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LPLA.OQ - Q2 2022 LPL Financial Holdings Inc Earnings Call

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OVERVIEW:

LPLA reported 2Q22 EPS prior to intangibles and acquisition costs of $2.24.

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PRESENTATION

Operator

Good afternoon, and thank you for joining the Second Quarter 2022 Earnings Conference Call for LPL Financial Holdings Inc. Joining on the call today are President and Chief Executive Officer, Dan Arnold; and Chief Financial Officer, Matt Audette. Dan and Matt will offer introductory remarks, and then the call will be open for questions. (Operator Instructions) The company has posted its earnings and press release and supplementary information on the Investor Relations section of the company's website, investor.lpl.com.

Today's call includes forward-looking statements, including statements about LPL's financial future and operating results, outlook, business strategies and plans as well as other opportunities and potential risks that management foresees. Such forward-looking statements reflect management's current estimates or beliefs and are subject to known and unknown risks and uncertainties that may cause actual results or the timing of events to differ materially from those expressed or implied in such forward-looking statements.

For more information about such risks and uncertainties, the company refers listeners to the disclosures set forth under the caption Forward-looking Statements in the earnings press release as well as the risk factors and other disclosures contained in the company's recent filings with the Securities and Exchange Commission.

During the call, the company will also discuss certain non-GAAP financial measures for a reconciliation of such non-GAAP financial measures to the comparable GAAP figures, please refer to the company's earnings release, which can be found at investor.lpl.com.

With that, I will now turn the call over to Mr. Arnold.

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Thank you, Justin, and thanks to everyone for joining our call today. Over the past quarter, we remained focused on our mission of taking care of our advisers so they can take care of their clients. Amid persistent market volatility and geopolitical uncertainty, our advisers reinforced the value they provide to their clients by helping them navigate through times of uncertainty. In that spirit, I want to recognize our advisers for their continued care and dedication to their clients, especially when they need it most.

With respect to our performance, our second quarter business results led to solid financial outcomes. At the same time, we continue to make progress on our strategic plan. I'll review both of these areas, starting with our second quarter business results.

In the quarter, total assets decreased to $1.1 trillion as continued solid organic growth was more than offset by lower equity markets. With respect to organic growth, the business continued to perform well despite market volatility. Second quarter net new assets were $37 billion, which included $25 billion from CUNA and represented 13% annualized growth. These quarterly results contributed to a 10% organic growth rate for the past 12 months.

Looking at recruited assets, they were $44 billion in Q2, including $32 billion from CUNA. This brought our total recruited assets over the past 12 months to $84 billion, which is up $4 billion from the same period a year ago. These results were driven by the ongoing enhancements to our model and our expanded addressable markets.

Looking at same-store sales, our advisers continue to focus on serving their clients and differentiating their solutions in the marketplace. And while market volatility led some clients to moderate their activity in the quarter, periods of heightened uncertainty are often the environments that reinforce the value of professional advice and with time and can serve as a catalyst for advisers to grow their practices.

With respect to retention, we continue to enhance the adviser experience through 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 approximately 98% in the second quarter and 98% over the past 12 months.

Our second quarter business results led to solid financial outcomes of $2.24 of EPS prior to intangibles and acquisition costs, an increase of 21% 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 become the leader across the entire advisor-centered marketplace, which for us means being the best at empowering advisers and institutions to deliver great advice to their clients and to be great operators of their businesses. To bring this vision to life, we are providing the capabilities and solutions that help our advisers deliver personalized advice and planning experiences to their clients. At the same time, through human-driven technology-enabled solutions and expertise, we're supporting advisers in their efforts to be extraordinary business owners. Doing this well gives us a sustainable path to industry leadership across the adviser experience, organic growth and market share.

Now to execute on our strategy, we have organized our work into 4 strategic plays, which I'll review in turn.

Our first strategic play involves meeting advisers and institutions where they are in the evolution of their businesses by winning in our traditional markets while also leveraging new affiliation models to expand our addressable markets.

Our recruiting in traditional markets continued to be a source of growth in Q2 with approximately $9 billion in assets. We continued to increase our win rates and expand the depth and breadth of our pipeline, notwithstanding a broader slowdown in adviser movement over the past couple of quarters. Historically, during the initial stages of elevated market volatility, advisers often focus on supporting existing clients and may pause on making strategic decisions like switching firms. However, after advisers have acclimated to the conditions, they will often use times like this to consider new options for their practice, likely creating an opportunity for us from a recruiting standpoint.

With respect to our new affiliation models, Strategic Wealth, Employee and our enhanced RIA offering, we recruited over $2 billion in assets in Q2 and believe we are well positioned to drive continued growth across all 3 models. The second quarter saw a new high for recruited assets in our employee model as the value proposition for advisers has proven to be compelling. As a complement to our organic growth, we recently announced the acquisition of the Private Client Group business of Boenning and Scattergood, which we will onboard to our employee model early next year.

With respect to large financial institutions, we onboarded CUNA in May, and we are on track to onboard People's United later this year. We continue to learn from each experience and use these findings to drive innovation that improves the transition to LPL and in turn helps make our offering even more appealing. As we look ahead, we expect to continue winning in this market as demand for our model grows.

Our second strategic play is focused on providing capabilities that help our advisers differentiate in the marketplace and drive efficiency in their practices. As a part of that focus, we continue to enhance ClientWorks, our core operating platform with the expansion of digitized workflows.

For example, in the second quarter, we introduced enhancements to our Move Money solution, which makes it easier and more automated for advisers to support deposits and withdrawals within client accounts. Separately, we also enhanced the client management workflow for advisors by integrating goal-planning data into our Meeting Manager solution, which facilitates more efficient preparation for, and more value-added dialogue within, client reviews. These enhancements help advisers operate more effectively and increase their scalability to serve more clients.

Let's next move to our third strategic play, which is focused on creating an industry-leading service experience that delights advisers and their clients and in turn, helps drive adviser recruiting and retention.

As a reminder, over the past 2 years we have transformed our service model into an omni-channel, Client Care Model, which includes voice, chat and digital support, thus giving advisers flexibility for when and how they access service. We continue to fine-tune this model to drive additional efficiency and an enhanced experience for advisers.

As part of the next phase of our transformation, we continue to expand and enrich our digital processing capabilities in order to provide greater flexibility, speed and accuracy for our advisers. Our transformation efforts are currently focused on core clearing functions, including money movement, account opening and account transfers, which collectively drive the majority of our operational processing. And while we remain early in these efforts, we are seeing solid progress as we are now processing millions of transactions for our advisers through the applications of robotics and AI. By expanding the automation of these critical processes, we continue to increase the scalability and efficiency of our platform while also enhancing the client experience.

Our fourth strategic play is focused on developing a services portfolio that helps advisers and institutions run thriving businesses and deliver comprehensive advice to their clients. In the second quarter, our subscription base ended the period at nearly 3,900 with sequential growth moderating slightly in the wake of macro volatility.

As we work with advisers on existing services, we continue to identify new needs we can solve for on their behalf, which is a catalyst for further innovation that expands the value proposition of our existing services and surfaces opportunities for new services. One example relates to how former Waddell & Reed advisers utilized our Admin Solutions on an interim basis to help them during the onboarding process. And based on that insight, we created a set of solutions for shorter-term engagement with our services to solve for a specific need in time for advisers. And we are testing some of these with CUNA advisers as they transition to our platform.

Looking at our pipeline for the second half of the year, we have several services in pilot and other offerings in the incubation phase. And as we move forward, we remain focused on enhancing and expanding our services portfolio to better support our advisers and drive growth.

In summary, in the second quarter, we continued to invest in the value proposition for advisers 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 advisers 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.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

All right. 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 advisers, growing our business and delivering shareholder value. Against a volatile market backdrop, we delivered another quarter of solid net new assets and earnings growth. In addition, we progressed the work to enhance our sweep program utilizing free credits to create the client cash account, substantially completed the integration of Waddell & Reed, signed an agreement to acquire Boenning and Scattergood, onboarded CUNA, and are preparing to onboard People's United. So as we look ahead, we continue to be excited by the opportunities to help our advisers differentiate and win in the marketplace.

Now let's turn to our second quarter business results. Total advisory and brokerage assets were $1.1 trillion, down 8% from Q1 as continued organic growth was more than offset by lower equity markets. Total net new assets were $37 billion or a 13% annualized growth rate.

Looking more closely at recruiting, Q2 recruited assets were the strongest in our history at $44 billion, which included $32 from CUNA. These results brought our 12-month total to $84 billion.

Now let's turn to our Q2 financial results. The combination of organic growth, rising interest rates, higher client cash balances, and expense discipline, led to EPS prior to intangibles and acquisition costs of $2.24. This was up 21% from a year ago and is the highest in our history.

Looking at our top line growth, gross profit reached a new high of $711 million, up $42 million or 6% sequentially. Looking at the components, commission and advisory fees net of payout were $205 million, down $22 million from Q1. The decrease was primarily driven by the seasonal increase in production bonus expense and lower advisory fees following the Q1 equity market decline.

In Q2, our payout rate was 87%, up about 90 basis points from Q1 due to typical seasonality. Looking ahead to Q3, we anticipate our payout rate will increase to roughly 88%, driven by the typical seasonal build in the production bonus as well as the onboarding of CUNA.

Moving on to asset-based revenue. Sponsor revenue was $208 million in Q2, down $4 million sequentially as average assets decreased during the quarter, driven by lower equity markets. This was partially offset by an $8 million payment from a sponsor related to prior period activity.

Turning to client cash revenue, it was $156 million, up $71 million from Q1. This was driven by higher client cash balance as well as higher average short-term interest rates.

Looking at overall client cash balances, they were up in the period, ending the quarter at $70 billion. Within our ICA portfolio, we added capacity in Q2 as we saw further improvements in bank deposit demand, leading to an increase in balances of $8 billion, of which $3 billion are fixed rate and $5 billion are floating rate.

Looking more closely at our ICA yield, it was 134 basis points in Q2, up 32 basis points from Q1, primarily driven by the increase in the Fed Funds rate during the quarter.

As we look ahead to Q3, we expect our ICA yield to continue to increase. Based on where interest rates are today, and our historical betas, we expect our Q3 ICA yield to increase to approximately 195 basis points.

Before moving on, I want to highlight that we updated our reporting of client cash balances this quarter. As we prepare for the introduction of the client cash account as our primary sweep overflow vehicle, we have updated our cash reporting to include these balances. In addition, purchased money market fund balances have been relocated to the endnotes of our release. The historical data reflecting these changes is available in our historical information file.

Now let's turn to service and fee revenue, which in Q2 was $113 million, unchanged from Q1. Within our Services Group, we ended the quarter with nearly 3,900 subscriptions, which is up about 300 from last quarter. Our Services Group now generates roughly $32 million of annual revenue, while also contributing to organic growth by helping drive recruiting, same-store sales and retention.

Looking ahead to Q3, we expect service and fee revenue to increase by roughly $10 million sequentially, driven by revenues from our national adviser conference and IRA fees.

Moving on to Q2 transaction revenue, it was $44 million, down $2 million sequentially due to decreased trading volume. As we look ahead to Q3, volumes in July have seasonally declined, which on a run rate basis would result in a decline in transaction revenue of around $10 million from Q2.

Now let's turn to expenses, starting with core G&A. It was $286 million in Q2. Looking ahead, we plan to stay disciplined on expenses while continuing to invest to drive growth. Given the increase in interest rates to date, including the rate hikes last week, we are poised to generate significant additional capital. Our framework for allocating this capital remains aligned with the returns we generate, which first and foremost, is investments to drive and support organic growth. Now that we are deeper into the rate cycle, we plan to accelerate some of these investments and anticipate up to $20 million of additional core G&A in 2022. This increases our 2022 core G&A outlook to a range of $1.170 billion to $1.195 billion.

Moving on to Q2 promotional expense, it was $84 million, down $4 million sequentially, primarily driven by lower conference expense.

Looking ahead to Q3, we expect promotional expense will increase to approximately $105 million, primarily driven by conference spend as we hosted our largest adviser conference of the year last week, which returned to an in-person format for the first time in 3 years.

Now let's move to Waddell & Reed. In total, we onboarded over $70 billion, as 99% of client assets joined our platform. We generated EBITDA of roughly $21 million in Q2 or $85 million on an annualized basis. At the end of the quarter, the run rate EBITDA benefit was approximately $100 million, bringing our estimated purchase multiple to 4.5x EBITDA. As we have now substantially completed the integration, going forward, we will no longer break out their stand-alone results.

Turning to depreciation and amortization, it was $48 million in Q2, up $3 million sequentially. Looking ahead to Q3, we expect depreciation and amortization to increase by up to $5 million sequentially.

As for interest expense, it was $29 million in Q2, up $2 million sequentially, as higher LIBOR rates increased the cost of our floating debt. Looking ahead to Q3, we expect interest expense to increase to approximately $33 million, primarily driven by the increase in LIBOR.

Moving on to capital management. Our balance sheet remained strong in Q2, with a leverage ratio at 2.1x and corporate cash of $241 million.

As for capital deployment, our framework remains focused on allocating capital aligned with the returns we get, investing in organic growth first and foremost, pursuing M&A where appropriate, and returning excess capital to shareholders. In Q2, we allocated capital to both organic growth and share repurchases, buying back $50 million of our shares.

As we look ahead to Q3, given our improved level of cash generation, we plan to increase share repurchases to approximately $75 million.

In closing, we delivered another quarter of strong business and financial results. As we look forward, we remain excited about the opportunities we see to continue investing to serve our advisers, grow our business and create long-term shareholder value.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Alex Blostein from Goldman Sachs.

Alexander Blostein - *Goldman Sachs Group, Inc., Research Division - Lead Capital Markets Analyst*

So Matt, maybe we'll just start off with some of the cash sweep dynamics. In one of the slides you guys referenced that the deposit betas on subsequent hikes beyond 100 basis points are running a little bit lower than what you experienced, I guess, in the last cycle. I guess just curious to get your thoughts on why that is. Is it just the pace of rate hikes has been too fast and we're going to likely play a little bit of a catch-up? Or do you think there's a reason to believe that, that's more sustainable? And maybe just as a follow-up to that, would love a comment on appetite for additional fixed duration as we saw you guys have done in the quarter?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Sure, Alex. I think the -- maybe the operative point on that slide, the primary point on that slide is the betas in the prior cycle. I think we are just given how much cash is in the system, it's not a surprise to me that the betas so far have been a little bit better, but I would just emphasize a little bit. So I think the center of gravity and where pricing in the product is probably in the zone of last time, which just highlights it's not really a rate-sensitive product.

On your second question on fixed, right, I think our objective and goals here remain the same that I think you've heard for quite some time, which is to get into a range of 50% to 75% of the portfolio on the fixed rate side. And I think the primary driver on our ability to do that is really demand coming back. So if you look at where we ended the quarter even though we added some fixed rates because of the growth that we had, we're at about 25% of the portfolio. And I think what -- when you think about the demand that came back in the market, it's really starting to build up quite well with us being able to add $8 billion of balances in the quarter, there was more demand on the variable rate side, right?

So about $5 billion of that came on the variable rate side. But the $3 billion on the fixed rate side, that was the most that we put in place in quite some time, probably since the pandemic began. So I think it's encouraging to see.

And as we look ahead, it's going to be really about is the additional demand on the fixed rate side there. And the environment, I think, is conducive in general to that, whether it's the fed continuing to raise rates or probably more importantly, shrinking their balance sheet and taking cash out of the system, to the consumer side where consumer spending remains healthy, loan balances are growing. Those are all things that ultimately would lead to sweep demand overall and then ultimately, I think, some fixed rate demand.

Alexander Blostein - *Goldman Sachs Group, Inc., Research Division - Lead Capital Markets Analyst*

Great. And just maybe for my second question around organic growth. Obviously, and again, perhaps not surprisingly, with more volatility, we've seen moderation in organic growth across the industry in terms of just net new assets. If you were to unpack that a bit and think about sort of the slightly lower run rate ex the larger transactions that we've seen from you guys, how much of that is coming from just slower same-store sales versus lower recruiting versus some retention dynamics? Just would love to get a little more color on that as we think on the forward organic growth rate opportunity for the firm as a whole.

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

I'll take that one, Alex. And look, I think if you look at the quarter more closely, right, we saw solid new store activities. And if you look across our traditional markets, the new models ex the large institutions, you saw a good robust activity with some slowing relative to prior quarters in new store sales as we believe more to do with just that macro backdrop as we talked about.

And I think, as advisers pivot through that and get a bit more acclimated to that environment and then begin to look forward, again, these types of conditions are usually an opportunity for us, as we believe there will be more demand, if you will, to explore looking at more into options and alternatives.

And so I think you've seen just a little sluggish in new store sales, which is more backed up with the environment. The retention levels have remained as we pointed out, that 2% range in the past year to 2 years, we feel good about where that is, and that's at the lower end of kind of our target range. And so I haven't seen much variability there through the period.

And then same-store sales is where you see most of the headwind. Of course, this quarter, you have the April dynamic of tax payments that are a headwind on April. And then you saw the equity market volatile and move down much of the quarter. We saw a real sluggishness in April. And we saw some same-store sales pick back up in May slightly with the market and then June, it returned to a headwind. At our conference last week, I think in the dialogue with advisers, you're beginning to hear those advisers get to a place, I think, in this period where they're beginning to see more growth opportunities as they work through this period of volatility.

And I think that's logical and normal as they see more opportunity to serve new clients who may not be being served as well by other advisers. And that ends up being quite frankly, a stimulus and a structural opportunity to demonstrate value to differentiate when required. So a headwind in the second quarter, I do think that structurally speaking, we still see good opportunity as we go forward on same-store sales. But that's the biggest headwind in the short. Let me pause there. I hope that helps.

Operator

(Operator Instructions) And our next question comes from Steven Chubak from Wolfe Research.

Steven Joseph Chubak - *Wolfe Research, LLC - Director of Equity Research*

First off, I just wanted to unpack a recent announcement that you guys made in hiring Bill Sappington. And I was hoping you could just speak to the decision around the new hire. It certainly sends a strong signal that you guys are focused on growing some of your banking and lending solutions. It is a sizable revenue opportunity. It's one that many of your peers have pursued. But just wanted to get a sense if you could help us frame the long-term revenue opportunity here, especially since your advisers haven't historically been strong users of that lending product.

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes. This is Dan. Look, from a strategic standpoint, we're trying to, I think, solve for 2 opportunities. One, we hear our advisers with the appetite to broaden their value to their clients and provide more of what I might call a holistic approach to that overall advice spectrum. And so it's logical that we would think about bringing lending capabilities, cash management solutions and integrate those in as part of the client experience and to create those products and solutions to add value to the end client.

And then if you -- by solving that, you create economics around that and that certainly is appealing from a strategic standpoint. So that's really what we're solving for. I think what we did was go out to the marketplace and say, hey, if we're going to do this right, let's go get the experience and the insight and the leadership to do that. We have been experimenting for a short period of time and just learning enough about it to probably ask smart questions and better identify where our opportunities were and then bring that leadership in to help us go operationalize and execute on that concept. So that's what we're doing.

We think there's interesting possibilities to do that through good third-party partnerships that have tight integrations into the overall client experience and thus deliver compelling solutions to the end client via those advisers. So I hope that helps. That's our strategy.

Steven Joseph Chubak - *Wolfe Research, LLC - Director of Equity Research*

Great. And just for my follow-up, maybe just unpacking some of the rate commentary that you made earlier, Matt. Two things I wanted to clarify. First, have you seen any change in client behavior in July in terms of cash allocations? How much of that cash, if any, has gone back into the market? And secondarily, you gave a lot of helpful color around fixed rate contracts. I noted that you had churned out some in the quarter. I'm just trying to gauge your sense of urgency there because the forward curve is pricing in cuts for next year. And there is some concern that if you still are running with a significant amount of floating rate ICA that the downside risk on cash sweep fees could be more acute if we do enter another easing patch.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes. I'll take the second one first, Steve. I think that what I'd emphasize on the fixed rate side is we're below our target range, right? So I think from our perspective, if there's availability in the marketplace for fixed rate, we're interested in doing that. And I think what's encouraging, as I said to Alex, right, having the ability to add $3 billion just this quarter is really the most amount we've been able to do in a quarter since the pandemic.

So I think it's encouraging. But our perspective, I think, is in line with the premise of your question that we'd like to increase fixed rates from here. It's just all about whether it's available in the market.

Now with respect to your first question, so balances in July. I think when you look at what you would typically see in the first month of the quarter, I'd just remind you that advisory fees are primarily charged or the -- or month 1 is the biggest month of the quarter. So that typically would reduce cash. But I think that was offset by the continued organic growth that we have as well as the volatility, at least in the first half of July. So those 2 things kind of netted off. And I'd say July cash balances were relatively flat. But I'd add that the mix improved, meaning we saw further demand or capacity on the ICA side. So ICA balances actually went up while the money market overflow went down.

And maybe just to complete the July update, even though you didn't ask it, just give a little bit of color on the NNA front, which has those same dynamics of advisory fees in the first month of the quarter as well as that choppy macro. And I think when you factor those things in July, it's looking like something that you would expect in that environment, which is organic growth, call it, in the 4% zone. And that is prior to any additional CUNA onboarding, which we have about $5 billion to go on the direct side of CUNA. So I hope that helps, and gave you a little answer.

Operator

And our next question comes from Michael Cyprys from Morgan Stanley.

Michael J. Cyprys - *Morgan Stanley, Research Division - Executive Director and Senior Research Analyst*

Great. Just had a question on expenses. As we think about the moving pieces for this year, but also into '23, I know probably not going to get any sort of guidance there. But I saw you increase the core G&A growth expense guidance here for '22, I think that implies around 10.5% growth to 13% growth for this year. So I guess, would you be surprised that, that level of growth persisted into '23? And just any sort of help on the moving pieces as we kind of build our models out to '23 here just in terms of some of the moving pieces around expenses that are coming in to the run rate this year from some of the acquisitions as well as the large mandate wins and initiatives that you have going on, just in terms of helping us with the run rate impact as we think about a full year impact in '23? But at the same time, I imagine there are some synergies and some expenses that will be falling out. So just any help there would be appreciated.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, sure, of course. I mean I think the key thing, I'll just start with the driver of the increase and specifically, where we are in the interest rate cycle. And I think you probably recall in the past few quarters, we talked about the economics of interest rates going up and our perspective on that, which is really for that first 100 basis points or so increase, that the benefits of that really having that fall to the bottom line and improve operating margin.

And once we got beyond that, really looking to our capital allocation framework to drive those decisions. And sitting here now well above 100 basis points, I think we feel well positioned to really allocate capital across all 3 of our primary areas, including what you're asking about on the expense front.

And I think when we look at how and where to allocate that, we do focus, first and foremost, on investments to really drive and support organic growth. And the investments that we've identified to accelerate into this year, that $20 million is really focused on that, in areas where we typically spend, like technology, capabilities, serving and supporting our advisers. We see opportunities in M&A. The Boenning and Scattergood is a good example of that, that we recently signed. And then, of course, returning capital to shareholders. And as I highlighted in the prepared remarks, we plan to increase our buyback to $75 million, up from $50 million in this quarter.

Now to your question about next year, right? I think what we'll do is really share our thinking on next year when we typically do, which is when we get closer to the end of this year. But I'd just emphasize, we'll continue to apply our capital allocation framework to really drive how and where we allocate that capital. Really focused on making sure we remain flexible and can make decisions really at that time. So we'll give you an update then.

And I would just highlight from a share repurchase standpoint with the $75 million planned for next quarter, we are getting close to completing our current authorization. So that's something that we'll naturally work to refresh with a new one, and we'll also give you an update after we do that as well.

Michael J. Cyprys - *Morgan Stanley, Research Division - Executive Director and Senior Research Analyst*

Okay. And maybe just on the capital management front, the $75 million of buybacks you mentioned for the next quarter, should we expect that pace to be sort of sustained into the fourth quarter and beyond? How are you thinking about that? And then just more broadly on M&A, clearly, you saw the transaction announced in the quarter. I think it was an employee model. So I guess where else might M&A be additive to the platform at this point? And what sort of properties are you seeing out there? And how much time are you guys spending on that?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes. I mean I think on the M&A front, all about anything that can accelerate our strategy, whether it's -- when you look at the different types of M&A that we've done from our traditional markets to helping advance our entry into the new market, and on the technology side in advancing capabilities that we otherwise would have had to build.

So I think it goes -- all goes back to our strategy and whether it can advance that or not. And of course, if it's a price that makes financial sense and if it's a growth acquisition, operationally we're in a position to be able to bring it on to it. So I think that perspective that we've had for a while is really the same.

On share repurchases, I'd just go back to what I said at answering the prior question, it's really about our framework and what the opportunities are to allocate capital. I think with where interest rates are, we do expect to have more capital to allocate, and we'll be focused then on the opportunities we see on organic growth and M&A and returning capital to shareholders through share repurchases. So just depending on what the opportunities look like, but if share repurchases make sense, we would allocate capital there. We'll just have to see what it looks like at the time.

Operator

And our next question comes from Brennan Hawken from UBS.

Brennan Hawken - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Financials*

I'd like to start with a follow-up to Steven and Alex's questions. So the floating rate ICA contracts, it looks like they're still being done at flat to Fed Funds. Matt, you indicated that demand was improving and we certainly saw that on the volume side this quarter. But when do you think that, that demand is going to translate into prices as well, thinking back to the historical premium to the Fed Fund rate that you typically get on the floating rate?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Sure, Brennan. I mean, I think -- remember, I think well back when it peaked, right? We -- I think the Fed Funds -- the variable contracts were in the Fed Funds of maybe plus 20, plus 25. And I think that was at the peak, right? So where we are now with just the amount of demand and volume, I would just emphasize, was a big, big positive in the quarter. And moving from contracts that were Fed funds through Fed funds minus a couple of basis points to now starting to get some that are Fed funds plus even in the 5 range or so. It's been a pretty quick improvement. So it's hard to know if that trend continues. I just will say when you look at the marketplace and the factors that would drive demand just continue to be there. So it would not surprise me from a balance standpoint if demand continued to increase.

And whether the spreads go from the 5-ish zone that we just saw up to that 20 or 25 that we saw at the peak, that's harder to know, but keep in mind with Fed funds at 225 to 250, the spread that we're talking about is a relatively small piece of that overall amount.

Brennan Hawken - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Financials*

Sure, sure. And I didn't realize that you are seeing some small improvements in price. So that's certainly encouraging, and it makes sense. On the other asset-based fees, Matt, I believe you flagged an $8 million payment related to prior period activity. Should we consider that to be one-time in nature? Or is there a reason why that might be recurring?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, its prior period related, so not recurring.

Operator

And our next question comes from Devin Ryan from JMP Securities.

Devin Patrick Ryan - *JMP Securities LLC, Research Division - MD and Equity Research Analyst*

First question, I just want to dig in a little bit more around if we can get some more flavor on just the pool of advisers in motion today. And what you're seeing both there and you touched a little bit, Matt, on kind of NNA properties. But just how that's been evolving in the current backdrop, if there's any affiliation model that people are gravitating to in this environment? And then whether in terms of just the strategy, whether people are seeking LPL out or if you're kind of aggressively proactively going after either M&A targets or recruiting. So we're hearing kind of 2 sides in the market. I know some people are having a lot of success as you are and some aren't seeing much at all. So just love to get a little flavor for that.

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes, Devin, let me take a stab at that and a couple of questions in there. If I don't get it all, please just circle back. So I think with respect to the opportunity set, I think you've heard us talk about for the good past year, there's been slower movement or less movement, if you will, than historical norms in the overall marketplace. And we've continued to expand our participation rate and grow our share during that period of time.

And I think that's probably reflective of the second quarter as well that we just saw and we are very proactive in the marketplace across all different models, affiliation models, in terms of making sure that we create awareness for the solutions that we have, the sort of horizontal expansion we've gone on with these multiple affiliation models. We want to make sure that people are aware of the different solutions and problems that we can help them solve for.

And certainly, our ongoing investment in the vertical integration of our capabilities is making the model more and more appealing to advisers again in all different segments. And so we want to make sure that people are aware of that capability set within the base of innovation and the change that's going on.

And the team has done a really good job, I think, of creating structure and using data and insights to go to the market in a smart way and a crisp way to tell that story in a consistent way.

And so we're very intentional about trying to be good at attracting new advisers and very intentional about constantly working on how can we improve and get better at that. So I think this combination of the capabilities that we've built, matched with the growing efficacy of our ability to recruit, is leading to that sort of consistent up and to the right kind of results related to our new store sales.

And again, we see a really strong pipeline, notwithstanding what's going on in the marketplace across all of our different models, that is very encouraging. I think that the employee-based solution that we have, still retains the independent principles. We're seeing it continuing to really resonate out in the marketplace as more and more people become aware of it, and understand the combination of value they get by preserving sort of that principles and most appealing attributes of the independent model. We think that has very interesting growth prospects. I hope that helps.

Devin Patrick Ryan - *JMP Securities LLC, Research Division - MD and Equity Research Analyst*

That's helpful. Maybe just a quick follow-up here on the services business. And you mentioned there's some new services in pilot and incubation at the moment. I'm not sure if you can give any more detail on what those might look like or what buckets they fit into?

And then if you think about kind of the bigger picture as you continue to scale, is there room for pricing uplift, as it sounds like a lot of the advisers are getting a lot of value out of it and maybe arguably even underpricing some of the services. Or really, is it just more about the differentiation of that platform? And so it just helps growth and stickiness. Just love to get more color as kind of the longer-term vision.

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes, it's a good question. And look, strategically, the hypothesis was, hey, there's real problems and challenges to help these advisers better operate their businesses that we could solve for in a more effective way and in a cheaper rate for them, thus creating real alternatives and real appeal.

And then if you can then integrate them from an automation and a technology standpoint, and when I take the service human center and that technology around it, well, that would be a great way to not only create scalability and efficiency in the overall delivery of those services, i.e., do them for a lower cost, but then again, improve and enhance the value of it.

So I think that's the journey we're on. That's the journey we're on with the first generation of solutions that we offer to the marketplace. I think Admin, CFO, Marketing, as the professional services that we started with.

I think as we continue to refine them and improve and enhance them, that will give us potential pricing power in certain of those solutions and services or continue to innovate on how you offer them to the marketplace, and it could be that you turn those, that holistic sort of CFO solution into different discrete solutions, think about bookkeeping as a derivative of that, that might have a lower price point but solve for a unique need within the old CFO scope. And so there's another number of iterations that we can take to create product expansion that have different price points that actually make it more accessible and easier for us to serve a broader set of advisers.

So you've got both dynamics. It's product innovation needs, different positioning in the marketplace that will drive price points. And to your point, if you create more value, then you can also charge more for historically consistent, but valuable existing services. So I think all of those spectrums of possibilities are there for us. We are heavily into the innovation and trying to learn and understand what problems or challenges we're hearing from advisers and then how we can turn that into a service.

You mentioned some things that are in the incubation phase and or what I might call, pilot-based -- bookkeeping is one of those that we think will be an interesting opportunity that we'll go to market later this year on and then we've got another probably 5 or 6 that are in that incubation phase that would then logically move to a pilot. I hope that helps.

Operator

And our next question comes from Gerald O'Hara from Jefferies.

Gerald Edward O'Hara - *Jefferies LLC, Research Division - Equity Analyst*

Maybe just sticking with the business solutions for a moment. Can you maybe give us a little bit of color or context around kind of the stickiness of the subscriptions and what those kind of renewal terms look like or how long the contracts are? Or anything to just give us some insight as to the longer-term kind of opportunity there?

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes. So there's a variety of different solutions and services that are offered, right? So you have the professional services that I mentioned before, Admin, CFO, marketing, business strategy, then you have some business solutions that we've created that are more like M&A solutions, our assurance plan, remote office, resilience plan and even now paraplanning as a solution.

And so they're slightly different in the value that they create, and they're slightly different in how an adviser may use them. And so they're distinctively different when they have when you think about contracts and things of that nature. But if you take the professional services, generally speaking, that's a 1-year contract to start, that typically speaking, we have done that as a way to present it to the marketplace to make sure that it's not a longer-term commitment, as people got acclimated to the service, understood whether that added value to them or not, but then gave us enough time, i.e., a year, to make sure that they had been informed and had used it enough to really understand whether it created value for them or not.

And I think you have high retention rates on those different types of services. We're also though learning into the marketplace, as I said in my remarks. We saw some advisers that moved over from Waddell & Reed on our admin services that used those for a shorter time frame, I think their intent was to say, hey, I just want these to help me transition over to LPL. So their vision was just one term on that contract and then ultimately would find a different long-term solution. So that's a good learning for us and an opportunity to innovate around that and create a different type of solution for a shorter-term specific need in time. That might have a higher price associated with it, but still create that value that they need for that short period of time.

So that was a good example in learning where you might have had higher attrition rates on the surface of the admin services for that period of time, but it was more related to how they were using the service, then dissatisfactory.

So again, I think as we innovate on this portfolio and we offer them to the marketplace, we're seeing how people use them in different ways, it's a good learning experience and evolution for us in terms of making sure we fine-tune the value and that we -- they're well positioned in the marketplace to meet those specific needs of the advisers that are looking for help.

So net out is, I think, high retention rates. And again, our opportunity is to continue to create awareness and to make sure that we expand that portfolio, so that we reach more advisers with a variety of different solutions that they need. And we think that there's a significant amount of value to be added. It also creates great stickiness and around that overall relationship with us and also has a residual knock-on effect of improving and enhancing the overall performance of the practice, I think high tailwind to same-store sales and higher retention rates that come along with those additional services as part of the relationship and even help us with new store sales as a differentiated more appealing model.

Gerald Edward O'Hara - *Jefferies LLC, Research Division - Equity Analyst*

Okay. That's helpful. And then as a follow-up, I think around -- about this time last year, you kind of gave some color with respect to the RIA relaunch and sort of how that strategy was coming along, I guess, the sort of early days, maybe encouraging pipeline comments along those lines. But I think you also ended by saying you kind of need to go out and sell it. So hoping you might be able to give us a little bit of an update as to how that's coming along.

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes, good question. And I think we -- that was like a year ago, we kind of relaunched, if you will, or went to the marketplace in a more offensive posture relative to our RIA offering. And we continue to go to the marketplace, looking for those opportunities for folks to leverage us as a vertically integrated strategic partner, that are RIAs only.

We continue to add capabilities and pricing that we believe is competitive and compelling and you're seeing that show up in the recruiting that we've had over the past 12 months. That said, I think there's more that we can do and more opportunity and more -- we can be more intentional about how we go to the market and really establish ourselves as a differentiated strategic partner and a value-added partner and not just a custodian to RIAs. And so we have more to play there that you'll hear more about in the coming quarters.

Operator

And our next question comes from Kyle Voigt from KBW.

Kyle Kenneth Voigt - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Maybe a follow-up question on capital management. Your current leverage ratio is roughly 2.1x, which is towards the bottom end of your range, your targeted range. I guess when you consider that ratio is calculated using LTM EBITDA, and the rate sensitivity you've disclosed, it's relatively easy to see how that leverage ratio can very quickly move below 1.5x without paying down any debt and still investing significantly in the business. I guess, how do you view your optimal leverage ratio in a period with rapidly growing EBITDA? And I guess, would you be willing to kind of let this trend significantly below your target as we look out this year?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, Kyle. I think we're just starting with the range. I think the 2x to 2.75x, we think, is the right range to operate in. And it does a handful of things. But I think the balance sheet strength is key and supportive of recruiting and supporting our advisers that are with us. It's really, really important. And I think in addition to that, positioning us to have flexibility to deploy capital based on the opportunities that we see including M&A, investments in organic growth, are important as well.

And I think to the point of your question, I think as we get deeper into the interest rate cycle or even where we are right now, I think we feel comfortable and like being positioned on the lower end of that range as the interest rates get higher and higher and the amount of EBITDA that's driven by that -- by those economics is a larger percentage of it.

I think if we end up dropping below the low end of that range and maybe I wouldn't say significantly to your question, but maybe by a small amount for a short period of time, I think that's okay. I think our center of gravity and focus is being really deliberate and thoughtful about not only where we allocate that capital, but when we allocate that capital. So I think that's our perspective. Overall, we want to allocate that capital to drive value and I think we feel good where we're positioned today.

Kyle Kenneth Voigt - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Understood. And as a follow-up on client cash, I appreciate the commentary on July, but just a question on the idea of potential sorting and adviser behavior around client cash. Are you seeing any incremental signs of more yield-seeking behavior whether that's demand for money -- treasury or short duration fixed income instruments? And given that we've just gotten the most recent rate hikes last week and obviously acknowledging that's a very small sample size. Just wondering if there's been any change in behavior you've seen recently that's been notable?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes. I think I got your question, Kyle, it's breaking up there. But I think when you look at the rate sensitivity of our cash and the question is, has anything changed? I think the answer is no. And I think just maybe a couple of reminders of the cash that we have in sweep on our business is largely operational. And that's why we tend to have some of the lowest cash as a percent of AUM in the industry where it's usually in the 5% zone. And the primary factor that tends to move that up and down is really market sentiment as opposed to rate-seeking behavior.

And I think when you look at just the last couple of quarters and especially this quarter, I think you're seeing that play out. Just looking at Q2 as interest rates have gone up meaningfully during the quarter, our cash balances actually grew both in dollars and as a percent of AUM, up to 6.5%, just given the volatility that you saw in the quarter.

So I think the cash tends to be operational and even looking back at Q1, the last couple of quarters, I think you're seeing empirical data that really validates that the cash -- the rate-seeking behavior is really not in the cash that we have.

Operator

And our next question comes from Craig Siegenthaler from Bank of America.

Craig William Siegenthaler - *BofA Securities, Research Division - MD and Head of the North American Asset Managers, Brokers & Exchanges Team*

I wanted to come back to the pure RIA channel, which you just relaunched a little more than a year ago. Can you provide us an update on how this channel is doing? And I was also interested in how the competitive landscape is evolving with both the merger of 2 of the biggest RIA custodians and also some changes to the macro backdrop year-to-date?

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes. So I think with respect to the RIA business, look, the last 2 quarters, you've seen our affiliation models collectively, we've recruited in each of those quarters, a little over $2 billion in assets. And certainly, the RIA solution is a significant contributor to that. So again, we're seeing good traction with our offering in the marketplace today.

As I shared with you, though, we see the opportunity to be a more significant vertically integrated strategic partner than just a custodian. And so that's one of the things that we're trying to be intentional about both in terms of how we think about our offering, our pricing and even potentially our branding of that offering.

And so there's more to play out there that you'll hear more about as we go forward. But we do see the opportunity, given the size of that market to continue to win share there. I do think with the consolidation of 2 large custodians, that creates disruption or some potential change in the marketplace. And usually, where there's change, if they're well prepared, chance favors the prepared and you can capitalize on that opportunity. And so I think we certainly see that as one of the possibilities and opportunities amongst a number, to win share as we go forward.

So I hope that helps give you a little bit more color and context on the opportunity we see and how we're trying to be intentional about capitalizing.

Craig William Siegenthaler - *BofA Securities, Research Division - MD and Head of the North American Asset Managers, Brokers & Exchanges Team*

And I wanted to do my follow-up on the bank channel. So 2 big wins last year, 2 this year with both CUNA and People's United coming shortly. What's the potential for additional bank channel wins? Can you keep the streak of 2 wins per year alive next year? And also, is the macro backdrop making it a little tougher to find the next win, just with banks focusing more internally right now?

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes. Good question. And so look, as we go forward, our pipeline continues to build across a larger spectrum of financial institution clients. So I think it's that typical momentum where you have some success, you continue to iterate and evolve your value proposition, and that tends to create more dialogue and more opportunity. So we certainly see that demand picking up.

And one of the biggest hurdles is just the whole onboarding change in a transition process. We continue to learn and apply those insights and new innovations, I'd like to say now make our onboarding and transition process, a differentiated capability. And that's one of the things that we saw as a big opportunity to reduce one of the barriers, if you will, of making that transition and the change.

And so we think that the track record of steady wins, the ongoing evolution and a feel of our model, smooth transitions, is increasingly making us confident in the durability of this -- of the growth in this channel. So that maybe answers your first question.

Your second question around the banks and their interest and their willingness to have this dialogue. Now I think the significant opportunity we have to add value across sort of a spectrum of economics, meets risk management, meets operational efficiency, meets potential growth in their programs, notwithstanding the market volatility. There's a lot of reasons to have a dialogue and a discussion. And again, we see those opportunities to explore those possibilities continuing to evolve in a constructive way. So macro hasn't really altered the trajectory of this.

Operator

And I am showing no further questions. I would now like to turn the call back over to Dan Arnold for closing remarks.

Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

I'd just like to thank everyone for taking the time to join us this afternoon, and we look forward to speaking with you again next quarter. Have a great day.

Operator

Thank you. You may now disconnect.
