

PRICE T ROWE GROUP INC

Form 10-Q

October 25, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2006

Commission File Number: 000-32191

T. ROWE PRICE GROUP, INC.

(Exact name of registrant as specified in its charter)

Maryland

52-2264646

(State of incorporation)

(I.R.S. Employer Identification No.)

100 East Pratt Street, Baltimore, Maryland 21202

(Address, including Zip Code, of principal executive offices)

(410) 345-2000

(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 of the Securities Exchange Act of 1934 during the preceding 12 months, 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 (based on definitions in Rule 12b-2 of the Exchange Act).

Large accelerated filer **Accelerated filer** **Non-accelerated filer**

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

The number of shares outstanding of the issuer's common stock (\$.20 par value), as of the latest practicable date, October 23, 2006, is **263,636,860**.

The exhibit index is at Item 6 on page 13.

PART I FINANCIAL INFORMATION**Item 1. Financial Statements.**

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	12/31/2005	9/30/2006
ASSETS		
Cash and cash equivalents	\$ 803,589	\$ 876,208
Accounts receivable and accrued revenue	175,030	196,863
Investments in sponsored mutual funds	264,238	404,980
Debt securities held by savings bank subsidiary	114,837	121,964
Property and equipment	214,790	250,969
Goodwill and other intangible assets	665,692	668,980
Other assets	72,370	135,743
Total assets	\$ 2,310,546	\$ 2,655,707
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities		
Accounts payable and accrued expenses	\$ 78,190	\$ 74,093
Accrued compensation and related costs	55,555	167,074
Dividends payable	36,870	36,879
Customer deposits at savings bank subsidiary	103,829	111,174
Total liabilities	274,444	389,220
Commitments and contingent liabilities		
Stockholders equity		
Preferred stock, undesignated, \$.20 par value-authorized and unissued 20,000,000 shares		
Common stock, \$.20 par value-authorized 500,000,000 shares; issued 131,678,371 shares in 2005 and 263,464,234 shares in 2006	26,336	52,693
Additional capital in excess of par value	279,680	203,899
Retained earnings	1,683,273	1,953,093
Accumulated other comprehensive income	48,544	56,802
Deferred stock-based compensation expense	(1,731)	
Total stockholders equity	2,036,102	2,266,487
	\$ 2,310,546	\$ 2,655,707

See the accompanying notes to these unaudited condensed consolidated financial statements.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per-share amounts)

	Three months ended		Nine months ended	
	9/30/2005	9/30/2006	9/30/2005	9/30/2006
Revenues				
Investment advisory fees	\$ 319,967	\$ 375,223	\$ 904,501	\$ 1,098,877
Administrative fees and other income	68,561	75,140	204,397	226,268
Investment income of savings bank subsidiary	1,077	1,388	3,126	3,943
Total revenues	389,605	451,751	1,112,024	1,329,088
Interest expense on savings bank deposits	902	1,123	2,704	3,144
Net revenues	388,703	450,628	1,109,320	1,325,944
Operating expenses				
Compensation and related costs	132,011	168,750	389,276	494,469
Advertising and promotion	15,394	17,464	57,688	66,514
Depreciation and amortization of property and equipment	10,795	11,088	31,069	33,164
Occupancy and facility costs	18,646	20,843	55,131	60,701
Other operating expenses	32,005	31,964	93,502	99,134
	208,851	250,109	626,666	753,982
Net operating income	179,852	200,519	482,654	571,962
Other investment income	4,464	17,007	12,041	48,336
Credit facility expenses	95		286	280
Net non-operating income	4,369	17,007	11,755	48,056
Income before income taxes	184,221	217,526	494,409	620,018
Provision for income taxes	67,886	89,336	181,028	239,423
Net income	\$ 116,335	\$ 128,190	\$ 313,381	\$ 380,595
Earnings per share				
Basic	\$.45	\$.49	\$ 1.21	\$ 1.44
Diluted	\$.43	\$.46	\$ 1.15	\$ 1.37
Dividends declared per share	\$.115	\$.14	\$.345	\$.42

Weighted average shares Outstanding	260,012	262,343	260,056	263,707
Outstanding assuming dilution	272,865	277,630	272,591	278,424

See the accompanying notes to these unaudited condensed consolidated financial statements.

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UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine months ended	
	9/30/2005	9/30/2006
Cash flows from operating activities		
Net income	\$ 313,381	\$ 380,595
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization of property and equipment	31,069	33,164
Stock-based compensation expense		45,113
Intangible asset amortization		205
Other changes in assets and liabilities	131,510	65,240
Net cash provided by operating activities	475,960	524,317
Cash flows from investing activities		
Investments in sponsored mutual funds	(31,120)	(136,292)
Dispositions of sponsored mutual funds	2,734	14,154
Debt securities held by savings bank subsidiary	205	(7,049)
Other investments made	(1,480)	(53,119)
Additions to property and equipment	(38,860)	(69,107)
Other activity	1,757	(3,355)
Net cash used in investing activities	(66,764)	(254,768)
Cash flows from financing activities		
Repurchases of common stock	(75,853)	(170,968)
Stock options exercised	28,838	77,460
Dividends paid to stockholders	(89,577)	(110,767)
Change in savings bank subsidiary deposits	20	7,345
Net cash used in financing activities	(136,572)	(196,930)
Cash and cash equivalents		
Net increase during period	272,624	72,619
At beginning of year	499,750	803,589
At end of period	\$ 772,374	\$ 876,208

See the accompanying notes to these unaudited condensed consolidated financial statements.

UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(dollars in thousands)

	Common stock	Additional capital in excess of par value	Retained earnings	Accumulated other comprehensive income	Deferred stock- based compensation expense	Total stockholders' equity
Balances at December 31, 2005, 131,678,371 common shares	\$ 26,336	\$ 279,680	\$ 1,683,273	\$ 48,544	\$ (1,731)	\$ 2,036,102
Reclassification arising from adoption of SFAS 123R		(1,731)			1,731	
1,402,915 common shares issued upon option exercises under stock-based compensation plans	281	49,672				49,953
1,000 restricted common shares forfeited		(24)	1			(23)
1,533,076 common shares repurchased	(307)	(117,385)				(117,692)
131,547,210 common shares issued in two-for-one split	26,309	(26,309)				
	52,619	183,903	1,683,274	48,544		1,968,340
Common shares issued under stock-based compensation plans						
4,000 restricted common shares	1	(1)				
1,800,814 common shares upon option exercises	360	27,849				28,209
1,435,000 common shares repurchased	(287)	(52,989)				(53,276)
Comprehensive income						
Net income			380,595			
Change in unrealized security holding gains, net of taxes, including \$4,328 in the third quarter				8,258		
						388,853

Total comprehensive income						
Stock-based compensation expense		45,137				45,137
Dividends declared			(110,776)			(110,776)
Balances at September 30, 2006, 263,464,234 common shares	\$ 52,693	\$ 203,899	\$ 1,953,093	\$ 56,802	\$	\$ 2,266,487

See the accompanying notes to these unaudited condensed consolidated financial statements.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 THE COMPANY AND BASIS OF PREPARATION.

T. Rowe Price Group derives its consolidated revenues and net income primarily from investment advisory services that its subsidiaries provide to individual and institutional investors in the sponsored T. Rowe Price mutual funds and other investment portfolios. We also provide our investment advisory clients with related administrative services, including mutual fund transfer agent, accounting and shareholder services; participant recordkeeping and transfer agent services for defined contribution retirement plans; discount brokerage; and trust services. The investors that we serve are primarily domiciled in the United States of America.

Investment advisory revenues depend largely on the total value and composition of assets under our management. Accordingly, fluctuations in financial markets and in the composition of assets under management impact our revenues and results of operations.

These unaudited condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and reflect all adjustments which are, in the opinion of management, necessary to a fair statement of our results for the interim periods presented. All such adjustments are of a normal recurring nature.

The unaudited interim financial information contained in these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements contained in our 2005 Annual Report.

NOTE 2 OTHER INTANGIBLE ASSETS.

On June 19, 2006, we completed two transactions involving the merger of \$615 million from the Preferred Group of Mutual Funds into ten of the T. Rowe Price mutual funds and the acquisition of \$115 million in separate accounts. We paid \$3.5 million as part of these transactions and recognized two related intangible assets that are being amortized on a straight-line basis over 8 years for the mutual fund customer relationships acquired and over 2.5 years for the separate account customer relationships acquired.

NOTE 3 OTHER ASSETS.

During the second and third quarters of 2006, we invested in \$50 million of U.S. Treasury Notes that will yield 4.9 5.2% and mature over the period of April 2008 through July 2011. These investments are accounted for as held-to-maturity securities and are included in our balance sheet in other assets. Our carrying amount at September 30, 2006 totals \$50.5 million representing the amortized cost of the notes and accrued interest thereon.

NOTE 4 COMMON STOCK SPLIT.

At the close of business on June 23, 2006, we effected a two-for-one split of our common stock by issuing additional \$.20 par value shares. Accordingly, the par value of the additional shares issued has been reclassified among our stockholders' equity accounts in the accompanying unaudited condensed consolidated statement of stockholders' equity. All per-share and share data in the accompanying unaudited condensed consolidated statements of income and in these accompanying notes has been adjusted to give retroactive effect to this stock split.

NOTE 5 INFORMATION ABOUT REVENUES AND SERVICES.

Revenues (in thousands) from advisory services provided under agreements with sponsored mutual funds and other investment clients for the interim periods ended September 30 include:

	Three months ended		Nine months ended	
	9/30/2005	9/30/2006	9/30/2005	9/30/2006
Sponsored mutual funds in the U.S.				
Stock and balanced	\$ 198,379	\$ 230,954	\$ 551,026	\$ 685,990
Bond and money market	36,246	39,800	105,926	114,104
	234,625	270,754	656,952	800,094
Other portfolios	85,342	104,469	247,549	298,783
Total investment advisory fees	\$ 319,967	\$ 375,223	\$ 904,501	\$ 1,098,877

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The following tables summarize the various investment portfolios and assets under management (in billions) on which advisory fees are earned.

	Average during the third quarter		Average during the first nine months	
	2005	2006	2005	2006
Sponsored mutual funds in the U.S.				
Stock and balanced	\$ 129.0	\$ 149.0	\$ 120.9	\$ 148.6
Bond and money market	32.6	35.4	32.0	34.3
	161.6	184.4	152.9	182.9
Other portfolios	92.5	113.5	89.7	108.5
	\$ 254.1	\$ 297.9	\$ 242.6	\$ 291.4

	12/31/2005	9/30/2006
Sponsored mutual funds in the U.S.		
Stock and balanced	\$ 137.7	\$ 154.7
Bond and money market	32.5	36.1
	170.2	190.8
Other portfolios	99.3	117.3
	\$ 269.5	\$ 308.1

Fees for advisory-related administrative services provided to our sponsored mutual funds were \$155,924,000 and \$177,133,000 for the first nine months of 2005 and 2006, respectively. Accounts receivable from the mutual funds aggregate \$104,537,000 at December 31, 2005 and \$109,328,000 at September 30, 2006.

NOTE 6 STOCK-BASED COMPENSATION.

On January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards No. 123R, *Share-Based Payment* (SFAS 123R), and began recognizing stock option-based compensation expense in our consolidated statement of income using the fair value based method applied on a modified prospective basis. Accordingly, financial statements for periods prior to 2006 have not been restated.

The following table compares our interim net income (in thousands) and earnings per share for 2006 with the pro forma interim 2005 results as if we applied the fair value based method last year.

	Three months ended		Nine months ended	
	9/30/2005	9/30/2006	9/30/2005	9/30/2006
Net income, as reported	\$ 116,335	\$ 128,190	\$ 313,381	\$ 380,595
Additional stock-option based compensation expense estimated using the fair value based method	(13,428)		(40,462)	
Related income tax benefits	4,359		13,077	
Pro forma net income	\$ 107,266	\$ 128,190	\$ 285,996	\$ 380,595
Earnings per share				
Basic as reported	\$ 0.45	\$ 0.49	\$ 1.21	\$ 1.44
Basic pro forma	\$ 0.41	\$ 0.49	\$ 1.10	\$ 1.44
Diluted as reported	\$ 0.43	\$ 0.46	\$ 1.15	\$ 1.37
Diluted pro forma	\$ 0.39	\$ 0.46	\$ 1.05	\$ 1.37

Net income for the 2006 periods includes stock-based compensation expense of \$15,568,000 for the third quarter and \$45,113,000 for the first nine months. Reload grants made during the same periods accounted for \$2,389,000 and \$5,585,000, respectively, of the expense recognized. Financing cash inflows from stock option exercises in the first nine months of 2006 include \$53,140,000 of tax benefits arising from related tax deductions that reduce the amount of income taxes that would otherwise be payable.

The following table summarizes the status of and changes in our stock option grants during the first nine months of 2006.

	Options	Weighted-average exercise price	Options exercisable	Weighted-average exercise price
Outstanding at December 31, 2005	45,896,848	\$ 21.42	26,979,048	\$ 18.13
Reload grants	941,161	40.60		
Other grants	110,000	40.16		
Exercised	(6,628,501)	16.20		
Forfeited or cancelled	(380,800)	26.77		

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Outstanding at September 30, 2006	39,938,708	\$ 22.74	23,875,708	\$ 19.06
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The following table presents the future stock-based compensation expense (in thousands) expected to be recognized over the vesting period of the 16,063,000 nonvested options and 65,000 restricted shares outstanding at September 30, 2006.

Fourth quarter 2006	\$ 9,875
2007	28,489
2008 through 2011	24,613
Total	\$ 62,977

Estimated future compensation expense will change to reflect future option grants including reloads, future share awards, changes in estimated forfeitures, and adjustments for actual forfeitures.

NOTE 7 CREDIT FACILITY.

On May 30, 2006, we voluntarily terminated our \$300 million syndicated credit facility that was to expire in June 2007.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

T. Rowe Price Group, Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of T. Rowe Price Group, Inc. and subsidiaries as of September 30, 2006, the related condensed consolidated statements of income for the three- and nine-month periods ended September 30, 2005 and 2006, the related condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2005 and 2006, and the related condensed consolidated statement of stockholders' equity for the nine-month period ended September 30, 2006. These condensed consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole.

Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of T. Rowe Price Group, Inc. and subsidiaries as of December 31, 2005, and the related consolidated statements of income, cash flows, and stockholders' equity for the year then ended (not presented herein); and in our report dated February 9, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2005, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Baltimore, Maryland

October 24, 2006

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

GENERAL.

Our revenues and net income are derived primarily from investment advisory services provided to individual and institutional investors in our sponsored mutual funds and other managed investment portfolios. Investment advisory revenues depend largely on the total value and composition of assets under our management. Accordingly, fluctuations in financial markets and in the composition of assets under management impact our revenues and results of operations. Investment advisory clients outside the United States account for more than 6% of our assets under management at September 30, 2006.

Equity markets in the United States entered the third quarter of 2006 in an unsettled environment after posting mixed results during the first half of the year when the NASDAQ, which is heavily weighted with technology companies, was down 1.5%, the blue-chip Dow Industrials were up 4%, and the broad S&P 500 was up less than 2%. July proved quite disappointing as even the favorable outcomes for the first six months were reversed. Market sentiment changed in early August when the Federal Reserve did not continue its series of interest rate increases. Taken together with declines in energy costs and increasing optimism about the U.S. economy, a stock market rally ensued, continuing through the third quarter and into October when the Dow Industrials reached new all-time highs. For the third quarter, the NASDAQ was up 4.0%, the Dow Industrials were up 4.7%, and the S&P 500 posted a gain of 5.2%. For the first nine months of 2006, the Dow Industrials were up 9%, the S&P 500 increased 7%, and the NASDAQ reversed its first half losses to post a 2.4% year-to-date increase.

The changing positive environment in the United States in the third quarter was mirrored by equity markets in most of the rest of the world. The Morgan Stanley EAFE (Europe, Australia and Far East) Index rose 3.4% bringing 2006 year-to-date gains to more than 12%.

Yields for 10-year U.S. Treasuries declined to 4.64% at the end of the third quarter from 5.15% at June 30, 2006. The yield curve was inverted at quarter end with the six-month and two-year maturities yielding 38 and 7 basis points more, respectively, than the 10-year Treasuries. The Federal Reserve target short-term rate of 5.25% remained unchanged from the end of June 2006.

In this financial environment, total assets under our management ended September 2006 at a record \$308.1 billion, up 5% or \$14.4 billion during the third quarter and \$38.6 billion for the first nine months of the year. Our strong relative investment performance and brand awareness contributed significantly to investors entrusting a net of more than \$4.2 billion to our management in the third quarter and \$21.5 billion thus far in 2006. Year-to-date net inflows include \$615 million from the merger of the Preferred Group of Mutual Funds into the T. Rowe Price funds and the acquisition of \$115 million of separate account assets in the second quarter. Higher market valuations and income during the third quarter resulted in a \$10.2 billion increase in our assets under management and, for the year-to-date period, market gains and income have added \$17.1 billion to our assets under management.

Assets under management at September 30, 2006 include \$242.7 billion in equity and balanced investment portfolios and \$65.4 billion fixed income investment portfolios. The underlying investment portfolios consist of \$190.8 billion in the T. Rowe Price mutual funds distributed in the United States and \$117.3 billion in other investment portfolios that we manage, including separately managed accounts, sub-advised funds, and other sponsored investment funds offered to investors outside the U.S. and through variable annuity life insurance plans.

RESULTS OF OPERATIONS Three months ended September 30, 2006 versus 2005.

Investment advisory revenues were up 17% to \$375 million as a result of a \$44 billion increase in average assets under our management to \$298 billion. Net revenues increased 16% or \$62 million to almost \$451 million. Net operating income increased 11.5% to \$200.5 million from \$179.9 million. Net income increased 10% to \$128 million from \$116 million in the 2005 quarter. Diluted earnings per share increased 7% from \$.43 to \$.46.

On January 1, 2006, we adopted SFAS 123R and, for the third quarter of 2006, recognized \$15.6 million of non-cash stock-based compensation expense using the fair value based method. Had we applied the fair value method in 2005, we would have recognized \$13.4 million of additional compensation expense in the third quarter last year and our comparable pro forma diluted earnings for that period would have been \$.39 per share. On a basis comparable with reported 2006 results, diluted earnings per share would have increased 18% from the 2005 quarter. See Note 6 to our financial statements in Item 1 of this report for more information.

We split our common stock two-for-one in June 2006 and have restated our per-share results for all periods presented. Investment advisory revenues earned from the T. Rowe Price mutual funds distributed in the United States increased \$36 million to nearly \$271 million. Average mutual fund assets were \$184.4 billion in the 2006 quarter, 14% higher than the \$161.6 billion average during the 2005 period. Mutual fund assets ended the third quarter up \$7.6 billion from June 30, 2006, as higher market valuations and income added \$6.0 billion and net inflows to our funds were \$1.6 billion during the period. Net inflows comprised more than \$1 billion to our stock and balanced funds, including \$.9 billion to the Growth Stock Fund, and \$.6 billion to the bond and money market funds.

Investment advisory revenues earned on the other investment portfolios that we manage increased \$19 million to \$104.5 million as average assets increased nearly 23% versus the 2005 period to \$113.5 billion. Assets in these portfolios increased \$6.8 billion during the third quarter of 2006 from net inflows of \$2.6 billion from investors in the U.S. and other countries and higher market valuations of more than \$4.2 billion.

Administrative fees and other income increased \$6.6 million to \$75 million. The change in these revenues includes \$5.7 million from our servicing activities, including shareholder account and transaction volume in our transfer agent and defined contribution plan recordkeeping services for the mutual funds and their investors. Additionally, revenues increased \$0.9 million from 12b-1 distribution fees received on greater assets under management in the Advisor and R classes of our sponsored mutual fund shares. These changes in administrative fees are generally offset by similar changes in related operating expenses that we incur to provide these services and distribute the Advisor and R classes of mutual fund shares through third party financial intermediaries.

Operating expenses were \$250 million in the third quarter of 2006, up \$41 million from the 2005 period. Our largest expense, compensation and related costs, increased \$36.7 million or 28% from last year's quarter. The number of our associates, their total compensation, and the costs of their employee benefits have all increased. The most significant portion of the increase is attributable to the \$15.6 million expense recognized for stock-based compensation in the 2006 quarter. Expenses in the 2006 period also reflect an increase in our interim bonus compensation accrual, which is based on projected operating results for 2006 as well as our strong relative and risk-adjusted investment performance, our growth in assets under management including new investor inflows, and the high quality of our investor services. Finally, we modestly increase our associates' base salaries at the beginning of each year, and have increased our average staff size by 5.4% since the third quarter of 2005, primarily to handle increased volume-related activities and growth. At September 30, 2006, we employed 4,495 associates.

Advertising and promotion expenditures increased 13%, or \$2.1 million, versus the 2005 quarter. We expect our advertising and promotion expenditures in the fourth quarter of 2006 will be up about 10% versus the \$28.4 million expended in the fourth quarter of 2005. We vary our level of spending based on market conditions and investor demand as well as our efforts to expand our investor base in the United States and abroad.

Occupancy and facility costs together with depreciation expense increased \$2.5 million. Our costs for rented office facilities, including increased space, and related maintenance and operating costs have increased along with our staff size and business needs.

Other operating expenses were flat versus the 2005 period, including \$0.9 million of higher distribution expenses recognized on greater assets under management sourced from financial intermediaries that distribute our Advisor and R classes of mutual fund shares. These distribution costs are offset by an equal increase in our administrative revenues recognized from 12b-1 fees as discussed above.

Our net non-operating income, which includes interest income as well as the recognition of investment gains and losses and credit facility expenses, increased \$12.6 million to \$17.0 million. We realized a gain of \$6.4 million in the 2006 quarter upon the realignment of a portion of our mutual fund investment holdings. Additionally, larger money market mutual fund balances yielding higher rates of return accounted for \$5.2 million of the increase.

Our third quarter 2006 income tax provision includes \$2.4 million to increase the estimated effective tax rate on our pre-tax income for the year 2006 from 37.3% to 37.8%, and \$5.3 million for additional prior years' taxes. Together, these adjustments reduced our reported diluted earnings per share for the third quarter by \$0.03 per share. We currently estimate that the effective tax rate for the full year 2006 will be about 38.4%, including the additional accrual for prior years' taxes and the effect of non-deductible incentive stock option compensation that we began recognizing in our consolidated statement of income this year.

RESULTS OF OPERATIONS Nine months ended September 30, 2006 versus 2005.

Investment advisory revenues were up 21.5% to \$1.1 billion as a result of a \$49 billion increase in average assets under our management to more than \$291 billion. Net revenues increased \$217 million to \$1.3 billion. Net operating income increased 18.5% to \$572 million from \$483 million. Net income increased more than 21% to \$380.6 million from \$313.4 million in the 2005 period. Diluted earnings per share increased 19% from \$1.15 to \$1.37. Had we applied the fair value method to recognize stock option-based compensation in 2005, we would have recognized \$40.5 million of additional compensation expense in the first nine-months of last year and our comparable pro forma

diluted earnings for that period would have been \$1.05 per share.

Investment advisory revenues earned from the T. Rowe Price mutual funds distributed in the United States increased \$143 million to \$800 million. Average mutual fund assets were \$183 billion in the first nine months of 2006, nearly 20% higher than the \$153 billion average during the 2005 period. Net inflows to the U.S. mutual funds were \$9.7 billion during the first nine months of 2006, including \$.6 billion from the merger of Preferred Group funds into the Price funds. Investors added \$5.0 billion to the U.S. stock and balanced funds, \$2.2 billion to our international stock funds, and \$2.5 billion to our bond and money market funds. The Growth Stock Fund has added \$2.9 billion of net investments this year while the Value Fund added more than \$1.4 billion. Higher market valuations and income also added more than \$10.8 billion to fund assets during the 2006 period.

Investment advisory revenues earned on the other investment portfolios that we manage increased \$51 million to \$299 million. Average assets in these portfolios were \$108.5 billion, up nearly \$19 billion or 21% from almost \$90 billion in the 2005 period. Assets in these portfolios have increased over \$18 billion thus far in 2006, including net inflows from U.S. and international investors of almost \$11.8 billion and market gains and income of \$6.3 billion. Administrative fees and other income increased nearly \$22 million to \$226 million. The change in these revenues includes \$18.3 million from our servicing activities including shareholder account and transaction volume in our transfer agent and defined contribution plan recordkeeping services for the mutual funds and their investors. Additionally, revenues increased \$3.6 million from 12b-1 distribution fees received on greater assets under management in the Advisor and R classes of our sponsored mutual fund shares.

Operating expenses were \$754 million in the first nine months of 2006, up 20% or \$127 million from the 2005 period. Our largest expense, compensation and related costs, increased 27% or \$105.2 million from last year's period. The largest portion of the increase is attributable to the \$45.1 million expense recognized for stock-based compensation. Advertising and promotion expenditures increased 15% or \$8.8 million due to more favorable market conditions and investor demand in 2006.

Occupancy and facility costs together with depreciation expense increased \$7.7 million while other operating expenses increased \$5.6 million, including \$3.6 million of distribution expenses recognized on greater assets under management sourced from financial intermediaries that distribute our Advisor and R classes of mutual fund shares. Our operating costs have increased along with business needs and our increase in staff size.

Our net non-operating income, which includes interest income as well as the recognition of investment gains and losses and credit facility expenses, increased \$36 million to \$48 million. Larger money market mutual fund balances at higher interest rates added \$15.7 million of the increase, the liquidation of the sponsored 2001 collateralized bond obligation in June 2006 added \$11.5 million dollars, and gains on dispositions of mutual fund investments added \$6.1 million.

CAPITAL RESOURCES AND LIQUIDITY.

Stockholders' equity at September 30, 2006 includes net liquid assets of more than \$1.2 billion. Given our strong financial position, we terminated our \$300 million syndicated credit facility in May 2006.

Operating activities during the first nine months of 2006 provided cash flows of \$524 million, up \$48 million from the 2005 period, including increased net income of more than \$67 million and non-cash stock-based compensation expense of \$45 million. Timing differences in the cash settlements of our assets and liabilities, primarily third quarter U.S. income tax payments that were due in October of 2005 versus September of 2006, reduced comparative cash flows by \$66 million. In addition, it should be noted that our interim operating cash outflows do not include bonus compensation that is accrued throughout the year before being substantially paid out in December. Net cash used in investing activities totaled \$255 million, up \$188 million from the 2005 period. Our investments in mutual funds and other securities made from our larger available cash balances were \$145 million more in the 2006 period than in the comparable 2005 period. Capital spending for property and equipment was \$69 million in the 2006 period, up \$30 million versus the 2005 period. Net cash used in financing activities was \$197 million in the 2006 period, up \$60 million from the comparable 2005 period. In the first nine months of 2006, we increased our expenditures for common stock repurchases by \$95 million and our dividends paid to stockholders by \$21 million. Offsetting these outflows were \$53 million of tax benefits realized from option exercises in the 2006 period.

PENDING CHANGE IN ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES.

On January 1, 2007, we will adopt the provisions of recently issued FASB Interpretation 48 in regards to our accounting for and disclosure of uncertain tax positions. We are in the process of reviewing our accounting for income taxes in light of the provisions of FIN 48 and, though our work is not yet complete, do not expect that adoption will materially affect our consolidated financial statements. Our critical accounting policy regarding our provision for income taxes (from Item 7 of our Form 10-K Annual Report for 2005) follows for the reader's reference.

After compensation and related costs, our provision for income taxes on our earnings is our largest annual expense. We operate in several states and several countries through our various subsidiaries, and must allocate our income, expenses, and earnings under the various laws and regulations of each of these taxing jurisdictions. Accordingly, our provision for income taxes represents our total estimate of the liability that we have incurred for doing business each

year in all of our locations. Annually, we file tax returns which represent our filing positions with each jurisdiction and settle our return liabilities. Each jurisdiction has the right to audit those returns and may take different positions with respect to income and expense allocations and taxable earnings determinations. From time-to-time, we may also provide for estimated liabilities associated with uncertain tax return filing positions that are subject to, or in the process of, being audited by various tax authorities. Because the determinations of our annual provisions are subject to judgments and estimates, it is likely that actual results will vary from those recognized in our financial statements. As a result, additions to, or reductions of, income tax expense will occur each year for prior reporting periods as our estimates change and actual tax returns and tax audits are settled. We recognize any such prior year adjustment in the discrete quarterly period in which it is determined.

FORWARD-LOOKING INFORMATION.

From time to time, information or statements provided by or on behalf of T. Rowe Price, including those within this report, may contain certain forward-looking information, including information or anticipated information relating to changes in our revenues and net income, changes in the amount and composition of our assets under management, our 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 T. Rowe Price is not a guarantee of future performance. Actual results may differ materially from those in forward-looking information because of various factors including, but not limited to, those discussed below and in Item 1A of our Form 10-K Annual Report for 2005 under the caption Risk Factors. Further, forward-looking statements speak only as of the date on which they are made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made or to reflect the occurrence of unanticipated events.

Our future revenues and results of operations will fluctuate primarily due to changes in the total value and composition of assets under our management. Such changes result from many factors including, among other things: cash inflows and outflows in the T. Rowe Price mutual funds and other managed investment portfolios; fluctuations in the financial markets around the world that result in appreciation or depreciation of the assets under our management; our introduction of new mutual funds and investment portfolios; and changes in retirement savings trends favoring participant-directed investments and defined contribution plans. The ability to attract and retain investors' assets under our management is dependent on: investor sentiment and confidence; the relative investment performance of the Price mutual funds and other managed investment portfolios as compared to competing offerings and market indexes; the ability to maintain our investment management and administrative fees at appropriate levels; competitive conditions in the mutual fund, asset management, and broader financial services sectors; and our level of success in implementing our strategy to expand our business. Our revenues are substantially dependent on fees earned under contracts with the Price funds and could be adversely affected if the independent directors of one or more of the Price funds terminated or significantly altered the terms of the investment management or related administrative services agreements.

Our future results are also dependent upon the level of our expenses, which are subject to fluctuation for the following or other reasons: changes in the level of our advertising expenses in response to market conditions, including our efforts to expand our investment advisory business to investors outside the United States and to further penetrate our distribution channels within the United States; variations in the level of total compensation expense due to, among other things, bonuses, stock option grants, stock awards, changes in our employee count and mix, and competitive factors; any impairment of goodwill or other intangible assets that may arise; fluctuation in foreign currency exchange rates applicable to the costs of our international operations; expenses and capital costs, such as technology assets, depreciation, amortization, and research and development, incurred to maintain and enhance our administrative and operating services infrastructure; unanticipated costs that may be incurred to protect investor accounts and the goodwill of our clients; and disruptions of services, including those provided by third parties, such as facilities, communications, power, and the mutual fund transfer agent and accounting systems.

Our 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 that 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.

There has been no material change in the information provided in Item 7A of the Form 10-K Annual Report for 2005.

Item 4. Controls and Procedures.

Our management, including our principal executive and principal financial officers, has evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2006. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, including this Form 10-Q quarterly report, is appropriately recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. Based on that evaluation, our principal executive and principal financial officers have concluded that our disclosure controls and procedures as of September 30, 2006 are effective at the reasonable assurance level.

Our management, including our principal executive and principal financial officers, has evaluated any change in our internal control over financial reporting that occurred during the third quarter of 2006, and has concluded that there was no change during the third quarter of 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION**Item 1. Legal Proceedings.**

In September 2003, a purported class action (T.K. Parthasarathy, et al., including Woodbury, v. T. Rowe Price International Funds, Inc., et al.) was filed in the Circuit Court, Third Judicial Circuit, Madison County, Illinois, against T. Rowe Price International and the T. Rowe Price International Funds with respect to the T. Rowe Price International Stock Fund. The basic allegations in the case were that the T. Rowe Price defendants did not make appropriate price adjustments to the foreign securities owned by the T. Rowe Price International Stock Fund prior to calculating the Fund's daily share prices, thereby allegedly enabling market timing traders to trade the Fund's shares in such a way as to disadvantage long-term investors. The plaintiffs sought monetary damages. Following three years of procedural litigation in State and Federal courts, this case is now back in the Illinois State Court. The U.S. Supreme Court recently issued an important ruling in the Dabit case holding that actions such as this one are barred by a federal preemption statute and may not be maintained as class actions under state law. We expect to raise the Dabit ruling at the appropriate time and believe that doing so should result in a favorable outcome for the T. Rowe Price defendants. We do not believe that this case will have a material effect on our financial position or results of operations.

Item 1A. Risk Factors.

There has been no material change in the information provided in Item 1A of the Form 10-K Annual Report for 2005.

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

- (c) The following table summarizes activity during the third quarter of 2006 under the 2003 Board of Director's repurchase authorization.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Number of Shares that May Yet Be Purchased Under the Programs
July 2006	500,000	\$ 37.42	500,000	3,790,868
August 2006				3,790,868
September 2006				3,790,868
Total	500,000	\$ 37.42	500,000	

Item 5. Other Information.

On October 25, 2006, we issued a press release reporting our results of operations for the third quarter and first nine months of 2006. A copy of this press release is furnished herewith as Exhibit 99. The information in this Item 5 and in Exhibit 99 shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933.

Item 6. Exhibits.

The following exhibits required by Item 601 of Regulation S-K are furnished herewith.

- 3(i) Amended and Restated Charter of T. Rowe Price Group, Inc. as of March 9, 2001. (Incorporated by reference from Form 10-K for 2000; Accession No. 0001113169-01-000003.)
- 3(ii) Amended and Restated By-Laws of T. Rowe Price Group, Inc. as of December 12, 2002. (Incorporated by reference from Form 10-K for 2002; Accession No. 0000950133-03-000699.)

Letter from KPMG LLP, independent registered public accounting firm, re unaudited interim financial information.

- 31(i).1 Rule 13a-14(a) Certification of Principal Executive Officer.
- 31(i).2 Rule 13a-14(a) Certification of Principal Financial Officer.
- 32 Section 1350 Certifications.
- 99 Press release issued October 25, 2006 reporting our results of operations for the third quarter and the first nine months of 2006.

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 on October 25, 2006.

T. Rowe Price Group, Inc.

/s/ Kenneth V. Moreland
Vice President and Chief Financial Officer

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