LPL Financial

LPL Financial
Q2 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, 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 July 25, 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; the negotiation of definitive terms of separation with strategically misaligned large enterprises; 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; 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 market 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 settling and remediating issues related to regulatory matters or legal proceedings, including actual costs of reimbursing customers for losses in excess of our reserves; 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 committed revolving credit facility and LPL Financial's committed revolving credit facility, 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 and Prudential 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 agreement with Prudential, or the Company's purchase agreement with Atria, including regulatory approvals; the SEC's approval of the settlement agreement in connection with the settlement of the industry-wide civil investigation into compliance with records preservation requirements for business-related electronic communications stored on personal devices applicable to broker-dealer firms and investment advisors; 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 July 25, 2024 and you should not rely on statements contained herein as representing the Company's view as of any date subsequent July 25, 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.

Dan Arnold, President and CEO

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

To set the stage for tonight's call, I'll start by taking us through our quarterly business results and hand it over to Matt to cover the financials. Then, before we open the call for Q&A, I'll take a few minutes to share our perspective on recent events in the marketplace related to sweep deposits.

Ok, with that as context, our advisors continued to provide their clients with personalized financial guidance on the journey to help them achieve their life goals and dreams. To help support that important work, we remained focused on our mission: of taking care of advisors so they can take care of their clients.

During the second quarter, we continued to see the appeal of our model grow due to the combination of our robust and feature-rich platform, the stability and scale of our industry-leading model, and our capacity and commitment to invest back into the platform.

As a result, we continue to make solid progress in helping advisors and institutions solve challenges and capitalize on opportunities better than anyone else, and thereby serve as the most appealing player in the industry.

Now, with respect to our performance, we delivered another quarter of solid results, while also continuing to make progress, on the execution of our strategic plan. I'll review both of these areas starting with our second quarter business results.

In the quarter, total assets increased to $1.5 trillion, as continued solid organic growth was complemented by higher equity markets. Regarding organic growth, second quarter organic net new assets were $29 billion, representing 8 percent annualized growth. This contributed to organic net new assets over the past twelve months of $104 billion, also representing an 8 percent growth rate.

In the second quarter, recruited assets were $24 billion, bringing our total for the trailing twelve months to a record $93 billion. These results reflect the continuing appeal of our model, as well as the strength of our recruiting across our expanded addressable markets.

Looking at same store sales, our advisors remain focused on taking care of their clients and delivering a differentiated experience. As a result, our advisors are both winning new clients, and expanding wallet share with existing clients, a combination that drove solid same store sales in Q2.

At the same time, we continue to enhance the advisor experience through the delivery of new capabilities and technology and the evolution of our service and operations functions. As a result, asset retention for the second quarter was approximately 98 percent and 98 percent over the last twelve months.

Our second quarter business results led to solid financial outcomes with adjusted EPS of $3.88.

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

Now, 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 to provide unprecedented 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 sustainable path to industry leadership across the advisor experience, organic growth, and market share.

Now, to execute on our strategy, we organize our work into two strategic categories. Horizontal expansion, where we look to expand the ways that advisors and institutions can affiliate with us, such that we are positioned to compete for all 300,000 advisors in the marketplace. And vertical integration, where we focus on delivering capabilities, technology, and services that help our advisors differentiate and win in the marketplace and be great operators of their businesses.

Now, with that as context, let's start with our efforts around horizontal expansion.

Over the second quarter, we saw strong recruiting in our traditional independent market, reaching a new quarterly high of approximately $19 billion in assets. At the same time, due to the ongoing appeal of our model and the evolution of our go-to-market approach, we maintained our industry-leading win rates while also expanding the breadth and depth of our pipeline.

With respect to our new affiliation models, Strategic Wealth, Employee, and our enhanced RIA offering, we delivered another solid quarter, recruiting roughly $4 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.

Next, in Q2 we added approximately $1 billion of recruited assets in the traditional bank and credit union space, which continues to be a consistent contributor to organic 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 deals will add approximately $66 billion of brokerage and advisory assets by early 2025.

Now, as a complement to our organic growth, we are on track to close the acquisition of Atria Wealth Solutions later this year and complete the conversion in mid-2025. As a reminder, this acquisition will add approximately 2,400 advisors and 150 banks and credit unions, managing approximately $100 billion in client assets.

In addition, we're seeing solid momentum within our Liquidity & Succession solution as demand continues to build with existing LPL advisors, and with advisors outside of our ecosystem including the signing of another external deal in Q2.

Next, I want to update you on our OSJ ecosystem. A reminder that for many years, we have collaborated with large OSJs in serving and supporting independent advisors on our platform. We've been actively working to strengthen our alignment with these firms for a number of years, driving incremental changes to the broader OSJ ecosystem over that period. This year, we put a capstone on those efforts and through that work, there were a couple of isolated firms that surfaced as strategically misaligned with our mission and model as they were limiting advisors' ability to choose how and where they do business. That posture is in stark contrast to our core principles of advisor independence and, as a result we have resolved to separate from these relationships. Collectively, these firms have roughly $20 billion of client assets, which began to off-board from our platform in July. At the end of the day, these separations will strengthen our overall ecosystem and position us to better serve the great partners on our platform.

Now, within our vertical integration efforts, we remain focused on investing back into the model to deliver a comprehensive platform of capabilities, services, and technology that help our advisors differentiate and win in the marketplace and run thriving businesses.

As part of this effort, we continue to make progress across several key areas of focus, including our ongoing journey to build a world-class wealth management platform.

Now, within this body of work, we are developing a comprehensive suite of trading capabilities that will help advisors deliver a differentiated client experience and manage their advisory business more efficiently and effectively.

In that spirit, we're rolling out a new trading system, ClientWorks Rebalancer, which enables advisors to rebalance models across multiple client accounts at one time and deliver a more-personalized client experience across their book of business. In doing so, our aspiration is to help more advisors run models-based practices and ultimately turn trading from an administrative function into a strategic asset. The initial feedback on ClientWorks Rebalancer has been positive and we're seeing solid early adoption.

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 and Head of Business Operations

Alright, 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 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. In addition, we continued to build momentum in our Liquidity & Succession solution, closing six deals during the quarter, and signing one deal with an external practice. Lastly, we remain on track to close on the Atria transaction in the second half of the year, and plan to onboard their business in mid-2025. So, as we look ahead, we remain excited by the opportunities we have to serve and support our 23,000 advisors, while continuing to deliver an industry leading value proposition and drive organic growth.

Now let’s turn to our second quarter business results. Total advisory and brokerage assets were $1.5 trillion, up 4% from Q1, as continued organic growth was complemented by higher equity markets. Total organic net new assets were $29 billion or approximately an 8% annualized growth rate.

Our Q2 recruited assets were $24 billion, which prior to large institutions, was the highest quarter on record. Looking ahead to Q3, our momentum continues, and we are on pace to deliver another strong quarter of recruiting.

As for our Q2 financial results, the combination of organic growth and expense discipline, led to adjusted EPS of $3.88.

Gross Profit was $1 billion 79 million, up $13 million sequentially. As for the components, commission and advisory fees net of payout were $263 million, up $3 million from Q1.

Our payout rate was 87.3%, up 70 basis points from Q1 due to typical seasonality. Looking ahead to Q3, we anticipate our payout rate will increase to approximately 87.5%, driven by the typical seasonal build in the production bonus.

With respect to client cash revenue, it was $361 million, down $12 million from Q1, as average client cash balances declined slightly during the quarter. Overall client cash balances ended the quarter at $44 billion, down $2 billion sequentially, driven by record client net buying activity of $39 billion.

Within our ICA portfolio, the mix of fixed rate balances increased slightly to roughly 70%, within our target range of 50% to 75%.

As a reminder, during Q2 there were roughly $2.1 billion of fixed rate contracts that matured. We placed $1.7 billion of these maturing balances into new, three- to six-year contracts… yielding approximately 420 basis points, which is roughly 220 basis points higher than their prior yield.

Looking more closely at our ICA yield, it was 318 basis points in Q2, down 5 basis points from Q1. As for Q3, based on where client cash balances and interest rates are today, as well as the yields on our new fixed rate contracts, we expect our ICA yield to increase by approximately 10 basis points.

As for Service and Fee revenue, it was $135 million in Q2, up $3 million from Q1. Looking ahead to Q3, we expect Service and Fee revenue to increase by approximately $10 million sequentially, driven by revenues from our annual Focus conference, as well as higher IRA fees. Also, depending on the timing of the previously mentioned separation from a couple large OSJs, we could record up to an additional $5 million of fees.

Moving on to Q2 transaction revenue. It was $59 million, up $2 million sequentially due to increased trading volumes. As we look ahead to Q3, we expect transaction revenue to be relatively flat with Q2.

Now let's turn to expenses, starting with Core G&A. It was $371 million in Q2. Looking ahead, if our strong levels of organic growth continue into the second half of this year, we would expect to be in the upper half of our 2024 core G&A guidance range. As a reminder, this is prior to expenses associated with Prudential and Atria. To give you a sense of the near-term timing of the spend, in Q3, we expect core G&A to increase by $5 to $10 million sequentially.

Moving on to Q2 promotional expense. It was $148 million, up $16 million from Q1, primarily driven by Prudential-related onboarding costs, as well as increased transition assistance resulting from our strong recruiting. Looking ahead to Q3, we expect promotional expense to increase to approximately $170 to $180 million, primarily driven by conference spend as we will host our annual Focus conference next month, as well as continued Prudential-related onboarding and integration costs.

Turning to depreciation and amortization, it was $71 million in Q2, up $4 million sequentially. Looking ahead to Q3, we expect depreciation and amortization to increase by roughly $8 million sequentially, which includes approximately $3 million of technology development related to Prudential.

Regarding capital management, we ended Q2 with corporate cash of $684 million, up $373 million from Q1. Our leverage ratio increased slightly to 1.7 times, within our target leverage range of 1.5 to 2.5x. I would note that during the quarter we issued $1 billion of senior notes, the proceeds of which, will be used to finance our acquisition of Atria.

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 Q2, 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 closed on the acquisition of Crown Capital. Specific to share repurchases, a reminder that we paused buybacks following the announcement of the Atria acquisition. Our plan remains to evaluate restarting share repurchases following the close, which we expect to occur in the second half of this year.

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 advisors, grow our business, and create long-term shareholder value.

Before we open the call up for questions, I'd like to turn it back over to Dan.

Dan Arnold, President and CEO

Thanks Matt. I would be remiss not to acknowledge recent developments in the marketplace related to cash revenue and speculation on the potential read throughs to our business. We have been evaluating the announced changes to better understand the impetus, magnitude, and competitive implications. As for the firms that have made changes, they have different business models and monetization frameworks than ours, so, we can only speculate as to the issues they may be addressing. As it relates to LPL, we continuously strive to ensure advisors have choice in the tools and products they use to serve their clients in a comprehensive way and feel good about our position both competitively and regulatorily.

To that end, and specific to client cash, our broad-based offerings range from solutions for operational balances, to cash-like alternatives when seeking yield or income. Solutions like our sweep deposit program, which offers expanded FDIC insurance and immediate liquidity for transactional cash, to positional money market funds, for those seeking higher yield in a liquid product, to CDs and fixed income funds to achieve interest rate exposure at various maturities.

In all, we feel good about the strong complement of cash solutions we provide. In that spirit, we do not have plans to change our pricing and believe our product set provides advisors with the solutions they need to successfully serve their clients. As always, we will remain agile and nimble, as we continuously evaluate our solution set and control framework for opportunities to enhance our offering.

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