LPL Financial

LPL Financial
Q1 2023 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 2023), promotional, share-based compensation and depreciation and amortization expenses, Gross Profit* benefits, EBITDA* benefits, target leverage ratio, client cash balances and yields, service and fee revenue, transaction revenue, investments, capital returns and planned share repurchases, 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 as of April 27, 2023 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: 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 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 revenues; effects of competition in the financial services industry and the success of the Company in attracting and retaining financial advisors and enterprises; 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 costs 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, and the effect that such changes may have on the Company's Gross Profit* streams and costs; the execution of the Company's plans and its success in realizing the synergies, expense savings, service improvements and efficiencies expected to result from its initiatives, acquisitions and programs; 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 April 27, 2023 and you should not rely on statements contained herein as representing the Company's view as of any date subsequent to April 27, 2023.

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 May 18, 2023. Please refer to the Company's earnings release for additional information.

*Notice to Investors: Non-GAAP Financial Measures

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

Dan Arnold, President and CEO

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

Over the past quarter, our advisors continued to help their clients navigate through market volatility and macroeconomic uncertainty. In doing so, they reinforced the value of their advice and collectively helped millions of Americans continue to pursue their financial goals and aspirations. We thank them for their important work and remain focused on our mission: of taking care of our advisors so they can take care of their clients.

Now, as we look at the marketplace, we continue to experience the growing appeal of our model due to the combination of our robust and feature-rich platform, stability and scale of our industry-leading model, and capacity and commitment to invest. As a result, we continued to make solid progress toward our vision of becoming the leader across the advisor-mediated marketplace. In that spirit, we will continue to focus on helping advisors and enterprises solve challenges and capitalize on opportunities better than anyone else and thereby serving as the most appealing player in the industry.

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 first quarter business results.

In the quarter, total assets increased to $1.2 trillion, as continued solid organic growth was complemented by higher equity markets. With respect to organic growth, first quarter organic net new assets were $21 billion, representing 7.5 percent annualized growth. This contributed to organic net new assets over the past twelve months of $99 billion, representing approximately a 9 percent organic growth rate.

Recruited Assets were $13 billion in Q1, bringing our total for the trailing twelve months to $85 billion. These results were driven by the ongoing enhancements to our model and our expanded addressable markets.

Looking at same store sales, 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 that drove a sequential improvement in same store sales in Q1. This increase occurred across all of our affiliation models led by solid growth in our enterprise channel.

With respect to Retention, we continue to enhance the advisor experience through the delivery of new capabilities and technology as well as the evolution of our service and operations functions. As a result, Asset Retention for the first quarter was approximately 99 percent and 98 percent over the last 12 months.

Our first quarter business results led to solid financial outcomes, of $4.49 of adjusted EPS which is more than double our level from a year ago.

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 which, for us, means being the best at empowering advisors and enterprises to deliver great advice to their clients and to be great operators of their businesses. Now, 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. And 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.

As we look ahead, we continue to see both a growing demand for advice, and increasing appeal of receiving that advice from a financial professional. And we believe that our strategy positions us well to capitalize on these key structural trends.

Now, to execute on our strategy, we organize our work around two primary categories: horizontal expansion, where we look to expand the ways that advisors and enterprises can affiliate with us such that we can compete for all 300,000 advisors in the advisor-mediated marketplace; and vertical integration, where we focus on providing capabilities that solve for a broader spectrum of advisor needs and, in doing so create durable, differentiated value.

While our strategy has not changed, we will use the framework of horizontal expansion and vertical integration to review our strategic agenda. This structure is an evolution of our Strategic Plays framework and you can see how the strategic plays map to this new orientation within our Investor Presentation.

With that as context, let’s start with our efforts around horizontal expansion. This work involves meeting advisors and enterprises where they are in the evolution of their businesses by creating flexibility in our affiliation models so they can design the perfect practice for themselves and their clients. As a result, this component of our strategy helps contribute to solid growth in our traditional markets while also expanding our addressable markets through our new affiliation models.

Our recruiting in traditional markets continued to be a significant source of growth reaching a new first-quarter high of approximately $9 billion in assets. In the quarter, 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.

With respect to our new affiliation models, Strategic Wealth, Employee, and our enhanced RIA offering, we delivered our strongest quarter to date, recruiting roughly $3 billion in assets in Q1. In each of these models, we continue to realize growing demand and expanding pipelines which position them for increased contribution to our organic growth.

Looking ahead, we expect to carry this recruiting momentum into Q2 for both our traditional markets and our new affiliation models.

With respect to large enterprises, today we announced that BMO will onboard the wealth management business of Bank of the West to our enterprise platform. In addition, we continue to prepare to onboard Commerce Bank. Collectively, these two deals will add approximately $11 billion of brokerage and advisory assets in the second half of the year. Looking ahead, we continue to build our pipeline as demand for our model grows. Now, in Q1, we also continued to have success in our traditional bank and credit union space, including approximately $1 billion of recruited assets in this channel.

Now shifting to our vertical integration efforts. Here, we are focused on delivering value-added capabilities, services, and technology that extend across an advisor’s end-to-end business all for the purpose of helping them differentiate and win in the marketplace and run thriving businesses.

Now, core to this part of our strategy is helping advisors deliver their differentiated wisdom, insight, and advice wrapped in an easily-accessible and highly-personalized experience for their clients.

In that spirit, this quarter we continued to enhance our advisors' value proposition for their clients by introducing new account-aggregation capabilities, to help advisors consider their clients' holistic financial picture, by enriching the end-client digital portal through the expansion of customizable self-service capabilities, and by evolving our Research offering to include increased market commentary delivered how and where it works best for the advisor.

Now, in a separate play within our vertical integration strategy, we continue to expand and enhance our services portfolio and are encouraged by the evolving appeal of our value proposition and the seasoning of this business. As a result of solid demand in Q1, the number of advisors utilizing our Services Group continued to increase and we ended the quarter at over 3,300 active users, up roughly 30 percent year-over-year.

As we work with advisors to increase the utilization of existing services, we're also continuing to create new services, such as our Partial Book Sales solution, where we provide the flexibility for advisors to sell us their smaller accounts or clients that don't necessarily fit their practice, thus creating more capacity for them to focus on managing and growing their business more robustly. This service has been well received, and we are seeing solid early momentum with a growing pipeline of demand.

Now, at the same time, we're seeing good success with our set of services that help solve for the industry-wide challenge of up to a third of advisors retiring over the next decade. In that spirit, over the past year we've facilitated approximately 150 acquisitions among advisors through our M&A Solutions program. And since launching our Liquidity & Succession capability in Q4, we have completed more than 10 of these deals with LPL advisors and have growing interest both inside and outside of the LPL ecosystem.

In summary, in the first 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.

As we move into 2023, we remain focused on serving our advisors, growing our business and delivering shareholder value. Against a backdrop of market uncertainty, our business performed well as we continue to execute on our strategic priorities. In recent years we've invested in capabilities, technology, and service to enhance the experience of advisors, enterprises, and their clients. At the same time, we've maintained a strong balance sheet with significant corporate liquidity and low leverage, positioning us to support our advisors and clients in a range of macro environments. This was most recently recognized by S&P, who upgraded our credit rating earlier this month, establishing us as an investment grade credit with both our rating agencies. By leveraging the investments in our platform and our financial strength, we continued to grow assets organically in both our traditional and new markets, closed two strategic acquisitions, continued our momentum with our Liquidity & Succession capability, and are preparing to onboard Commerce Bank and Bank of the West in the second half of the year. We accomplished all of this while continuing to invest in our industry leading value proposition, and delivering record adjusted earnings per share. So as we look ahead, we continue to be excited by the opportunities we have to help our advisors differentiate and win in the marketplace.

Now let's turn to our first quarter business results. Total advisory and brokerage assets were $1.2 trillion, up 6% from Q4, as continued organic growth was complemented by higher equity markets. Total organic net new assets were $21 billion or a 7.5% annualized growth rate.

Our Q1 recruited assets were $13 billion, which prior to large enterprises, was a record first quarter of the year. This included $3 billion of recruited assets from our new affiliation models, the largest contribution since their launch a few years ago. Looking ahead to Q2, our momentum continues across our traditional independent and new models, and we are on pace to deliver another strong quarter of recruiting.

As for our Q1 financial results, the combination of organic growth, rising interest rates, and expense discipline, led to adjusted EPS of $4.49, the highest in our history.

Looking at our top line growth, Gross Profit reached a new high of $1 billion $20 million, up $48 million or 5% sequentially. As for the components, commission and advisory fees net of payout were $215 million, up $43 million from Q4, primarily driven by higher advisory fees and a seasonally lower production bonus.

In Q1 our payout rate was 86.2%, down about 220 basis points from Q4 largely due to the seasonal reset of the production bonus at the beginning of the year as well as a non-recurring benefit of approximately 50 basis points realized during the quarter. Looking ahead to Q2, we anticipate our payout rate will increase to approximately 87 and a half percent, primarily driven by the typical seasonal build in the production bonus.

With respect to client cash revenue, it was $439 million, flat to Q4, as the impact of higher short-term interest rates was offset by a sequential decline in balances.

Looking at overall client cash balances, they ended the quarter at $55 billion, down $10 billion, driven by record net buying of $37 billion. Within our ICA portfolio, we added $3 billion of new fixed rate contracts, bringing our fixed rate balances to roughly 55% of the ICA portfolio, within our target range of 50 to 75 percent.

Our ICA yield averaged 320 basis points in the quarter, up 29 basis points from Q4, primarily due to the increases in short-term rates.

As for Q2, based on where interest rates are today, and what we've seen with client cash balances so far in April, we expect our ICA yield to remain unchanged at approximately 320 basis points, as the full quarter benefit of the Q1 rate hikes is offset by the mix impact of lower floating rate balances.

As for Service and Fee revenue, it was $119 million in Q1, down $1 million from Q4 primarily driven by lower conference revenue, offset by seasonal increases in IRA fees. Looking ahead to Q2, we expect service and fee revenue to be roughly flat sequentially.

Moving on to Q1 transaction revenue. It was $49 million, up $2 million sequentially as trading volume increased slightly. Looking ahead to Q2, we expect a seasonal decline of a couple million dollars.

Now let's turn to expenses, starting with Core G&A. It was $326 million in Q1. For the full year 2023, we continue to anticipate core G&A to be in a range of $1 billion $335 million to $1 billion $370 million. As a reminder, this year we are opportunistically accelerating our investments to support our core business growth, expand our addressable markets, and scale our new services. We have also sequenced our spending plans to build gradually through the year, which positions us to be flexible and dynamic depending on how our growth opportunities and the macro evolve from here. To give you a sense of the near-term timing of this spend, in Q2 we expect Core G&A to be in a range of $330 to $340 million.

Moving on to Q1 promotional expense. It was $101 million, up $17 million sequentially, primarily driven by conference spend as we had two of our largest conferences of the year during the quarter.

In Q2, we expect promotional expense to increase to a range of $105 to $110 million, due to increased transition assistance resulting from strong recruiting and large enterprise onboarding as we prepare for Commerce Bank and Bank of the West to join us in the second half of this year.

Looking at share-based compensation expense, it was $18 million in Q1, up from $12 million in Q4. In Q2, we expect a similar level of expense as the majority of our grants occur in the first two quarters of the year.

Turning to depreciation and amortization, it was $56 million in Q1, up $2 million sequentially and we expect it to increase to approximately $60 million next quarter.

Regarding capital management, our balance sheet remained strong. We ended Q1 with corporate cash of $234 million, down $225 million from Q4, as we closed on two acquisitions during the quarter. Our leverage ratio was 1.3 times, down from 1.4 times in Q4, driven by a combination of our continued growth and a higher interest rate environment, both of which have meaningfully improved our earnings power.

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 Q1 we allocated capital across our entire framework. We continued to invest to drive and support organic growth. On traditional M&A, we closed on two acquisitions for approximately $150 million. Within our Liquidity & Succession offering, we closed 7 deals for around $100 million, and we continue to have a solid pipeline. With regards to capital return, we increased our share repurchases to $275 million in Q1. We plan to further increase share repurchases in Q2 to approximately $300 million dollars. To summarize, our balance sheet is strong and we are well positioned to drive value through our capital allocation framework.

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