.

Underwriting and distribution expenses in 2011 increased by \$66.8 million, or 14%, compared to 2010. A significant part of this increase was attributable to higher direct expenses in the Wholesale channel of \$28.7 million as a result of an increase in average wholesale assets under management year over year. We incurred higher dealer compensation paid to third party distributors, increased Rule 12b-1 asset-based service and distribution expenses and higher wholesaler commissions, partially offset by lower amortization expense of deferred sales commissions. Direct expenses in the Advisors channel increased \$27.2 million, or 15%, compared to 2010 due to higher fee-based asset allocation expenses of \$23.8 million, higher Rule 12b-1 asset-based service and distribution commissions of \$6.3 million and higher amortization expense of deferred sales commissions of \$0.9 million, partially offset by lower point of sale commissions on front-load product sales of \$2.6 million and insurance expenses of \$0.6 million. The indirect expenses increase of \$1.2 million in the Wholesale channel was mostly due to higher employee compensation and benefits expense. The increase in indirect expenses in the Advisors channel of \$9.7 million was due to increased employee compensation and benefits expenses, higher convention costs, increased field office expenses and higher expenses incurred beginning mid-year 2011 related to our electronic books and records conversion project.

*Shareholder Service Fees Revenue*

Shareholder service fee revenue primarily includes transfer agency fees, custodian fees from retirement plan accounts, and portfolio accounting and administration fees. Transfer agency fees and portfolio accounting and administration fees are asset-based revenues or account-based revenues, while custodian fees from retirement plan accounts are based on the number of client accounts.

During 2012, shareholder service fees revenue increased \$5.7 million, or 5%, over 2011, due to higher asset-based fees of \$4.5 million year over year in certain share classes and \$1.2 million attributable to account-based revenues, due to a 1% increase in the average number of client accounts.

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During 2011, shareholder service fees revenue increased \$12.1 million, or 11%, over 2010, due to higher asset-based fees of \$8.6 million year over year in certain share classes and \$3.5 million attributable to account-based revenues, due to a 2% increase in the average number of client accounts.

***Total Operating Expenses***

Operating expenses increased \$35.0 million, or 4%, in 2012 compared to 2011 primarily due to increased underwriting and distribution expenses and compensation and related costs, partially offset by decreased subadvisory fees. Underwriting and distribution expenses are discussed above.

Operating expenses increased \$102.5 million, or 14%, in 2011 compared to 2010 primarily due to increased underwriting and distribution expenses, compensation and related costs, and general and administrative expenses.

|                                | For the Year Ended<br>December 31,     |         |         | Variance         |                  |
|--------------------------------|----------------------------------------|---------|---------|------------------|------------------|
|                                | 2012                                   | 2011    | 2010    | 2012 vs.<br>2011 | 2011 vs.<br>2010 |
|                                | (in thousands, except percentage data) |         |         |                  |                  |
| Underwriting and distribution  | \$ 589,981                             | 560,219 | 493,456 | 5%               | 14%              |
| Compensation and related costs | 171,775                                | 157,332 | 138,207 | 9%               | 14%              |
| General and administrative     | 75,332                                 | 74,110  | 60,785  | 2%               | 22%              |
| Subadvisory fees               | 21,009                                 | 29,885  | 27,823  | -30%             | 7%               |
| Depreciation                   | 13,211                                 | 14,764  | 13,525  | -11%             | 9%               |
| Total operating expenses       | \$ 871,308                             | 836,310 | 733,796 | 4%               | 14%              |

***Compensation and Related Costs***

Compensation and related costs in 2012 increased \$14.4 million, or 9%, compared to 2011. Base salaries and payroll taxes contributed \$6.1 million to the increase, due to an increase in average headcount of 6% and annual merit increases during 2012. Share-based compensation increased \$3.4 million compared to 2011 primarily due to higher amortization expense associated with our April 2012, December 2011 and April 2011 grants of nonvested stock compared to grants that became fully vested in 2012. Pension costs increased \$3.2 million year over year, incentive compensation expense increased \$0.9 million and group insurance costs increased \$0.6 million based on unfavorable claims experience.

Compensation and related costs in 2011 increased \$19.1 million, or 14%, compared to 2010. Base salaries and payroll taxes contributed \$6.8 million to the increase, due to an increase in average headcount of 12% and annual merit increases during 2011. Share-based compensation increased \$6.3 million compared to 2010 primarily due to higher amortization expense associated with our April 2011, December 2010 and April 2010 grants of nonvested stock compared to grants that became fully vested in 2011. We had a decrease in capitalized software development activities of \$2.7 million, higher commission expense on managed and institutional accounts of \$1.5 million and experienced higher incentive compensation expense of \$0.8 million and group insurance costs of \$0.3 million.

***General and Administrative Expenses***

General and administrative expenses are operating costs other than those related to compensation and to distribution efforts, including, but not limited to, computer services and software costs, telecommunications, facilities costs of our home offices, costs of professional services including legal and accounting, and insurance.

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General and administrative expenses increased \$1.2 million for the year ended December 31, 2012 compared to 2011. During 2012, we recorded a charge of \$5.0 million to reflect the impairment of certain capitalized software development costs. Our ongoing assessment and changes to our enterprise information technology infrastructure and software resulted in the decision to discontinue the usage of certain software. Also included in 2012 was an adjustment to lower general and administrative expenses by \$3.5 million to reflect lower estimated costs of distributing an SEC market timing settlement dating back to 2006, and a reduction in the estimated legal costs related to an ongoing class action suit. Included in 2011 is a \$1.8 million charge related to the write-off of software capitalization costs due to the discontinuation of use of certain software licenses. Excluding these charges, general and administrative expenses increased \$1.5 million, due primarily to increased costs incurred for third party servicing of our shareholder accounts of \$3.1 million, higher computer services and software costs and increased costs for temporary office staff related to our electronic books and records conversion project. Costs decreased related to our national branding campaign launched in 2011 year over year. We expect computer services and software costs to increase in the coming year based on our current project plan.

General and administrative expenses increased \$13.3 million in 2011 compared to 2010. Included in 2011 is a \$1.8 million charge related to the write-off of software capitalization costs due to the discontinuation of use of certain software licenses. The remaining variance is due to increased costs incurred for third party servicing of our shareholder accounts of \$4.1 million, costs incurred for our national branding campaign launched in the first quarter of 2011, higher computer services and software costs of \$2.7 million and increased legal expenses of \$2.4 million, partially offset by lower fund expenses of \$0.7 million. Fee waivers were recorded as part of fund expenses prior to the third quarter of 2010. Fee waivers are now netted against management fee revenues.

### *Subadvisory Fees*

Subadvisory fees represent fees paid to other asset managers for providing advisory services for certain mutual fund portfolios. These expenses reduce our operating margin since we pay out approximately half of our management fee revenue received from subadvised products. Gross management fee revenues for products subadvised by others were \$41.7 million for the year ended December 31, 2012 compared to \$59.3 million and \$55.3 million for 2011 and 2010, respectively, due to a 31% decrease in average assets from 2011 to 2012 and a 8% increase in average assets from 2010 to 2011. Subadvisory expenses followed the same pattern for the past three years.

Subadvised assets under management at December 31, 2012 were \$4.3 billion compared to the annual average of \$5.0 billion for 2012. Since subadvisory expenses are a function of sales, redemptions and market action for subadvised assets, assuming a flat market in 2013, the lower asset base will likely result in a decrease to both gross management fee revenues and subadvisory expenses for the coming year.

### *Other Income and Expenses*

#### *Investment and Other Income*

Investment and other income increased \$7.7 million in 2012 compared to 2011. The current year included mark-to-market gains on mutual fund holdings in our trading portfolio of \$4.8 million compared to losses in 2011 of \$1.1 million. We recorded realized gains on the sale of available for sale mutual funds of \$3.2 million during 2012 compared to \$2.2 million in 2011. Interest and gains related to our corporate bond portfolio increased \$0.8 million compared to the prior year. In 2012 and 2011, we recorded write-downs of our investment in limited partnerships of \$2.0 million and \$1.5 million, respectively.

Investment and other income decreased \$6.5 million in 2011 compared to 2010. The most significant contributor to this decrease related to mark-to-market losses on mutual fund holdings in our trading portfolio of \$1.1 million in 2011 compared to gains in 2010 of \$5.1 million. We recorded realized gains on the sale of available for sale mutual funds of \$2.2 million during 2011 compared to \$2.9 million in 2010. Higher dividend income on available for sale mutual fund holdings of \$1.0 million in 2011 compared to 2010 partially offset these declines. We recorded write-downs of our investment in a limited partnership of \$1.5 million in both years.

Table of Contents*Interest Expense*

Interest expense was \$11.3 million, \$11.4 million and \$12.7 million in 2012, 2011 and 2010, respectively. In January 2011, we completed the refinancing of our senior notes with more favorable terms, which resulted in lower interest expense in 2011 compared to 2010. We also experienced lower costs associated with our \$125.0 million credit facility, which was entered into in August 2010.

*Income Taxes*

Our effective income tax rate from continuing operations was 36.0%, 37.8% and 36.2% in 2012, 2011 and 2010, respectively. During 2009, the Company sold a subsidiary, which generated a capital loss available to offset potential future and prior period capital gains. Due to the character of the loss and the limited carryforward period permitted by law, a valuation allowance was recorded on a portion of this capital loss. The lower effective tax rate in 2012 was primarily the result of additional utilization of the capital loss in 2012 as compared to 2011. During 2012 and 2011, realized capital gains allowed for a release of the valuation allowance of \$2.3 million and \$0.4 million, respectively. In both years, this release of the valuation allowance was recorded as a reduction to income tax expense and, as a result, decreased our effective tax rate. The higher effective tax rate in 2011 over 2010 was primarily the result of less utilization of the capital loss in 2011 as compared to 2010.

Our 2012, 2011 and 2010 effective tax rates from continuing operations, removing the effects of the valuation allowance, would have been 36.8%, 38.0% and 37.3%, respectively. The effective income tax rate, exclusive of the valuation allowance, decreased in 2012 as compared to 2011 due to the lapse of the statute of limitations in tax years, which allowed for the recognition of tax benefits previously considered partially uncertain. Also in 2012, the Company identified favorable treatment on expenses previously considered nondeductible for income tax purposes in years for which the statute of limitations remains open. The effective income tax rate, exclusive of the valuation allowance, increased in 2011 over that of 2010 due to changes in state legislation in jurisdictions in which the Company operates as well as a charge to tax expense in 2011 on tax positions for which the outcome is uncertain in tax years in which the statute of limitations remains open.

**Liquidity and Capital Resources**

The following table summarizes certain key financial data relating to our liquidity and capital resources:

|                                        | For the Year Ended<br>December 31, |             |             | Variance         |                  |
|----------------------------------------|------------------------------------|-------------|-------------|------------------|------------------|
|                                        | 2012                               | 2011        | 2010        | 2012 vs.<br>2011 | 2011 vs.<br>2010 |
| (in thousands, except percentage data) |                                    |             |             |                  |                  |
| <b>Balance Sheet Data:(2)</b>          |                                    |             |             |                  |                  |
| Cash and cash equivalents              | \$ 328,027                         | 323,916     | 190,070     | 1%               | 70%              |
| Cash and cash equivalents - restricted | 92,980                             | 50,556      | 71,689      | 84%              | -29%             |
| Investment securities                  | 176,142                            | 134,262     | 191,322 (1) | 31%              | -30%             |
| Long-term debt                         | 190,000                            | 190,000     | 189,999     | 0%               | 0%               |
| <b>Cash Flow Data:</b>                 |                                    |             |             |                  |                  |
| Cash flows from operating activities   | 233,435                            | 283,139 (1) | 140,643     | -18%             | 101%             |
| Cash flows from investing activities   | (17,129)                           | (30,242)    | (67,806)    | -43%             | -55%             |
| Cash flows from financing activities   | (213,059)                          | (121,129)   | (121,881)   | -76%             | 1%               |

(1)

At December 31, 2010, investment securities included U.S. treasury bills of \$117.9 million and commercial paper of \$5.0 million with maturities of less than 180 days at the date of purchase.

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Maturities of the U.S. treasury bills and commercial paper during 2011 of \$66.0 million is included in cash flows from operating activities.

(2)

Balance sheet data excludes discontinued operations held for sale for all periods presented.

Our operations provide much of the cash necessary to fund our priorities, as follows:

Finance internal growth

Pay dividends

Repurchase our stock

*Finance Internal Growth*

We use cash to fund growth in our distribution channels. Our Wholesale channel, which has a higher cost to gather assets, requires cash outlays for wholesaler commissions and commissions to third parties on deferred load product sales. We continue to invest in our Advisors channel by providing additional support to our advisors through wholesaling efforts and enhanced technology tools.

*Pay Dividends*

The Board of Directors approved a special cash dividend on our common stock of \$1.00 per share that was paid on December 6, 2012, and an increase in the quarterly dividend on our common stock from \$0.25 per share to \$0.28 per share beginning with our fourth quarter 2012 dividend, paid on February 1, 2013. Dividends on our common stock resulted in financing cash outflows of \$171.3 million, \$68.8 million and \$65.2 million in 2012, 2011 and 2010, respectively.

*Repurchase Our Stock*

In 2012, we purchased 1.5 million of our shares, compared to 2.0 million shares in both 2011 and 2010. These share repurchase amounts included 568,568 shares, 494,207 shares and 426,665 shares from employees who elected to tender shares to cover their minimum tax withholdings with respect to vesting of stock awards during the years ended December 31, 2012, 2011 and 2010, respectively.

In the future, we plan to repurchase shares, at a minimum, to offset dilution from shares issued for employee share plans. During 2013, we estimate that we will repurchase approximately 670 thousand shares from employees who elect to tender shares to cover their minimum tax withholdings arising from the vesting of nonvested shares.

**Operating Cash Flows**

Excluding the cash flows from operating activities generated from the maturity of U.S. treasuries and commercial paper in 2011 of \$66.0 million, net cash provided by operating activities increased \$16.3 million from 2011 to 2012.

The payable to investment companies for securities and other receivables accounts can fluctuate significantly based on trading activity at the end of a reporting period. Changes in these accounts result in variances within cash from operations on the statement of cash flows; however, there is no impact to the Company's liquidity and operations for the variances in these accounts.

We pay our financial advisors and third parties upfront commissions on the sale of Class B and C shares and certain fee-based asset allocation products. Funding of such commissions during the years ended December 31, 2012, 2011 and 2010 totaled \$54.4 million, \$57.9 million and \$59.0 million, respectively. The drivers of commission funding in 2012 were fee-based asset allocation products, for which \$28.0 million was funded, and Class C shares, for which \$19.0 million was funded. The drivers of commission funding in 2011 were fee-based asset allocation products, for which \$26.5 million was funded, and Class C shares, for which \$23.0 million was funded. The drivers of commission funding in 2010 were Class C shares, for which \$25.9 million was funded, and fee-based asset allocation products, for which \$24.8 million was funded. Management expects future cash requirements for sales commissions may





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exceed the level experienced in previous years due to increased sales in our fee-based asset allocation products.

Contributions to our pension plan are not expected to exceed \$20 million for 2013. A contribution of \$10 million was made to the plan in January 2013.

**Investing Cash Flows**

Investing activities consist primarily of the purchase and sale of available for sale investment securities, as well as capital expenditures. We expect our 2013 capital expenditures to be in the range of \$15.0 to \$20.0 million.

**Financing Cash Flows**

As noted previously, dividends and stock repurchases accounted for a majority of our financing cash outflows in 2012.

During 2010, we repurchased \$10.0 million of our \$200.0 million aggregate principal amount 5.6% senior notes due January 2011 (the "Notes"). On August 31, 2010, the Company entered into an agreement to complete a \$190.0 million private placement of senior notes (the "Senior Notes"). The agreement contained a delayed funding provision that allowed the Company to draw down the proceeds in January 2011 when the existing Notes matured. The Company used the proceeds of the issuance and sale of the Senior Notes to repay in full the Notes expiring in January 2011. The Senior Notes are unsecured and were issued in two tranches: \$95.0 million bearing interest at 5% and maturing January 13, 2018, Series A, and \$95.0 million bearing interest of 5.75% and maturing January 13, 2021, Series B. Interest is payable semi-annually in January and July of each year.

Simultaneous with the refinancing of our senior notes, the Company entered into a three year revolving credit facility (the "Credit Facility") with various lenders, effective August 31, 2010, which provides for initial borrowings of up to \$125.0 million and replaced the Company's previous revolving credit facility. Lenders could, at their option upon the Company's request, expand the facility to \$200.0 million. At December 31, 2012, there were no borrowings outstanding under the Credit Facility. Both the Credit Facility and Senior Notes contain financial covenants with respect to leverage and interest coverage, both of which we were in compliance with throughout fiscal 2012.

**Short Term Liquidity and Capital Requirements**

Management believes its available cash, marketable securities and expected cash flow from operations will be sufficient to fund its short-term operating and capital requirements during 2013. Expected short-term uses of cash include dividend payments, interest payments on outstanding debt, income tax payments, seed money for new products, share repurchases, payment of deferred commissions to our financial advisors and third parties, capital expenditures and home office leasehold improvements, and could include strategic acquisitions.

**Long Term Liquidity and Capital Requirements**

Expected long-term capital requirements include indebtedness, operating leases and purchase obligations, and potential recognition of tax liabilities, summarized in the following table as of December 31, 2012. Purchase obligations include amounts that will be due for the purchase of goods and

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services to be used in our operations under long-term commitments or contracts. The majority of our purchase obligations are reimbursable to us by the Funds.

|                                                | Total          | 2013   | 2014-<br>2015 | 2016-<br>2017 | Thereafter/<br>Indeterminate |
|------------------------------------------------|----------------|--------|---------------|---------------|------------------------------|
|                                                | (in thousands) |        |               |               |                              |
| Long-term debt obligations, including interest | \$ 262,557     | 10,213 | 20,425        | 20,425        | 211,494                      |
| Non-cancelable operating lease commitments     | 89,386         | 20,498 | 29,998        | 17,313        | 21,577                       |
| Purchase obligations                           | 261,419        | 38,358 | 63,714        | 59,087        | 100,260                      |
| Unrecognized tax benefits                      | 10,788         | 329    | -             | -             | 10,459                       |
|                                                | \$ 624,150     | 69,398 | 114,137       | 96,825        | 343,790                      |

Other possible long-term discretionary uses of cash could include capital expenditures for enhancement of technology infrastructure and home office expansion, strategic acquisitions, payment of dividends, income tax payments, seed money for new products, payment of upfront fund commissions for Class B shares, Class C shares and certain fee-based asset allocation products, pension funding and repurchases of our common stock.

**Off-Balance Sheet Arrangements**

Other than operating leases, which are included in the table above, the Company does not have any off-balance sheet financing. The Company has not created, and is not party to, any special-purpose or off-balance sheet entities for the purpose of raising capital, incurring debt or operating its business.

**Critical Accounting Policies and Estimates**

Management believes the following critical accounting policies affect its significant estimates and judgments used in the preparation of its consolidated financial statements.

*Accounting for Goodwill and Intangible Assets*

As of December 31, 2012, our total goodwill and intangible assets were \$162.0 million, or 14%, of our total assets. Two significant considerations arise with respect to these assets that require management estimates and judgment: (i) the valuation in connection with the initial purchase price allocation, and (ii) the ongoing evaluation of impairment.

In connection with all of our acquisitions, an evaluation is completed to determine reasonable purchase price allocations. The purchase price allocation process requires management estimates and judgments as to expectations for the various products, distribution channels and business strategies. For example, certain growth rates and operating margins were assumed for different products and distribution channels. If actual growth rates or operating margins, among other assumptions, differ from the estimates and judgments used in the purchase price allocation, the amounts recorded in the financial statements for identifiable intangible assets and goodwill could be subject to charges for impairment in the future.

We complete an ongoing review of the recoverability of goodwill and intangible assets using a fair-value based approach on an annual basis or more frequently whenever events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Intangible assets with indefinite lives, primarily acquired mutual fund advisory contracts, are also tested for impairment annually by comparing their fair value to the carrying amount of the asset. We consider mutual fund advisory contracts indefinite lived intangible assets as they are expected to be renewed without significant cost or modification of terms. Factors that are considered important in determining whether an impairment of goodwill or intangible assets might exist include significant continued underperformance compared to peers, the likelihood of termination or non-renewal of a mutual fund advisory or subadvisory contract or substantial changes in revenues earned from such contracts, significant changes in our business

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and products, material and ongoing negative industry or economic trends, or other factors specific to each asset or subsidiary being evaluated. Because of the significance of goodwill and other intangibles to our consolidated balance sheets, the annual impairment analysis is critical. Any changes in key assumptions about our business and our prospects, or changes in market conditions or other externalities, could result in an impairment charge.

As of June 30, 2012, the Company's annual impairment test indicated that the fair value of the Legend reporting unit exceeded its carrying value, which resulted in no goodwill impairment. During preliminary due diligence conducted in the third quarter regarding a possible sale of Legend, several significant issues arose regarding executive leadership, advisor retention and employee morale. As due diligence discussions progressed into formal negotiations throughout the third quarter, the Company's concerns regarding these matters escalated, the depth and consequence of which led us to determine that a change in the strategic direction of Legend was necessary, and as a result, the Company decided to move forward with a sale of Legend at a price lower than the fair value utilized in the annual impairment analysis in the second quarter. During the third quarter of 2012, \$59.2 million of goodwill related to Legend was allocated to assets of discontinued operations held for sale and \$42.4 million of goodwill related to Legend was written down and is included in the loss from discontinued operations in the statement of income.

The Company's annual impairment test indicated that remaining goodwill and identifiable intangible assets were not impaired. Related to goodwill, the fair value of the investment management and related services reporting unit exceeded its carrying value by more than 100%. The fair value of our indefinite-life intangible assets exceeded their respective carrying values by more than 80%.

*Accounting for Income Taxes*

In the ordinary course of business, many transactions occur for which the ultimate tax outcome is uncertain. In addition, respective tax authorities periodically audit our income tax returns. These audits examine our significant tax filing positions, including the timing and amounts of deductions and the allocation of income among tax jurisdictions. We adjust our income tax provision in the period in which we determine the actual outcomes will likely be different from our estimates. The recognition or derecognition of income tax expense related to uncertain tax positions is determined under the guidance as prescribed by Accounting Standards Codification ("ASC") "Income Taxes Topic" ASC 740. During 2012 and 2010, the Company settled three and nine open tax years, respectively, that were undergoing audit by state jurisdictions in which the Company operates. These audits were settled in all material respects with no significant adjustments. The Company is currently undergoing audits in various other state jurisdictions that have not yet been settled.

We recognize an asset or liability for the deferred tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements, including the determination of any valuation allowance that might be required for deferred tax assets. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of assets are recovered or liabilities are settled.

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In 2009, the Company sold a subsidiary that generated a capital loss available to offset potential future capital gains. Due to the character of the loss and the limited carryforward period permitted by law, the Company may not realize the full tax benefit of the capital loss. The capital loss carryforward generated in 2009, if not utilized, will expire in 2014. During 2012, the Company recorded a non-cash impairment charge for its investment in the Legend subsidiaries. The impairment created excess tax basis in its investment in Legend that will be characterized as a capital loss upon the sale of Legend. Capital losses generated by the Legend sale will expire five years from when the loss is realized. Management believes it is not more likely than not that the Company will generate sufficient future capital gains to realize the full benefit of these capital losses. Accordingly, a valuation allowance has been recorded on the deferred tax assets that were capital in nature as of December 31, 2012 and December 31, 2011.

Also as of December 31, 2012, four of the Company's subsidiaries have state net operating loss carryforwards in certain states in which those companies file on a separate company basis. These entities have recognized a deferred tax asset for such carryforwards. The carryforwards, if not utilized, will expire between 2013 and 2032. Management believes it is not more likely than not that three of the subsidiaries will generate sufficient future taxable income in these states to realize the benefit of these state net operating loss carryforwards and, accordingly, a valuation allowance has been recorded at December 31, 2012 and December 31, 2011. We have not recorded a valuation allowance on any other deferred tax assets as of the current reporting period based on our belief that operating income will, more likely than not, be sufficient to realize the benefit of these assets over time. In the event that actual results differ from estimates or if our historical trend of positive operating income changes, we may be required to record a valuation allowance on deferred tax assets, which could have a significant effect on our consolidated financial condition and results of operations.

Income taxes are recorded at the rates in effect in the various tax jurisdictions in which we operate. Tax law and rate changes are reflected in the income tax provision in the period in which such changes are enacted.

*Pension and Other Postretirement Benefits*

Accounting for our pension and postretirement benefit plans requires us to estimate the cost of benefits to be provided well into the future and the current value of our benefit obligations. Three critical assumptions affecting these estimates are the discount rate, the expected return on assets, and the expected health care cost trend rate. In 2012 and 2011, the discount rate assumption was based on the Aon Hewitt AA Only Above Median Yield Curve. This discount rate was determined separately for each plan by plotting the expected benefit payments from each plan against a yield curve of high quality, zero coupon bonds and calculating the single rate that would produce the same present value of liabilities as the yield curve. Prior to 2011, the discount rate assumption was based on the Mercer Bond Model, which calculated the yield on a theoretical portfolio of high-grade corporate bonds with cash flows that generally matched our expected benefit payments. The expected return on plan assets and health care cost trend rates are based upon an evaluation of our historical trends and experience, taking into account current and expected future market conditions. Other assumptions include rates of future compensation increases, participant withdrawals and mortality rates, and participant retirement ages. These estimates and assumptions impact the amount of net pension expense or income recognized each year and the measurement of our reported benefit obligation under the plans.

In 2012, we decreased the discount rate for our pension plan to 4.22% from 4.99% used in 2011 and 6.00% used in 2010, and decreased the discount rate for our postretirement plan to 4.18% from 5.00% used in 2011 and 6.00% used in 2010, to reflect market interest rates. We continue to assume long-term asset returns of 7.75% on the assets in our pension plan, the same as our assumption in 2011 and 2010. Our pension plan assets at December 31, 2012 were 100% invested in the Asset Strategy style and we have targeted this same investment strategy going forward.

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The effect of hypothetical changes to selected assumptions on the Company's retirement benefit plans would be as follows:

| Assumptions                 | Change     | December 31,<br>2012                   | December 31,<br>2013                  |
|-----------------------------|------------|----------------------------------------|---------------------------------------|
|                             |            | Increase<br>(Decrease)<br>PBO/APBO (1) | Increase<br>(Decrease)<br>Expense (2) |
| (in thousands)              |            |                                        |                                       |
| <b>Pension</b>              |            |                                        |                                       |
| Discount rate               | +/-50 bps  | \$ (11,388)/12,626                     | \$ (1,281)/1,407                      |
| Expected return on assets   | +/-100 bps | N/A                                    | (1,396)/1,396                         |
| Salary scale                | +/-100 bps | 9,060/(8,440)                          | 2,090/(1,901)                         |
| <b>Other Postretirement</b> |            |                                        |                                       |
| Discount rate               | +/-50 bps  | (550)/605                              | (47)/80                               |
| Health care cost trend rate | +/-100 bps | 1,162/(985)                            | 260/(163)                             |

- (1) Projected benefit obligation ("PBO") for pension plans and accumulated postretirement benefit obligation ("APBO") for other postretirement plans.
- (2) Pre-tax impact on expense.

## Deferred Sales Commissions

We pay upfront sales commissions to our financial advisors and third party intermediary broker/dealers in connection with the sale of certain classes of mutual fund shares sold without a front-end sales charge. These costs are capitalized and amortized over the period during which the shareholder is subject to a CDSC, not to exceed five years. We recover these costs through Rule 12b-1 and other distribution plan fees, which are paid by the applicable share classes of the Advisors Funds, Ivy Funds and InvestEd Portfolios, along with CDSCs paid by shareholders who redeem their shares prior to completion of the specified holding periods. Should we lose our ability to recover such sales commissions through distribution plan payments and CDSCs, the value of these assets would immediately decline, as would future cash flows. We periodically review the recoverability of deferred sales commission assets as events or changes in circumstances indicate that the carrying amount of deferred sales commission assets may not be recoverable and adjust the deferred assets accordingly.

## Valuation of Investments

We record substantially all investments in our financial statements at fair value. Where available, we use prices from independent sources such as listed market prices or broker/dealer price quotations. We evaluate our investments for other than temporary declines in value on a periodic basis. This may exist when the fair value of an investment security has been below the current value for an extended period of time. As most of our investments are carried at fair value, if an other than temporary decline in value is determined to exist, the unrealized investment loss recorded net of tax in accumulated other comprehensive income is realized as a charge to net income, in the period in which the other than temporary decline in value is determined. While we believe that we have accurately estimated the amount of the other than temporary decline in the value of our portfolio, different assumptions could result in changes to the recorded amounts in our financial statements.

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*Loss Contingencies*

The likelihood that a loss contingency exists is evaluated using the criteria of "*Contingencies Topic*," ASC 450 through consultation with legal counsel. A loss contingency is recorded if the contingency is considered probable and reasonably estimable as of the date of the financial statements.

**Seasonality and Inflation**

We do not believe our operations are subject to significant seasonal fluctuation. We have historically experienced increased sales activity in the first and fourth quarters of the year due to funding of retirement accounts by our clients. The Company has not suffered material adverse effects from inflation in the past. However, a substantial increase in the inflation rate in the future may adversely affect customers' purchasing decisions, may increase the costs of borrowing, or may have an impact on the Company's margins and overall cost structure.

**ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk**

We use various financial instruments with certain inherent market risks, primarily related to interest rates and securities prices. The principal risks of loss arising from adverse changes in market rates and prices to which we are exposed relate to interest rates on debt and marketable securities. Generally, these instruments have not been entered into for trading purposes. Management actively monitors these risk exposures; however, fluctuations could impact our results of operations and financial position. As a matter of policy, we only execute derivative transactions to manage exposures arising in the normal course of business and not for speculative or trading purposes. The following information, together with information included in other parts of Management's Discussion and Analysis of Financial Condition and Results of Operations, which are incorporated herein by reference, describe the key aspects of certain financial instruments that have market risk to us.

*Interest Rate Sensitivity*

Our interest sensitive liabilities include our long-term fixed rate senior notes and obligations for any balances outstanding under our credit facility or other short-term borrowings. Increases in market interest rates would generally cause a decrease in the fair value of the senior notes and an increase in interest expense associated with short-term borrowings and borrowings under the credit facility. Decreases in market interest rates would generally cause an increase in the fair value of the senior notes and a decrease in interest expense associated with short-term borrowings and borrowings under the credit facility. We had no short-term borrowings outstanding as of December 31, 2012.

*Available for Sale Investments Sensitivity*

We maintain an investment portfolio of various holdings, types and maturities. Our portfolio is diversified and consists primarily of investment grade debt securities and equity mutual funds. A portion of investments are classified as available for sale investments. At any time, a sharp increase in interest rates or a sharp decline in the United States stock market could have a significant negative impact on the fair value of our investment portfolio. If a decline in fair value is determined to be other than temporary by management, the cost basis of the individual security or mutual fund is written down to fair value. We do not currently hedge these exposures. Conversely, declines in interest rates or a sizeable rise in the United States stock market could have a significant positive impact on our investment portfolio. However, unrealized gains are not recognized in operations on available for sale securities until they are sold.

*Securities Price Sensitivity*

Our revenues are dependent on the underlying assets under management in the Funds to which investment advisory services are provided. The Funds include portfolios of investments comprised of various combinations of equity, fixed income and other types of securities and commodities. Fluctuations in the value of these securities are common and are generated by numerous factors, including, without

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limitation, market volatility, the overall economy, inflation, changes in investor strategies, availability of alternative investment vehicles, government regulations and others. Accordingly, declines in any one or a combination of these factors, or other factors not separately identified, may reduce the value of investment securities and, in turn, the underlying assets under management on which our revenues are earned. These declines have an impact in our investment sales and our trading portfolio, thereby compounding the impact on our earnings.

**ITEM 8. Financial Statements and Supplementary Data**

Reference is made to the Consolidated Financial Statements referred to in the Index on page 48 setting forth our consolidated financial statements, together with the report of KPMG LLP dated February 27, 2013 on page 49.

**ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**ITEM 9A. Controls and Procedures**

(a)

*Evaluation of Disclosure Controls and Procedures.* The Company maintains a system of disclosure controls and procedures that is designed to provide reasonable assurance that information, which is required to be timely disclosed, is accumulated and communicated to management in a timely fashion. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report, have concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure and are effective to provide reasonable assurance that such information is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

(b)

*Management's Report on Internal Control Over Financial Reporting.* Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our principal executive officer and our principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in "*Internal Control-Integrated Framework*" issued by the Committee of Sponsoring Organizations of the Treadway Commission. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable, not absolute, assurance with respect to financial statement preparation and presentation. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on our evaluation under the framework in "*Internal Control-Integrated Framework*," management concluded that, as of December 31, 2012, our internal control over financial reporting was effective. KPMG LLP, the independent registered public accounting firm that audited the financial statements included in this Annual Report on Form 10-K, also audited the effectiveness of our internal control over financial reporting as of December 31, 2012, as stated in their attestation report which follows.

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Waddell & Reed Financial, Inc.:

We have audited Waddell & Reed Financial, Inc.'s (the Company) internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Waddell & Reed Financial, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Waddell & Reed Financial, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Waddell & Reed Financial, Inc. and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2012, and our report dated February 27, 2013 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Kansas City, Missouri  
February 27, 2013



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- (c) *Changes in Internal Control over Financial Reporting.* The Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. There were no changes in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**ITEM 9B. Other Information**

None.

**PART III**

**ITEM 10. Directors, Executive Officers and Corporate Governance**

Information required by this Item 10. is incorporated herein by reference to our definitive proxy statement for our 2013 Annual Meeting of Stockholders to be filed pursuant to Regulation 14A under the Exchange Act.

**ITEM 11. Executive Compensation**

Information required by this Item 11. is incorporated herein by reference to our definitive proxy statement for our 2013 Annual Meeting of Stockholders to be filed pursuant to Regulation 14A under the Exchange Act.

**ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information required by this Item 12. is incorporated herein by reference to our definitive proxy statement for our 2013 Annual Meeting of Stockholders to be filed pursuant to Regulation 14A under the Exchange Act.

**ITEM 13. Certain Relationships and Related Transactions, and Director Independence**

Information required by this Item 13. is incorporated herein by reference to our definitive proxy statement for our 2013 Annual Meeting of Stockholders to be filed pursuant to Regulation 14A under the Exchange Act.

**ITEM 14. Principal Accounting Fees and Services**

Information required by this Item 14. is incorporated herein by reference to our definitive proxy statement for our 2013 Annual Meeting of Stockholders to be filed pursuant to Regulation 14A under the Exchange Act.

**PART IV**

**ITEM 15. Exhibits, Financial Statement Schedules**

- (a)(1) Financial Statements.  
Reference is made to the Index to Consolidated Financial Statements on page 48 for a list of all financial statements filed as part of this Report.
- (a)(2) Financial Statement Schedules.  
None.
- (b) Exhibits.  
Reference is made to the Index to Exhibits beginning on page 84 for a list of all exhibits filed as part of this Report.

Table of Contents**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Company has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Overland Park, State of Kansas, on February 27, 2013.

WADDELL & REED FINANCIAL, INC.

By: /s/ HENRY J. HERRMANN

Henry J. Herrmann

*Chairman of the Board and Chief Executive Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this Report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

| <b>Name</b>                                             | <b>Title</b>                                                                              | <b>Date</b>       |
|---------------------------------------------------------|-------------------------------------------------------------------------------------------|-------------------|
| <u>/s/ HENRY J. HERRMANN</u><br>Henry J. Herrmann       | Chief Executive Officer, Chairman of the Board and Director (Principal Executive Officer) | February 27, 2013 |
| <u>/s/ DANIEL P. CONNEALY</u><br>Daniel P. Connealy     | Senior Vice President and Chief Financial Officer<br>(Principal Financial Officer)        | February 27, 2013 |
| <u>/s/ BRENT K. BLOSS</u><br>Brent K. Bloss             | Senior Vice President Finance and Treasurer<br>(Principal Accounting Officer)             | February 27, 2013 |
| <u>/s/ SHARILYN S. GASAWAY</u><br>Sharilyn S. Gasaway   | Director                                                                                  | February 27, 2013 |
| <u>/s/ THOMAS C. GODLASKY</u><br>Thomas C. Godlasky     | Director                                                                                  | February 27, 2013 |
| <u>/s/ ALAN W. KOSLOFF</u><br>Alan W. Kosloff           | Director                                                                                  | February 27, 2013 |
| <u>/s/ DENNIS E. LOGUE</u><br>Dennis E. Logue           | Director                                                                                  | February 27, 2013 |
| <u>/s/ MICHAEL F. MORRISSEY</u><br>Michael F. Morrissey | Director                                                                                  | February 27, 2013 |
| <u>/s/ JAMES M. RAINES</u><br>James M. Raines           | Director                                                                                  | February 27, 2013 |

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/s/ RONALD C. REIMER

Director

February 27, 2013

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Ronald C. Reimer

/s/ JERRY W. WALTON

Director

February 27, 2013

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Jerry W. Walton

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**WADDELL & REED FINANCIAL, INC.**

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Waddell & Reed Financial, Inc.:

We have audited the accompanying consolidated balance sheets of Waddell & Reed Financial, Inc. and subsidiaries (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2012. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Waddell & Reed Financial, Inc. and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Waddell & Reed Financial, Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 27, 2013 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Kansas City, Missouri  
February 27, 2013

Table of Contents**WADDELL & REED FINANCIAL, INC.****CONSOLIDATED BALANCE SHEETS****December 31, 2012 and 2011**

|                                                                                                                                                 | <b>2012</b>           | <b>2011</b>   |
|-------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|---------------|
|                                                                                                                                                 | <b>(in thousands)</b> |               |
| <b>Assets:</b>                                                                                                                                  |                       |               |
| Cash and cash equivalents                                                                                                                       | \$ 328,027            | 323,916       |
| Cash and cash equivalents - restricted                                                                                                          | 92,980                | 50,556        |
| Investment securities                                                                                                                           | 176,142               | 134,262       |
| <b>Receivables:</b>                                                                                                                             |                       |               |
| Funds and separate accounts                                                                                                                     | 33,886                | 31,842        |
| Customers and other                                                                                                                             | 136,073               | 107,125       |
| Deferred income taxes                                                                                                                           | 7,978                 | 11,900        |
| Income taxes receivable                                                                                                                         | 5,577                 | 15,067        |
| Prepaid expenses and other current assets                                                                                                       | 9,080                 | 10,042        |
| Assets of discontinued operations held for sale                                                                                                 | 15,150                | 14,901        |
| <br>Total current assets                                                                                                                        | <br>804,893           | <br>699,611   |
| Property and equipment, net                                                                                                                     | 69,328                | 73,143        |
| Deferred sales commissions, net                                                                                                                 | 69,355                | 68,788        |
| Goodwill and identifiable intangible assets                                                                                                     | 161,969               | 161,969       |
| Deferred income taxes                                                                                                                           | 17,797                | 5,046         |
| Other non-current assets                                                                                                                        | 11,491                | 13,533        |
| Assets of discontinued operations held for sale                                                                                                 | 18,010                | 60,274        |
| <br>Total assets                                                                                                                                | <br>\$ 1,152,843      | <br>1,082,364 |
| <br><b>Liabilities:</b>                                                                                                                         |                       |               |
| Accounts payable                                                                                                                                | \$ 68,977             | 51,951        |
| Payable to investment companies for securities                                                                                                  | 152,749               | 104,304       |
| Accrued compensation                                                                                                                            | 46,347                | 42,670        |
| Payable to third party brokers                                                                                                                  | 46,169                | 41,125        |
| Other current liabilities                                                                                                                       | 43,504                | 42,298        |
| Liabilities of discontinued operations held for sale                                                                                            | 7,587                 | 6,550         |
| <br>Total current liabilities                                                                                                                   | <br>365,333           | <br>288,898   |
| Long-term debt                                                                                                                                  | 190,000               | 190,000       |
| Accrued pension and postretirement costs                                                                                                        | 62,458                | 56,548        |
| Other non-current liabilities                                                                                                                   | 24,531                | 23,068        |
| Liabilities of discontinued operations held for sale                                                                                            | 281                   | 207           |
| <br>Total liabilities                                                                                                                           | <br>642,603           | <br>558,721   |
| <br><b>Commitments and contingencies</b>                                                                                                        |                       |               |
| <b>Stockholders' equity:</b>                                                                                                                    |                       |               |
| Preferred stock \$1.00 par value; 5,000 shares authorized; none issued                                                                          | -                     | -             |
| Class A Common stock \$0.01 par value; 250,000 shares authorized; 99,701 shares issued; 85,679 shares outstanding (85,564 at December 31, 2011) | 997                   | 997           |
| Additional paid-in capital                                                                                                                      | 230,021               | 216,426       |
| Retained earnings                                                                                                                               | 698,423               | 721,281       |
| Cost of 14,022 common shares in treasury (14,137 at December 31, 2011)                                                                          | (372,404)             | (366,954)     |
| Accumulated other comprehensive loss                                                                                                            | (46,797)              | (48,107)      |

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|                                            |              |           |
|--------------------------------------------|--------------|-----------|
| Total stockholders' equity                 | 510,240      | 523,643   |
| Total liabilities and stockholders' equity | \$ 1,152,843 | 1,082,364 |

See accompanying notes to consolidated financial statements.

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**WADDELL & REED FINANCIAL, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**Years ended December 31, 2012, 2011 and 2010**

|                                                                                                                      | 2012                                  | 2011             | 2010           |
|----------------------------------------------------------------------------------------------------------------------|---------------------------------------|------------------|----------------|
|                                                                                                                      | (in thousands, except per share data) |                  |                |
| <b>Revenues:</b>                                                                                                     |                                       |                  |                |
| Investment management fees                                                                                           | \$ 549,231                            | 530,599          | 457,538        |
| Underwriting and distribution fees                                                                                   | 496,465                               | 469,484          | 410,380        |
| Shareholder service fees                                                                                             | 128,109                               | 122,449          | 110,348        |
| <b>Total</b>                                                                                                         | <b>1,173,805</b>                      | <b>1,122,532</b> | <b>978,266</b> |
| <b>Operating expenses:</b>                                                                                           |                                       |                  |                |
| Underwriting and distribution                                                                                        | 589,981                               | 560,219          | 493,456        |
| Compensation and related costs (including share-based compensation of \$48,748, \$45,384 and \$39,128, respectively) | 171,775                               | 157,332          | 138,207        |
| General and administrative                                                                                           | 75,332                                | 74,110           | 60,785         |
| Subadvisory fees                                                                                                     | 21,009                                | 29,885           | 27,823         |
| Depreciation                                                                                                         | 13,211                                | 14,764           | 13,525         |
| <b>Total</b>                                                                                                         | <b>871,308</b>                        | <b>836,310</b>   | <b>733,796</b> |
| <b>Operating income</b>                                                                                              | <b>302,497</b>                        | <b>286,222</b>   | <b>244,470</b> |
| Investment and other income                                                                                          | 9,817                                 | 2,105            | 8,619          |
| Interest expense                                                                                                     | (11,311)                              | (11,408)         | (12,728)       |
| <b>Income from continuing operations before provision for income taxes</b>                                           | <b>301,003</b>                        | <b>276,919</b>   | <b>240,361</b> |
| Provision for income taxes                                                                                           | 108,475                               | 104,714          | 86,933         |
| <b>Income from continuing operations</b>                                                                             | <b>192,528</b>                        | <b>172,205</b>   | <b>153,428</b> |
| Income (loss) from discontinued operations net of tax expense of \$1,058, \$2,556 and \$2,592, respectively          | (41,576)                              | 3,254            | 3,531          |
| <b>Net income</b>                                                                                                    | <b>\$ 150,952</b>                     | <b>175,459</b>   | <b>156,959</b> |
| <b>Net income per share, basic and diluted:</b>                                                                      |                                       |                  |                |
| Income from continuing operations                                                                                    | \$ 2.25                               | 2.01             | 1.79           |
| Income (loss) from discontinued operations                                                                           | (0.49)                                | 0.04             | 0.04           |
| <b>Net income</b>                                                                                                    | <b>\$ 1.76</b>                        | <b>\$ 2.05</b>   | <b>\$ 1.83</b> |
| <b>Weighted average shares outstanding:</b>                                                                          |                                       |                  |                |
| Basic                                                                                                                | 85,726                                | 85,783           | 85,618         |
| Diluted                                                                                                              | 85,728                                | 85,793           | 85,647         |

See accompanying notes to consolidated financial statements.



Table of Contents**WADDELL & REED FINANCIAL, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****Years ended December 31, 2012, 2011 and 2010**

|                                                                                                                                                          | <b>2012</b> | <b>2011</b>           | <b>2010</b> |
|----------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-----------------------|-------------|
|                                                                                                                                                          |             | <b>(in thousands)</b> |             |
| Net income                                                                                                                                               | \$ 150,952  | 175,459               | 156,959     |
| Other comprehensive income:                                                                                                                              |             |                       |             |
| Net unrealized appreciation (depreciation) of investment securities during the year, net of income taxes of \$3,195, \$(2,120) and \$2,028, respectively | 5,444       | (3,635)               | 3,493       |
| Valuation allowance on investment securities' deferred tax asset during the year                                                                         | 2,024       | (2,955)               | 963         |
| Pension and postretirement benefits, net of income taxes of \$(2,532), \$(13,232) and \$628, respectively                                                | (4,157)     | (22,062)              | 1,061       |
| Reclassification adjustments for amounts included in net income, net of income taxes of \$(1,162), \$(830) and \$(1,139), respectively                   | (2,001)     | (1,428)               | (1,980)     |
| Total other comprehensive income                                                                                                                         | 1,310       | (30,080)              | 3,537       |
| Comprehensive income                                                                                                                                     | \$ 152,262  | 145,379               | 160,496     |

See accompanying notes to consolidated financial statements.

Table of Contents**WADDELL & REED FINANCIAL, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY****Years ended December 31, 2012, 2011 and 2010****(in thousands)**

|                                                                        | <b>Common Stock</b> |               | <b>Additional</b>          | <b>Retained</b> | <b>Treasury</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income<br/>(Loss)</b> | <b>Total<br/>Stockholders'<br/>Equity</b> |
|------------------------------------------------------------------------|---------------------|---------------|----------------------------|-----------------|-----------------|----------------------------------------------------------------------|-------------------------------------------|
|                                                                        | <b>Shares</b>       | <b>Amount</b> | <b>Paid-in<br/>Capital</b> | <b>Earnings</b> | <b>Stock</b>    |                                                                      |                                           |
| Balance at December 31, 2009                                           | 99,701              | \$ 997        | 189,900                    | 527,876         | (328,154)       | (21,564)                                                             | 369,055                                   |
| Net income                                                             |                     |               |                            | 156,959         |                 |                                                                      | 156,959                                   |
| Recognition of equity compensation                                     |                     |               | 40,319                     | 19              |                 |                                                                      | 40,338                                    |
| Issuance of nonvested shares and other                                 |                     |               | (37,631)                   |                 | 37,631          |                                                                      |                                           |
| Dividends accrued, \$.77 per share                                     |                     |               |                            | (66,041)        |                 |                                                                      | (66,041)                                  |
| Exercise of stock options                                              |                     |               | 2,726                      |                 | 10,331          |                                                                      | 13,057                                    |
| Excess tax benefits from share-based<br>payment arrangements           |                     |               | 6,128                      |                 |                 |                                                                      | 6,128                                     |
| Repurchase of common stock                                             |                     |               |                            |                 | (65,872)        |                                                                      | (65,872)                                  |
| Unrealized appreciation on available for<br>sale investment securities |                     |               |                            |                 |                 | 3,493                                                                | 3,493                                     |
| Valuation allowance on investment<br>securities' deferred tax asset    |                     |               |                            |                 |                 | 963                                                                  | 963                                       |
| Pension and postretirement benefits                                    |                     |               |                            |                 |                 | 1,061                                                                | 1,061                                     |
| Reclassification for amounts included in<br>net income                 |                     |               |                            |                 |                 | (1,980)                                                              | (1,980)                                   |
| Balance at December 31, 2010                                           | 99,701              | 997           | 201,442                    | 618,813         | (346,064)       | (18,027)                                                             | 457,161                                   |
| Net income                                                             |                     |               |                            | 175,459         |                 |                                                                      | 175,459                                   |
| Recognition of equity compensation                                     |                     |               | 46,457                     | 16              |                 |                                                                      | 46,473                                    |
| Issuance of nonvested shares                                           |                     |               | (40,442)                   |                 | 40,442          |                                                                      |                                           |
| Dividends accrued, \$.85 per share                                     |                     |               |                            | (73,007)        |                 |                                                                      | (73,007)                                  |
| Exercise of stock options                                              |                     |               | 949                        |                 | 4,131           |                                                                      | 5,080                                     |
| Excess tax benefits from share-based<br>payment arrangements           |                     |               | 8,020                      |                 |                 |                                                                      | 8,020                                     |
| Repurchase of common stock                                             |                     |               |                            |                 | (65,463)        |                                                                      | (65,463)                                  |
| Unrealized depreciation on available for<br>sale investment securities |                     |               |                            |                 |                 | (3,635)                                                              | (3,635)                                   |
| Valuation allowance on investment<br>securities' deferred tax asset    |                     |               |                            |                 |                 | (2,955)                                                              | (2,955)                                   |
| Pension and postretirement benefits                                    |                     |               |                            |                 |                 | (22,062)                                                             | (22,062)                                  |
| Reclassification for amounts included in<br>net income                 |                     |               |                            |                 |                 | (1,428)                                                              | (1,428)                                   |
| Balance at December 31, 2011                                           | 99,701              | 997           | 216,426                    | 721,281         | (366,954)       | (48,107)                                                             | 523,643                                   |
| Net income                                                             |                     |               |                            | 150,952         |                 |                                                                      | 150,952                                   |
| Recognition of equity compensation                                     |                     |               | 49,937                     | 56              |                 |                                                                      | 49,993                                    |
| Issuance of nonvested shares                                           |                     |               | (43,106)                   |                 | 43,106          |                                                                      |                                           |
| Dividends accrued, \$2.03 per share                                    |                     |               |                            | (173,866)       |                 |                                                                      | (173,866)                                 |
| Exercise of stock options                                              |                     |               | (27)                       |                 | 132             |                                                                      | 105                                       |
| Excess tax benefits from share-based<br>payment arrangements           |                     |               | 6,791                      |                 |                 |                                                                      | 6,791                                     |
| Repurchase of common stock                                             |                     |               |                            |                 | (48,688)        |                                                                      | (48,688)                                  |
| Unrealized appreciation on available for<br>sale investment securities |                     |               |                            |                 |                 | 5,444                                                                | 5,444                                     |
| Valuation allowance on investment<br>securities' deferred tax asset    |                     |               |                            |                 |                 | 2,024                                                                | 2,024                                     |
| Pension and postretirement benefits                                    |                     |               |                            |                 |                 | (4,157)                                                              | (4,157)                                   |

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Reclassification for amounts included in  
net income

(2,001) (2,001)

|                              |        |        |         |         |           |          |         |
|------------------------------|--------|--------|---------|---------|-----------|----------|---------|
| Balance at December 31, 2012 | 99,701 | \$ 997 | 230,021 | 698,423 | (372,404) | (46,797) | 510,240 |
|------------------------------|--------|--------|---------|---------|-----------|----------|---------|

See accompanying notes to consolidated financial statements.

Table of Contents**WADDELL & REED FINANCIAL, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****Years ended December 31, 2012, 2011 and 2010**

|                                                                                   | 2012           | 2011       | 2010       |
|-----------------------------------------------------------------------------------|----------------|------------|------------|
|                                                                                   | (in thousands) |            |            |
| Cash flows from operating activities:                                             |                |            |            |
| Net income                                                                        | \$ 150,952     | 175,459    | 156,959    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                |            |            |
| Write-down of impaired assets                                                     | 42,373         |            |            |
| Depreciation and amortization                                                     | 15,093         | 16,332     | 13,834     |
| Amortization of deferred sales commissions                                        | 53,863         | 53,855     | 58,381     |
| Share-based compensation                                                          | 49,993         | 46,473     | 40,338     |
| Excess tax benefits from share-based payment arrangements                         | (6,791)        | (8,020)    | (6,128)    |
| Gain on sale of available for sale investment securities                          | (3,163)        | (2,258)    | (2,893)    |
| Net purchases and sales or maturities of trading securities                       | (27,470)       | 59,034     | (60,623)   |
| Unrealized (gain) loss on trading securities                                      | (5,470)        | 1,231      | (5,101)    |
| Loss on sale and retirement of property and equipment                             | 5,326          | 2,059      | 201        |
| Capital gains and dividends reinvested                                            |                |            | (365)      |
| Deferred income taxes                                                             | (6,236)        | 2,395      | (5,200)    |
| Changes in assets and liabilities:                                                |                |            |            |
| Cash and cash equivalents - restricted                                            | (42,812)       | 30,628     | (8,256)    |
| Receivables from funds and separate accounts                                      | (2,044)        | (4,608)    | 7,714      |
| Other receivables                                                                 | (29,422)       | (32,260)   | 94,678     |
| Other assets                                                                      | 2,872          | (512)      | (4,245)    |
| Deferred sales commissions                                                        | (54,430)       | (57,933)   | (58,968)   |
| Accounts payable and payable to investment companies                              | 65,753         | (2,002)    | (88,946)   |
| Other liabilities                                                                 | 25,048         | 3,266      | 9,263      |
| Net cash provided by operating activities                                         | 233,435        | 283,139    | 140,643    |
| Cash flows from investing activities:                                             |                |            |            |
| Purchases of available for sale investment securities                             | (51,676)       | (102,451)  | (76,961)   |
| Proceeds from sales and maturities of available for sale investment securities    | 49,809         | 92,282     | 26,463     |
| Additions to property and equipment                                               | (15,300)       | (20,078)   | (17,313)   |
| Proceeds from sales of property and equipment                                     | 38             | 5          | 5          |
| Net cash used in investing activities                                             | (17,129)       | (30,242)   | (67,806)   |
| Cash flows from financing activities:                                             |                |            |            |
| Debt repayment                                                                    |                |            | (10,000)   |
| Dividends paid                                                                    | (171,267)      | (68,766)   | (65,194)   |
| Repurchase of common stock                                                        | (48,688)       | (65,463)   | (65,872)   |
| Exercise of stock options                                                         | 105            | 5,080      | 13,057     |
| Excess tax benefits from share-based payment arrangements                         | 6,791          | 8,020      | 6,128      |
| Net cash used in financing activities                                             | (213,059)      | (121,129)  | (121,881)  |
| Net increase (decrease) in cash and cash equivalents                              | 3,247          | 131,768    | (49,044)   |
| Cash and cash equivalents at beginning of year                                    | 327,083        | 195,315    | 244,359    |
| Cash and cash equivalents at end of year                                          | 330,330        | 327,083    | 195,315    |
| Less cash and cash equivalents of discontinued operations at end of year          | 2,303          | 3,167      | 5,245      |
| Cash and cash equivalents of continuing operations at end of year                 | \$ 328,027     | \$ 323,916 | \$ 190,070 |

Cash paid for:

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|                    |    |        |         |        |
|--------------------|----|--------|---------|--------|
| Income taxes (net) | \$ | 98,181 | 105,080 | 92,038 |
| Interest           | \$ | 10,286 | 10,426  | 10,920 |

See accompanying notes to consolidated financial statements.

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**WADDELL & REED FINANCIAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012, 2011 and 2010**

**1. Description of Business**

Waddell & Reed Financial, Inc. and subsidiaries (hereinafter referred to as the "Company," "we," "our" and "us") derive revenues from investment management, investment product underwriting and distribution, and shareholder services administration provided to the Waddell & Reed Advisors Group of Mutual Funds (the "Advisors Funds"), Ivy Funds (the "Ivy Funds"), Ivy Funds Variable Insurance Portfolios (the "Ivy Funds VIP") and InvestEd Portfolios ("InvestEd") (collectively, the Advisors Funds, Ivy Funds, Ivy Funds VIP and InvestEd are referred to as the "Funds"), and institutional and separately managed accounts. The Funds and the institutional and separately managed accounts operate under various rules and regulations set forth by the United States Securities and Exchange Commission (the "SEC"). Services to the Funds are provided under investment management agreements, underwriting agreements and shareholder servicing and accounting service agreements that set forth the fees to be charged for these services. The majority of these agreements are subject to annual review and approval by each Fund's board of trustees and shareholders. Our revenues are largely dependent on the total value and composition of assets under management. Accordingly, fluctuations in financial markets and composition of assets under management can significantly impact revenues and results of operations.

**2. Summary of Significant Accounting Policies**

*Basis of Presentation*

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Amounts in the accompanying financial statements and notes are rounded to the nearest thousand unless otherwise stated. Certain amounts in the prior years' financial statements have been reclassified for consistent presentation.

The Company operates in one business segment. Although the Company does provide supplemental disclosure regarding assets under management and underwriting revenues and expenses by distribution channel, the Company's determination that it operates in one business segment is based on the fact that the Company's Chief Executive Officer, who is the chief operating decision maker, reviews financial results, assesses performance and allocates resources at the consolidated level.

During the third quarter of 2012, the Company committed to a plan to sell its Legend group of subsidiaries ("Legend") and on October 29, 2012 the Company signed a definitive agreement to execute the transaction. The sale closed effective January 1, 2013. The operational results of Legend have been reclassified as discontinued operations in our consolidated financial statements for all periods presented. Unless otherwise stated, footnote references refer to continuing operations.

*Use of Estimates*

GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the consolidated financial statements and accompanying notes, and related disclosures of commitments and contingencies. Estimates are used for, but are not limited to, depreciation and amortization, income taxes, valuation of assets, pension and postretirement obligations, and contingencies. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment. Actual results could differ from our estimates.

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**WADDELL & REED FINANCIAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 31, 2012, 2011 and 2010**

*Cash and Cash Equivalents*

Cash and cash equivalents include cash on hand and short-term investments. We consider all highly liquid investments with maturities upon acquisition of 90 days or less to be cash equivalents. Cash and cash equivalents restricted represents cash held for the benefit of customers segregated in compliance with federal and other regulations.

*Disclosures About Fair Value of Financial Instruments*

Fair value of cash and cash equivalents, short-term investments, receivables and payables approximates carrying value. Fair value of long-term debt is disclosed in the indebtedness footnote. Fair values for investment securities are based on quoted market prices, where available. Otherwise, fair values for investment securities are based on quoted market prices of comparable instruments.

*Investment Securities and Investments in Affiliated Mutual Funds*

Our investments are comprised of United States, state and government obligations, corporate debt securities and investments in affiliated mutual funds. Investments are classified as available for sale or trading. Unrealized holding gains and losses on securities available for sale, net of related tax effects, are excluded from earnings until realized and are reported as a separate component of comprehensive income. For trading securities, unrealized holding gains and losses are included in earnings. Realized gains and losses are computed using the specific identification method for investment securities, other than mutual funds. For mutual funds, realized gains and losses are computed using the average cost method.

Our available for sale investments are reviewed each quarter and adjusted for other than temporary declines in value. We consider factors affecting the issuer and the industry the issuer operates in, general market trends including interest rates, and our ability and intent to hold an investment until it has recovered. Consideration is given to the length of time an investment's market value has been below carrying value and prospects for recovery to carrying value. When a decline in the fair value of equity securities is determined to be other than temporary, the unrealized loss recorded net of tax in other comprehensive income is realized as a charge to net income and a new cost basis is established for financial reporting purposes. When a decline in the fair value of debt securities is determined to be other than temporary, the amount of the impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If so, the other than temporary impairment recognized in earnings is equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If not, the portion of the impairment related to the credit loss is recognized in earnings while the portion of the impairment related to other factors is recognized in other comprehensive income, net of tax.

*Property and Equipment*

Property and equipment are carried at cost. The costs of improvements that extend the life of a fixed asset are capitalized, while the costs of repairs and maintenance are expensed as incurred. Depreciation and amortization are calculated and recorded using the straight-line method over the estimated useful life of the related asset (or lease term if shorter), generally three to 10 years for furniture and fixtures; one to 10 years for computer software; two to five years for data processing equipment; 10 to 30 years for buildings; three to 26 years for other equipment; and up to 15 years for leasehold improvements, which is the lesser of the lease term or expected life.

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**WADDELL & REED FINANCIAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 31, 2012, 2011 and 2010**

*Software Developed for Internal Use*

Certain internal costs incurred in connection with developing or obtaining software for internal use are capitalized in accordance with "Intangibles Goodwill and Other Topic," ASC 350. Internal costs capitalized are included in property and equipment, net in the consolidated balance sheets, and were \$9.6 million and \$12.5 million as of December 31, 2012 and 2011, respectively. Amortization begins when the software project is complete and ready for its intended use and continues over the estimated useful life, generally one to 10 years.

*Goodwill and Identifiable Intangible Assets*

Goodwill represents the excess of the cost of the Company's investment in the net assets of acquired companies over the fair value of the underlying identifiable net assets at the dates of acquisition. Goodwill is not amortized, but is reviewed annually for impairment in the second quarter of each year and when events or circumstances occur that indicate that goodwill might be impaired. Factors that the Company considers important in determining whether an impairment of goodwill or intangible assets might exist include significant continued underperformance compared to peers, the likelihood of termination or non-renewal of a mutual fund advisory or subadvisory contract or substantial changes in revenues earned from such contracts, significant changes in our business and products, material and ongoing negative industry or economic trends, or other factors specific to each asset being evaluated.

During the period covered by these financial statements, the Company had two reporting units for goodwill: (i) investment management and related services and (ii) Legend. The investment management and related services reporting unit's goodwill was recorded as part of the spin-off of the Company from its former parent, and to a lesser extent, was recorded as part of subsequent business combinations that were merged into existing investment management operations. Legend, our second reporting unit for goodwill, was a stand-alone investment management subsidiary and goodwill associated with Legend could be assessed separately from other investment management operations. During the third quarter of 2012, the Company committed to a plan to sell Legend. Additional information is included below in Notes 6 and 7.

To determine fair values of the reporting units, our review process uses the market and income approaches. In performing the analyses, the Company uses the best information available under the circumstances, including reasonable and supportable assumptions and projections.

The market approach employs market multiples for comparable companies in the financial services industry. Estimates of fair values of the reporting units are established using multiples of earnings before interest, taxes, depreciation and amortization ("EBITDA"). The Company believes that fair values calculated based on multiples of EBITDA are an accurate estimation of fair value.

If the fair value coverage margin calculated under the market approach is not considered significant, the Company utilizes a second approach, the income approach, to estimate fair values and averages the results under both methodologies. The income approach employs a discounted free cash flow approach that takes into account current actual results, projected future results, and the Company's estimated weighted average cost of capital.

The Company compares the fair values of the reporting units to their carrying amounts, including goodwill. If the carrying amount of the reporting unit exceeds its implied fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any.



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**WADDELL & REED FINANCIAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 31, 2012, 2011 and 2010**

Indefinite-life intangible assets represent advisory and subadvisory management contracts for managed assets obtained in acquisitions. The Company considers these contracts to be indefinite-life intangible assets as they are expected to be renewed without significant cost or modification of terms. The Company also tests these assets for impairment annually by comparing their fair values to the carrying amount of the assets.

*Deferred Sales Commissions*

We defer certain costs, principally sales commissions and related compensation, which are paid to financial advisors and broker/dealers in connection with the sale of certain mutual fund shares sold without a front-end load sales charge. The costs incurred at the time of the sale of Class B shares are amortized on a straight-line basis over five years, which approximates the expected life of the shareholders' investments. The costs incurred at the time of the sale of Class C shares are amortized on a straight-line basis over 12 months. In addition, the costs incurred at the time of the sale of shares for certain asset allocation products are deferred and amortized on a straight-line basis, not to exceed three years. We recover these deferred costs through Rule 12b-1 and other distribution fees, which are paid on the Class B and Class C shares of the Advisors Funds and Ivy Funds, along with contingent deferred sales charges ("CDSCs") paid by shareholders who redeem their shares prior to completion of the specified holding period (three years for shares of certain asset allocation products, six years for a Class B share and 12 months for a Class C share), as well as through client fees paid on the asset allocation products. Should we lose our ability to recover such sales commissions through distribution fees or CDSCs, the value of these assets would immediately decline, as would future cash flows. We periodically review the recoverability of the deferred sales commission assets as events or changes in circumstances indicate that their carrying amount may not be recoverable and adjust them accordingly.

*Revenue Recognition*

We recognize investment management fees as earned over the period in which services are rendered. We charge the Funds daily based upon average daily net assets under management in accordance with investment management agreements between the Funds and the Company. The majority of investment management fees earned from institutional and separate accounts are charged either monthly or quarterly based upon an average of net assets under management in accordance with such investment management agreements.

Underwriting and distribution commission revenues resulting from the sale of investment products are recognized on the trade date. Fee-based asset allocation revenues are charged quarterly based upon average daily net assets under management. We also recognize distribution revenues monthly for certain types of investment products, primarily variable annuity products that are generally calculated based upon average daily net assets under management.

Shareholder service fees are recognized monthly and are calculated based on the number of accounts or assets under management as applicable. Other administrative service fee revenues are recognized when contractual obligations are fulfilled or as services are provided.

*Advertising and Promotion*

We expense all advertising and promotion costs as incurred. Advertising expense was \$9.9 million, \$10.0 million and \$5.4 million for the years ended December 31, 2012, 2011 and 2010, respectively, and is

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**WADDELL & REED FINANCIAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 31, 2012, 2011 and 2010**

classified in both underwriting and distribution expense and general and administrative expense in the consolidated statements of income.

*Share-Based Compensation*

We account for share-based compensation expense using the fair value method. Under the fair value method, share-based compensation expense reflects the fair value of share-based awards measured at grant date, is recognized over the service period, and is adjusted each period for anticipated forfeitures. The Company also issues share-based awards to our financial advisors (our sales force) who are independent contractors. Changes in the Company's share price result in variable compensation expense over the vesting period. The fair value of options granted are calculated using a Black-Scholes option-pricing model. The Black-Scholes model incorporates assumptions as to dividend yield, risk-free interest rate, expected volatility and expected life of the option.

*Accounting for Income Taxes*

Income tax expense is based on pre-tax financial accounting income, including adjustments made for the recognition or derecognition related to uncertain tax positions. The recognition or derecognition of income tax expense related to uncertain tax positions is determined under the guidance as prescribed by "Income Taxes Topic, " ASC 740. Deferred tax assets and liabilities are recognized for the future tax attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. A valuation allowance is recognized for deferred tax assets if, based on available evidence, it is more likely than not that all or some portion of the asset will not be realized. Deferred tax assets and liabilities are measured using enacted tax rates expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date.

**3. Accounting Pronouncements Not Yet Adopted**

In July 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2011-06, "Other Topics (Topic 720): Fees Paid to the Federal Government by Health Insurers" ("ASU 2011-06"). This ASU was issued to address questions about how health insurers should recognize and classify in their income statements fees mandated by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act (the "Acts"). The Acts impose an annual fee on health insurers for each calendar year beginning on or after January 1, 2014. A health insurer's portion of the annual fee is payable no later than September 30 of the applicable calendar year and is not tax deductible. The ASU specifies that the liability for the fee should be estimated and recorded in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year that it is payable. ASU 2011-06 is effective for calendar years beginning after December 31, 2013. The Company is evaluating the impact the adoption of ASU 2011-06 in 2014 will have on its consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, "Intangibles - Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment" ("ASU 2012-02"). This ASU permits an entity to make a qualitative assessment of whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, "Intangibles - Goodwill and Other - General Intangibles Other than Goodwill." ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company will comply with this standard upon adoption in 2013.

Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010****4. Investment Securities**

Investment securities at December 31, 2012 and 2011 are as follows:

| 2012                           | Amortized<br>cost | Unrealized<br>gains | Unrealized<br>losses | Fair value |
|--------------------------------|-------------------|---------------------|----------------------|------------|
| (in thousands)                 |                   |                     |                      |            |
| Available for sale securities: |                   |                     |                      |            |
| Mortgage-backed securities     | \$ 9              | 1                   | -                    | 10         |
| Corporate bonds                | 30,408            | 248                 | (3)                  | 30,653     |
| Affiliated mutual funds        | 73,443            | 3,749               | (1,090)              | 76,102     |
|                                | \$ 103,860        | 3,998               | (1,093)              | 106,765    |
| Trading securities:            |                   |                     |                      |            |
| Mortgage-backed securities     |                   |                     |                      | 44         |
| Municipal bonds                |                   |                     |                      | 501        |
| Corporate bonds                |                   |                     |                      | 12,112     |
| Common stock                   |                   |                     |                      | 37         |
| Affiliated mutual funds        |                   |                     |                      | 56,683     |
|                                |                   |                     |                      | 69,377     |
| Total investment securities    |                   |                     |                      | 176,142    |

| 2011                           | Amortized<br>cost | Unrealized<br>gains | Unrealized<br>losses | Fair value |
|--------------------------------|-------------------|---------------------|----------------------|------------|
| (in thousands)                 |                   |                     |                      |            |
| Available for sale securities: |                   |                     |                      |            |
| Mortgage-backed securities     | \$ 9              | 2                   | -                    | 11         |
| Municipal bonds                | 2,549             | -                   | (13)                 | 2,536      |
| Corporate bonds                | 45,893            | 170                 | (89)                 | 45,974     |
| Affiliated mutual funds        | 51,456            | 2,738               | (5,379)              | 48,815     |
|                                | \$ 99,907         | 2,910               | (5,481)              | 97,336     |
| Trading securities:            |                   |                     |                      |            |
| Mortgage-backed securities     |                   |                     |                      | 63         |
| Municipal bonds                |                   |                     |                      | 500        |
| Corporate bonds                |                   |                     |                      | 17,319     |
| Common stock                   |                   |                     |                      | 37         |
| Affiliated mutual funds        |                   |                     |                      | 19,007     |
|                                |                   |                     |                      | 36,926     |
| Total investment securities    |                   |                     |                      | 134,262    |



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A summary of available for sale debt securities and affiliated mutual funds with fair values below carrying values at December 31, 2012 is as follows:

|                                              | <b>Less than 12 months</b> |                          | <b>12 months or longer</b> |                          | <b>Total</b>      |                          |
|----------------------------------------------|----------------------------|--------------------------|----------------------------|--------------------------|-------------------|--------------------------|
|                                              | <b>Fair value</b>          | <b>Unrealized losses</b> | <b>Fair value</b>          | <b>Unrealized losses</b> | <b>Fair value</b> | <b>Unrealized losses</b> |
|                                              | <b>(in thousands)</b>      |                          |                            |                          |                   |                          |
| Corporate bonds                              | \$ 997                     | (3)                      | -                          | -                        | 997               | (3)                      |
| Affiliated mutual funds                      | 23,478                     | (469)                    | 5,604                      | (621)                    | 29,082            | (1,090)                  |
| <b>Total temporarily impaired securities</b> | <b>\$ 24,475</b>           | <b>(472)</b>             | <b>5,604</b>               | <b>(621)</b>             | <b>30,079</b>     | <b>(1,093)</b>           |

Based upon our assessment of these corporate bonds and affiliated mutual funds, the time frame investments have been in a loss position, our intent to hold affiliated mutual funds until they have recovered and our history of holding bonds until maturity, we determined that a write-down was not necessary at December 31, 2012.

Mortgage-backed securities and corporate bonds accounted for as available for sale and held as of December 31, 2012 mature as follows:

|                                    | <b>Amortized cost</b> | <b>Fair value</b> |
|------------------------------------|-----------------------|-------------------|
|                                    | <b>(in thousands)</b> |                   |
| Within one year                    | \$ 15,488             | 15,529            |
| After one year but within 10 years | 14,929                | 15,134            |
|                                    | <b>\$ 30,417</b>      | <b>30,663</b>     |

Mortgage-backed securities, municipal bonds and corporate bonds accounted for as trading and held as of December 31, 2012 mature as follows:

|                                    | <b>Fair value</b>     |
|------------------------------------|-----------------------|
|                                    | <b>(in thousands)</b> |
| Within one year                    | \$ 2,531              |
| After one year but within 10 years | 10,126                |
|                                    | <b>\$ 12,657</b>      |

Investment securities with fair values of \$79.9 million, \$55.7 million and \$45.1 million were sold during 2012, 2011 and 2010, respectively. During 2012, net realized gains of \$3.2 million and \$5.3 million were recognized from the sale of \$32.9 million in available for sale securities and the sale of \$47.0 million in trading securities, respectively. During 2011, net realized gains of \$2.3 million and \$1.4 million were recognized from the sale of \$22.1 million in available for sale securities and the sale of \$33.6 million in trading securities, respectively. During 2010, net gains of \$2.9 million and \$2.9 million were recognized

Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010**

from the sale of \$24.2 million in available for sale securities and the sale of \$20.9 million in trading securities, respectively.

The aggregate carrying amount of our equity method investments, classified in other assets, was \$4.6 million and \$5.6 million at December 31, 2012 and 2011, respectively. At December 31, 2012, our investments consist of limited partnership interests in venture capital funds.

Accounting standards establish a framework for measuring fair value and a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of the asset. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset. An individual investment's fair value measurement is assigned a level based upon the observability of the inputs that are significant to the overall valuation. The three-tier hierarchy of inputs is summarized as follows:

Level 1 Investments are valued using quoted prices in active markets for identical securities.

Level 2 Investments are valued using other significant observable inputs, including quoted prices in active markets for similar securities.

Level 3 Investments are valued using significant unobservable inputs, including the Company's own assumptions in determining the fair value of investments.

Assets classified as Level 2 can have a variety of observable inputs. These observable inputs are collected and utilized, primarily by an independent pricing service, in different evaluated pricing approaches depending upon the specific asset to determine a value. The fair value of municipal bonds is measured based on pricing models that take into account, among other factors, information received from market makers and broker/dealers, current trades, bid-wants lists, offerings, market movements, the callability of the bond, state of issuance and benchmark yield curves. The fair value of corporate bonds is measured using various techniques, which consider recently executed transactions in securities of the issuer or comparable issuers, market price quotations (where observable), bond spreads and fundamental data relating to the issuer.

Securities' values classified as Level 3 are primarily determined through the use of a single quote (or multiple quotes) from dealers in the securities using proprietary valuation models. These quotes involve significant unobservable inputs, and thus, the related securities are classified as Level 3 securities.

The following tables summarize our investment securities as of December 31, 2012 and 2011 that are recognized in our consolidated balance sheets using fair value measurements based on the differing levels of inputs. There were no transfers between levels for the years ended December 31, 2012 or 2011.

| <b>2012</b>                | <b>Level 1</b>        | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|----------------------------|-----------------------|----------------|----------------|--------------|
|                            | <b>(in thousands)</b> |                |                |              |
| Mortgage-backed securities | \$ -                  | 54             | -              | 54           |
| Municipal bonds            | -                     | 501            | -              | 501          |
| Corporate bonds            | -                     | 42,765         | -              | 42,765       |
| Common stock               | 37                    | -              | -              | 37           |
| Affiliated mutual funds    | 132,785               | -              | -              | 132,785      |
| Total                      | \$ 132,822            | \$ 43,320      | \$ -           | \$ 176,142   |



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| <b>2011</b>                | <b>Level 1</b>        | <b>Level 2</b>   | <b>Level 3</b> | <b>Total</b>      |
|----------------------------|-----------------------|------------------|----------------|-------------------|
|                            | <b>(in thousands)</b> |                  |                |                   |
| Mortgage-backed securities | -                     | 74               | -              | 74                |
| Municipal bonds            | -                     | 3,036            | -              | 3,036             |
| Corporate bonds            | -                     | 63,293           | -              | 63,293            |
| Common stock               | 37                    | -                | -              | 37                |
| Affiliated mutual funds    | 67,822                | -                | -              | 67,822            |
| <b>Total</b>               | <b>\$ 67,859</b>      | <b>\$ 66,403</b> | <b>\$ -</b>    | <b>\$ 134,262</b> |

**5. Property and Equipment**

A summary of property and equipment at December 31, 2012 and 2011 is as follows:

|                                 | <b>2012</b>           | <b>2011</b> | <b>Estimated<br/>useful lives</b> |
|---------------------------------|-----------------------|-------------|-----------------------------------|
|                                 | <b>(in thousands)</b> |             |                                   |
| Leasehold improvements          | \$ 19,610             | 19,345      | 1 - 15 years                      |
| Furniture and fixtures          | 30,670                | 30,590      | 3 - 10 years                      |
| Equipment                       | 19,660                | 18,482      | 3 - 26 years                      |
| Computer software               | 74,081                | 72,184      | 1 - 10 years                      |
| Data processing equipment       | 20,207                | 19,692      | 2 - 5 years                       |
| Buildings                       | 5,284                 | 3,765       | 10 - 30 years                     |
| Land                            | 1,940                 | 1,940       |                                   |
| Property and equipment, at cost | 171,452               | 165,998     |                                   |
| Accumulated depreciation        | (102,124)             | (92,855)    |                                   |
| Property and equipment, net     | \$ 69,328             | 73,143      |                                   |

Depreciation expense was \$13.2 million, \$14.8 million and \$13.5 million during the years ended December 31, 2012, 2011 and 2010, respectively.

At December 31, 2012, we had property and equipment under capital leases with a cost of \$1.9 million and accumulated depreciation of \$0.8 million. At December 31, 2011, we had property and equipment under capital leases with a cost of \$1.8 million and accumulated depreciation of \$1.0 million.

**6. Discontinued Operations**

During the third quarter of 2012, the Company committed to a plan to sell Legend. On October 29, 2012, the Company signed a definitive agreement with First Allied Holdings Inc. to sell all of the common interests of Legend Group Holdings, LLC and the sale closed effective January 1, 2013. Based on the value of the consideration the Company expected to receive upon closing, which is less than the carrying value of net assets to be sold, the Company recorded a non-cash impairment charge of \$42.4 million, which is reflected in income (loss) from discontinued operations on the statement of income. The consideration received was subject to working capital and regulatory capital adjustments through the closing date. The Company retained \$7.7 million of Legend's excess working capital as part of the agreement. The





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agreement also includes an earnout provision based on asset retention for a period of two years following the closing date.

The operational results of Legend have been presented as discontinued operations in the consolidated financial statements for all periods presented. Legend's revenues and income (loss) before provision for income taxes follow:

|                                                 | <b>2012</b>           | <b>2011</b> | <b>2010</b> |
|-------------------------------------------------|-----------------------|-------------|-------------|
|                                                 | <b>(in thousands)</b> |             |             |
| Revenues                                        | \$ 74,033             | 72,644      | 66,619      |
| Income (loss) before provision for income taxes | \$ (40,518)           | 5,810       | 6,123       |

For income tax purposes, the sale will result in a \$48.3 million capital loss that may only be utilized to offset future capital gains. Due to the character of the loss and the limited carry forward period permitted by law, the Company may not realize the full tax benefit of the capital loss.

The assets and liabilities of Legend, classified as discontinued operations held for sale in the consolidated balance sheets are as follows:

|                                           | <b>December 31,<br/>2012</b> | <b>December 31,<br/>2011</b> |
|-------------------------------------------|------------------------------|------------------------------|
|                                           | <b>(in thousands)</b>        |                              |
| <b>Assets</b>                             |                              |                              |
| Cash and cash equivalents                 | \$ 2,303                     | 3,167                        |
| Cash and cash equivalents - restricted    | 401                          | 13                           |
| Investment securities                     | 1,352                        | 1,235                        |
| Receivables                               | 10,345                       | 9,871                        |
| Prepaid expenses and other current assets | 749                          | 615                          |
| <b>Total current assets</b>               | <b>15,150</b>                | <b>14,901</b>                |
| Property and equipment, net               | 992                          | 885                          |
| Goodwill                                  | 16,868                       | 59,241                       |
| Other non-current assets                  | 150                          | 148                          |
| <b>Total non-current assets</b>           | <b>18,010</b>                | <b>60,274</b>                |
| <b>Total assets</b>                       | <b>33,160</b>                | <b>75,175</b>                |
| <b>Liabilities</b>                        |                              |                              |
| Accounts payable                          | 464                          | -                            |
| Accrued compensation                      | 6,243                        | 5,812                        |
| Other current liabilities                 | 880                          | 738                          |
| <b>Total current liabilities</b>          | <b>7,587</b>                 | <b>6,550</b>                 |
| Non-current liabilities                   | 281                          | 207                          |
| <b>Total liabilities</b>                  | <b>7,868</b>                 | <b>6,757</b>                 |
| <b>Assets less liabilities</b>            | <b>\$ 25,292</b>             | <b>68,418</b>                |



Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010****7. Goodwill and Identifiable Intangible Assets**

Goodwill represents the excess of purchase price over the tangible assets and identifiable intangible assets of an acquired business. Our goodwill is not deductible for tax purposes. Goodwill and identifiable intangible assets (all considered indefinite lived) at December 31, 2012 and 2011 are as follows:

|                                              | 2012              | 2011           |
|----------------------------------------------|-------------------|----------------|
|                                              | (in thousands)    |                |
| Goodwill                                     | \$ 138,947        | 138,947        |
| Accumulated amortization                     | (31,977)          | (31,977)       |
| <b>Total goodwill</b>                        | <b>106,970</b>    | <b>106,970</b> |
| Mutual fund management advisory contracts    | 38,699            | 38,699         |
| Mutual fund management subadvisory contracts | 16,300            | 16,300         |
| <b>Total identifiable intangible assets</b>  | <b>54,999</b>     | <b>54,999</b>  |
| <b>Total</b>                                 | <b>\$ 161,969</b> | <b>161,969</b> |

During the third quarter of 2012, \$59.2 million of goodwill related to Legend was allocated to assets of discontinued operations held for sale. Amounts at December 31, 2011 have been adjusted to reflect this change.

As of June 30, 2012, the Company's annual impairment test indicated that the fair value of the Legend reporting unit exceeded its carrying value, which resulted in no goodwill impairment. During preliminary due diligence conducted in the third quarter regarding a possible sale of Legend, several significant issues arose regarding executive leadership, advisor retention and employee morale. As due diligence discussions progressed into formal negotiations throughout the third quarter, the Company's concerns regarding these matters escalated, the depth and consequence of which led us to determine that a change in the strategic direction of Legend was necessary, and as a result, the Company decided to move forward with a sale of Legend at a price lower than the fair value utilized in the annual impairment analysis in the second quarter. During the third quarter of 2012, \$42.4 million of goodwill related to Legend was written down and is included in the loss from discontinued operations in the statement of income.

**8. Indebtedness**

On January 13, 2006, the Company issued \$200.0 million in principal amount 5.60% senior notes due 2011 (the "Notes") resulting in net proceeds of approximately \$198.2 million (net of discounts, commissions and estimated expenses). Interest was payable semi-annually on January 15 and July 15 at a fixed rate of 5.60% per annum. Upon issuance of these Notes, the Company terminated two forward interest rate swap agreements entered into in 2005. In connection with the termination, we received a net cash settlement of \$1.1 million. The Company's gain was amortized into earnings as a reduction to interest expense over the five year term of the Notes and was fully amortized as of December 31, 2010. During the first quarter of 2010, we repurchased \$10.0 million of the Notes.

On August 31, 2010, the Company entered into an agreement to complete a \$190.0 million private placement of senior unsecured notes that were issued and sold in two tranches: \$95.0 million bearing interest at 5.0% and maturing January 13, 2018, Series A, and \$95.0 million bearing interest of 5.75% and

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maturing January 13, 2021, Series B. The agreement contained a delayed funding provision that allowed the Company to draw down the proceeds in January 2011 when the Notes matured. The Company used the proceeds of the issuance and sale of the Senior Notes to repay in full the Notes. Interest is payable semi-annually in January and July of each year. The most restrictive provisions of the agreement require the Company to maintain a consolidated leverage ratio not to exceed 3.0 to 1.0 for four consecutive quarters and a consolidated interest coverage ratio of not less than 4.0 to 1.0 for four consecutive quarters. The Company was in compliance with these covenants and similar covenants in prior facilities for all periods presented.

The Company entered into a three year revolving credit facility (the "Credit Facility") with various lenders, effective August 31, 2010, which provides for initial borrowings of up to \$125.0 million and replaced the Company's previous revolving credit facility. Lenders could, at their option upon the Company's request, expand the Credit Facility to \$200.0 million. At December 31, 2012 and 2011, there were no borrowings outstanding under the facility. Borrowings under the Credit Facility bear interest at various rates including adjusted LIBOR or an alternative base rate plus, in each case, an incremental margin based on the Company's credit rating. The Credit Facility also provides for a facility fee on the aggregate amount of commitments under the revolving facility (whether or not utilized). The facility fee is also based on the Company's credit rating level. The Credit Facility's covenants match those outlined above for the Senior Notes.

Debt is reported at its carrying amount in the consolidated balance sheet. The fair value of the Company's outstanding indebtedness is approximately \$208.8 million at December 31, 2012 compared to the carrying value of \$190.0 million. The following is a summary of long-term debt at December 31, 2012 and 2011:

|                                                           | 2012           | 2011      |
|-----------------------------------------------------------|----------------|-----------|
|                                                           | (in thousands) |           |
| Principal amount unsecured 5.0% senior notes due in 2018  | \$ 95,000      | \$ 95,000 |
| Principal amount unsecured 5.75% senior notes due in 2021 | 95,000         | 95,000    |
| Total                                                     | \$ 190,000     | 190,000   |

**9. Income Taxes**

The provision for income taxes from continuing operations for the years ended December 31, 2012, 2011 and 2010 consists of the following:

|                            | 2012           | 2011    | 2010    |
|----------------------------|----------------|---------|---------|
|                            | (in thousands) |         |         |
| Currently payable:         |                |         |         |
| Federal                    | \$ 104,922     | 93,677  | 85,394  |
| State                      | 9,335          | 9,033   | 6,730   |
|                            | 114,257        | 102,710 | 92,124  |
| Deferred taxes             | (5,782)        | 2,004   | (5,191) |
| Provision for income taxes | \$ 108,475     | 104,714 | 86,933  |

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The following table reconciles the statutory federal income tax rate with our effective income tax rate from continuing operations for the years ended December 31, 2012, 2011 and 2010:

|                                                 | <b>2012</b> | <b>2011</b> | <b>2010</b> |
|-------------------------------------------------|-------------|-------------|-------------|
| Statutory federal income tax rate               | 35.0%       | 35.0%       | 35.0%       |
| State income taxes, net of federal tax benefits | 2.2         | 2.4         | 1.9         |
| State tax incentives                            | (0.2)       | (0.2)       | (0.2)       |
| Valuation allowance on losses capital in nature | (0.8)       | (0.2)       | (1.1)       |
| Other items                                     | (0.2)       | 0.8         | 0.6         |
| Effective income tax rate                       | 36.0%       | 37.8%       | 36.2%       |

The tax effect of temporary differences that give rise to significant portions of deferred tax liabilities and deferred tax assets at December 31, 2012 and 2011 are as follows:

|                                                 | <b>2012</b>           | <b>2011</b> |
|-------------------------------------------------|-----------------------|-------------|
|                                                 | <b>(in thousands)</b> |             |
| Deferred tax liabilities:                       |                       |             |
| Deferred sales commissions                      | \$ (7,405)            | (7,861)     |
| Property and equipment                          | (8,010)               | (13,017)    |
| Benefit plans                                   | (9,723)               | (9,617)     |
| Identifiable intangible assets                  | (8,583)               | (8,523)     |
| Unrealized gains on investment securities       | (1,084)               | -           |
| Purchase of fund assets                         | (7,458)               | (6,631)     |
| Prepaid expenses                                | (2,138)               | (2,430)     |
| Total gross deferred liabilities                | (44,401)              | (48,079)    |
| Deferred tax assets:                            |                       |             |
| Acquisition lease liability                     | 953                   | 1,108       |
| Additional pension and postretirement liability | 28,935                | 26,403      |
| Accrued expenses                                | 12,705                | 13,285      |
| Unrealized losses on investment securities      | 843                   | 2,318       |
| Unrealized losses on investment in partnerships | 789                   | 196         |
| Capital loss carryforwards                      | 169                   | 3,022       |
| Excess tax basis on investment in subsidiary    | 17,921                | -           |
| Nonvested stock                                 | 21,070                | 19,051      |
| Unused state tax credits                        | 972                   | 1,123       |
| State net operating loss carryforwards          | 6,284                 | 5,893       |
| Other                                           | 4,230                 | 3,817       |
| Total gross deferred assets                     | 94,871                | 76,216      |
| Valuation allowance                             | (24,695)              | (11,191)    |
| Net deferred tax asset                          | \$ 25,775             | 16,946      |

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**WADDELL & REED FINANCIAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 31, 2012, 2011 and 2010**

In 2009, the Company sold one of its subsidiaries, Austin Calvert & Flavin, Inc., which generated a capital loss available to offset potential future capital gains. Due to the character of the loss and the limited carryforward period permitted by law, the Company may not realize the full tax benefit of the capital loss. The capital loss carryforward, if not utilized, will expire in 2014. As of December 31, 2012, the Company had a deferred tax asset, net of federal tax effect, for a capital loss carryforward of \$0.2 million, excess tax basis in Legend of \$17.9 million, and other net deferred tax assets that were capital in nature of \$0.5 million. As of December 31, 2011, the Company had a deferred tax asset, net of federal tax effect, for a capital loss carryforward of \$3.0 million and other net deferred tax liabilities which were capital in nature of approximately \$2.5 million. Management believes it is not more likely than not that the Company will generate sufficient future capital gains to realize the full benefit of these capital losses and accordingly, a valuation allowance in the amount of \$18.6 million and \$5.5 million has been recorded at December 31, 2012 and 2011, respectively. During 2012, a non-cash impairment charge to Legend resulted in an increase in the valuation allowance of \$17.9 million. Losses from partnership investments also increased the valuation allowance by \$0.6 million. These increases were partially offset by realized capital gains on securities classified as available for sale and appreciation in the fair value of the Company's investment portfolios, which reduced the valuation allowance by \$3.4 million. The remaining \$2.0 million decrease in the valuation allowance resulted from appreciation in the fair value of the Company's available for sale securities portfolio, which was recorded as an increase to accumulated other comprehensive income.

Certain subsidiaries of the Company have net operating loss carryforwards in certain states in which these companies file on a separate company basis. The deferred tax asset, net of federal tax effect, relating to the carryforwards as of December 31, 2012 and 2011 is approximately \$6.3 million and \$5.9 million, respectively. The carryforwards, if not utilized, will expire between 2013 and 2032. Management believes it is not more likely than not that these subsidiaries will generate sufficient future taxable income in these states to realize the benefit of the net operating loss carryforwards and, accordingly, a valuation allowance in the amount of \$6.1 million and \$5.7 million has been recorded at December 31, 2012 and 2011, respectively. The Company has state tax credit carryforwards of \$1.0 million and \$1.1 million as of December 31, 2012 and 2011, respectively. Of these state tax credit carryforwards, \$0.7 million will expire between 2024 and 2028 if not utilized and \$0.3 million will expire in 2026 if not utilized. The Company anticipates these credits will be fully utilized prior to their expiration date.

As of January 1, 2012, the Company had unrecognized tax benefits, including penalties and interest, of \$9.8 million (\$6.9 million net of federal benefit) that, if recognized, would impact the Company's effective tax rate. As of December 31, 2012, the Company had unrecognized tax benefits, including penalties and interest, of \$10.8 million (\$7.5 million net of federal benefit) that, if recognized, would impact the Company's effective tax rate. The unrecognized tax benefits that are not expected to be settled within the next 12 months are included in other liabilities in the accompanying consolidated balance sheets; unrecognized tax benefits that are expected to be settled within the next 12 months are included in income taxes payable.

The Company's accounting policy with respect to interest and penalties related to income tax uncertainties is to classify these amounts as income taxes. As of January 1, 2012, the total amount of accrued interest and penalties related to uncertain tax positions recognized in the consolidated balance sheet was \$2.3 million (\$1.8 million net of federal benefit). The total amount of penalties and interest, net of federal benefit, related to tax uncertainties recognized in the statement of income for the period ended December 31, 2012 was \$0.2 million. The total amount of accrued penalties and interest related to uncertain tax positions at December 31, 2012 of \$2.5 million (\$2.0 million net of federal benefit) is included in the total unrecognized tax benefits described above.

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The following table summarizes the Company's reconciliation of unrecognized tax benefits, excluding penalties and interest, for the years ended December 31, 2012, 2011 and 2010:

|                                                      | <b>2012</b>           | <b>2011</b> | <b>2010</b> |
|------------------------------------------------------|-----------------------|-------------|-------------|
|                                                      | <b>(in thousands)</b> |             |             |
| Balance at January 1                                 | \$ 7,467              | 4,759       | 4,857       |
| Increases during the year:                           |                       |             |             |
| Gross increases - tax positions in prior period      | 275                   | 1,684       | 189         |
| Gross increases - current-period tax positions       | 2,215                 | 1,844       | 981         |
| Decreases during the year:                           |                       |             |             |
| Gross decreases - tax positions in prior period      | (429)                 | (183)       | (490)       |
| Decreases due to settlements with taxing authorities | -                     | -           | (629)       |
| Decreases due to lapse of statute of limitations     | (1,206)               | (637)       | (149)       |
| Balance at December 31                               | \$ 8,322              | 7,467       | 4,759       |

In the ordinary course of business, many transactions occur for which the ultimate tax outcome is uncertain. In addition, respective tax authorities periodically audit our income tax returns. These audits examine our significant tax filing positions, including the timing and amounts of deductions and the allocation of income among tax jurisdictions. During 2012, the Company settled three open tax years that were undergoing audit by a state jurisdiction in which the Company operates. No audits were settled in 2011. During 2010, the Company settled nine open tax years that were undergoing audits by state jurisdictions in which the Company operates. The Company also received notification of a favorable outcome on a tax position that the Company had previously considered partially uncertain, and therefore, had not previously recognized the full tax benefit. The 2009, 2010 and 2011 federal income tax returns are open tax years that remain subject to potential future audit. The 2006 and 2007 federal tax years also remain open to a limited extent due to capital loss carryback claims. State income tax returns for all years after 2008 and, in certain states, income tax returns prior to 2009, are subject to potential future audit by tax authorities in the Company's major state tax jurisdictions.

The Company is currently being audited in various state jurisdictions. It is reasonably possible that the Company will settle the audits in these jurisdictions within the next 12-month period. It is estimated that the Company's liability for unrecognized tax benefits, including penalties and interest, could decrease by approximately \$0.4 million to \$2.5 million (\$0.3 million to \$1.6 million net of federal benefit) upon settlement of these audits. Such settlements are not anticipated to have a significant impact on the results of operations.

**10. Pension Plan and Postretirement Benefits Other Than Pension**

We provide a non-contributory retirement plan that covers substantially all employees and certain vested employees of our former parent company (the "Pension Plan"). Benefits payable under the Pension Plan are based on employees' years of service and compensation during the final ten years of employment. We also sponsor an unfunded defined benefit postretirement medical plan that covers substantially all employees, including Waddell & Reed and Legend advisors. The medical plan is contributory with retiree



Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010**

contributions adjusted annually. The medical plan does not provide for post age 65 benefits with the exception of a small group of employees that were grandfathered when such plan was established.

A reconciliation of the funded status of these plans and the assumptions related to the obligations at December 31, 2012, 2011 and 2010 follows:

|                                             | <b>Pension Benefits</b> |             |             | <b>Other<br/>Postretirement Benefits</b> |             |             |
|---------------------------------------------|-------------------------|-------------|-------------|------------------------------------------|-------------|-------------|
|                                             | <b>2012</b>             | <b>2011</b> | <b>2010</b> | <b>2012</b>                              | <b>2011</b> | <b>2010</b> |
|                                             | <b>(in thousands)</b>   |             |             |                                          |             |             |
| Change in projected benefit obligation:     |                         |             |             |                                          |             |             |
| Net benefit obligation at beginning of year | \$ 148,412              | 118,860     | 110,962     | 8,145                                    | 6,850       | 5,945       |
| Service cost                                | 9,373                   | 7,101       | 6,140       | 693                                      | 558         | 443         |
| Interest cost                               | 7,570                   | 7,195       | 6,596       | 400                                      | 402         | 364         |
| Benefits paid                               | (5,760)                 | (6,522)     | (6,589)     | (560)                                    | (554)       | (528)       |
| Actuarial (gain) loss                       | 24,570                  | 21,778      | 1,751       | (223)                                    | 530         | 389         |
| Retiree contributions                       |                         |             |             | 337                                      | 359         | 237         |
| Net benefit obligation at end of year       | \$ 184,165              | 148,412     | 118,860     | 8,792                                    | 8,145       | 6,850       |

The accumulated benefit obligation for the Pension Plan was \$150.8 million and \$124.7 million at December 31, 2012 and 2011, respectively.

As part of the agreement to sell Legend, the Company retained the liability for pension and other postretirement benefits related to Legend, and these liabilities are included in the tables above.

|                                                | <b>Pension Benefits</b> |             |             | <b>Other<br/>Postretirement Benefits</b> |             |             |
|------------------------------------------------|-------------------------|-------------|-------------|------------------------------------------|-------------|-------------|
|                                                | <b>2012</b>             | <b>2011</b> | <b>2010</b> | <b>2012</b>                              | <b>2011</b> | <b>2010</b> |
|                                                | <b>(in thousands)</b>   |             |             |                                          |             |             |
| Change in plan assets:                         |                         |             |             |                                          |             |             |
| Fair value of plan assets at beginning of year | \$ 103,404              | 106,568     | 91,551      |                                          |             |             |
| Actual return on plan assets                   | 21,267                  | (6,642)     | 9,106       |                                          |             |             |
| Employer contributions                         | 15,000                  | 10,000      | 12,500      | 223                                      | 195         | 291         |
| Retiree contributions                          |                         |             |             | 337                                      | 359         | 237         |
| Benefits paid                                  | (5,760)                 | (6,522)     | (6,589)     | (560)                                    | (554)       | (528)       |
| Fair value of plan assets at end of year       | \$ 133,911              | 103,404     | 106,568     |                                          |             |             |
| Funded status at end of year                   | \$ (50,254)             | (45,008)    | (12,292)    | (8,792)                                  | (8,145)     | (6,850)     |

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|                                                                                                                   | Pension Benefits                       |          |          | Other<br>Postretirement Benefits |         |         |
|-------------------------------------------------------------------------------------------------------------------|----------------------------------------|----------|----------|----------------------------------|---------|---------|
|                                                                                                                   | 2012                                   | 2011     | 2010     | 2012                             | 2011    | 2010    |
|                                                                                                                   | (in thousands, except percentage data) |          |          |                                  |         |         |
| Amounts recognized in the statement of financial position:                                                        |                                        |          |          |                                  |         |         |
| Current liabilities                                                                                               | \$ -                                   | -        | -        | (304)                            | (289)   | (303)   |
| Noncurrent liabilities                                                                                            | (50,254)                               | (45,008) | (12,292) | (8,488)                          | (7,856) | (6,547) |
| Net amount recognized at end of year                                                                              | \$ (50,254)                            | (45,008) | (12,292) | (8,792)                          | (8,145) | (6,850) |
|                                                                                                                   |                                        |          |          |                                  |         |         |
| Amounts not yet reflected in net periodic benefit cost and included<br>in accumulated other comprehensive income: |                                        |          |          |                                  |         |         |
| Transition obligation                                                                                             | \$ (32)                                | (37)     | (42)     | -                                | -       | -       |
| Prior service cost                                                                                                | (2,377)                                | (2,932)  | (3,486)  | (127)                            | (183)   | (238)   |
| Accumulated loss                                                                                                  | (74,286)                               | (66,747) | (31,369) | (765)                            | (999)   | (469)   |
| Accumulated other comprehensive loss                                                                              | (76,695)                               | (69,716) | (34,897) | (892)                            | (1,182) | (707)   |
| Cumulative employer contributions in excess of net periodic benefit<br>cost                                       | 26,441                                 | 24,708   | 22,605   | (7,900)                          | (6,963) | (6,143) |
| Net amount recognized at end of year                                                                              | \$ (50,254)                            | (45,008) | (12,292) | (8,792)                          | (8,145) | (6,850) |

Weighted average assumptions used to determine benefit obligation at December 31:

|                               |       |       |       |                |       |       |
|-------------------------------|-------|-------|-------|----------------|-------|-------|
| Discount rate                 | 4.22% | 4.99% | 6.00% | 4.18%          | 5.00% | 6.00% |
| Rate of compensation increase | 3.99% | 4.04% | 3.86% | Not applicable |       |       |

In 2012 and 2011, the discount rate assumption used to determine the pension and other postretirement benefits obligations was based on the Aon Hewitt AA Only Above Median Yield Curve. This discount rate was determined separately for each plan by plotting the expected benefit payments from each plan against a yield curve of high quality, zero coupon bonds and calculating the single rate that would produce the same present value of liabilities as the yield curve. Prior to 2011, the discount rate assumption was based on the Mercer Bond Model, which calculated the yield on a theoretical portfolio of high-grade corporate bonds with cash flows that generally matched our expected benefit payments. To the extent scheduled bond proceeds exceeded the estimated benefit payments in a given period, the yield calculation assumed those excess proceeds were reinvested at the one-year forward rates implied by the Citigroup Pension Discount Curve.

Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010**

Our Pension Plan asset allocation at December 31, 2012 and 2011 is as follows:

| <b>Plan assets by category</b> | <b>Percentage of<br/>Plan Assets at<br/>December 31, 2012</b> | <b>Percentage of<br/>Plan Assets at<br/>December 31, 2011</b> |
|--------------------------------|---------------------------------------------------------------|---------------------------------------------------------------|
| Cash                           | 11%                                                           | 7%                                                            |
| Equity securities:             |                                                               |                                                               |
| Domestic                       | 38%                                                           | 43%                                                           |
| International                  | 40%                                                           | 38%                                                           |
| Private equity                 | 1%                                                            | -                                                             |
| Gold bullion                   | 10%                                                           | 12%                                                           |
| Total                          | 100%                                                          | 100%                                                          |

The primary investment objective is to maximize growth of the Pension Plan assets to meet the projected obligations to the beneficiaries over a long period of time, and to do so in a manner that is consistent with the Company's earnings strength and risk tolerance. Asset allocation is the most important decision in managing the assets, and it is reviewed regularly. The asset allocation policy considers the Company's financial strength and long-term asset class risk/return expectations since the obligations are long-term in nature. As of December 31, 2012, our Pension Plan assets were invested in our Asset Strategy style and are managed by our in-house investment professionals.

Asset Strategy invests in the domestic or foreign market that is believed to offer the greatest probability of return or, alternatively, that provides the highest degree of safety in uncertain times. This style may allocate its assets among stocks, bonds and short-term investments and since the allocation is dynamically managed and able to take advantage of opportunities as they are presented by the market, there is not a predetermined asset allocation. Dependent on the outlook for the U.S. and global economies, our investment managers make top-down allocations among stocks, bonds, cash, precious metals and currency markets around the globe. After determining allocations, we seek the best opportunities within each market. Derivative instruments play an important role in this style's investment process, to manage risk and maximize stability of the assets in the portfolio.

At December 31, 2012, the Pension Plan had multiple investment concentrations that are not typical of a classic pension plan, including a significant weighting of plan assets invested in equity securities, including 40% international equities, of which a third was invested in Chinese equities. The Pension Plan also had 10% of plan assets invested in gold bullion.

Risk management is primarily the responsibility of the investment portfolio manager, who incorporates it with day-to-day research and management. Although investment flexibility is essential to this style's investment process, the Pension Plan does not invest in a number of asset classes that are commonly referred to as alternative investments, namely venture capital, private equity funds, direct real estate properties, timber, or oil, gas or other mineral explorations or development programs or leases. The Pension Plan also has a number of specific guidelines that serve to manage investment risk by placing limits on net securities exposure and concentration of assets within specific companies or industries.

Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010**

We determine the fair value of our Pension Plan assets using broad levels of inputs as defined by related accounting standards and categorized as Level 1, Level 2 or Level 3, as previously defined above in Note 4. The following tables summarize our Pension Plan assets as of December 31, 2012 and 2011. There were no transfers between levels for the years ended December 31, 2012 or 2011.

| <b>2012</b>                 | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|-----------------------------|----------------|----------------|----------------|--------------|
| <b>(in thousands)</b>       |                |                |                |              |
| Equity securities:          |                |                |                |              |
| Domestic                    | \$ 51,289      | -              | -              | 51,289       |
| International               | 53,291         | -              | -              | 53,291       |
| Fixed income securities:    |                |                |                |              |
| Mortgage-backed securities  | -              | 50             | -              | 50           |
| Private equity              | -              | -              | 1,772          | 1,772        |
| Gold bullion                | 13,452         | -              | -              | 13,452       |
| Total investment securities | 118,032        | 50             | 1,772          | 119,854      |
| Cash and other              |                |                |                | 14,057       |
| Total                       |                |                | \$             | 133,911      |

| <b>2011</b>                 | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|-----------------------------|----------------|----------------|----------------|--------------|
| <b>(in thousands)</b>       |                |                |                |              |
| Equity securities:          |                |                |                |              |
| Domestic                    | \$ 44,818      | -              | -              | 44,818       |
| International               | 38,942         | -              | -              | 38,942       |
| Fixed income securities:    |                |                |                |              |
| Mortgage-backed securities  | -              | 98             | -              | 98           |
| Gold bullion                | 12,857         | -              | -              | 12,857       |
| Total investment securities | 96,617         | 98             | -              | 96,715       |
| Cash and other              |                |                |                | 6,689        |
| Total                       |                |                | \$             | 103,404      |

The fair value of the private equity investment classified as Level 3 as of December 31, 2012 was determined to be the investment cost. As a result, this investment's valuation had no effect on the plan's asset value in 2012. There was no Level 3 activity during the year ended December 31, 2011.

Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010**

The following table summarizes the activity of plan assets categorized as Level 3 for the year ended December 31, 2012:

|                                                      | <b>Private Equity<br/>(in thousands)</b> |
|------------------------------------------------------|------------------------------------------|
| Balance at December 31, 2011                         | \$ -                                     |
| Purchases, issuances and settlements                 | 1,772                                    |
| Actual return on plan assets, sold during the period | -                                        |
| Proceeds from sales                                  | -                                        |
| Balance at December 31, 2012                         | \$ 1,772                                 |

The 7.75% expected long-term rate of return on Pension Plan assets reflects management's expectations of long-term average rates of return on funds invested to provide for benefits included in the projected benefit obligations. The expected return is based on the outlook for inflation, fixed income returns and equity returns, while also considering historical returns, asset allocation and investment strategy. The plan expects a relatively high return because of the types of investment the portfolio incorporates, the success the portfolio managers have had with generating returns in excess of passive management in those types of investments, and the past history of returns. The ability to use a high concentration of equities, especially international equities, within the plan's investment policy presents portfolio managers the opportunity to earn higher returns than other investment strategies that are restricted to owning lower returning asset classes.

The components of net periodic pension and other postretirement costs and the assumptions related to those costs consisted of the following for the years ended December 31, 2012, 2011 and 2010:

|                                          | <b>Pension Benefits</b> |             |             | <b>Other<br/>Postretirement Benefits</b> |             |             |
|------------------------------------------|-------------------------|-------------|-------------|------------------------------------------|-------------|-------------|
|                                          | <b>2012</b>             | <b>2011</b> | <b>2010</b> | <b>2012</b>                              | <b>2011</b> | <b>2010</b> |
|                                          | <b>(in thousands)</b>   |             |             |                                          |             |             |
| Components of net periodic benefit cost: |                         |             |             |                                          |             |             |
| Service cost                             | \$ 9,373                | 7,101       | 6,140       | 693                                      | 558         | 443         |
| Interest cost                            | 7,570                   | 7,195       | 6,596       | 400                                      | 402         | 364         |
| Expected return on plan assets           | (8,799)                 | (8,764)     | (7,499)     |                                          |             |             |
| Actuarial loss amortization              | 4,563                   | 1,805       | 1,617       | 12                                       |             |             |
| Prior service cost amortization          | 555                     | 555         | 555         | 55                                       | 55          | 45          |
| Transition obligation amortization       | 5                       | 5           | 5           |                                          |             |             |
| Net periodic benefit cost (1)            | \$ 13,267               | 7,897       | 7,414       | 1,160                                    | 1,015       | 852         |

- (1) Net periodic pension benefit cost related to discontinued operations and included in the table above was \$738 thousand, \$525 thousand and \$489 thousand for the years ended December 31, 2012, 2011 and 2010, respectively. Net periodic cost for the postretirement medical plan related to discontinued operations and included in the table above was \$11 thousand, \$18 thousand and \$20 thousand for the years ended December 31, 2012, 2011 and 2010, respectively.

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The estimated net loss, prior service cost and transition obligation for the Pension Plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost in 2013 are \$4.4 million, \$555 thousand and \$5 thousand, respectively. The estimated prior service cost for the postretirement medical plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost in 2013 is \$55 thousand.

|                                                                                                           | <b>Pension Benefits</b> |             |             | <b>Other Postretirement Benefits</b> |             |             |
|-----------------------------------------------------------------------------------------------------------|-------------------------|-------------|-------------|--------------------------------------|-------------|-------------|
|                                                                                                           | <b>2012</b>             | <b>2011</b> | <b>2010</b> | <b>2012</b>                          | <b>2011</b> | <b>2010</b> |
| Weighted average assumptions used to determine net periodic benefit cost for the years ended December 31: |                         |             |             |                                      |             |             |
| Discount rate                                                                                             | 4.99%                   | 6.00%       | 6.25%       | 5.00%                                | 6.00%       | 6.25%       |
| Expected return on plan assets                                                                            | 7.75%                   | 7.75%       | 7.75%       | Not applicable                       |             |             |
| Rate of compensation increase                                                                             | 4.04%                   | 3.86%       | 3.86%       | Not applicable                       |             |             |

We expect the following benefit payments to be paid, which reflect future service as appropriate:

|                   | <b>Pension Benefits</b> | <b>Other Postretirement Benefits</b> |
|-------------------|-------------------------|--------------------------------------|
|                   | <b>(in thousands)</b>   |                                      |
| 2013              | \$ 7,985                | 304                                  |
| 2014              | 9,567                   | 317                                  |
| 2015              | 8,022                   | 349                                  |
| 2016              | 10,691                  | 377                                  |
| 2017              | 10,147                  | 402                                  |
| 2018 through 2022 | 60,647                  | 2,961                                |
|                   | \$ 107,059              | 4,710                                |

Our policy with respect to funding the Pension Plan is to fund at least the minimum required by the Employee Retirement Income Security Act of 1974, as amended, and not more than the maximum amount deductible for tax purposes. All contributions made to the Pension Plan for 2012, 2011 and 2010 were voluntary. Contributions are not expected to exceed \$20 million for 2013. A contribution of \$10 million was made to the Pension Plan in January 2013.

All Company contributions to other postretirement medical benefits are voluntary, as the postretirement medical plan is not funded and is not subject to any minimum regulatory funding requirements. The contributions for each year represent claims paid for medical expenses, and we anticipate making the 2013 expected contribution with cash generated from operations. Contributions by participants to the postretirement plan were \$337 thousand, \$359 thousand and \$237 thousand for the years ended December 31, 2012, 2011 and 2010, respectively.

For measurement purposes, the initial health care cost trend rate was 9.01% for 2012, 9.51% for 2011 and 10% for 2010. The health care cost trend rate reflects anticipated increases in health care costs. The

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**WADDELL & REED FINANCIAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 31, 2012, 2011 and 2010**

initial assumed growth rate of 9.01% for 2012 is assumed to gradually decline over the next 15 years to a rate of 4.5%. The effect of a 1% annual increase in assumed cost trend rates would increase the December 31, 2012 accumulated postretirement benefit obligation by approximately \$1.2 million, and the aggregate of the service and interest cost components of net periodic postretirement benefit cost for the year ended December 31, 2012 by approximately \$180 thousand. The effect of a 1% annual decrease in assumed cost trend rates would decrease the December 31, 2012 accumulated postretirement benefit obligation by approximately \$985 thousand, and the aggregate of the service and interest cost components of net periodic postretirement benefit cost for the year ended December 31, 2012 by approximately \$150 thousand.

We also sponsor the Waddell & Reed Financial, Inc. Supplemental Executive Retirement Plan, as amended and restated (the "SERP"), a non-qualified deferred compensation plan covering eligible employees. The SERP provides certain benefits for Company officers that the Pension Plan is prevented from providing because of compensation and benefit limits in the Internal Revenue Code.

The SERP was adopted to supplement the annual pension paid to certain senior executive officers. Each calendar year, the Compensation Committee of the Board of Directors (the "Compensation Committee") credits participants' SERP accounts with (i) an amount equal to 4% of the executive's base salary, less the amount of the maximum employer matching contribution available under our 401(k) plan, and (ii) a non-formula award, if any, as determined by the Compensation Committee in its discretion. There were no discretionary awards made to participants during 2012, 2011 or 2010. Additionally, each calendar year, participants' accounts are credited (or charged) with an amount equal to the performance of certain hypothetical investment vehicles since the last preceding year. Upon a participant's separation, or at such other time based on a pre-existing election by a participant, benefits accumulated under the SERP are payable in installments or in a lump sum. As of December 31, 2012 and 2011, the aggregate liability to participants was \$3.7 million.

At December 31, 2012, the accrued pension and postretirement liability recorded in the consolidated balance sheet was comprised of accrued pension costs of \$50.3 million, a liability for postretirement benefits in the amount of \$8.5 million and an accrued liability for SERP benefits of \$3.7 million. The current portion of postretirement liability of \$0.3 million is included in other current liabilities on the balance sheet. At December 31, 2011, the accrued pension and postretirement liability recorded on the balance sheet was comprised of accrued pension costs of \$45.0 million, a liability for postretirement benefits in the amount of \$7.8 million and an accrued liability for SERP benefits of \$3.7 million. The current portion of postretirement liability of \$0.3 million is included in other current liabilities on the balance sheet.

**11. Employee Savings Plan**

We sponsor a defined contribution plan that qualifies under Section 401(k) of the Internal Revenue Code to provide retirement benefits to substantially all of our employees following the completion of an eligibility period. As allowed under Section 401(k), the plan provides tax-deferred salary deductions for eligible employees. Our matching contributions to the plan for the years ended December 31, 2012, 2011 and 2010 were \$4.7 million, \$4.5 million and \$4.1 million, respectively.

Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010****12. Stockholders' Equity***Earnings per Share*

For the years ended December 31, 2012, 2011 and 2010, earnings per share from continuing operations were computed as follows:

|                                                                  | <b>2012</b>                                     | <b>2011</b> | <b>2010</b> |
|------------------------------------------------------------------|-------------------------------------------------|-------------|-------------|
|                                                                  | <b>(in thousands, except per share amounts)</b> |             |             |
| Net income from continuing operations                            | \$ 192,528                                      | 172,205     | 153,428     |
| Weighted average shares outstanding basic                        | 85,726                                          | 85,783      | 85,618      |
| Dilutive potential shares from stock options                     | 2                                               | 10          | 29          |
| Weighted average shares outstanding diluted                      | 85,728                                          | 85,793      | 85,647      |
| Earnings per share from continuing operations, basic and diluted | \$ 2.25                                         | 2.01        | 1.79        |

*Anti-dilutive Securities*

There were no anti-dilutive options for the year ended December 31, 2012. Options to purchase 16 thousand shares and 203 thousand shares of Class A common stock ("common stock") were excluded from the diluted earnings per share calculation for the years ended December 31, 2011 and 2010, respectively, because they were anti-dilutive.

*Dividends*

We declared dividends on our common stock of \$2.03 per share, \$0.85 per share and \$0.77 per share for the years ended December 31, 2012, 2011 and 2010, respectively. The Board of Directors approved a special cash dividend on our common stock of \$1.00 per share (included in the 2012 total above) that was paid on December 6, 2012, and an increase in the quarterly dividend on our common stock from \$0.25 per share to \$0.28 per share beginning with our fourth quarter 2012 dividend, paid on February 1, 2013. As of December 31, 2012 and 2011, other current liabilities included \$24.0 million and \$21.4 million, respectively, for dividends payable to stockholders.

*Common Stock Repurchases*

The Board of Directors has authorized the repurchase of our common stock in the open market and/or private purchases. The acquired shares may be used for corporate purposes, including shares issued to employees in our stock-based compensation programs. There were 1,536,968 shares, 1,951,331 shares and 2,043,545 shares repurchased in the open market or privately during the years ended December 31, 2012, 2011 and 2010, respectively, which includes 568,568 shares, 494,207 shares and 426,665 shares repurchased from employees who elected to tender shares to cover their minimum tax withholdings with respect to vesting of stock awards during the years ended December 31, 2012, 2011 and 2010, respectively.

**13. Share-Based Compensation**

The Company has three stock-based compensation plans: the Company 1998 Stock Incentive Plan, as amended and restated (the "SI Plan"), the Company 1998 Executive Stock Award Plan, as amended and





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**WADDELL & REED FINANCIAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 31, 2012, 2011 and 2010**

restated (the "ESA Plan") and the Company 1998 Non-Employee Director Stock Award Plan, as amended and restated (the "NED Plan") (collectively, the "Stock Plans").

The SI Plan allows us to grant equity compensation awards, including, among other awards, non-qualified stock options and nonvested stock as part of our overall compensation program to attract and retain key personnel and encourage a greater personal financial investment in the Company. All of the Stock Plans also allow us to grant non-qualified stock options and/or nonvested stock to promote the long-term growth of the Company. A maximum of 30.0 million shares of common stock are authorized for issuance under the SI Plan. A maximum of 3.75 million and 1.2 million shares of common stock are authorized for issuance under the ESA Plan and NED Plan, respectively. In total, 8,811,318 shares of common stock are available for issuance as of December 31, 2012 under these plans. In addition, we make incentive payments under the Company 2003 Executive Incentive Plan, as amended and restated (the "EIP") in the form of cash, stock options, nonvested stock or a combination thereof. Incentive awards paid under the EIP in the form of stock options or nonvested stock, or granted following the conversion of cash bonus amounts into stock options and/or nonvested stock, are issued out of shares reserved for issuance under the SI and ESA Plans. Generally, shares of common stock covered by terminated, surrendered or cancelled options, by forfeited nonvested stock, or by the forfeiture of other awards that do not result in issuance of shares of common stock are again available for awards under the plan from which they were terminated, surrendered, cancelled or forfeited.

Under our Stock Plans, the exercise price of a stock option is equal to the closing market price of Company common stock on the date of grant. The maximum term of non-qualified options granted under the SI Plan is ten years and two days and the options generally vest in 33<sup>1</sup>/<sub>3</sub>% increments on the second, third and fourth anniversaries of the grant date. The maximum term of non-qualified options granted under the ESA Plan and NED Plan is 11 years and the options generally vest 10% each year, beginning on the first anniversary of the grant date. Our Stock Plans include a Stock Option Restoration Program feature (the "SORP") that allows, on the first trading day of August, a holder to pay the exercise price on vested in-the-money options by surrendering common stock of the Company that has been owned for at least six months. This feature also permits a holder exercising an option to be granted new options in an amount equal to the number of common shares used to satisfy both the exercise price and withholding taxes due upon exercise. New options are granted with an expiration date equal to that of the original option and vest six months after the grant date. The SORP results in a net issuance of shares of common stock and fewer stock options outstanding. We receive a current income tax benefit for stock option exercises.

Nonvested stock awards are valued on the date of grant, have no purchase price and generally vest over four years in 33<sup>1</sup>/<sub>3</sub>% increments on the second, third and fourth anniversaries of the grant date. The Company also issues nonvested stock awards to our financial advisors (our sales force) who are independent contractors. These awards have the same terms as awards issued to employees; however, changes in the Company's share price result in variable compensation expense over the vesting period. Under the Stock Plans, nonvested shares are forfeited upon the termination of employment with or service to the Company, as applicable, or service on the Board of Directors, dependent upon the circumstances of termination. Except for restrictions placed on the transferability of nonvested stock, holders of nonvested stock have full stockholders' rights during the term of restriction, including voting rights and the rights to receive cash dividends.

Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010**

(a)

**Stock Options**

A summary of stock option activity and related information for the year ended December 31, 2012 is presented in the table below. All options outstanding expire in 2013.

|                                  | <b>Options</b> | <b>Weighted<br/>average<br/>exercise<br/>price</b> | <b>Weighted<br/>average<br/>remaining<br/>contractual term<br/>(in years)</b> |
|----------------------------------|----------------|----------------------------------------------------|-------------------------------------------------------------------------------|
| Outstanding at December 31, 2011 | 27,595         | \$ 28.64                                           | 0.62                                                                          |
| Granted                          |                |                                                    |                                                                               |
| Exercised                        | (5,000)        | 21.09                                              |                                                                               |
| Terminated/Canceled              | (16,224)       | 33.94                                              |                                                                               |
| Outstanding at December 31, 2012 | 6,371          | \$ 21.09                                           | 0.50                                                                          |
| Exercisable at December 31, 2012 | 6,371          | \$ 21.09                                           | 0.50                                                                          |

The aggregate intrinsic value of outstanding options and exercisable options as of December 31, 2012 was \$87 thousand. The total intrinsic value (on date of exercise) of options exercised during the years ended December 31, 2012, 2011 and 2010 was \$72 thousand, \$1.4 million and \$2.0 million, respectively. The related income tax benefit recognized was \$26 thousand, \$0.5 million and \$0.6 million for the years ended December 31, 2012, 2011 and 2010, respectively.

(b)

**Nonvested Stock**

A summary of nonvested share activity and related fair value for the year ended December 31, 2012 follows:

|                                | <b>Nonvested<br/>Stock Shares</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|--------------------------------|-----------------------------------|-----------------------------------------------------------|
| Nonvested at December 31, 2011 | 4,868,017                         | \$ 31.52                                                  |
| Granted                        | 1,739,775                         | 33.43                                                     |
| Vested                         | (1,600,553)                       | 27.89                                                     |
| Forfeited                      | (93,159)                          | 33.69                                                     |
| Nonvested at December 31, 2012 | 4,914,080                         | \$ 33.34                                                  |

For the years ended December 31, 2012, 2011 and 2010, compensation expense for continuing operations related to nonvested stock totaled \$48.7 million, \$45.4 million and \$39.1 million, respectively. For the years ended December 31, 2012, 2011, and 2010, compensation expense for discontinued operations related to nonvested stock totaled \$1.2 million, \$1.1 million and \$1.2 million, respectively.

Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010**

The related income tax benefit was \$17.9 million, \$16.7 million and \$14.4 million for the years ended December 31, 2012, 2011 and 2010, respectively. These benefits will be recognized upon vesting and may increase or decrease depending on the fair value of the shares on the date of vesting. As of December 31, 2012, the remaining unamortized expense of \$107.2 million is expected to be recognized over a weighted average period of 2.3 years.

The total fair value of shares vested (at vest date) during the years ended December 31, 2012, 2011 and 2010 was \$53.5 million, \$52.5 million and \$46.5 million, respectively. The Company permits employees the right to tender a portion of their vested shares to the Company to satisfy the minimum tax withholding obligations of the Company with respect to vesting of the shares. During 2013, we expect to repurchase approximately 670 thousand shares from employees who elect to tender shares to cover their minimum tax withholdings.

**14. Uniform Net Capital Rule Requirements**

Two of our subsidiaries, Waddell & Reed, Inc. ("W&R") and Ivy Funds Distributor, Inc. ("IFDI") are registered broker/dealers and members of the Financial Industry Regulatory Authority. A third broker/dealer subsidiary, Legend Equities Corporation ("LEC"), was sold as part of the Legend transaction, effective January 1, 2013. Broker/dealers are subject to the SEC's Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15.0 to 1.0. The primary difference between net capital and stockholders' equity is the non-allowable assets that are excluded from net capital.

A broker/dealer may elect not to be subject to the Aggregate Indebtedness Standard of paragraph (a)(1)(i) of Rule 15c3-1, in which case net capital must exceed the greater of \$250 thousand or 2% of aggregate debit items computed in accordance with the Formula for Determination of Reserve Requirements for broker/dealers. W&R made this election and thus is not subject to the aggregate indebtedness ratio as of December 31, 2012 or 2011.

Net capital and aggregated indebtedness information for our broker/dealer subsidiaries is presented in the following table as of December 31, 2012 and 2011:

|                                                | 2012           |                   |             | 2011           |             |             |
|------------------------------------------------|----------------|-------------------|-------------|----------------|-------------|-------------|
|                                                | (in thousands) |                   |             |                |             |             |
|                                                | W&R            | LEC               | IFDI        | W&R            | LEC         | IFDI        |
| Net capital                                    | \$ 24,690      | 782               | 19,681      | 34,524         | 1,654       | 45,579      |
| Required capital                               | 250            | 268               | 2,648       | 250            | 251         | 2,353       |
| Excess of required capital                     | \$ 24,440      | 514               | 17,033      | 34,274         | 1,403       | 43,226      |
| Ratio of aggregate indebtedness to net capital | Not applicable | 5.14 to 1.0<br>80 | 2.02 to 1.0 | Not applicable | 2.28 to 1.0 | 0.77 to 1.0 |

Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010****15. Rental Expense and Lease Commitments**

We lease our home office buildings, certain sales and other office space and equipment under long-term operating leases. Rent expense was \$21.9 million, \$21.6 million and \$21.5 million, for the years ended December 31, 2012, 2011 and 2010, respectively. Future minimum rental commitments under non-cancelable operating leases are as follows:

| <b>Year</b> | <b>Commitments<br/>(in thousands)</b> |
|-------------|---------------------------------------|
| 2013        | \$ 20,498                             |
| 2014        | 16,749                                |
| 2015        | 13,249                                |
| 2016        | 10,164                                |
| 2017        | 7,149                                 |
| Thereafter  | 21,577                                |
|             | <b>\$ 89,386</b>                      |

New leases are expected to be executed as existing leases expire. Thus, future minimum lease commitments are not expected to be materially different than those in 2012.

**16. Related Party Transactions**

We earn investment management fee revenues from the Funds for which we also act as an investment adviser, pursuant to an investment management agreement with each Fund. In addition, we have agreements with the Funds pursuant to Rule 12b-1 under the Investment Company Act of 1940, as amended, pursuant to which distribution and service fees are collected from the Funds for distribution of mutual fund shares, for costs such as advertising and commissions paid to broker/dealers, and for providing ongoing services to shareholders of the Funds and/or maintaining shareholder accounts. We also earn service fee revenues by providing various services to the Funds and their shareholders pursuant to a shareholder servicing agreement with each Fund (except the Ivy Funds VIP) and an accounting service agreement with each Fund. Certain of our officers and directors are also officers and/or trustees for the various Funds for which we act as an investment adviser. These agreements are approved or renewed on an annual basis by each Fund's board of trustees, including a majority of the disinterested members. Funds and separate accounts receivable includes amounts due from the Funds for aforementioned services.

**17. Contingencies**

The Company is involved from time to time in various legal proceedings, regulatory investigations and claims incident to the normal conduct of business, which may include proceedings that are specific to us and others generally applicable to business practices within the industries in which we operate. A substantial legal liability or a significant regulatory action against us could have an adverse effect on our business, financial condition and on the results of operations in a particular quarter or year.

The Company accrues an undiscounted liability for those contingencies where the incurrence of a loss is probable, and the amount can be reasonably estimated. These amounts are not reduced by amounts that may be recovered under insurance or claims against third parties, but undiscounted receivables from insurers or other third parties may be accrued separately. The Company regularly revises such accruals in

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**WADDELL & REED FINANCIAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 31, 2012, 2011 and 2010**

light of new information. For contingencies where an unfavorable outcome is reasonably possible and that are significant, the Company discloses the nature of the contingency and, where feasible, an estimate of the possible loss. For purposes of our litigation contingency disclosures, "significant" includes material matters as well as other items that management believes should be disclosed. Management judgment is required related to contingent liabilities and the outcome of litigation because both are difficult to predict.

*Michael E. Taylor, Kenneth B. Young, individuals, on behalf of themselves individually and on behalf of others similarly situated v. Waddell & Reed, Inc., a Delaware Corporation; and DOES 1 through 10 inclusive; Case No. 09-CV-2909 DMS WVG; in the United States District Court for the Southern District of California.*

In this action filed December 28, 2009, the Company was sued in an individual action, class action and Fair Labor Standards Act ("FLSA") nationwide collective action by two former advisors asserting misclassification of financial advisors as independent contractors instead of employees. Plaintiffs, on behalf of themselves and a purported class of Waddell & Reed, Inc. financial advisors, assert claims under the FLSA for minimum wages and overtime wages, and under California Labor Code Statutes for timely payment of wages, minimum wages, overtime compensation, meal periods, reimbursement of losses and business expenses and itemized wage statements and a claim for Unfair Business Practices under §17200 of the California Business & Professions Code. Plaintiffs seek declaratory and injunctive relief and monetary damages.

Plaintiffs moved for conditional collective action certification under the FLSA. The Company opposed this motion and additionally moved for summary judgment on Plaintiffs' individual FLSA claims. The Court issued an order on January 3, 2012 granting the Company's summary judgment motions, holding that Plaintiffs' individual FLSA claims fail as a matter of law, and denying Plaintiffs' motion for conditional collective action certification under the FLSA as moot. This ruling effectively removes all nationwide FLSA claims from the case.

Subsequently, the Company moved for summary judgment on Plaintiffs' individual California claims. The Court issued an order on August 20, 2012 granting the Company's summary judgment motions, holding that Plaintiffs' individual California claims fail as a matter of law. This order effectively dismissed Plaintiffs from the case, both individually and as putative class representatives.

However, in its August 20, 2012 order, the Court also granted Plaintiffs' motion to add a new individual and putative class representative to the action, effectively replacing the originally named Plaintiffs. The newly named Plaintiff continued to pursue the California claims referenced above on behalf of the putative class, as well as newly added representative derivative claims under the California Private Attorney General Act.

The Company moved for summary judgment, asking the Court to dismiss the newly named Plaintiff's individual claims. The arguments made in support of this request were the same as those that prevailed in the Taylor and Young motions for summary judgment. On February 1, 2013, the Court issued an order granting the Company's summary judgment motion. This ruling effectively dismisses all remaining claims in the case in their entirety, pending appeal. No appeal has yet been filed. The Company intends to continue to vigorously defend the matter at appeal, if any.

Table of Contents**WADDELL & REED FINANCIAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2012, 2011 and 2010****18. Selected Quarterly Information (Unaudited)**

|                                            | <b>First</b>          | <b>Second</b> | <b>Third</b> | <b>Fourth</b> |
|--------------------------------------------|-----------------------|---------------|--------------|---------------|
|                                            | <b>Quarter</b>        |               |              |               |
|                                            | <b>(in thousands)</b> |               |              |               |
| <b>2012</b>                                |                       |               |              |               |
| Total revenues                             | \$ 287,871            | 289,686       | 293,365      | 302,883       |
| Income from continuing operations          | 46,837                | 41,225        | 52,116       | 52,350        |
| Income (loss) from discontinued operations | 550                   | 493           | (43,590) (1) | 971           |
| Net income                                 | \$ 47,387             | 41,718        | 8,526        | 53,321        |
| Net income per share, basic and diluted:   |                       |               |              |               |
| Income from continuing operations          | \$ 0.55               | 0.48          | 0.61         | 0.61          |
| Income (loss) from discontinued operations |                       |               | (0.51)       | 0.01          |
| Net income                                 | \$ 0.55               | 0.48          | 0.10         | 0.62          |

|                                          | <b>First</b>          | <b>Second</b> | <b>Third</b> | <b>Fourth</b> |
|------------------------------------------|-----------------------|---------------|--------------|---------------|
|                                          | <b>Quarter</b>        |               |              |               |
|                                          | <b>(in thousands)</b> |               |              |               |
| <b>2011</b>                              |                       |               |              |               |
| Total revenues                           | \$ 278,435            | 291,195       | 280,341      | 272,561       |
| Income from continuing operations        | 44,369                | 49,094        | 39,371       | 39,371        |
| Income from discontinued operations      | 1,264                 | 876           | 463          | 651           |
| Net income                               | \$ 45,633             | 49,970        | 39,834       | 40,022        |
| Net income per share, basic and diluted: |                       |               |              |               |
| Income from continuing operations        | \$ 0.52               | 0.57          | 0.46         | 0.46          |
| Income from discontinued operations      | 0.01                  | 0.01          |              | 0.01          |
| Net income                               | \$ 0.53               | 0.58          | 0.46         | 0.47          |

(1)

Includes a non-cash impairment charge of \$42.4 million related to the sale of Legend.

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### WADDELL & REED FINANCIAL, INC.

#### Index to Exhibits

| Exhibit No. | Exhibit Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|-------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1         | Restated Certificate of Incorporation of Waddell & Reed Financial, Inc. Filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q, File No. 333-43687, for the quarter ended June 30, 2006 and incorporated herein by reference.                                                                                                                                                                                                                                                                                                              |
| 3.2         | Amended and Restated Bylaws of Waddell & Reed Financial, Inc. Filed as Exhibit 3.1 to the Company's Current Report on Form 8-K, File No. 001-13913, filed February 25, 2011 and incorporated herein by reference.                                                                                                                                                                                                                                                                                                                                       |
| 4.1         | Specimen of Class A Common Stock Certificate, par value \$0.01 per share. Filed as Exhibit 4.1 to the Company's Registration Statement on Form S-1/A, File No. 333-43687, on February 27, 1998 and incorporated herein by reference.                                                                                                                                                                                                                                                                                                                    |
| 4.2         | Certificate of Designation, Preferences and Rights of Series B Junior Participating Preferred Stock of Waddell & Reed Financial, Inc., as filed on April 9, 2009 with the Secretary of State of the State of Delaware. Filed as Exhibit 4.1 to the Company's Current Report on Form 8-K, File No. 333-43687, on April 10, 2009 and incorporated herein by reference.                                                                                                                                                                                    |
| 4.3         | Rights Agreement, dated as of April 8, 2009, by and between Waddell & Reed Financial, Inc. and Computershare Trust Company, N.A., which includes the Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of the Company, as filed on April 9, 2009 with the Secretary of State of Delaware, as Exhibit A and the form of Rights Certificate as Exhibit B. Filed as Exhibit 4.2 to the Company's Current Report on Form 8-K, File No. 333-43687, on April 10, 2009 and incorporated herein by reference. |
| 4.5         | Form of Indenture to be used in connection with the Senior Debt Securities. Filed as Exhibit 4.4 to the Company's Form S-3ASR, File No. 333-179111, on January 20, 2012 and incorporated herein by reference.                                                                                                                                                                                                                                                                                                                                           |
| 10.1        | General Agent Contract, dated as of October 20, 2000, by and among Nationwide Life Insurance Company, Nationwide Life and Annuity Insurance Company and Waddell & Reed, Inc. and its affiliated insurance companies. Filed as Exhibit 10.5 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2000 and incorporated herein by reference.                                                                                                                                                                  |
| 10.2        | Administrative and Marketing Services Agreement, dated as of January 1, 2012, by and among Nationwide Life Insurance Company, Nationwide Life and Annuity Insurance Company and Waddell & Reed, Inc. and its affiliated insurance companies.                                                                                                                                                                                                                                                                                                            |
| 10.3        | Fund Participation Agreement, dated as of December 1, 2000, by and among Nationwide Life Insurance Company and/or Nationwide Life and Annuity Insurance Company, Waddell & Reed Services Company and Waddell & Reed, Inc. Filed as Exhibit 10.6 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2000 and incorporated herein by reference.                                                                                                                                                             |
| 10.4        | Fund Participation Agreement, dated as of September 19, 2003, by and among Minnesota Life Insurance Company, Waddell & Reed, Inc. and Ivy Funds VIP. Filed as Exhibit 10.3 to the Company's Annual Report on Form 10-K, File No. 333-43687, for the year ended December 31, 2007 and incorporated herein by reference.                                                                                                                                                                                                                                  |



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| <b>Exhibit No.</b> | <b>Exhibit Description</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|--------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.5               | Variable Products Distribution Agreement, dated as of December 12, 2003, by and among Minnesota Life Insurance Company, Securian Financial Services, Inc. and Waddell & Reed, Inc. and its affiliated insurance companies. Filed as Exhibit 10.4 to the Company's Annual Report on Form 10-K, File No. 333-43687, for the year ended December 31, 2004 and incorporated herein by reference.                                                                                                                                       |
| 10.6               | Waddell & Reed Financial, Inc. 1998 Stock Incentive Plan, as amended and restated. Filed as Exhibit 10.6 to the Company's Annual Report on Form 10-K, File No. 333-43687, for the year ended December 31, 2008 and incorporated herein by reference.*                                                                                                                                                                                                                                                                              |
| 10.7               | Waddell & Reed Financial, Inc. 1998 Stock Incentive Plan, as amended and restated. Filed as Exhibit 10.7 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2011 and incorporated herein by reference.*                                                                                                                                                                                                                                                                              |
| 10.8               | Waddell & Reed Financial, Inc. 1998 Executive Stock Award Plan, as amended and restated. Filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q, File No. 333-43687, for the quarter ended September 30, 2005 and incorporated herein by reference.*                                                                                                                                                                                                                                                                 |
| 10.9               | Waddell & Reed Financial, Inc. 1998 Executive Stock Award Plan, as amended and restated. Filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q, File No. 001-13913, for the quarter ended September 30, 2012 and incorporated herein by reference.*                                                                                                                                                                                                                                                                 |
| 10.10              | Waddell & Reed Financial, Inc. 1998 Non-Employee Director Stock Award Plan, as amended and restated. Filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q, File No. 333-43687, for the quarter ended September 30, 2005 and incorporated herein by reference.*                                                                                                                                                                                                                                                     |
| 10.11              | Waddell & Reed Financial, Inc. 1998 Non-Employee Director Stock Award Plan, as amended and restated. Filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q, File No. 001-13913, for the quarter ended September 30, 2012 and incorporated herein by reference.*                                                                                                                                                                                                                                                     |
| 10.12              | Credit Agreement, dated August 31, 2010, by and among Waddell & Reed Financial, Inc., the lenders party thereto, Bank of America, N.A. as Administrative Agent, Bank of America Securities LLC as Lead Arranger and Book Manager, UMB Bank, N.A. and The Bank of Nova Scotia as Co-Syndication Agents, and Citibank, N.A. and Wells Fargo Bank, N.A. as Co-Documentation Agents. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, File No. 001-13913, on September 7, 2010 and incorporated herein by reference. |
| 10.13              | Note Purchase Agreement, dated August 31, 2010, by and among Waddell & Reed Financial, Inc. and the purchasers party thereto. Filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, File No. 001-13913, on September 7, 2010 and incorporated herein by reference.                                                                                                                                                                                                                                                    |
| 10.14              | Fixed Rate Promissory Note for Multiple Loans, dated as of August 15, 2000, by and between Waddell & Reed Financial, Inc. and Chase Manhattan Bank. Filed as Exhibit 10.15 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2000 and incorporated herein by reference.                                                                                                                                                                                                             |
| 10.15              | Waddell & Reed Financial, Inc. Supplemental Executive Retirement Plan, as amended and restated. Filed as Exhibit 10.11 to the Company's Annual Report on Form 10-K, File No. 333-43687, for the year ended December 31, 2008 and incorporated herein by reference.*                                                                                                                                                                                                                                                                |

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| Exhibit<br>No. | Exhibit Description                                                                                                                                                                                                                                                                                                                                 |
|----------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.16          | Waddell & Reed Financial, Inc. 2003 Executive Incentive Plan, as amended and restated. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, File No. 333-43687, on April 11, 2008 and incorporated herein by reference.*                                                                                                              |
| 10.17          | Investment Management Agreement, dated January 30, 2009, by and between the Advisors Funds and Waddell & Reed Investment Management Company. Filed as Exhibit 10.21 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2009 and incorporated herein by reference.                                     |
| 10.18          | Investment Management Agreement, dated April 10, 2009, by and between Ivy Funds VIP and Waddell & Reed Investment Management Company. Filed as Exhibit 10.26 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2009 and incorporated herein by reference.                                            |
| 10.19          | Investment Management Agreement, dated April 10, 2009, by and between Ivy Funds VIP and Waddell & Reed Investment Management Company. Filed as Exhibit 10.27 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2009 and incorporated herein by reference.                                            |
| 10.20          | Investment Management Agreement, dated November 13, 2008, by and between Ivy Funds and Ivy Investment Management Company. Filed as Exhibit 10.18 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2011 and incorporated herein by reference.                                                        |
| 10.21          | Investment Management Agreement, dated April 30, 2009, by and between Waddell & Reed InvestEd Portfolios and Waddell & Reed Investment Management Company.                                                                                                                                                                                          |
| 10.22          | Administrative Agreement, dated as of March 9, 2001, by and among W&R Insurance Agency, Inc., Waddell & Reed, Inc., BISYS Insurance Services, Inc. and Underwriters Equity Corp. Filed as Exhibit 10.28 to the Company's Annual Report on Form 10-K, File No. 333-43687, for the year ended December 31, 2001 and incorporated herein by reference. |
| 10.23          | Consulting Agreement, dated May 25, 2005, by and between Waddell & Reed Financial, Inc. and Keith A. Tucker. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, File No. 333-43687, on May 27, 2005 and incorporated herein by reference.                                                                                           |
| 10.24          | Form of Change in Control Employment Agreement, dated December 14, 2001, by and between Henry J. Herrmann and Waddell & Reed Financial, Inc. Filed as Exhibit 10.30 to the Company's Annual Report on Form 10-K, File No. 333-43687, for the year ended December 31, 2001 and incorporated herein by reference.*                                    |
| 10.25          | First Amendment to Change in Control Employment Agreement, dated December 17, 2008, by and between Henry J. Herrmann and Waddell & Reed Financial, Inc. Filed as Exhibit 10.26 to the Company's Annual Report on Form 10-K, File No. 333-43687, for the year ended December 31, 2008 and incorporated herein by reference.*                         |
| 10.26          | Second Amendment to Change in Control Employment Agreement, dated December 17, 2009, by and between Henry J. Herrmann and Waddell & Reed Financial, Inc. Filed as Exhibit 10.52 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2009 and incorporated herein by reference.*                        |

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| Exhibit<br>No. | Exhibit Description                                                                                                                                                                                                                                                                                                                                        |
|----------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.27          | Form of Restricted Stock Award Agreement for awards pursuant to the Waddell & Reed Financial, Inc. 1998 Stock Incentive Plan, as amended and restated. Filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q, File No. 333-43687, for the quarter ended September 30, 2007 and incorporated herein by reference.*                           |
| 10.28          | Form of Restricted Stock Award Agreement for awards pursuant to the Waddell & Reed Financial, Inc. 1998 Stock Incentive Plan, as amended and restated. Filed as Exhibit 10.29 to the Company's Annual Report on Form 10-K, File No. 333-43687, for the year ended December 31, 2008 and incorporated herein by reference.*                                 |
| 10.29          | Form of Restricted Stock Award Agreement for awards pursuant to the Waddell & Reed Financial, Inc. 1998 Stock Incentive Plan, as amended and restated. Filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q, File No. 001-13913, for the quarter ended March 31, 2009 and incorporated herein by reference.*                               |
| 10.30          | Form of Restricted Stock Award Agreement for awards pursuant to the Waddell & Reed Financial, Inc. 1998 Stock Incentive Plan, as amended and restated. Filed as Exhibit 10.28 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2011 and incorporated herein by reference.*                                 |
| 10.31          | Form of Restricted Stock Award Agreement for awards to Non-Employee Directors pursuant to the Waddell & Reed Financial, Inc. 1998 Stock Incentive Plan, as amended and restated. Filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q, File No. 333-43687, for the quarter ended September 30, 2007 and incorporated herein by reference.* |
| 10.32          | Form of Restricted Stock Award Agreement for awards pursuant to the Waddell & Reed Financial, Inc. 1998 Executive Stock Award Plan, as amended and restated. Filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q, File No. 001-13913, for the quarter ended September 30, 2012 and incorporated herein by reference.*                     |
| 10.33          | Form of Restricted Stock Award Agreement for awards pursuant to the Waddell & Reed Financial, Inc. 1998 Non-Employee Director Stock Award Plan, as amended and restated. Filed as Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q, File No. 333-43687, for the quarter ended September 30, 2007 and incorporated herein by reference.*         |
| 10.34          | Form of Restricted Stock Award Agreement for awards pursuant to the Waddell & Reed Financial, Inc. 1998 Non-Employee Director Stock Award Plan, as amended and restated. Filed as Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q, File No. 001-13913, for the quarter ended September 30, 2012 and incorporated herein by reference.*         |
| 10.35          | Portfolio Managers Revenue Sharing Plan for Flow Accounts. Filed as Exhibit 10.64 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2010 and incorporated herein by reference.*                                                                                                                             |
| 10.36          | Portfolio Managers Revenue Sharing Schedule. Filed as Exhibit 10.65 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2010 and incorporated herein by reference.*                                                                                                                                           |
| 10.37          | Portfolio Managers Revenue Sharing Schedule Large Cap Growth. Filed as Exhibit 10.36 to the Company's Annual Report on Form 10-K, File No. 001-13913, for the year ended December 31, 2011 and incorporated herein by reference.*                                                                                                                          |

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| <b>Exhibit No.</b> | <b>Exhibit Description</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|--------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.38              | Form of Indemnification Agreement. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, File No. 001-13913, on November 16, 2009 and incorporated herein by reference.*                                                                                                                                                                                                                                                                                                              |
| 10.39              | 2012 Performance Goals established pursuant to the Waddell & Reed Financial, Inc. 2003 Executive Incentive Plan, as amended and restated. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, File No. 001-13913, on February 16, 2012 and incorporated herein by reference.*                                                                                                                                                                                                       |
| 10.40              | 2013 Performance Goals established pursuant to the Waddell & Reed Financial, Inc. 2003 Executive Incentive Plan, as amended and restated. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, File No. 001-13913, on February 19, 2013 and incorporated herein by reference.*                                                                                                                                                                                                       |
| 10.41              | Offer of Settlement. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, File No. 333-43687, on July 24, 2006 and incorporated herein by reference.                                                                                                                                                                                                                                                                                                                                 |
| 10.42              | Assurance of Discontinuance. Filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, File No. 333-43687, on July 24, 2006 and incorporated herein by reference.                                                                                                                                                                                                                                                                                                                         |
| 10.43              | Stipulation for Consent Order. Filed as Exhibit 10.3 to the Company's Current Report on Form 8-K, File No. 333-43687, on July 24, 2006 and incorporated herein by reference.                                                                                                                                                                                                                                                                                                                       |
| 11                 | Statement regarding computation of per share earnings                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| 12                 | Statement re computation of ratios of earnings to fixed charges                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| 21                 | Subsidiaries of Waddell & Reed Financial, Inc.                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| 23                 | Consent of KPMG LLP                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| 31.1               | Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer                                                                                                                                                                                                                                                                                                                                                                                                                              |
| 31.2               | Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer                                                                                                                                                                                                                                                                                                                                                                                                                              |
| 32.1               | Section 1350 Certification of the Chief Executive Officer                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| 32.2               | Section 1350 Certification of the Chief Financial Officer                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| 101                | Materials from the Waddell & Reed Financial, Inc. Annual Report on Form 10-K for the year ended December 31, 2012, formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Stockholders' Equity, (v) Consolidated Statements of Cash Flows, and (vi) related Notes to the Consolidated Financial Statements, tagged in detail. |

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\*  
Indicates management contract or compensatory plan, contract or arrangement.