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LPL Financial
Q2 2021 Earnings
Prepared Remarks

Notice to Investors: Safe Harbor Statement

Statements in these prepared remarks regarding LPL Financial Holdings Inc.'s (together with its subsidiaries, the "Company") future financial and operating results, plans, priorities, strategies and outlook, including forecasts and statements relating to market trends, economic conditions, investor engagement, market opportunities and the Company's future growth, market share, investments, affiliation models, business development results, capabilities (including technology and digital capabilities), services, service model, client experience, improvements, business mix, brokerage and advisory asset levels, advisory fees, return on assets, client cash balances and yields (including the future fixed rate portion of the portfolio), expenses (including Core G&A* outlook for 2021), gross profit*, EBITDA*, capital deployment (including planned share repurchases), returns to shareholders, long-term value and the expected benefits and costs of the acquisition of Waddell & Reed's wealth management business, as well as any other statements that are not related to present facts or current conditions or that are not purely historical, constitute forward-looking statements. These forward-looking statements are based on the Company's historical performance and its plans, estimates and expectations as of July 29, 2021. Forward-looking statements are not guarantees that the future results, plans, intentions or expectations expressed or implied will be achieved. Matters subject to forward-looking statements involve known and unknown risks and uncertainties, including economic, legislative, regulatory, competitive and other factors, which may cause actual financial or operating results, levels of activity or the timing of events to be materially different from those expressed or implied by forward-looking statements. Important factors that could cause or contribute to such differences include: the spread of COVID-19 and its direct and indirect effects on global economic and financial conditions; changes in general economic and financial market conditions, including retail investor sentiment; changes in interest rates and fees payable by banks participating in the Company's client cash programs; the Company's strategy and success in managing client cash program fees; changes in the growth and profitability of the Company's fee-based business; fluctuations in the levels of advisory and brokerage assets, including net new assets, and the related impact on revenue; the effects of competition in the financial services industry, and the success of the Company in attracting and retaining financial advisors and institutions; whether retail investors served by newly-recruited advisors choose to move their respective assets to new accounts at the Company; the effect of current, pending and future legislation, regulation and regulatory actions, including disciplinary actions imposed by federal and state regulators and self-regulatory organizations, and the implementation of Regulation BI (Best Interest); the costs of settling and remediating issues related to regulatory matters or legal proceedings, including actual costs of reimbursing customers for losses in excess of the Company's reserves; changes made to the Company's services and pricing, and the effect that such changes may have on the Company's gross profit* streams and costs; the execution of the Company's plans and its success in realizing the expense savings, synergies, service improvements and/or efficiencies expected to result from its investments, initiatives, acquisitions and programs; the successful onboarding of advisors and client assets in connection with the Waddell & Reed acquisition; and the other factors set forth in Part I, "Item 1A. Risk Factors" in the Company's 2020 Annual Report on Form 10-K, as may be amended or updated in the Company's Quarterly Reports on Form 10-Q or other filings with the SEC. Except as required by law, the Company specifically disclaims any obligation to update any forward-looking statements as a result of developments occurring after July 29, 2021, even if its estimates change, and statements contained herein are not to be relied upon as representing the Company's views as of any date subsequent to July 29, 2021.

Actual remarks made on the Company's earnings conference call could vary from the prepared remarks presented here. A webcast replay of the Company's earnings conference call will be available on the Investor Relations section of the Company's website, investor.lpl.com, until August 19, 2021. Please refer to the Company's earnings release for additional information.

*Notice to Investors: Non-GAAP Financial Measures

The prepared remarks set forth herein include discussion of certain non-GAAP financial measures. At the time these remarks were made, listeners were referred to the Company's earnings release, which had been previously published on the Company's website at investor.lpl.com, and which contained reconciliations of such non-GAAP financial measures to comparable GAAP figures. Management believes that presenting certain non-GAAP financial measures by excluding or including certain items can be helpful to investors and analysts who may wish to use some or all of this information to analyze the Company's current performance, prospects and valuation. Management uses this non-GAAP information internally to evaluate operating performance and in formulating the budget for future periods. Management believes that the non-GAAP financial measures and metrics discussed herein are appropriate for evaluating the performance of the Company. These non-GAAP financial measures include but are not limited to EPS prior to Amortization of Intangible Assets and Acquisition Costs, Gross Profit, Core G&A, EBITDA and Credit Agreement EBITDA.

Dan Arnold, President and CEO

Thank you, [Operator], and thanks to everyone for joining our call today.

Over the past quarter, our advisors continued to provide their clients with personalized financial guidance on their journey to achieve their life goals and dreams and at the same time, we remained focused on our mission of taking care of our advisors, so they can take of their clients. This combination positioned us to deliver another quarter of solid results while also continuing to make progress on our strategic plan. I'd like to review both of these areas, starting with our second quarter business results.

In the quarter, total assets reached a new high of $1.1 trillion, up more than 45 percent from a year ago. This increase was primarily driven by continued organic growth, our Waddell & Reed acquisition, and equity market appreciation.

With respect to organic growth, second quarter net new assets were $37 billion. This result translated to a 16 percent annualized growth rate - driven by continued strength across new store sales, same store sales, and retention – and brought our organic growth rate to over 12 percent for the past year.

In the second quarter, Recruited Assets were $35 billion, which brought our total over the past year to $80 billion. Our continued growth in recruited assets including new quarterly and full year highs reflects our ongoing progress on enhancing the appeal of our model and expanding our addressable markets.

During the quarter, our recruiting results increased in each of our markets with over $10 billion in our traditional independent model; over $22 billion in our institution services model; and approximately $2.5 billion in our new affiliation models. These broader and more diversified results help position us to drive higher levels of recruiting going forward.

Looking at same store sales with the backdrop of continued strong retail engagement our advisors remain proactive and focused on serving their clients and enhancing their offering. As a result, advisors are both winning new clients and capturing more assets from existing clients which drove same store sales to new highs in the second quarter.

At the same time, we further enhanced the advisor experience through the continued delivery of new capabilities and technology as well as the ongoing modernization of our service and operations functions. As a result, Asset Retention was over 98 percent in the second quarter and 98 percent over the past year.

Now, our second quarter business results led to solid financial outcomes, with $1.85 of EPS prior to intangibles and acquisition cost, which is an increase of 30 percent from a year ago.

Let’s now turn to the progress we made on our strategic plan.

As a reminder our long-term vision is to redefine the independent model over time and by doing so, become the leader across the entire advisor-centered marketplace. Our approach is to provide a platform that is simple and straightforward for advisors to design and run their perfect practice through a breadth of affiliation models and the ability to personally configure the components of our offering to align with each advisors’ unique needs and goals. Doing this well gives us a sustainable path to continued solid organic growth, increased market leadership, and long-term shareholder value creation.

Now to execute on our strategy, we have organized our work into four strategic plays which I would like to review with you in turn.

Our first strategic play involves meeting advisors where they are in the evolution of their practice by winning in our traditional markets where our leading market share is now over 15 percent while also leveraging new affiliation models to expand our addressable markets.

In our traditional markets despite advisor movement in the overall industry remaining lower in the second quarter, we continued to increase our recruiting results and gain market share. The combination of our recruiting momentum and the appeal of our model continues to expand the depth and breadth of our pipeline.

Looking at our financial institutions channel within the past two quarters, we onboarded two new clients: BMO Harris and M&T. Then in June, we announced that CUNA Brokerage Services made the decision to partner with us and plans to join early next year. These results reflect the market opportunity that exists to leverage our capabilities to serve large institutions. As we look ahead, we continue to progress prospects through the pipeline and see large financial institutions as a sustainable, multi-year contributor to organic growth.

With respect to the expansion of our addressable markets we continue to see momentum building across all three of our new affiliation models. Over the past quarter, we added five new practices across our Strategic Wealth Services and Employee models and after relaunching the RIA only offering in April, we have been encouraged by the positive market reaction including a new RIA that joined in May. Looking ahead, we see a growing pipeline across all of our new affiliation models.

Another key component of this strategic play is using M&A as a complement to organic growth. Now after closing our Waddell & Reed acquisition in April last week, we transitioned to our platform over 900 advisors who serve approximately 98 percent of client assets.

Our second strategic play is focused on providing capabilities that help our existing advisors differentiate in the marketplace and drive efficiency in their practices. One of the key components of this play is helping our advisors enrich how they serve their clients through the use of advisory platforms. In that spirit, we continue to innovate on our platform, most recently with the introduction of a number of product, pricing, and capability enhancements.

One new capability to highlight increases the personalization available within our centrally managed advisory solutions. Now two years ago, we introduced Advisor Sleeve, which allows advisors to personalize centrally managed portfolios with their own asset allocation models while outsourcing the day-to-day work of portfolio allocation and trading to us. To build on this capability, last quarter we launched Firm Sleeve. This innovation enables larger firms, RIAs, and institutions to develop models that all advisors across their firms can use and thus providing additional ways to leverage our centrally managed platforms to help meet client needs, differentiate in the marketplace, and drive efficiency in advisors' practices. To date, over $9 billion of client assets is invested across Advisor Sleeve and Firm Sleeve and we will continue innovating to increase the value of these personalized investment offerings.

Let's next move to our third strategic play, which involves creating an industry-leading service experience to delight advisors and their clients and, in turn, help drive advisor recruiting and retention.

A key component of this strategic play is transforming our service model into an omni-channel, Client Care Model. In Q2, we launched a Digital Help Center a machine learning-based solution that gives advisors easy access to information that addresses their most common service-related needs. This resource puts information that's personalized, timely, and relevant at their fingertips thus positioning advisors to serve their clients in a simpler and more efficient way. Together with our voice and chat channels, the Digital Help Center enables advisors to access industry-leading service at a time and in a manner that works best for them.

We also continue to automate and streamline key elements of our service operations through the enhancement of our digital operating model including investing in new bots across our care organization. This helps us to increase both our service levels and our capacity to grow as we continue to scale our business.

We believe these investments in our Client Care Model and the automation and streamlining of our service operations are making positive contributions to the service experience while also increasing the scalability of our platform.

Our fourth strategic play is focused on helping advisors run the most successful businesses in the independent marketplace. One of the key components of this play is our portfolio of Business Solutions, which helps advisors more effectively operate their businesses, so they can focus on serving their clients and growing their practices.

Now, as we discussed last quarter, we see multiple pathways for continued growth in Business Solutions including delivering existing solutions to additional advisors and introducing new solutions to expand our product portfolio.

In the second quarter, our subscription base continued to scale to approximately 2,100 monthly subscribers more than double a year ago. This includes about 80 subscriptions with advisors who joined from Waddell & Reed.

The more we work on Business Solutions the more opportunities we find to help our advisors solve additional challenges through the expansion of our product portfolio. We now have seven solutions available in our product portfolio, three additional solutions in pilot, and a handful of other offerings in the incubation phase. As we continue to add new solutions, we expect to expand the addressable market while at the same time accelerating our pace of innovation.

Before closing, I want to highlight our ongoing efforts to actively shape and refine our advisor-centric culture, which is instrumental to executing our strategy. In the second quarter, we rolled out our Advisor Promise which is a modern evolution of the advisor commitment [creed] our founders wrote more than 30 years ago. We will use this promise to drive further accountability for providing an industry-leading advisor experience and to continue to increase the competitive advantage that our advisor-centric culture provides in the marketplace.

In summary, in the second quarter, we continued to invest in the value proposition for advisors and their clients while driving growth and increasing our market leadership. As we look ahead, we remain focused on executing our strategy to help our advisors further differentiate and win in the marketplace and as a result drive long-term shareholder value.

With that, I'll turn the call over to Matt.

Matt Audette, CFO

Thank you, Dan, and I'm glad to speak with everyone on today's call.

In the second quarter, we remained focused on serving our advisors, growing our business, and delivering shareholder value. This focus led to the highest quarter of organic growth in our history. And in addition, we have now onboarded three of our largest partners in BMO, M&T, and Waddell and Reed who collectively added over $100 billion of assets to our platform helping drive our total assets to over $1.1 trillion.

Now let’s turn to our second quarter business results. Starting with organic growth, total net new assets were $37 billion, which translates to a 16 percent annualized growth rate. This was driven by strength across all three channels of growth: recruiting, same store sales, and retention.

Looking more closely at recruiting, in Q2 recruited assets were the strongest in our history at $35 billion which brought our twelve month total to a new high of $80 billion.

Moving on to our business mix we continued to see positive trends in Q2. Advisory net new assets were $21 billion, or a 17 percent annualized growth rate. With this growth, our advisory assets are 52 percent of total assets, as we continue to deliver differentiated advisory capabilities and benefit from the secular trend towards advisory.

Now let's turn to our Q2 financial results. Strong organic growth, combined with expense discipline, led to EPS prior to intangibles and acquisition costs of $1.85, up 30 percent from a year ago.

Looking at our top line growth, Gross Profit reached a new high of $602 million, up $22 million or 4 percent sequentially. Looking at the components commission and advisory fees net of payout were $197 million, up $13 million from Q1, primarily driven by organic growth and assets from Waddell and Reed.

In Q2 our payout ratio was 86.3 percent, up about 70 basis points from Q1 due to typical seasonality. Looking ahead to Q3, we anticipate our payout ratio will be up approximately 100 basis points, driven by the expected seasonal build in production bonus as well as the onboarding of Waddell and Reed assets which earned a slightly lower payout on their platform.

Moving on to asset-based revenues Sponsor revenues were $189 million in Q2, up $22 million sequentially. This was driven by an increase in average assets due to organic growth, Waddell and Reed, and equity market appreciation.

Turning to client cash revenues, they were $90 million, down $7 million from Q1, driven by lower ICA balances during the quarter. Looking at overall client cash balances, they were $48 billion, roughly flat with last quarter.

Looking more closely at our ICA yield, it was 98 basis points in Q2, relatively flat with Q1. As we look ahead to Q3, given where interest rates, client rates, and cash balances are today, we expect our Q3 ICA yield to be roughly flat to Q2.

Now looking at our fixed rate portfolio as a reminder, we have a fixed rate maturity at the end of the third quarter, which will lower our Q4 ICA yield by approximately 10 basis points. That said, I would highlight that as the yield curve steepened earlier in Q2, we saw demand start to return to the fixed rate sweep market. As a result, we were able to enter into $600 million of new fixed rate contracts at the three-year point, which was about 40 basis points at the time.

Looking beyond Q3 and given the expectation that short-term interest rates will begin rising in late 2022 or early 2023 we thought it would be helpful to share the economic benefit of rising rates using the deposit betas we experienced in the most recent interest rate cycle. Using our current sweep balances, a 100 basis point increase in the Fed Funds rate would translate to approximately $340 million of annual gross profit.

Moving on to Q2 transaction and fee revenues, they were $137 million, down $4 million sequentially, driven by trading volume that decreased throughout the quarter. Looking ahead to Q3 prior to Waddell and Reed, we expect transaction and fee revenue to be relatively in line with Q2 as we anticipate seasonally lower transaction volumes and IRA fees will be offset by revenues from our national adviser conference.

Turning to Business Solutions, we ended the quarter with approximately 2,100 subscriptions, which is up 400 from last quarter, and more than double a year ago. These offerings now generate roughly $20 million of annual revenue and more importantly, they help free up additional time for advisors to spend on more valuable activities, including serving their clients and growing their practices.

Now let's turn to expenses, starting with Core G&A. It was $252 million in Q2 and $240 million prior to Waddell and Reed. Looking ahead, we continue to anticipate full year 2021 Core G&A to be in a range of $975 million to $1 billion. As a reminder, this includes costs to support BMO and M&T, but is prior to expenses associated with Waddell and Reed.

Moving on to Q2 promotional expenses, they were $64 million, up $10 million sequentially. Prior to Waddell and Reed costs, promotional was $57 million, up $3 million sequentially, primarily driven by large financial institution onboarding and increased marketing expense.

Turning to Q3 prior to Waddell and Reed, we anticipate promotional expense will increase by around $10 million as we have two of our largest advisor conferences in Q3. I would also note that we have shifted several conferences that are typically in the first half of the year to the fourth quarter. This will likely lead to a similar level of promotional spend in Q4. However, our plans could change depending on the environment, so we’ll give you a more specific update next quarter.

Now let's move to Waddell and Reed overall the transaction is progressing even better than we expected across multiple fronts. As mentioned, Waddell and Reed advisors serving approximately 98 percent of client assets have joined our platform, which is up from our prior estimate of 95 percent. Factoring in this higher level of retention and current asset levels, we now expect the run-rate EBITDA benefit to be at least $85 million, up from $80 million and we continue to expect to reach this run rate by the middle of next year.

Moving on to capital management our balance sheet remained strong in Q2 with the leverage ratio at 2.3x times and corporate cash of $278 million.

As for capital deployment our framework remains focused on allocating capital aligned with the returns we generate: investing in organic growth first and foremost, pursuing M&A where appropriate, and returning excess capital to shareholders. In the first half of this year, the majority of our capital deployment was focused on supporting organic growth and M&A. Looking ahead, while we continue to see compelling opportunities to deploy capital to drive growth, we also feel well positioned to restart our share repurchase program, initially focusing on repurchasing shares to offset dilution, which we estimate to be approximately $40 million per quarter. We will of course remain flexible and dynamic should additional opportunities to deploy capital to drive growth emerge.

In closing, we delivered another quarter of strong business and financial results, including the best organic growth in our history and just last week onboarded the advisors from Waddell and Reed. As we look forward, we remain excited about the opportunities we see to continue investing to serve our advisors, grow our business, and create long-term shareholder value.

With that, Operator, please open the call for questions.