

WADDELL & REED FINANCIAL INC
Form 10-Q
July 24, 2007

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

FORM 10-Q

(Mark
One)

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

For the quarterly period ended June 30, 2007

OR

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

For the transition period from _____ to _____

Commission file number 001-13913

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

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

(913) 236-2000

(Registrant's telephone number, including area code)

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

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

Edgar Filing: WADDELL & REED FINANCIAL INC - Form 10-Q

Large accelerated filer

Accelerated Filer

Non-accelerated Filer

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

Shares outstanding of each of the registrant's classes of common stock as of the latest practicable date:

Class	Outstanding as of July 20, 2007
Class A common stock, \$.01 par value	83,846,125

WADDELL & REED FINANCIAL, INC.
INDEX TO QUARTERLY REPORT ON FORM 10-Q
Quarter Ended June 30, 2007

		Page No.
<u>Part I.</u>	<u>Financial Information</u>	
<u>Item 1.</u>	<u>Financial Statements (unaudited)</u>	
	<u>Consolidated Balance Sheets at June 30, 2007 and December 31, 2006</u>	3
	<u>Consolidated Statements of Operations for the three months and six months ended June 30, 2007 and June 30, 2006</u>	4
	<u>Consolidated Statements of Comprehensive Income for the three months and six months ended June 30, 2007 and June 30, 2006</u>	5
	<u>Consolidated Statement of Stockholders' Equity for the six months ended June 30, 2007</u>	6
	<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and June 30, 2006</u>	7
	<u>Notes to the Unaudited Consolidated Financial Statements</u>	8
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	30
<u>Item 4.</u>	<u>Controls and Procedures</u>	30
<u>Part II.</u>	<u>Other Information</u>	
<u>Item 1.</u>	<u>Legal Proceedings</u>	31
<u>Item 1A.</u>	<u>Risk Factors</u>	31
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	31
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	32
<u>Item 6.</u>	<u>Exhibits</u>	33
	<u>Signatures</u>	34

PART I. FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES**

Consolidated Balance Sheets

(in thousands)

	June 30, 2007 (unaudited)	December 31, 2006
Assets:		
Cash and cash equivalents	\$ 171,274	196,516
Investment securities	58,280	48,129
Receivables:		
Funds and separate accounts	41,553	38,806
Customers and other	48,062	59,863
Deferred income taxes	1,054	2,923
Income taxes receivable	1,641	
Prepaid expenses and other current assets	6,868	5,766
Total current assets	328,732	352,003
Property and equipment, net	48,948	50,875
Deferred sales commissions, net	26,463	20,462
Goodwill and identifiable intangible assets	228,432	228,432
Other assets	9,787	10,942
Total assets	\$ 642,362	662,714
Liabilities:		
Accounts payable	\$ 15,022	16,415
Payable to investment companies for securities	69,391	75,607
Accrued compensation	30,617	32,994
Income taxes payable		14,804
Other current liabilities	43,021	44,710
Total current liabilities	158,051	184,530
Long-term debt	199,948	199,942
Accrued pension and post-retirement costs	16,021	12,663
Deferred income taxes	10,096	12,082
Other	13,173	8,797
Total liabilities	397,289	418,014
Commitments and contingencies (Note 9)		
Stockholders' equity :		
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; 83,797 shares outstanding (84,660 at December 31, 2006)	997	997
Additional paid-in capital	182,110	189,299
Retained earnings	418,340	388,422
Cost of 15,904 common shares in treasury (15,041 at December 31, 2006)	(352,260)	(327,966)
Accumulated other comprehensive loss	(4,114)	(6,052)

Edgar Filing: WADDELL & REED FINANCIAL INC - Form 10-Q

Total stockholders' equity	245,073	244,700
Total liabilities and stockholders' equity	\$ 642,362	662,714

See accompanying notes to unaudited consolidated financial statements.

3

WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(Unaudited, in thousands, except for per share data)

	For the three months		For the six months	
	ended June 30, 2007	2006	ended June 30, 2007	2006
Revenues:				
Investment management fees	\$ 89,383	78,190	172,243	152,239
Underwriting and distribution fees	88,556	80,494	172,572	157,506
Shareholder service fees	23,347	22,627	45,970	44,636
Total revenues	201,286	181,311	390,785	354,381
Operating expenses:				
Underwriting and distribution	99,528	91,545	193,925	176,299
Compensation and related costs (including share-based compensation of \$6.4 million, \$5.8 million, \$11.3 million and \$11.3 million, respectively)	28,312	27,076	55,244	56,018
General and administrative	11,840	64,982	21,923	75,227
Subadvisory fees	10,638	7,599	19,853	14,147
Depreciation	3,062	2,956	6,105	5,810
Goodwill impairment		20,000		20,000
Total	153,380	214,158	297,050	347,501
Operating income (loss)	47,906	(32,847)	93,735	6,880
Investment and other income	2,609	2,144	5,089	4,407
Interest expense	(2,982)	(2,984)	(5,966)	(6,238)
Income (loss) before provision for income taxes	47,533	(33,687)	92,858	5,049
Provision for income taxes	17,827	(665)	34,425	13,479
Net income (loss)	\$ 29,706	(33,022)	58,433	(8,430)
Net income (loss) per share:				
Basic	\$ 0.37	(0.40)	0.72	(0.10)
Diluted	\$ 0.36	(0.40)	0.71	(0.10)
Weighted average shares outstanding:				
Basic	80,559	81,570	80,653	81,388
Diluted	82,323	81,570	82,561	81,388
Dividends declared per common share	\$ 0.17	0.15	0.34	0.30

See accompanying notes to unaudited consolidated financial statements.

WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(Unaudited, in thousands)

	For the three months ended June 30,		For the six months ended June 30,	
	2007	2006	2007	2006
Net income (loss)	\$ 29,706	(33,022)	58,433	(8,430)
Other comprehensive income:				
Available-for-sale investments:				
Net unrealized appreciation (depreciation) of investments during the period, net of income taxes of \$873, \$(145), \$1,150 and \$300, respectively	1,533	(247)	2,029	511
Derivatives:				
Net unrealized loss on derivatives during the period, net of income taxes of \$0, \$0, \$0 and \$(174), respectively				(297)
Reclassification adjustment for amounts included in net income, net of income taxes of \$(21), \$(21), \$(40) and \$(127), respectively	(36)	(36)	(73)	(215)
Comprehensive income (loss)	\$ 31,203	(33,305)	60,389	(8,431)

See accompanying notes to unaudited consolidated financial statements.

WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity

For the Six Months Ended June 30, 2007

(Unaudited, in thousands)

	Common stock		Additional	Retained	Treasury	Accumulated	Total
	Shares	Amount	paid-in	earnings	stock	other	stockholders'
			capital			comprehensive	equity
						income (loss)	
Balance at December 31, 2006	99,701	\$ 997	189,299	388,422	(327,966)	(6,052)	244,700
Net income				58,433			58,433
Recognition of equity compensation			11,264				11,264
Issuance of nonvested shares and other			(18,842)		18,842		
Dividends accrued				(28,515)			(28,515)
Exercise of stock options			(1,243)		4,093		2,850
Excess tax benefits from share-based payment arrangements			1,632				1,632
Other stock transactions					(5,420)		(5,420)
Repurchase of common stock					(41,809)		(41,809)
Unrealized gain on available for sale investment securities						2,029	2,029
Reclassification for amounts included in net income						(73)	(73)
Pension and postretirement plan adjustment						(18)	(18)
Balance at June 30, 2007	99,701	\$ 997	182,110	418,340	(352,260)	(4,114)	245,073

See accompanying notes to unaudited consolidated financial statements.

WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited, in thousands)

	For the six months ended June 30,	
	2007	2006
Cash flows from operating activities:		
Net income (loss)	\$ 58,433	(8,430)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	6,133	5,965
Share-based compensation	11,264	11,292
Excess tax benefits from share-based payment arrangements	(1,632)	(539)
Gain on sale of available-for-sale investment securities		(1,040)
Net purchases and sales of trading securities	(649)	(838)
Unrealized gain on trading securities	(678)	(157)
Goodwill impairment		20,000
Write down of investment securities		750
Loss on sale and retirement of property and equipment	113	111
Capital gains and dividends reinvested	(131)	(99)
Deferred income taxes	(1,245)	2,181
Changes in assets and liabilities:		
Receivables from funds and separate accounts	(2,747)	(1,451)
Other receivables	11,801	14,972
Other assets	(5,949)	(5,429)
Accounts payable	(7,608)	(8,391)
Other liabilities	(12,692)	30,610
Net cash provided by operating activities	\$ 54,413	59,507
Cash flows from investing activities:		
Purchases of available-for-sale investment securities	(5,650)	(2,200)
Proceeds from sales of available-for-sale investment securities		3,524
Proceeds from maturities of available-for-sale investment securities		59
Additions to property and equipment	(4,290)	(4,598)
Net cash used in investing activities	\$ (9,940)	(3,215)
Cash flows from financing activities:		
Proceeds from long term debt and interest rate swap termination		199,862
Repayment of long term debt		(200,000)
Dividends paid	(26,968)	(25,291)
Repurchase of common stock	(41,809)	
Exercise of stock options	2,850	1,098
Excess tax benefits from share-based payment arrangements	1,632	539
Other stock transactions	(5,420)	(4,673)
Net cash used in financing activities	\$ (69,715)	(28,465)
Net increase (decrease) in cash and cash equivalents	(25,242)	27,827
Cash and cash equivalents at beginning of period	196,516	162,775

Cash and cash equivalents at end of period	\$	171,274	190,602
--------------------------------------------	----	---------	---------

See accompanying notes to unaudited consolidated financial statements.

7

WADDELL & REED FINANCIAL, INC.
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. The Company and Significant Accounting Policies

Waddell & Reed Financial, Inc. and Subsidiaries

Waddell & Reed Financial, Inc. and subsidiaries (hereinafter referred to as the Company, we, our and us) derive revenues primarily 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), W&R Target Funds, Inc. (the Target Funds), Ivy Funds, Inc. and the Ivy Funds portfolios (collectively, the Ivy Funds), and Waddell & Reed InvestEd Portfolios, Inc. (InvestEd) (collectively, 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 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 directors/trustees and shareholders. Our revenues are largely dependent on the total value and composition of assets under management, which include mainly domestic equity securities, but also debt securities and international equities. Accordingly, fluctuations in financial markets and composition of assets under management can significantly impact revenues and results of operations.

Basis of Presentation

We have prepared the accompanying unaudited consolidated financial statements included herein pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations, although we believe that the disclosures are adequate to enable a reasonable understanding of the information presented. The information in this Quarterly Report on Form 10-Q should be read in conjunction with Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations and our audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006 (the 2006 Form 10-K). Certain amounts in the prior years financial statements have been reclassified for consistent presentation.

The accompanying unaudited consolidated financial statements have been prepared consistently with the accounting policies described in Note 2 to the consolidated financial statements included in our 2006 Form 10-K, which include the following: use of estimates, cash and cash equivalents, disclosures about fair value of financial instruments, investment securities and investments in affiliated mutual funds, property and equipment, software developed for internal use, goodwill and intangible assets, deferred sales commissions, revenue recognition, advertising and promotion, share-based compensation and derivatives and hedging activities. Due to the implementation of Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), we modified our accounting policy related to accounting for income taxes, which is listed below. In our opinion, the accompanying unaudited consolidated financial statements reflect all adjustments (consisting of only a normal and recurring nature) necessary to present fairly our financial position at June 30, 2007 and December 31, 2006, the results of operations for the three months and six months ended June 30, 2007 and 2006 and cash flows for the six months ended June 30, 2007 and 2006 in conformity with accounting principles generally accepted in the United States.

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 FIN 48. 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 bases. 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.

2. Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and short-term investments. We consider all highly liquid investments with original or remaining maturities of 90 days or less at the date of purchase to be cash equivalents. Cash and cash equivalents at June 30, 2007 and December 31, 2006 include amounts of \$39.6 million and \$32.6 million, respectively, for the benefit of customers segregated in compliance with federal and other regulations. Substantially all cash balances are in excess of federal deposit insurance limits.

3. Investment Securities

Investment securities are as follows:

	Fair Value June 30, 2007 (in thousands)	December 31, 2006
Available-for-sale securities:		
Affiliated mutual funds	\$ 38,607	29,716
Municipal bonds	7,151	7,184
Mortgage-backed securities	12	13
	45,770	36,913
Trading securities:		
Affiliated mutual funds	11,609	10,196
Municipal bonds	509	510
Corporate bonds	227	340
Mortgage-backed securities	119	124
Common stock	46	46
	12,510	11,216
Total investment securities	\$ 58,280	48,129

Edgar Filing: WADDELL & REED FINANCIAL INC - Form 10-Q

Certain information related to our available-for-sale securities is as follows:

	June 30, 2007 (in thousands)	December 31, 2006
Cost	\$ 35,161	29,483
Gross unrealized gains	10,627	7,546
Gross unrealized losses	(18)	(116)
Fair value	\$ 45,770	36,913

Purchases and sales of trading securities during the six months ended June 30, 2007 were \$1.0 million and \$359 thousand, respectively.

In the first quarter of 2006, the Company recorded a \$750 thousand write-down for other-than-temporary impairment of a municipal bond classified as available-for-sale. In the third quarter of 2006, the Company sold the same bond and realized a gain on the sale (after the first quarter write-down) of \$183 thousand.

4. Stockholders Equity

Earnings per Share

The components of basic and diluted earnings per share were as follows:

	Three months ended June 30, 2007 (in thousands, except per share amounts)		Six months ended June 30, 2006	
	2007	2006	2007	2006
Net income (loss), as reported	\$ 29,706	(33,022)	58,433	(8,430)
Weighted average shares outstanding - basic	80,559	81,570	80,653	81,388
Dilutive potential shares from stock options and certain nonvested stock awards	1,764		1,908	
Weighted average shares outstanding - diluted	82,323	81,570	82,561	81,388
Earnings (loss) per share				
Basic	\$ 0.37	(0.40)	0.72	(0.10)
Diluted	\$ 0.36	(0.40)	0.71	(0.10)

Anti-dilutive Securities

Options to purchase 2.73 million shares of common stock were excluded from the dilutive earnings per share calculation for the three and six months ended June 30, 2007, because they were anti-dilutive. There were no anti-dilutive shares of nonvested stock for the three and six months ended June 30, 2007. Diluted loss per share is the same as basic loss per share for the three and six month periods ended June 30, 2006 as the impact of stock options and nonvested stock would have been anti-dilutive. Had the Company generated net income for the three and six months ended June 30, 2006, the number of diluted shares outstanding would have been 83,155 thousand shares and 83,043 thousand shares, respectively.

Dividends

On April 11, 2007, the Board of Directors (the Board) approved a dividend on our Class A common stock (common stock) in the amount of \$0.17 per share to stockholders of record as of July 9, 2007 to be paid on August 1, 2007. The total dividend to be paid is approximately \$14.2 million.

Common Stock Repurchases

The Board has authorized the repurchase of our common stock in the open market and/or private purchases. Our stock repurchase program does not have an expiration date or an aggregate maximum number or dollar value of shares that may be repurchased. The acquired shares may be used for corporate purposes, including shares issued to employees in our stock-based compensation programs. There were 205,000 shares and 1,670,000 shares repurchased in the open market for the three and six months ended June 30, 2007. No shares were repurchased during the three and six months ended June 30, 2006.

5. Share-Based Compensation

On April 2, 2007, we granted 833,976 shares of nonvested stock with a fair value of \$23.46 per share under the Company's 1998 Stock Incentive Plan, as amended and restated. The fair value of those shares at April 2, 2007, aggregating \$19.6 million, will be amortized to expense over the four year vesting period.

6. Goodwill and Identifiable Intangible Assets*Goodwill*

Goodwill represents the excess of the purchase price over the tangible assets and identifiable intangible assets of an acquired business. At June 30, 2007 and December 31, 2006, gross goodwill was \$212.0 million and accumulated amortization was \$38.6 million. Our goodwill is not deductible for tax purposes.

Goodwill is not amortized, but instead is reviewed annually and when events or circumstances occur which indicate that goodwill might be impaired. Impairment of goodwill is tested at the Company's reporting unit level. To determine fair value, our review process uses the income and market approaches. In performing the analysis, we use the best information available under the circumstances, including reasonable and supportable assumptions and projections. 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.

Based on our annual review of goodwill in the second quarter of fiscal 2006, in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, we recorded an impairment charge of \$20.0 million related to our subsidiary, Austin Calvert & Flavin (ACF). The goodwill impairment was not deductible for income tax purposes and as a result, no tax benefit was recognized for the goodwill impairment charge. ACF's remaining unamortized goodwill balance at June 30, 2007 and 2006 was \$7.2 million.

Identifiable Intangible Assets

Identifiable intangible assets (all considered indefinite lived) are summarized as follows:

	June 30, 2007 (in thousands)	December 31, 2006
Unamortized intangible assets:		
Mutual fund management advisory contracts.	\$ 38,699	38,699
Mutual fund subadvisory management contracts.	16,300	16,300
Total	\$ 54,999	54,999

7. Income Taxes

In June 2006, the Financial Accounting Standards Board issued FIN 48 to clarify certain aspects of accounting for uncertain tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold that a tax provision is required to meet before being recognized in the

financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted FIN 48 on January 1, 2007.

As of January 1, 2007, the Company had unrecognized tax benefits, including penalties and interest, of \$5.1 million (\$3.5 million net of federal benefit) that if recognized, would impact the Company's effective tax rate. As of June 30, 2007 the Company had unrecognized tax benefits, including penalties and interest, of \$7.0 million (\$4.8 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 sheet; unrecognized tax benefits that are expected to be settled within the next 12 months are included in income taxes payable. The Company had no cumulative effect of adopting FIN 48, and therefore, no adjustment was recorded to retained earnings upon such adoption.

The Company's historical accounting policy with respect to interest and penalties related to tax uncertainties has been to classify these amounts as income taxes, and the Company continued this classification upon the adoption of FIN 48. As of January 1, 2007, the total amount of accrued interest and penalties related to uncertain tax positions recognized in the consolidated balance sheet was \$1.9 million (\$1.3 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 six month period ended June 30, 2007 was \$416 thousand. The total amount of accrued penalties and interest related to uncertain tax positions at June 30, 2007 of \$2.4 million (\$1.8 million net of federal benefit) is included in the total unrecognized tax benefits described above.

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 2006 the Company settled four open tax years, 2000 through 2004, that were undergoing audit by the United States Internal Revenue Service. The 2005 and 2006 federal income tax returns are the only open tax years that remain subject to potential future audit. State income tax returns for all years after 2002 are subject to potential future audit by tax authorities in the Company's major state tax jurisdictions.

The Company is currently being audited in four state jurisdictions. It is reasonably possible that the Company will settle the audits in all four jurisdictions within the next 12-month period. It is estimated that the Company's FIN 48 liability could decrease by approximately \$2.4 million to \$3.0 million (\$1.4 million to \$2.0 million net of federal benefit) upon settlement of these audits. Such settlements are not anticipated to have a significant impact on the reported income.

8. 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 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.

The following table presents the components of net periodic pension and other postretirement costs related to these plans.

	Pension Benefits		Other Postretirement Benefits		Pension Benefits		Other Postretirement Benefits	
	Three months ended June 30, 2007	2006	Three months ended June 30, 2007	2006	Six months ended June 30, 2007	2006	Six months ended June 30, 2007	2006
	(in thousands)				(in thousands)			
Components of net periodic benefit cost:								
Service cost	\$ 1,489	1,238	73	75	2,859	2,723	146	150
Interest cost	1,448	1,158	61	52	2,745	2,374	122	104
Expected return on plan assets	(1,651)	(1,405)			(3,221)	(2,811)		
Actuarial loss (gain) amortization	295	163	(9)	(9)	404	417	(19)	(19)
Prior service costs amortization	109	109	9	5	218	218	19	12
Transition obligation amortization	2	1			3	3		
Total	\$ 1,692	1,264	134	123	3,008	2,924	268	247

We anticipate that our contribution to the Pension Plan for 2007 will range from \$5.0 to \$10.0 million. During the six month period ended June 30, 2007 we did not make a contribution to the Pension Plan.

9. 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.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Certain statements contained in this Quarterly Report on Form 10-Q constitute 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, including statements regarding our expectations, hopes, beliefs, intentions or strategies regarding the future. All statements, other than statements of historical fact included in this Form 10-Q regarding our financial position, business strategy and other plans and objectives for future operations are forward-looking statements. All forward-looking statements included in this Form 10-Q are based on information available to us on the date hereof, and we assume no obligation to update such forward-looking statements, whether as a result of new information, future events or otherwise. Although we believe that the assumptions and expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to have been correct or that we will take any actions that may presently be planned and neither us nor any other person will be responsible for the accuracy or completeness of any such forward-looking statements. Certain important factors that could cause actual results to differ materially from our expectations are disclosed in the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2006, which include, without limitation, the adverse effect from regulatory settlements, a decline in securities markets or a decline in our products performance, reduction of investment management fees, failure to renew investment management or subadvisory agreements, a decline in distribution sources, the unsuccessful implementation of new information systems, a change in the classification of our advisors as independent contractors, increased redemptions in funds with a high concentration of assets, adverse results of litigation and/or arbitration, acts of terrorism and/or war, competition, changes in government regulation, and availability and terms of capital. Should one or more of these risks materialize or should the underlying assumptions prove incorrect, actual results could differ materially from those forecasted or expected. All subsequent written or oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by such factors.

The information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in this Form 10-Q and the audited financial statements and notes thereto in our 2006 Annual Report on Form 10-K, as well as a more detailed explanation of risk factors at the end of this Item 2 under the heading entitled Forward Looking Information.

Overview

Our earnings and cash flows are heavily dependent on financial market conditions. Significant increases or decreases in the various securities markets, particularly United States equity markets, can have a material impact on our results of operations, financial condition and cash flows. We derive our revenues primarily from providing investment management, investment product underwriting and distribution, and shareholder services administration to the Funds and institutional and separately managed accounts. Investment management fees, a substantial source of our revenues, 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. Underwriting and distribution revenues, another substantial source of 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 product sales vary based on the type and amount sold. We operate our business through three distinct channels. Our retail products are distributed through our sales force of registered financial advisors (the Advisors channel) or through third-parties such as other broker/dealers, registered investment advisors (including the retirement advisors of the Legend group of subsidiaries (Legend)) and various retirement platforms (together with Legend, the Wholesale channel). We also market our investment advisory services to institutional investors, either directly or through consultants (the Institutional channel).

Recent Accounting Developments

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of SFAS No. 115*, (SFAS No. 159), which provides companies with an option to report select financial assets and liabilities at fair value. This statement also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective as of the beginning of the 2008 fiscal year. We are in the process of evaluating the impact that adoption of SFAS No. 159 will have on our results of operations and financial condition.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). This statement defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and accordingly, does not require any new fair value measurements. SFAS No. 157 is effective as of the beginning of the 2008 fiscal year. We are in the process of evaluating the impact that adoption of SFAS No. 157 will have on our results of operations and financial condition.

In June 2006, the Emerging Issues Task Force (the EITF) reached a consensus on EITF Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* (EITF 06-4) which requires the application of the provisions of Statement of Financial Accounting Standards No. 106, *Employers Accounting for Postretirement Benefits Other Than Pensions* (SFAS No. 106) to split-dollar life insurance arrangements. SFAS No. 106 would require the Company to recognize a liability for the discounted future benefit obligation that the Company will have to pay upon the death of the underlying insured employee. EITF 06-4 is effective as of the beginning of the 2008 fiscal year. We currently have certain policies subject to the provisions of this new pronouncement and are evaluating the impact the adoption of EITF 06-4 might have on our results of operations and financial condition.

Second Quarter Highlights

Highlights for the current quarter:

- Overall gross sales increased 21% to \$2.7 billion compared to the second quarter of 2006, driven by sales in our Wholesale channel.
- Total assets under management increased \$9.0 billion compared to the second quarter of 2006, due to a combination of organic growth and market action.
- Shareholder accounts exceeded 3.0 million at quarter-end.
- Sales of fee-based allocation products increased significantly during the quarter, to \$172 million, primarily driven by modified products introduced in April 2007.
- Our effective tax rate increased to 37.5% as a result of new state tax legislation passed during the quarter.

Additionally, we repurchased 205,000 shares of our Class A common stock (the common stock) in the open market during the quarter.

Results of Operations Three and Six Months Ended June 30, 2007 as Compared with Three and Six Months Ended June 30, 2006*Net Income*

	Three months ended		Six months ended	
	June 30,	June 30,	June 30,	June 30,
	2007	2006	2007	2006
	(in thousands, except per share amounts)			
Net Income	\$ 29,706	(33,022)	58,433	(8,430)
Earnings per share:				
Basic	\$ 0.37	(0.40)	0.72	(0.10)
Diluted	\$ 0.36	(0.40)	0.71	(0.10)

Net income for the second quarter of 2007 was \$29.7 million, or \$0.36 per diluted share, compared to a net loss of \$33.0 million, or \$0.40 per diluted share, for the same period in 2006. Net income for the six months ended June 30, 2007 was \$58.4 million, or \$0.71 per diluted share, compared to a net loss of \$8.4 million, or \$0.10 per diluted share, for the same period in 2006. The net losses in 2006 were primarily attributable to our settlement with the SEC, the New York Attorney General and the Kansas Securities Commission regarding market timing allegations that resulted in a charge of \$55 million, \$12 million of which represented non-deductible penalties. In addition, effective October 1, 2006, we instituted an annual \$5.0 million investment management fee waiver pursuant to the New York Attorney General settlement by adjusting management fee rates on certain funds. Net losses in 2006 were also impacted by a non-deductible goodwill impairment charge of \$20 million related to our subsidiary, Austin, Calvert & Flavin, Inc. (ACF) based on the negative impact of the continued decline in ACF's assets under management and diminished involvement of ACF's investment staff in mutual fund advisory responsibilities.

The following series of tables, including Average Assets Under Management and Changes in Assets Under Management, provide data that should be helpful in understanding the Company's business and should be referred to while reading the discussions that follow the tables.

Average Assets Under Management

The following tables provide information regarding the composition of our average assets under management by asset class and distribution channel.

	Second Quarter 2007			
	Advisors	Wholesale	Institutional	Total
	(in millions)			
Asset Class:				
Equity	\$ 26,633	12,786	6,908	\$ 46,327
Fixed Income	4,119	366	601	5,086
Money Market	977	55		1,032
Total	\$ 31,729	13,207	7,509	\$ 52,445

	Second Quarter 2006 Advisors (in millions)	Wholesale	Institutional	Total
Asset Class:				
Equity	\$ 23,870	8,271	7,147	\$ 39,288
Fixed Income	3,855	334	614	4,803
Money Market	735	63		798
Total	\$ 28,460	8,668	7,761	\$ 44,889

	Year to Date 2007 Advisors (in millions)	Wholesale	Institutional	Total
Asset Class:				
Equity	\$ 25,924	11,844	6,975	\$ 44,743
Fixed Income	4,080	365	616	5,061
Money Market	958	59		1,017
Total	\$ 30,962	12,268	7,591	\$ 50,821

	Year to Date 2006 Advisors (in millions)	Wholesale	Institutional	Total
Asset Class:				
Equity	\$ 23,719	7,723	7,269	\$ 38,711
Fixed Income	3,867	338	614	4,819
Money Market	724	59		783
Total	\$ 28,310	8,120	7,883	\$ 44,313

Change in Assets Under Management

The following tables summarize changes in our assets under management by distribution channel. All sales are net of commissions. The activity 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.

	Second Quarter 2007			
	Advisors	Wholesale	Institutional	Total
	(in millions)			
Beginning Assets	\$ 30,427	11,996	7,315	\$ 49,738
Sales (net of commissions)	866	1,703	137	2,706
Redemptions	(1,027)	(635)	(319)	(1,981)
Net Sales	(161)	1,068	(182)	725
Net Exchanges	(46)	45		(1)
Reinvested Dividends & Capital				
Gains	108	35	28	171
Net Flows	(99)	1,148	(154)	895
Market Appreciation	1,825	1,103	403	3,331
Ending Assets	\$ 32,153	14,247	7,564	\$ 53,964

	Second Quarter 2006			
	Advisors	Wholesale	Institutional	Total
	(in millions)			
Beginning Assets	\$ 28,630	8,227	7,995	\$ 44,852
Sales (net of commissions)	847	1,175	222	2,244
Redemptions	(810)	(505)	(369)	(1,684)
Net Sales	37	670	(147)	560
Net Exchanges	(40)	38		(2)
Reinvested Dividends & Capital				
Gains	112	25	30	167
Net Flows	109	733	(117)	725
Market Depreciation	(378)	(8)	(190)	(576)
Ending Assets	\$ 28,361	8,952	7,688	\$ 45,001

	Year to Date 2007 Advisors (in millions)	Wholesale	Institutional	Total
Beginning Assets	\$ 29,905	10,819	7,677	\$ 48,401
Sales (net of commissions)	1,649	3,003	490	5,142
Redemptions	(1,942)	(1,231)	(1,218)	(4,391)
Net Sales	(293)	1,772	(728)	751
Net Exchanges	(85)	82		(3)
Reinvested Dividends & Capital Gains	173	47	56	276
Net Flows	(205)	1,901	(672)	1,024
Market Appreciation	2,453	1,527	559	4,539
Ending Assets	\$ 32,153	14,247	7,564	\$ 53,964

	Year to Date 2006 Advisors (in millions)	Wholesale	Institutional	Total
Beginning Assets	\$ 27,188	6,729	7,946	\$ 41,863
Sales (net of commissions)	1,690	2,326	394	4,410
Redemptions	(1,659)	(853)	(819)	(3,331)
Net Sales	31	1,473	(425)	1,079
Net Exchanges	(104)	99		(5)
Reinvested Dividends & Capital Gains	160	35	59	254
Net Flows	87	1,607	(366)	1,328
Market Appreciation	1,086	617	107	1,810
Ending Assets	\$ 28,361	8,953	7,687	\$ 45,001

Total Revenues

Total revenues increased 11% to \$201.2 million and 10% to \$390.8 million for the three and six months ended June 30, 2007, respectively, compared to the same periods in 2006. Increases in both periods can be attributed to growth in average assets under management of 17% and 15% for the three and six months ended June 30, 2007, respectively, and an increase in gross sales of 21% and 17% for the three and six months ended June 30, 2007, respectively, compared to the same periods in the prior year.

	Three months ended			
	June 30,	June 30,	Variance	
	2007	2006	Percentage	
	(in thousands, except percentage data)			
Investment management fees	\$ 89,383	78,190	14	%
Underwriting and distribution fees	88,556	80,494	10	%
Shareholder service fees	23,347	22,627	3	%
Total revenues	\$ 201,286	181,311	11	%

	Six months ended			
	June 30,	June 30,	Variance	
	2007	2006	Percentage	
	(in thousands, except percentage data)			
Investment management fees	\$ 172,243	152,239	13	%
Underwriting and distribution fees	172,572	157,506	10	%
Shareholder service fees	45,970	44,636	3	%
Total revenues	\$ 390,785	354,381	10	%

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 \$11.2 million, or 14%, from last year's second quarter and \$20.0 million, or 13%, for the six month period ended June 30, 2007 compared to the same period in the prior year.

Revenues from investment management services provided to our retail mutual funds, which are distributed through the Advisors and Wholesale channels, were \$79.8 million for the quarter ended June 30, 2007. Revenues increased \$12.5 million, or 19%, compared to the second quarter of 2006, while the related retail average assets increased 21% to \$44.9 billion. For the six months ended June 30, 2007, revenues from investment management services provided to our retail mutual funds increased \$21.5 million, or 16%, to \$152.6 million compared to the first six months of 2006, while the related retail average assets increased 19% to \$43.2 billion. Investment management fee revenues increased less than the related retail average assets due to the decrease to management fee rates on certain funds, effective October 1, 2006, in compliance with our settlement with the New York Attorney General. This decrease in management fee rates will reduce management fees by approximately \$5.0 million annually. Retail sales in the second quarter of 2007 were \$2.6 billion, a 27% increase over sales in the second quarter of 2006 and were \$4.7 billion for the six months ended June 30, 2007, a 16% increase over the same period in 2006.

Institutional and separate account revenues were \$9.6 million for the quarter ended June 30, 2007, representing a decrease of \$1.3 million, or 12%, from last year's second quarter. The decrease was primarily due to a management fee rate decrease on certain institutional accounts. Year-to-date institutional and separate account revenues decreased 7% to \$19.6 million in 2007 compared to the same period in 2006 primarily due to a reduction in management fee revenues of \$900 thousand earned by ACF based on a decline in average assets of 35% over the same period.

Gross sales of subadvised funds were \$947 million for the three months ended June 30, 2007 compared to \$751 million for the second quarter of 2006 and remained level at \$1.6 billion for both the six months ended June 30, 2007 and June 30, 2006.

The long-term redemption rate (which excludes money market fund redemptions) in the Advisors channel was 10.0% in this year's second quarter and 9.9% year-to-date, compared to 8.9% in the second quarter of 2006 and 9.4% for the first six months of 2006. In the Wholesale channel, long-term redemption rates were lower in this year's second quarter, at 18.8%, compared to 23.1% in the second quarter last year due to growth in average assets under management, which was higher than the dollar value increase in redemptions. For the six months ended June 30, 2007, the Wholesale channel's long-term redemption rates also decreased to 19.8% compared to 20.8% for the comparable period in 2006. We expect the Advisors channel long-term redemption rate to remain lower than that of the Wholesale channel due to the personal and customized manner in which our financial advisors provide service to clients. The long-term redemption rate for our Institutional channel decreased to 17.0% for the second quarter of 2007 compared to 19.1% for the second quarter of 2006, and increased from 21.0% to 32.4% for the six month period ended June 30, 2007 compared to the same period in 2006. The higher redemption rate for the six months ended June 30, 2007, which is based on total redemptions for the period of \$1.2 billion in this channel, reflected redemptions across multiple investment disciplines, including large cap growth, small cap growth, core equity and international growth. During July 2007, we were notified that a large state pension and retirement fund intended to withdraw over \$300 million from our institutional large-cap core strategy. The redemption is a result of this fund's desire to shift more assets to indexed funds. ACF's redemptions were \$136 million for the first six months of 2007 compared to \$426 million for the same period in 2006.

Edgar Filing: WADDELL & REED FINANCIAL INC - Form 10-Q

Underwriting and Distribution Fee Revenues and Expenses

The following tables illustrate our underwriting and distribution fee revenues and expenses segregated by the method of distribution within the respective Advisors or Wholesale channel:

	Second Quarter 2007			
	Advisors (in thousands)	Wholesale Third-Party	Legend	Total
Revenue	\$ 57,839	15,609	15,108	\$ 88,556
Expenses				
Direct	40,173	20,025	10,165	70,363
Indirect	20,057	6,158	2,950	29,165
	60,230	26,183	13,115	99,528
Net Underwriting & Distribution	(\$2,391)	(10,574)	1,993	(\$10,972)

	Second Quarter 2006			
	Advisors (in thousands)	Wholesale Third-Party	Legend	Total
Revenue	\$ 57,724	9,468	13,302	\$ 80,494
Expenses				
Direct	40,736	12,708	8,992	62,436
Indirect	21,523	4,917	2,669	29,109
	62,259	17,625	11,661	91,545
Net Underwriting & Distribution	(\$4,535)	(8,157)	1,641	(\$11,051)

	Year to Date 2007			
	Advisors (in thousands)	Wholesale Third-Party	Legend	Total
Revenue	\$ 114,646	28,577	29,349	\$ 172,572
Expenses				
Direct	79,513	36,976	19,643	136,132
Indirect	40,832	11,159	5,802	57,793
	120,345	48,135	25,445	193,925
Net Underwriting & Distribution	(\$5,699)	(19,558)	3,904	(\$21,353)

	Year to Date 2006			
	Advisors (in thousands)	Wholesale Third-Party	Legend	Total
Revenue	\$ 114,004	17,377	26,125	\$ 157,506
Expenses				
Direct	79,204	23,799	17,646	120,649
Indirect	41,389	8,749	5,512	55,650
	120,593	32,548	23,158	176,299
Net Underwriting & Distribution	(\$6,589)	(15,171)	2,967	(\$18,793)

The following table illustrates commissionable investment product sales by our financial advisors, including sales of our InvestEd portfolios. Sales are shown gross of commissions and exclude sales by Legend retirement advisors, sales of money market funds, non-proprietary funds, insurance products, and mutual funds sold at net asset value for which we receive no commission.

	Second Quarter 2007 (in millions, except percentage data)	Second Quarter 2006	Variance Amount	Percentage
Front-end load sales	\$ 350	464	(114)	-25 %
Variable annuity products	103	84	19	23 %
Front-load product total	453	548	(95)	-17 %
Deferred-load sales	36	51	(15)	-29 %
Fee-based allocation products	172	16	156	975 %
Total advisor sales	\$ 661	615	46	7 %

	Year to Date 2007 (in millions, except percentage data)	Year to Date 2006	Variance Amount	Percentage
Front-end load sales	\$ 757	936	(179)	-19 %
Variable annuity products	177	147	30	20 %
Front-load product total	934	1,083	(149)	-14 %
Deferred-load sales	74	107	(33)	-31 %
Fee-based allocation products	201	29	172	593 %
Total advisor sales	\$ 1,209	1,219	(10)	-1 %

Underwriting and distribution revenues earned in this year's second quarter increased \$8.1 million, or 10%, compared with the second quarter of last year. The increase in revenues was due to higher 12b-1 asset based service and distribution fees of \$8.1 million as a result of an increase in average mutual fund assets under management. Higher advisory fees and 12b-1 service fee revenues earned by Legend drove a \$1.8 million revenue increase compared to last year as their assets under administration increased. These quarter over quarter increases were offset by an overall decrease of \$2.3 million related to revenue on front-load product sales sold in the Advisors channel, although variable annuity revenues increased \$1.4 million quarter over quarter. In April 2007, we introduced modified fee-based asset allocation products that

contributed to the decline in front-load product sales. Sales of these fee-based allocation products were \$172 million for the quarter. While we expect this shift from front-load to fee-based sales to put some short-term pressure on both the underwriting and distribution margin and the operating margin in the Advisors channel, the asset-based fee structure has better long-term margin characteristics.

Underwriting and distribution revenues earned for the six months ended June 30, 2007 increased \$15.1 million, or 10%, compared with the same period in the prior year. The increase in revenues was due to higher 12b-1 asset based service and distribution fees of \$15.7 million as a result of an increase in average mutual fund assets under management. Higher advisory fees, point of sale commissions and 12b-1 service fee revenues earned by Legend drove a \$3.2 million revenue increase compared to last year as their assets under administration increased. These increases were offset by an overall decrease of \$4.3 million related to revenue on front-load product sales sold in the Advisors channel, which included a \$2.4 million increase of variable annuity sales.

Underwriting and distribution expenses increased by \$8.0 million, or 9%, when compared with the second quarter of 2006. A majority of this increase was attributed to higher direct expenses (12b-1 asset based service and distribution expenses, dealer compensation paid to third party distributors and wholesaler commissions) in the Wholesale channel of \$8.5 million. These increased costs were a result of higher sales volume and an increase in average Wholesale channel assets under management. Indirect expenses remained unchanged quarter over quarter. The indirect expenses decrease of \$1.4 million in the Advisors channel was due to lower group health costs, and to a lesser extent, lower compensation and sales meeting costs. The indirect expenses increase of \$1.5 million in the Wholesale channel was driven by higher marketing, business travel and compensation costs.

Underwriting and distribution expenses for the six months ended June 30, 2007 increased by \$17.6 million, or 10%, when compared with the same period in 2006. A majority of this increase was attributed to higher direct expenses (12b-1 asset based service and distribution expenses, dealer compensation paid to third party distributors and wholesaler commissions) in the Wholesale channel of \$15.2 million. These increased costs were a result of higher sales volume and an increase in average Wholesale channel assets under management. Indirect expenses contributed \$2.1 million to the overall increase in expenses for the six months ended June 30, 2007 compared to the prior year. The indirect expenses increase of \$2.7 million in the Wholesale channel was due to higher costs for marketing, business travel and compensation. The indirect expenses decrease of \$0.6 million in the Advisors channel was due to lower group health costs, offset by increased compensation costs in the channel.

Shareholder Service Fees Revenue

Shareholder service fee revenues for the quarter from transfer agency fees, custodian fees from retirement plan accounts, and portfolio accounting and administration fees increased 3% over the second quarter of 2006 compared to an 8% increase in the average number of accounts. For the six months ended June 30, 2007, shareholder service fee revenues increased 3% over the same period in the prior year compared to a 9% increase in the average number of accounts. Effective September 1, 2006, our servicing contract with the Funds was renegotiated resulting in reduced fees received by us for servicing wholesale accounts. Historically our account growth has mirrored our growth in revenue; however, with this reduced fee structure for wholesale accounts, our future revenue growth will not necessarily be tied to overall account growth. A portion of the fee reduction for wholesale accounts was offset by negotiating a networking fee reimbursement with the Funds for amounts paid to third party broker/dealers.

Compensation and Related Costs

On April 2, 2007, we granted 833,976 shares of nonvested stock with a fair value of \$23.46 per share under the Company's 1998 Stock Incentive Plan, as amended and restated. The value of those shares, aggregating \$19.6 million, will be amortized to expense over a four year vesting period.

In the second quarter of 2007, compensation and related costs increased \$1.2 million compared to the second quarter of 2006. The second quarter of 2007 reflects higher salaries, wages and related payroll taxes of \$800 thousand based on increased headcount, higher incentive compensation accruals of \$400 thousand and higher pension costs of \$400 thousand based on finalized census data which reflected higher than expected salary increases, offset by lower group insurance costs due to favorable experience in claims activity. Share-based compensation increased \$600 thousand quarter over quarter, primarily due to nonvested stock grants in December 2006 and April 2007 and higher share-based compensation from non-employee advisor stock awards. Non-employee stock awards are adjusted to market each period based on the fluctuation in our share price.

Compensation and related costs for the six months ended June 30, 2007 decreased \$800 thousand compared to the same period in 2006. The first six months of 2007 reflects lower group insurance costs of \$800 thousand due to favorable experience in claims activity, increased capitalization of software development activities of \$500 thousand, and lower incentive compensation accruals of \$500 thousand, offset by higher salaries, wages and related payroll taxes of \$1.0 million based on increased headcount. Share-based compensation for the two periods was unchanged; however, 2007 included share-based compensation charges for nonvested stock grants in December 2006 and April 2007, while 2006 included share-based compensation charges of \$1.5 million at ACF for employee separation costs in response to a decline in investment performance and related loss of assets under management and a credit of \$0.5 million related to a cumulative change in accounting principle upon adoption of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*, (revised 2004) .

General and Administrative Costs

General and administrative expenses decreased to \$11.8 million for the second quarter of 2007 compared to \$65.0 million for the second quarter in the prior year and decreased to \$21.9 million for the six months ended June 30, 2007 compared to \$75.2 million for the same period in 2006. The second quarter of 2006 included a \$55.0 million charge for the settlement with the SEC and state regulators. Excluding this charge, general and administrative expenses increased \$1.8 million for the quarter compared to the prior year and increased \$1.7 million for the six months ended June 30, 2007 compared to the prior year. The increase for the second quarter compared to the prior year is primarily due to increased fund related compliance and reporting expenses associated with the New York Attorney General settlement. The increase for the six month period ended June 30, 2007 compared to the prior year is due to increased fund related compliance and reporting expenses, offset by lower legal expenses and the effect of a networking fee reimbursement with the Funds for amounts paid to third party broker/dealers, effective September 1, 2006, as further described in the Shareholder Service Fee Revenues section above.

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. The growth trend in the sales of our own managed products should help to improve our future operating margin. Subadvisory expenses increased \$3.0 million this quarter compared to last year's second quarter. For the six months ended June 30, 2007, subadvisory expenses increased \$5.7 million compared to the same period in the prior year. Significant sales growth in our Wholesale channel, particularly sales of our subadvised specialty mutual fund products, has driven these increased expenses. As this expense is a function of sales, redemptions and market action for subadvised assets, a continuation of the growth trend of these assets would likely result in future increases to subadvisory expenses.

Other Income and Expenses

Investment and Other Income, Interest Expense and Taxes

Investment and other income increased 22% from last year's second quarter to \$2.6 million for the second quarter of 2007 primarily due to higher gains of \$564 thousand from mutual funds in the trading portfolio and increased interest earned on cash balances of \$337 thousand in the current year's second quarter, offset by interest earned on tax refunds of \$278 thousand in 2006. For the six months ended June 30, 2007, investment and other income increased 15% to \$5.1 million compared to the same period in the prior year. Interest earned on cash balances of \$616 thousand in the first six months of 2007 and higher earnings of \$437 thousand from mutual funds in the trading portfolio compared to 2006, as well as a \$750 thousand write-down for an other-than-temporary decline in the fair value of a municipal bond investment in 2006 were offset by gains from the sale of available-for-sale securities of \$1.0 million in 2006 and interest earned on tax refunds of \$278 thousand in 2006.

Interest expense was \$3.0 million for the second quarter of both 2007 and 2006. Interest expense for the six months ended June 30, 2007 decreased 4% to \$6.0 million compared to the same period in the prior year primarily due to refinancing our senior notes in January 2006 at a lower effective interest rate.

Our effective tax rate was 37.5% for the second quarter of 2007 and 37.1% for the six months ended June 30, 2007. The increase to our effective tax rate in the second quarter of 2007 resulted from new state tax legislation passed during the quarter that requires the Company to file future returns in this state tax jurisdiction on a combined basis. In addition, the filing of amended state returns to report changes made to federal taxable income upon settlement of federal examinations, as well as refinement of positions taken for tax years currently under state audit also impacted the Company's state tax rate. The impact of these increases was somewhat offset by state tax incentives the Company qualified for in this same period. The Company expects its future effective tax rate, exclusive of any state tax incentives and the impact of state tax audit settlements, to range from 36.7% to 37.3%.

The higher effective tax rate in 2006 reflects the impact of non-deductible charges recorded in connection with a portion of the settlement of litigation with the SEC and state regulators and a non-deductible goodwill impairment charge for ACF.

Liquidity and Capital Resources

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

- Finance internal growth
- Pay dividends
- Repurchase our common 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, payment to our distribution partners, and commissions to third parties on deferred load product sales. The growth we have experienced in our Wholesale channel also requires that we add additional resources and infrastructure to manage this growth. We also continue to invest in our Advisors channel by providing additional support to our advisors through training, wholesaling efforts and enhanced technology tools.

Pay Dividends

We paid quarterly dividends on our common stock of \$.17 per share, which resulted in financing cash outflows of \$27.0 million for the first six months of 2007.

Repurchase Our Common Stock

We repurchased 1,670,000 shares of our common stock in the first six months of 2007.

Operating Cash Flows

Cash from operations is our primary source of funds and decreased \$5.1 million for the six months ended June 30, 2007 compared to the previous year.

We anticipate that the 2007 contribution to our Pension Plan will be made from cash generated from operations and will be in the range of \$5.0 to \$10.0 million.

Investing Cash Flows

Investing activities in the first six months of 2007 consisted of purchases of available-for-sale investment securities and additions to property and equipment for the purchase of leasehold improvements and computer software, and capitalization of software development costs during the period. In the first six months of 2006 proceeds from the sale or maturity of available-for-sale investment securities were offset by purchases of available-for-sale investment securities and capital expenditures, mainly for data processing equipment, computer software and software development.

Financing Cash Flows

As noted previously, dividends and stock repurchases accounted for a majority of our financing cash outflows in the first six months of 2007. We did not repurchase any of our common stock in the first six months of 2006.

On January 13, 2006, we issued \$200 million in principal amount 5.60% senior notes due 2011 resulting in net proceeds of approximately \$198.2 million (net of discounts, commissions and estimated expenses). We used the net proceeds, together with cash on hand, to repay the entire \$200 million aggregate principal amount outstanding of our 7.50% senior notes due January 18, 2006. The notes represent senior unsecured obligations and are rated Baa2 by Moody's and BBB by Standard & Poor's. Interest is payable semi-annually on January 15 and July 15 at a rate of 5.60% per annum. The Company, at its option, may call these notes at any time pursuant to a make whole redemption provision, which would compensate holders for any changes in interest rate levels of the notes upon early extinguishment. The Company currently has no intention to call these notes.

In 2005, we entered into a three year revolving credit facility with various lenders, which initially provides for borrowings of up to \$200 million. Borrowings under the credit facility bear interest at various rates including adjusted LIBOR or an alternate 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 daily aggregate amount of commitment under the revolving facility (whether or not utilized). The facility fee is also based on the Company's credit rating level. The credit facility contains financial covenants with respect to leverage and interest coverage, both of which we were in compliance with through the second quarter of 2007. At June 30, 2007, there were no borrowings outstanding under the credit facility.

Future Capital Requirements

We expect significant uses of cash in 2007 to include expected dividend payments, interest payments on outstanding debt, share repurchases, payment of deferred commissions to our financial advisors and third parties, capital expenditures, pension funding and home office leasehold improvements and could include

strategic acquisitions. Management believes its available cash, marketable securities, and expected cash flow from operations will be sufficient to fund its operating and capital requirements for 2007. We may continue to repurchase shares of our common stock from time to time, as management deems appropriate. Share repurchases should be financed by our available cash and investments and/or cash from operations.

Long-term capital requirements could include capital expenditures for enhancement of technology infrastructure and home office improvements, strategic acquisitions, payment of dividends, seed money for new products, payment of upfront fund commissions for fee-based products, Class B shares and Class C shares and repurchases of our common stock.

Critical Accounting Policies and Estimates

Management believes certain critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements. Due to the implementation of Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48), we modified our critical accounting policy related to accounting for income taxes, which is listed below. The Company's other critical accounting policies and estimates are disclosed in the Critical Accounting Policies and Estimates section of our 2006 Form 10-K.

In June 2006, the Financial Accounting Standards Board issued FIN 48 to clarify certain aspects of accounting for uncertain tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold that a tax provision is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted FIN 48 on January 1, 2007.

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 FIN 48. 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 bases. 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.

Supplemental Information

Edgar Filing: WADDELL & REED FINANCIAL INC - Form 10-Q

	Second Quarter 2007	Second Quarter 2006	Change		Year to Date 2007	Year to Date 2006	Change
Redemption rates - long term (annualized)							
Advisors	10.0	% 8.9	%		9.9	% 9.4	%
Wholesale	18.8	% 23.1	%		19.8	% 20.8	%
Institutional	17.0	% 19.1	%		32.4	% 21.0	%
Total	13.3	% 13.4	%		15.8	% 13.6	%
Sales per advisor (000 \$)(1)							
Total	305	269	13.4	%	557	527	5.7
2+ Years (2)	434	396	9.6	%	799	784	1.9
0 to 2 Years (3)	102	83	22.9	%	167	145	15.2
Gross production per advisor (000 \$)							
Total	15.9	15.9	0.0	%	32.0	31.8	0.6
Number of financial advisors (1)							
Total	2,175	2,273	-4.3	%	2,175	2,273	-4.3
Average number of financial advisors (1)							
Total	2,166	2,284	-5.2	%	2,170	2,313	-6.2
Number of shareholder accounts (000 \$)							
Total	3,047	2,833	7.6	%	3,047	2,833	7.6
Number of shareholders							
Total	687,625	651,542	5.5	%	687,625	651,542	5.5

- (1) Excludes Legend retirement advisors
- (2) Financial advisors licensed with the Company for two or more years
- (3) Financial advisors licensed with the Company less than two years

Forward Looking Information

From time-to-time, information or statements provided by or on behalf of the Company, including those within this Quarterly Report on Form 10-Q may contain certain forward-looking information, including information relating to anticipated growth in our revenues or earnings, anticipated changes in the amount and composition of assets under management, our anticipated expense levels, and our expectations regarding financial markets and other conditions. Readers are cautioned that any forward-looking information provided by or on behalf of the Company is not a guarantee of future performance. Actual results may differ materially from those contained in these forward-looking statements as a result of various factors, including but not limited to those discussed below. Further, such forward-looking statements speak only as of the date on which such statements are made, and the Company undertakes no obligation to update or revise any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events, whether as a result of new information, future developments or otherwise.

Our future revenues will fluctuate due to many factors, such as the total value and composition of assets under our management and related cash inflows or outflows in the Funds and other investment portfolios; fluctuations in national and worldwide financial markets resulting in appreciation or depreciation of assets under our management; the relative investment performance of the Funds and other investment portfolios as compared to competing offerings; the expense ratios of the Funds; investor sentiment and investor confidence; the ability to maintain our investment management and administrative fees at current levels; competitive conditions in the mutual fund, asset management, and broader financial services sectors; our introduction of new mutual funds and investment portfolios; our ability to contract with the Funds for

payment for investment advisory-related administrative services provided to the Funds and their shareholders; the continuation of trends in the retirement plan marketplace favoring defined contribution plans and participant-directed investments; potential misuse of client funds and information in the possession of our financial advisors; and the development of additional distribution channels may not be successful. Our revenues are substantially dependent on fees earned under contracts with the Funds and could be adversely affected if the independent directors of one or more of the Funds determined to terminate or significantly alter the terms of the investment management or related administrative services agreements.

Our future operating results are also dependent upon the level of our operating expenses, which are subject to fluctuation for the following or other reasons: variations in the level of compensation expense due to, among other things, performance-based bonuses, changes in our employee count and mix, and competitive factors; unanticipated costs that may be incurred to protect investor accounts and the goodwill of our clients; legal expenses; and disruptions of services, including those provided by third parties such as communications, power and the mutual fund transfer agent system. In addition, our future operating results may also be impacted by our ability to incur additional debt, by adverse litigation and/or arbitration judgments or settlements, failure to retain key personnel and financial advisors, regulatory enforcement exams, actions or settlements and acts of terrorism and/or war. The Company's business is also subject to substantial governmental regulation, and changes in legal, regulatory, accounting, tax and compliance requirements may have a substantial effect on our operations and results, including, but not limited to, effects on costs we incur and effects on investor interest in mutual funds and investing in general or in particular classes of mutual funds or other investments.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company has had no significant changes in its Quantitative and Qualitative Disclosures About Market Risk from that previously reported in the Company's 2006 Form 10-K.

Item 4. 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 Rule 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 quarterly 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.

The Company's internal control over financial reporting (as defined in Exchange Act Rule 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. However, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

Part II. Other Information**Item 1. 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.

Item 1A. Risk Factors

The Company has had no significant changes to its Risk Factors from those previously reported in the Company's 2006

Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table sets forth certain information about the shares of common stock we repurchased during the second quarter of 2007.

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Program
April 1 - April 30	338,134	\$ 23.85	338,134	n/a(1)
May 1 - May 31	50,000	24.23	50,000	n/a(1)
June 1 - June 30	12,451	26.42	12,451	n/a(1)
Total	400,585	\$ 23.98	400,585	

(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 such as POSIT, during regular or after-hours trading sessions. POSIT is an alternative trading system that uses passive pricing to anonymously match buy and sell orders. To date, we have not used electronic communication networks or alternative trading systems to repurchase any of our common stock and do not intend to use such networks or systems in the foreseeable future. Our stock repurchase program does not have an expiration date or an aggregate maximum number or dollar value of shares that may be repurchased. During the second quarter of 2007, all stock repurchases were made pursuant to this repurchase program including 195,585 shares that were purchased in connection with funding employee income tax withholding obligations arising from the vesting of nonvested shares.

Item 4. Submission of Matters to a Vote of Security Holders

(a) Annual Meeting of Stockholders held on April 11, 2007.

(b) Directors re-elected to additional three year terms at the Annual Meeting:

Henry J. Herrmann, James M. Raines and William L. Rogers

Other Directors whose terms of office continued after the Annual Meeting:

Alan W. Kosloff, Dennis E. Logue, Ronald C. Reimer and Jerry W. Walton

(c)(1) - <u>Election of Directors</u>	- <u>For</u>	- <u>Withheld</u>
Henry J. Herrmann	72,351,491	812,679
James M. Raines	72,337,777	826,393
William L. Rogers	71,703,519	1,460,651

No broker non-votes on this proposal.

(2) Approval of Amendment to the 1998 Stock Incentive Plan, As Amended and Restated The amendment was submitted to stockholders for approval to eliminate (i) the Company's ability to grant incentive stock options under the plan, (ii) the ten-year term of the plan, which was scheduled to expire on March 1, 2008, and (iii) the Company's ability to add back to the pool of shares reserved for issuance under the plan any shares of the Company's common stock that are tendered in payment of the exercise price and applicable taxes and commissions in exercising an option under the Stock Option Restoration Program.

For	Against	Abstain	Broker Non-Votes
42,424,402	23,947,474	589,816	6,202,478

(3) Ratify Appointment of KPMG LLP as independent auditors for 2007

For	Against	Abstain
70,509,675	2,567,418	87,077

No broker non-votes on this proposal.

Item 6. Exhibits

3.1 Amended and Restated Bylaws of Waddell & Reed Financial, Inc. Filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed on July 17, 2007 and incorporated here by reference.

10.1 Waddell & Reed Financial, Inc. 1998 Stock Incentive Plan, as Amended and Restated.

31.1 Section 302 Certification of Chief Executive Officer

31.2 Section 302 Certification of Chief Financial Officer

32.1 Section 906 Certification of Chief Executive Officer

32.2 Section 906 Certification of Chief Financial Officer

33

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 24th day of July 2007.

WADDELL & REED FINANCIAL, INC.

By: /s/ Henry J. Herrmann
Chief Executive Officer
(Principal Executive Officer)

By: /s/ Daniel P. Connealy
Senior Vice President
and Chief Financial Officer
(Principal Financial Officer)

By: /s/ Brent K. Bloss
Senior Vice President-Finance
and Treasurer
(Principal Accounting Officer)