LPL Financial

LPL Financial
Q3 2022 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 and outlook, including forecasts and statements relating to the Company's future advisory and brokerage asset levels and mix, organic asset growth, deposit betas, Core G&A* expenses (including outlook for 2022), promotional, share-based compensation and depreciation and amortization expenses, Gross Profit* benefits, EBITDA* benefits, payout ratio, client cash balances and yields, service and fee revenue, transaction revenue, investments, capital returns, planned share repurchases, the expected benefits and costs of the acquisition of Waddell & Reed's wealth management business, and the amount and timing of the onboarding of brokerage and advisory assets from People's United Bank ("People's") and CUNA Mutual Group ("CUNA"), as well as any other statements that are not related to present facts or current conditions or that are not purely historical, constitute forward-looking statements. These forward-looking statements are based on the Company's historical performance and its plans, estimates and expectations as of October 27, 2022. Forward-looking statements are not guarantees that the future results, plans, intentions or expectations expressed or implied by the Company will be achieved. Matters subject to forward-looking statements involve known and unknown risks and uncertainties, including economic, legislative, regulatory, competitive and other factors, which may cause actual financial or operating results, levels of activity or the timing of events to be materially different from those expressed or implied by forward-looking statements. Important factors that could cause or contribute to such differences include: the spread of COVID-19 and its direct and indirect effects on global economic and financial conditions; changes in interest rates and fees payable by banks participating in the Company's client cash programs; the Company's strategy and success in managing client cash program fees; changes in general economic and financial market conditions, including retail investor sentiment; fluctuations in the levels of advisory and brokerage assets, including net new assets, and the related impact on revenue; the effects of competition in the financial services industry; the success of the Company in attracting and retaining financial advisors and institutions, and their ability to market financial products and services effectively; whether retail investors served by newly-recruited advisors choose to move their respective assets to new accounts at the Company; changes in the growth and profitability of the Company's fee-based offerings; 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 costs of settling and remediating issues related to regulatory matters or legal proceedings, including actual costs of reimbursing customers for losses in excess of the Company's reserves; changes made to the Company's services and pricing, and the effect that such changes may have on the Company's Gross Profit* streams and costs; execution of the Company's plans and its success in realizing the synergies, expense savings, service improvements and/or efficiencies expected to result from its investments, initiatives, acquisitions and programs; difficulties and delays in onboarding the assets of People's and CUNA's advisors; disruptions in the businesses of the Company, People's or CUNA that could make it more difficult to maintain relationships with their respective advisors and their clients; the choice by clients of People's or CUNA's advisors not to open brokerage and/or advisory accounts at the Company; and the other factors set forth in Part I, "Item 1A. Risk Factors" in the Company's 2021 Annual Report on Form 10-K, as may be amended or updated in the Company's Quarterly Reports on Form 10-Q or other filings with the SEC. Except as required by law, the Company specifically disclaims any obligation to update any forward-looking statements as a result of developments occurring after October 27, 2022, even if its estimates change, and statements contained herein are not to be relied upon as representing the Company's views as of any date subsequent to October 27, 2022.

Actual remarks made on the Company's earnings conference call could vary from the prepared remarks presented here. A webcast replay of the Company's earnings conference call will be available on the Investor Relations section of the Company's website, investor.lpl.com, until November 17, 2022. Please refer to the Company's earnings release for additional information.

*Notice to Investors: Non-GAAP Financial Measures

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

Dan Arnold, President and CEO

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

Over the past quarter, amid persistent market volatility, our advisors continued to be a source of support and guidance for their clients by helping them navigate times of uncertainty. Their commitment to their clients underscores the importance of our work on our mission of taking care of our advisors, so they can take care of their clients.

With respect to our performance, the third quarter was marked by resilient business results which drove solid financial outcomes, as well as continued progress on our strategic plan. I'll review both of these areas, starting with our third quarter business results.

In the quarter, total assets decreased to $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. Third quarter net new assets were $20 billion, representing 7 percent annualized growth. This contributed to net new assets over the past twelve months of $101 billion, representing a 9 percent organic growth rate.

Looking at Recruited Assets, they were $13 billion in Q3, bringing our total recruited assets over the past twelve months to $84 billion. These results were driven by the ongoing enhancements to our model and our expanded addressable markets.

Looking at same store sales, against a backdrop of continued market volatility, our advisors remain focused on serving 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 which drove improvement in same store sales in the third quarter.

With respect to Retention, we continue to enhance the advisor experience through the continued delivery of new capabilities and technology, as well as the ongoing modernization of our service and operations functions. As a result, Asset Retention was approximately 98 percent in the third quarter and 98 percent over the past twelve months.

Our third quarter business results led to solid financial outcomes of $3.13 of EPS prior to intangibles and acquisition costs, an increase of 77 percent from a year ago.

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

As a reminder, our long-term vision is to become the leader across the entire advisor-centered marketplace which, for us, means being the best at empowering advisors 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 advisors deliver personalized advice and planning experiences to their clients. At the same time, through human-driven, technology-enabled solutions and expertise, we are supporting advisors in their efforts to be extraordinary business owners. 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 have organized our work into four strategic plays, which I’ll review in turn.

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

Our recruiting in traditional markets continued to be a source of growth in Q3 with approximately $6 billion in assets. We continued to increase our win rates and expand the depth and breadth of our pipeline, despite advisor movement in the industry remaining at lower levels. Following several quarters of elevated market volatility, advisors are acclimating to the conditions and increasingly exploring new strategic alternatives for their practices. This creates a more favorable scenario for us, as market-driven headwinds give way to the structural strength of our model. This should result in a solid finish to the year 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 Q3, and believe we are well positioned to drive continued growth across all three models.

With respect to large financial institutions, over the past two quarters, we onboarded two new clients: CUNA and People's United Bank. 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 continue to see our pipeline build as demand for our model grows.

Our second strategic play is focused on providing capabilities that help our advisors differentiate in the marketplace and drive efficiency in their practices.

A particular area of focus is helping our advisors create a digital experience for their clients that's personalized for their practice. As an example, this quarter, we extended the flexibility our advisors have in how they utilize their brand and the optionality of the content and features they present to their clients.

In addition, we are always looking for opportunities to arm our advisors and end-clients with expanded tools, products, and services to navigate the markets. To that end, we continue to build out our research capabilities in terms of content and subject matter expertise. We have also increased our focus on certain products, like annuities and alternative investments, which are in higher demand in this market environment. To that end, we are working on making it easier and more efficient for our advisors to provide these products, while also expanding the breadth of solutions available to meet their clients' needs.

These enhancements help advisors broaden their value proposition and enrich the offering they provide to clients, which further contributes to the appeal of our platform to both existing and prospective advisors.

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

As a reminder, over the past couple of years, we've been on a journey to transform our service model into an end-to-end Client Care Model. Now, we think about this journey through two primary lenses: transforming our service interface and reimagining the operational processing that takes place behind that interface.

Our aspiration is to provide advisors a multi-channel experience across voice chat and digital-first support, thus offering them greater flexibility for when and how they access service.

While we continue to fine-tune each of these three channels, we're currently focused on our digital-first support. We see it as an opportunity to create an easier and more efficient experience for advisors to access the information they need. Now, as we expand these capabilities, advisors can increasingly engage digitally to resolve their requests, and many have already shared that they prefer this simpler option over making a phone call. While we are still in the early innings, we believe these enhancements will have a meaningful impact to the scalability of our platform, while also enhancing the client experience.

Our fourth strategic play is focused on developing a services portfolio that helps advisors and institutions run thriving businesses and deliver comprehensive advice to their clients. We are encouraged by the seasoning of this business and that our value proposition continues to resonate with advisors. Four years ago, we started our Services Group with a strategic goal of solving the practice-level challenges advisors face, so they can spend more time with their clients. Through ongoing innovation and expansion, these efforts have translated into the comprehensive portfolio of services we offer today. As a result of growing demand, our Services Group subscription base continued to increase, ending the period at roughly 4,200, and generating run rate revenue of $34 million.

As we work with advisors on existing services, we continue to identify and solve for new needs on their behalf. One example is the launch of our latest solution, Bookkeeping Services. Based on insights from CFO Solutions, we created a new service to help advisors further streamline their business decisions with accurate and timely financial reports. As a result, advisors can spend more time growing and managing their business, while also tracking profit more closely.

Looking at our innovation pipeline for the remainder of the year, we have several services in pilot and other offerings in the incubation phase. As we move forward, we remain focused on enhancing and expanding our portfolio to better support our advisors and drive growth.

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

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

Matt Audette, CFO

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

In the third quarter, we remained focused on serving our advisors, growing our business, and delivering shareholder value. This focus lead to another quarter of solid net new assets and earnings growth. In addition, we enhanced our sweep deposit program with the launch of the client cash account, and onboarded People's United Bank. So as we look ahead, we continue to be excited by the opportunities to help our advisors differentiate and win in the marketplace.

Now let's turn to our third quarter business results. Total advisory and brokerage assets were $1.0 trillion, down 2 percent from Q2, as continued organic growth was more than offset by lower equity markets. Total net new assets were $20 billion or a 7 percent annualized growth rate.

Our Q3 recruited assets were $13 billion, bringing our twelve month total to $84 billion.

As for our Q3 financial results, the combination of organic growth, rising interest rates, higher ICA balances, and expense discipline, led to EPS prior to intangibles and acquisition costs of $3.13. This was up 77 percent from a year ago, and is the highest in our history.

Looking at our top line growth, Gross Profit reached a new high of $838 million, up $127 million or 18 percent sequentially. As for the components, commission and advisory fees net of payout were $182 million, down $23 million from Q2. The decrease was primarily driven by the seasonal uptick in production bonus expense and lower advisory fees following the Q2 equity market decline.

Our payout rate for the quarter was 87.9 percent, up about 90 basis points from Q2 due to typical seasonality and the onboarding of CUNA.

Regarding asset-based revenue, Sponsor revenue was $194 million in Q3, down $14 million sequentially. The decrease in Q3 was driven by lower average assets during the quarter, as well as a non-recurring $8 million sponsor payment in Q2.

With respect to client cash revenue, it was $304 million, up $147 million from Q2, driven by higher average short-term interest rates, as well as higher ICA balances.

Looking at overall client cash balances, they ended the quarter at $67 billion, down $3 billion sequentially, driven by client net buying activity of $20 billion, which was the highest quarterly level we have ever seen. Within our ICA portfolio, we added capacity in Q3 as we saw further improvements in bank deposit demand, leading to an increase in balances of $7 billion, and I would highlight that $5 billion of that increase was in new fixed rate contracts.

Looking more closely at our ICA yield, it was 212 basis points in Q3, up 78 basis points from Q2, primarily driven by the increase in short-term rates during the quarter.

As we look ahead to Q4, we expect our ICA yield to continue to increase. Based on where interest rates are today, we expect our Q4 ICA yield to increase to approximately 265 basis points.

As for Service and Fee revenue, it was $122 million in Q3, up $9 million from Q2, driven by revenues from our national advisor conference and IRA fees.

Within our Services Group, we ended the quarter with roughly 4,200 subscriptions, which is up about 300 from last quarter. Our Services Group now generates roughly $34 million of annual revenue, while also contributing to organic growth by helping drive recruiting, same store sales, and retention.

Looking ahead to Q4 results, we do not have any large advisor conferences in the quarter, so we expect Service and Fee revenue to decline by roughly $5 million sequentially.

Regarding Q3 transaction revenue, it was $43 million, down $1 million sequentially as trading volume declined. As we look ahead to Q4, we have seen an increase in trading activity in October. That said, I would note there is one less trading day in the quarter, so that would likely offset that increase. So based on what we have seen to date, we would expect transaction revenue to be relatively flat with Q3.

Turning now to expenses, Core G&A was $298 million in Q3, up $12 million sequentially. Looking ahead, we continue to see opportunities to invest to drive growth. So while we expect to be within our full year 2022 core G&A outlook range, we expect to be towards the higher end. As a result, we are tightening the outlook to a range of $1 billion $185 million to $1 billion $195 million.

On Q3 promotional expense, it was $99 million, up $15 million sequentially primarily driven by higher conference expense as we hosted our largest advisor conference of the year, which returned to an in-person format for the first time in three years.

Looking ahead to Q4, we expect lower conference spend, partially offset by continued growth in recruiting transition assistance. As a result, we expect promotional expense will decrease by approximately $15 million sequentially.

With respect to depreciation and amortization, it was $52 million in Q3, up $3 million sequentially. Looking ahead to Q4, we expect depreciation and amortization to increase by a few million sequentially.

As for interest expense, it was $33 million in Q3, up $4 million sequentially as higher LIBOR rates increased the cost of our floating rate debt. Looking ahead to Q4, given where LIBOR rates are today, we expect interest expense to increase to approximately $36 million.

Regarding capital management, our balance sheet remained strong in Q3 with corporate cash at $424 million, up $183 million from Q2. Our leverage ratio was 1.7 times, down from 2.1 times in Q2. This decline was driven by a combination of our continued growth and a higher interest rate environment, both of which have meaningfully improved our earnings power.

As we look at our leverage ratio going forward, our balance sheet strategy is unchanged. Our focus is to maintain a strong balance sheet that can absorb a market downturn, while at the same time having capacity to invest for growth.

With our improved earnings power, we are updating our leverage target to a range of 1.5 to 2.5 times which we believe positions us well to operate over a range of economic cycles and strikes the right balance between preserving balance sheet strength and investing for growth.

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 Q3 we allocated capital to both organic growth and share repurchases buying back $75 million dollars of our shares.

As we look ahead to Q4, we plan to increase share repurchases to approximately $150 million dollars. This will complete our existing authorization of $1 billion that we established at the end of 2018.

Looking to 2023, we worked to put in place a new share repurchase authorization. Our focus was on an amount that we'd be in position to execute against over roughly two years. With that framing in mind, we established a new authorization of $2 billion dollars .which we expect to begin executing in the first quarter of 2023. As always, we will retain the flexibility to adjust the pace of repurchases as the environment warrants, or as other capital allocation opportunities across organic growth and M&A emerge.

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.

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