LPL Financial

LPL Financial Q3 2024 Earnings Prepared Remarks

Notice to Investors: Safe Harbor Statement

Statements in this presentation regarding LPL Financial Holdings Inc.'s (together with its subsidiaries, the "Company") future financial and operating results, growth, plans, priorities, business strategies, capabilities, and outlook, including forecasts and statements relating to the Company's future advisory and brokerage asset levels and mix, organic asset growth, market share, deposit betas, core G&A* expenses (including outlook for 2024) and estimated expenses and financial impacts associated with the Company's strategic relationship with Prudential Financial, Inc. ("Prudential") and acquisition of Atria Wealth Solutions, Inc. ("Atria"), service offerings, operating margin, Gross Profit* benefits, EBITDA* benefits, target leverage ratio, client cash balances and yields, service and fee revenue, investments, acquisitions (including Liquidity & Succession transactions), capital returns, planned share repurchases, if any, the anticipated closing of pending transactions, and the amount and timing of the onboarding of acquired, recruited or transitioned brokerage and advisory assets, 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. They reflect the Company's expectations and objectives as of October 30, 2024 and are not guarantees that the expectations or objectives expressed or implied will be achieved. The achievement of such expectations and objectives involves risks and uncertainties that may cause actual results, levels of activity or the timing of events to differ materially from those expressed or implied by forward-looking statements. Important factors that could cause or contribute to such differences include: difficulties and delays in onboarding the assets of acquired or recruited advisors, including the receipt and timing of regulatory approvals that may be required; disruptions in the businesses of the Company that could make it more difficult to maintain relationships with advisors and their clients; the choice by clients of acquired or recruited advisors not to open brokerage and/or advisory accounts at the Company; 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, including the Company's success in negotiating agreements with current or additional counterparties; the Company's strategy and success in managing client cash program fees; changes in the growth and profitability of the Company's fee-based offerings and asset-based revenues; fluctuations in the levels of advisory and brokerage assets, including net new assets, and the related impact on revenue; effects of competition in the financial services industry and the success of the Company in attracting and retaining financial advisors and institutions, and their ability to provide financial products and services effectively; whether the 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; the cost of defending, settling and remediating issues related to regulatory matters or legal proceedings, including civil monetary policies or actual costs of reimbursing customers for losses in excess of our reserves or insurance; changes made to the Company's services and pricing, including in response to competitive developments and current, pending and future legislation, regulation and regulatory actions, and the effect that such changes may have on the Company's Gross Profit* streams and costs; execution of the Company's capital management plans, including its compliance with the terms of the Company's amended and restated credit agreement, the credit facilities of the Company and LPL Financial LLC, and the indentures governing the Company's senior unsecured notes; strategic acquisitions and investments, including pursuant to the Company's liquidity and succession solution, and the effect that such acquisitions and investments may have on the Company's capital management plans and liquidity; the price, availability and trading volumes of shares of the Company's common stock, which will affect the timing and size of future share repurchases by the Company, if any; whether advisors affiliated with Atria, Prudential, The Investment Center, Inc. ("The Investment Center") and Wintrust Financial Corporation ("Wintrust") will transition registration to the Company and whether assets reported as serviced by such financial advisors will translate into assets of the Company; the failure to satisfy the closing conditions applicable to the Company's strategic relationship agreements with Prudential and Wintrust, or the Company's purchase agreement with The Investment Center, including regulatory approvals; the execution of the Company's plans and its success in realizing the synergies, expense savings, service improvements or efficiencies expected to result from its investments, initiatives and acquisitions, expense plans and technology initiatives; the performance of third-party service providers to which business processes have been transitioned; the Company's ability to control operating risks, information technology systems risks, cybersecurity risks and sourcing risks; and the other factors set forth in the Company's most recent 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 Securities and Exchange Commission. Except as required by law, the Company specifically disclaims any obligation to update any forward-looking statements as a result of developments occurring after October 30, 2024 and you should not rely on statements contained herein as representing the Company's view as of any date subsequent October 30, 2024.

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/events. 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 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 adjusted EPS, Gross Profit, core G&A, EBITDA, Adjusted EBITDA and Credit Agreement EBITDA.

Rich Steinmeier, CEO

Thanks Operator. As a long-time listener and first-time caller, it's great to speak to everyone on today's call.

For those that haven't met me, I'm Rich Steinmeier, and it's my privilege to serve as LPL's Chief Executive Officer. I joined the firm in 2018, following roughly a decade working in wealth management at a couple wirehouses, after having started my career in management consulting. I joined LPL with the mandate to accelerate our growth, and for the past six years, have worked closely with Matt and the rest of our leadership team, to set our strategic vision, and to build and execute on the plan to achieve that vision. Looking forward, our opportunity is clear: to assert our leadership and shape both the advisor and institutional markets. Our focus is on creating the culture, strategy, and capabilities, to achieve sustainable outperformance by serving as an indispensable partner to our advisors and institutions, while delivering long-term value to shareholders.

OK. With introductions complete, let's turn to our results.

In the quarter, total assets increased to a record $1.6 trillion dollars, as we attracted organic net new assets of $27 billion, representing a 7% annualized growth rate. This was on pace with the past twelve months, during which we brought on nearly $100 billion of organic net new assets, representing approximately 8% growth.

Our third quarter business results led to strong financial performance with an adjusted EPS of $4.16.

Next, let's turn to our strategic plan and recent growth across our organic and inorganic initiatives.

As a reminder, our long-term vision is to become the leader across the advisor-centered marketplace. To do that, our strategy is to invest back into the platform, and provide unmatched flexibility in how advisors can affiliate with us, and to deliver capabilities and services to help maximize advisors' success throughout the lifecycle of their businesses.

Doing this well, gives us a path to sustainable industry leadership, not just in the independent and institution markets, but across all of wealth management.

In the third quarter, recruited assets were $26 billion, bringing our total for the trailing twelve months to $87 billion, both of which represent records excluding periods when we onboarded large institutions.

In our traditional independent market, recruiting reached a new quarterly high of approximately $23 billion in assets, improving on our already industry-leading capture rates of advisors in motion, while also expanding the breadth and depth of our pipeline.

With respect to our new affiliation models, Strategic Wealth, Independent Employee, and our enhanced RIA offering, we delivered another solid quarter, recruiting roughly $3 billion in assets. And, as we look ahead, we expect that the increasing awareness of these models in the marketplace, and the ongoing enhancements to our capabilities, will drive a sustained increase in their growth.

During the quarter, we also continued to make progress within the large institution marketplace, where we advanced our preparation to onboard the retail wealth management businesses of Prudential

Financial and Wintrust Financial. Collectively, these two partnerships will add approximately $76 billion of brokerage and advisory assets by early 2025.

As a complement to our organic growth, earlier this month, we closed the acquisition of Atria Wealth Solutions, welcoming their approximately 2,200 advisors, 160 institutions, and home office staff to the LPL family. The transaction is progressing well, and we are on track to meet our 80% retention target. As an aside, I've had the opportunity to spend time with the Atria team over the past several months, and it is clearer than ever, that their advisor-centric orientation and high-quality relationships with their advisors and institutions makes them a perfect fit for LPL.

As for our broader business, asset retention remains industry leading at 98% over the last twelve months. This is a testament to our continued efforts to enhance the advisor experience, through the delivery of new capabilities and technology, and the evolution of our service and operations functions. In that spirit, I would be remiss not to call out a driving force behind our improving advisor experience, which is the ongoing operational transformation of the firm, spearheaded by Matt. Beyond his leadership as CFO, Matt has been at the helm of our Operations and Risk organizations, and in his expanded role as President, we've consolidated additional responsibilities for the day-to-day operations of the firm under his purview, including customer service and supervision. It goes without saying that all of these critical functions are in very good hands.

In closing, I want to reiterate how honored I am to lead this amazing firm, and to express my gratitude to our employees for the way they show up every day, to our advisors and institutions for their partnership, and to our shareholders for continuing to place their support and trust in LPL Financial.

With that, I'll turn the call over to Matt, who I would like to point out, dressed up as Johnny Cash for our company Halloween event last Friday, and I just wanted you to visualize that image as he dives into our results.

Matt Audette, President and CFO

Are you telling me that was a Halloween event on Friday? That's what I normally wear, I figured the white onesie you were wearing was what you wore on Fridays. Who knew?

Well, thanks, Rich. I'm glad to speak with everyone on today's call. I too feel exceedingly fortunate to serve this great firm in an expanded capacity, as LPL's President and CFO. To echo Rich's sentiment, we have built an advantaged position in the advisor-mediated market, and have a tremendous opportunity to extend our leadership. I look forward to partnering with Rich and continuing to enhance value for all of the stakeholders we serve.

Turning to our results, in the third quarter, we remained focused on serving our advisors, growing our business and delivering shareholder value. This focus led to another quarter of strong organic growth in both our traditional and new markets, and we are preparing to onboard the wealth management businesses of Prudential and Wintrust. As a complement to our strong organic growth, we closed on the acquisition of Atria earlier this month. In addition, we entered into an agreement to acquire The Investment Center, which we plan to onboard in the first half of 2025. So, as we look ahead, we remain excited by the opportunities we have to serve and support our growing advisor base, while continuing to deliver an industry leading value proposition and drive organic growth.

With respect to our third quarter business results, as Rich mentioned, it was another quarter of strong growth, with an annualized growth rate of approximately 7%, or 9% prior to the planned separation from misaligned large OSJs.

On the recruiting front, Q3 recruited assets were $26 billion, which prior to large institutions, was a new quarterly high. Looking ahead to Q4, in addition to the expected onboarding of one of our largest institutional partners, Prudential, we continue to have a strong pipeline. However, I would note the natural seasonal headwinds to advisor movement during the back half of December related to FINRA's shut-down and the holidays.

As for our Q3 financial results, the combination of organic growth and expense discipline, led to adjusted EPS of $4.16.

Gross Profit was $1 billion 128 million, up $49 million sequentially. As for the components, commission and advisory fees net of payout were $274 million, up $11 million from Q2.

Our payout rate was 87.5%, up 20 basis points from Q2 due to typical seasonality.

With respect to client cash revenue, it was $372 million, up $11 million from Q2, driven by higher renewal rates on our fixed rate contracts. Overall client cash balances ended the quarter at $46 billion, up $2 billion sequentially, driven by organic growth.

Within our ICA portfolio, the mix of fixed rate balances was roughly 65%, within our target range of 50% to 75%.

Looking more closely at our ICA yield, it was 332 basis points in Q3, up 14 basis points from Q2. As we look ahead to Q4, we expect the yields on our new fixed rate contracts to more than offset the impact of the two additional rate cuts expected by year end. As a result, we expect our ICA yield to increase by approximately 5 basis points.

As for Service and Fee revenue, it was $146 million in Q3, up $11 million from Q2. Looking ahead to Q4, we do not have any large advisor conferences and expect seasonally lower IRA fees. However, given the acquisition of Atria earlier this month and the onboarding of Prudential later this quarter, we expect Service and Fee revenue to be roughly flat sequentially.

Moving on to Q3 transaction revenue. It was $59 million, flat compared to Q2. As we look ahead to Q4, based on activity levels to date, as well as the expected contribution from Atria and Prudential, we expect transaction revenue to increase by approximately $5 million sequentially.

Now let's move on to Atria and Prudential. Starting with Atria, as mentioned, we closed on the transaction and continue to expect to onboard the advisors in mid-2025. Overall, the transaction is progressing well. We are on track to meet our estimate of ~80% retention, but factoring in current asset levels, we now expect the run-rate EBITDA benefit to be approximately $150 million, up from our original estimate of $140 million. That said, in the near-term, given the timing of when synergies are realized, we anticipate our post-close, pre-conversion EBITDA to be roughly $40 million.

Moving on to Prudential, we are on track to onboard them during Q4. As for Prudential's financial contribution, given current asset levels, which at the end of Q3 were approximately $60 billion, as well as current cash balances, we now expect approximately $70 million of run-rate EBITDA, up from our original $60 million estimate.

Now let's turn to expenses, starting with Core G&A. It was $359 million in Q3. Looking ahead, while there are variable costs associated with supporting our strong levels of organic growth, given our ongoing focus on efficiency, we are tightening our 2024 core G&A outlook to a range of $1 billion 475 million to $1 billion 485 million. Additionally, now that we have closed on our acquisition of Atria, and expect to onboard Prudential by the end of the year, we are including those costs in our overall Core G&A outlook. As such, we expect Prudential and Atria to add $35 to $40 million of Core G&A in 2024. As a result, our new Core G&A outlook range is $1 billion $510 million to $1 billion $525 million.

Moving on to Q3 promotional expense. It was $176 million, up $28 million from Q2, primarily driven by conference spend as we hosted our annual Focus conference, as well as increased transition assistance resulting from our strong recruiting.

Looking ahead to Q4, we expect promotional expense to decrease by approximately $10 million, driven by lower conference spend, partially offset by transition assistance related to Atria.

As for regulatory expense, it was $25 million in Q3, up from Q2, as we recorded an $18 million charge related to a planned SEC settlement for anti-money laundering controls. Looking ahead, given the non-recurring nature of this item, we continue to expect regulatory expense to be roughly $10 million per quarter.

Turning to depreciation and amortization, it was $78 million in Q3, up $7 million sequentially. This included approximately $3 million of technology development related to Prudential. Looking ahead, we continue to invest in technology and recently, went live with two new internal data centers. As a result, we expect depreciation and amortization to increase by approximately $10 million sequentially. I would just note that we don't expect this level of sequential increase going forward.

As for interest expense, it was $68 million in Q3, up $4 million sequentially, driven by the full quarter impact of the May debt issuance. Looking ahead to Q4, given revolver balances following the close of the Atria transaction, we expect interest expense to increase by approximately $14 million sequentially.

Regarding capital management, we ended Q3 with corporate cash of $708 million, up $24 million from Q2. As for our leverage ratio, at the end of Q3, it was 1.6 times. Looking ahead, consistent with our expectations, following the closing of the Atria transaction earlier this month, we anticipate our Q4 leverage ratio to be near the midpoint of our target leverage range of 1.5 to 2.5x, and we expect corporate cash to return to more normalized levels, near our management target range of approximately $200 million.

Moving on to 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 Q3, the majority of our capital deployment was focused on supporting organic growth, as well as M&A, where we allocated capital to our Liquidity & Succession solution, and on October 1st, closed on the acquisition of Atria. Specific to share repurchases, a reminder that we paused buybacks following the announcement of the Atria acquisition. Now that we closed on the transaction, we plan to restart share repurchases in Q4, and anticipate buying back $100 million of our shares in the quarter. To summarize, our balance sheet is strong and we are well positioned to drive value through our capital allocation framework.

In closing, we delivered another quarter of strong business and financial results. As we look forward, we remain excited about the opportunities we have 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.