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LPLA - Q2 2018 LPL Financial Holdings Inc Earnings Call

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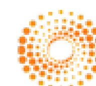

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PRESENTATION

Operator

Good evening, and thank you for joining the second quarter 2018 earnings conference call for LPL Financial Holdings Inc.

Joining the call today are our 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 opened for questions. (Operator Instructions)

The company has posted its earnings press release and supplementary information on the Events section of the company's website, investor.lpl.com.

Today's call will include forward-looking statements, including statements about LPL Financial's future revenue, expenses and other financial 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 risks and uncertainties that may cause actual results to differ materially. The company refers listeners to the safe harbor disclosures contained in the earnings press release and the company's latest SEC filings to appreciate those important factors that may cause actual financial or operating results or the timing of matters to differ from those contemplated in such forward-looking statements.

During the call, the company will also discuss non-GAAP financial measures governed by SEC Regulation G. For a reconciliation of non-GAAP 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 Arnold *- LPL Financial Holdings Inc. - President, CEO & Director*

Thank you, James, and thank you to everyone for joining our call today.

In the second quarter, we remain focused on our strategic priority of growing our core business and executing with excellence while continuing to assimilate advisers from NPH. This focus, combined with the support of macro environment, led to another quarter of business and financial growth.

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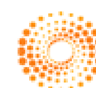

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Let's review our second quarter progress, starting with our advisers, where I want to take a moment to highlight some recent external recognitions. Over the last quarter, LPL advisers were named to both the Forbes Top Women Wealth Advisors list and the Barron's Top Women Financial Advisors list. In addition, several LPL Financial institution clients were named by Bank Investment Consultant magazine to its Top Program Manager list. This type of recognition reflects the quality of the advisers we serve as well as our emphasis on diversity and inclusion to attract more advisers and clients to LPL.

Moving to our second quarter financial results. We continue to grow and generate operating leverage. Gross profit increased 24% year-over-year, driven by growth across all of our revenue lines. We also remain disciplined on expenses. This combination led to second quarter EPS of $1.30, up more than 70% from a year ago. Matt will review our financial performance in greater depth.

Second quarter business performance was the primary driver of these financial results. Brokerage and advisory assets were $659 billion, up 22% year-over-year. This increase in assets was driven by a combination of organic growth, onboarding of NPH assets and market growth.

Organic net new assets were $1 billion, including net new advisory assets of $4.1 billion, which translates to a 6% annualized growth rate. The key drivers of our second quarter organic growth were $6 billion of recruited assets and solid asset gathering by existing advisers. Asset growth was reduced by outflows from a small group of hybrid firms.

Our overall production retention was 96% year-to-date. At the same time, we continue to see increasing use of our advisory, corporate and centrally managed solutions, which enhances our return on assets.

Looking more closely at NPH. We completed the onboarding of the remaining assets from this transaction. For the second quarter, we had $1.5 billion of net new assets associated with NPH, bringing our total to $72 billion. Advisers from NPH are now actively running their practices on our platform and are beginning to use our suite of services. They ramped up faster than we expected, which is a testament to their focus on the transition and the commitment to maintaining continuity for their clients. As a result, we reached our year-end goal of $90 million of run rate EBITDA in the second quarter. Looking forward, we will continue to partner with these advisers to help them take full advantage of our platform and capabilities.

Let's now turn to our strategic priorities, which, as a reminder, are driving growth in our core business and executing with excellence. With respect to core business growth, we think about that primarily in terms of adding new advisers, helping existing advisers grow and driving a better return on assets.

So with respect to adding new financial advisers, let me turn to recruiting. We had a solid second quarter with performance improving each month. This was driven by the return of our business development teams all focused on recruiting and the emerging benefits of reengineering our sales processes and capabilities across the recruiting team. Given the building momentum in the second quarter and the interest generated by our temporary increase in transition assistance, we feel well positioned with a solid pipeline entering the third quarter.

In addition, we look forward to having Rich Steinmeier join us next month as our new Head of Business Development. Rich brings a diverse set of skills and outside perspective and a track record of success. We believe his leadership will help us achieve greater growth moving forward.

In terms of our broader growth strategy, we view M&A as a strategic lever to bring assets onto our platform and expand our capability as long as opportunities that we see align with us strategically, financially and operationally. We will also look to leverage and deploy the experience we gained through the NPH acquisition and any future transactions.

With respect to same-store sales, we are investing in capabilities to help our advisers differentiate and win in the marketplace. In that spirit, we are working to help them execute by modernizing their practice management and by digitizing their businesses. These 2 things will drive efficiency, scalability and simplicity into their practices.

Let me provide a little color on modern practice management. We piloted our virtual admin service first, and we used the insights from this pilot to enhance our thinking and iterate on the solution. We are now in the market, offering advisers access to administrative support, who are fully

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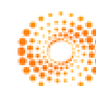

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trained on LPL processes and systems. This enhances the efficiency of the advisers' practice while also avoiding the challenges of sourcing, hiring and managing personnel.

In addition to virtual admin, we have 3 more virtual services in the pilot stage. First, our virtual Chief Marketing Officer is designed to help advisers find and win new clients as well as better serve and communicate with existing clients. Second, our virtual Chief Financial Officer aligns advisers on a plan to drive value into their practices by becoming more efficient, improving business mix and stimulating growth. As part of this effort, we are also providing advisers with capital for practice expansions or acquisitions. Third, our virtual Chief Technology Officer will more efficiently and effectively set up, manage and maintain local adviser practice technology, including computers and phones. Altogether, we believe our suite of virtual services will help advisers simplify, scale, lower cost and accelerate growth within their practices.

A second set of capabilities we are working on is digitizing advisers' practices across their technology stacks and workflows. As an example, this month, we announced that we are building improved end-to-end capabilities inside the ClientWorks. These capabilities will provide a consistent and integrated experience across the advisers' entire life cycle with their client from pursuing prospects to providing ongoing service and support. We are also moving to a more open architecture environment by establishing both new and enhanced integrations with a select group of third-party technology providers. This allows advisers to access ClientWorks data within the tools they value most.

Let's now turn to our second strategic priority, executing with excellence. We remain focused on enhancing our technology and making it easier for advisers and their clients to do business with us. With respect to our ClientWorks technology solution, it is our core operating platform that we will continue to invest into and evolve over time. We have set up those investments in 3 phases, which we are pursuing in parallel: first, we are executing immediate tactical improvements to the functionality, performance and resiliency of the system; second, we are working on ClientWorks version 2.0, which focuses on streamlining and increasing the efficiency of major system components; and then third, we have started work on ClientWorks version 3.0 to reimagine primary workflows from an adviser's point of view. We believe all of these efforts, combined with our increased levels of technology investment, can drive greater growth and improve service experience and increase efficiency in advisers' practices.

Let's next move to ease of doing business. We are focused on providing personalized service, making things simpler for advisers and turning adviser problems into opportunities. Over the past quarter, we completed our initiative to make 100 improvements in 100 days. We implemented changes that could be made quickly to policies, procedures and technology. We used this initiative as a catalyst to begin transforming our culture and capabilities to better serve and support our advisers and their clients. In the spirit of continuous improvement, we recently kicked off the next wave of 100 improvements. We are also building a road map to redesign our service model, including incorporating lessons from leading scalable service models from outside our industry. We believe this combination of activities will leverage the benefits of our scale to deliver a simpler, more personalized experience for our advisers and their clients.

In summary, we are pleased to deliver another quarter of business and financial growth. We plan to remain focused on our strategic priorities of growing our core business and executing with excellence. We believe our strategy positions us well to serve our advisers, drive profitable growth and create long-term shareholder value.

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

Matthew Audette - *LPL Financial Holdings Inc. - MD & CFO*

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

We had another strong quarter in Q2. We continued to grow assets and gross profit while remaining disciplined on expenses to drive operating leverage. As a result, our Q2 EPS prior to intangibles was $1.42, up 76% year-over-year. We are pleased with these results as we continue to focus on our strategy of growth and execution.

Let's look at our business results in greater depth, starting with total brokerage and advisory assets. We finished the quarter at $659 billion, up $12 billion or 2% sequentially, driven by organic growth, onboarding the remaining NPH assets and market appreciation. Total net new assets were $2.5 billion for the quarter, including $1 billion of organic net new assets and $1.5 billion from NPH.

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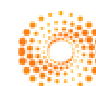

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Looking at organic growth in greater detail. Net new advisory assets were $4.1 billion or a 6% annualized growth rate. This included $1.5 billion in conversions from brokerage to advisory.

Looking at the mix of our advisory inflows. Over 75% of our net new advisory assets were on the corporate platform, totaling $3.6 billion or a 9% annualized rate. Our centrally managed platforms continue to grow as well, with inflows of $1.5 billion or approximately 1/3 of our net new advisory assets this quarter.

Turning to our NPH results. Q2 net new assets were $1.5 billion, including $1.3 billion of brokerage and $0.2 billion of advisory. In total, for this transaction, we onboarded approximately $72 billion of assets. As for accretion, we generated approximately $23 million in run rate EBITDA this quarter or $92 million on an annualized basis, above our year-end outlook of $90 million. We delivered this run rate earlier than expected as NPH advisers ramped up their business faster than we anticipated. As we have now finished onboarding NPH assets and reached our EBITDA outlook, going forward, we plan to end our pro forma reporting and focus on our consolidated results, including NPH.

Before moving on, I also want to highlight that we've added recruited assets to our disclosures this quarter to provide additional insight into our recruiting results. This metric represents the estimated amount of assets we expect to ultimately transfer onto our platform from advisers that move their licenses to us during the quarter. The assets from new advisers typically come onto our platform over the 2 to 3 quarters after their licenses transfer. So this metric is a good leading indicator of the contribution of recruiting to net new assets.

Now let's turn back to our Q2 results, starting with gross profit. It was $483 million, up $19 million or 4% sequentially. Prior to NPH, it was $440 million, flat to Q1, as higher cash sweep revenues were offset by the seasonal increase in production bonus as well as lower transaction in fee revenues. Gross profit from NPH was $42 million, up $18 million sequentially, primarily driven by increased activity from advisers who joined our platform. We also continue to see positive trends in our business mix as more assets move to advisory, corporate and centrally managed platforms.

Moving to commission and advisory fees, net of payout. They were $126 million in Q2, down $9 million or 7% sequentially, as the typical seasonal increase in production bonus expense more than offset growth in commission and advisory fees. Looking at sales commissions in more detail. They were $197 million in Q2, up $9 million or 5% sequentially, primarily driven by increased activity from NPH advisers. Prior to NPH, sales commissions were $170 million, down $3 million or 2% sequentially. Looking ahead, we typically see a seasonal decline in sales commissions from Q2 to Q3, which has averaged about 10% over the past few years.

And as a reminder, our production bonus expense increases seasonally throughout the year as advisers achieve higher levels of production. For example, from Q2 to Q3 last year, our production bonus rate increased by about 50 basis points or $3 million.

As for asset-based fees, which includes sponsor and cash sweep revenues, sponsor revenues were $117 million, up $2 million from Q1, primarily driven by higher average asset levels. Moving to cash sweep revenues. They were $121 million, up $17 million or 17% sequentially, as higher short-term interest rates increased our yields.

As for client cash balances, investors remained engaged in the market in Q2 and also withdrew money for tax season. So cash as a percent of total assets declined to 4.3%.

Looking at Q2 cash sweep yields. Our ICA yield was 179 basis points, up 27 basis points from Q1. As a reminder, our ICA balances are mostly indexed to Fed funds, but we also have some index to 1- and 3-month LIBOR as well as a small amount of fixed rate balances. And in Q2, while average Fed funds increased about 25 basis points due to the March and June rate hikes, average LIBOR increased by a greater amount as it rose in anticipation of the June rate hike. So about half of the ICA yield benefit of the June rate hike actually showed up in Q2.

As we think about our Q3 ICA yield, we will have the remaining benefit of the June rate hike. In connection with this rate hike, we increased client deposit rates equivalent to a deposit beta of about 25% or 6 basis points on average. So assuming no further benefits from interest rate increases or changes to our deposit rates, we anticipate our Q3 ICA yield will be in the mid- to upper 180 basis point range.

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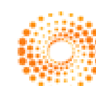

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Turning to DCA. As a reminder, DCA revenue is based on a fee per account rather than a rate on balances, and the fee moves along with changes in the Fed funds target range. And with the June rate hike, we had reached the cap on what we earn on DCA. In July, we increased the cap to a level that is consistent with our ICA max yield. With these changes, we will now have upside of about $5 million per rate hike on DCA revenue. So taken together with our ICA deposit beta outlook, we estimate gross profit upside of approximately $35 million to $45 million per rate hike.

Moving on to Q2 transaction and fee revenues. They were $116 million, flat with Q1. Prior to NPH, transaction and fee revenues were $110 million, down $4 million sequentially, primarily from lower trading revenue. Looking ahead to Q3, we have our national adviser conference, so we expect conference revenues will increase by approximately $3 million sequentially. We anticipate this will be partially offset by a seasonal decline in IRA fees of $2 million. I would also note that transaction revenue could decline in Q3, as Q2 trading volumes remained above our historical average, and we tend to see a decline in activity over the summer months.

Now turning to expenses, starting with core G&A. In Q2, core G&A expense was $192 million, including $4 million of NPH onboarding costs and $12 million of NPH run rate expense. Prior to NPH, core G&A was $176 million, down $6 million from Q1, primarily driven by 2 factors: first, we had a typical seasonal decline in payroll taxes; second, we also had more of our technology resources working on product development this quarter, which drove more capitalization than in the prior quarter. So in total, for the first half of the year, core G&A averaged just under $200 million per quarter. As we look ahead to the second half, we plan to invest more in service and technology. Within service, we increased hiring at the end of Q2, and the associated costs will increase our Q3 run rate. And for technology, we plan to increase our level of development work in the second half. As a result, we are tightening our full year core G&A outlook range to $805 million to $825 million, which translates to an average of about $210 million per quarter for the second half.

Moving on to Q2 promotional expenses. They were $43 million, down $24 million or 36% sequentially. Prior to NPH costs, promotional was $36 million in Q2, up $3 million sequentially, primarily driven by higher conference expense. As for NPH promotional costs, they were at a run rate of $7 million, primarily from forgivable loan amortization.

Looking ahead to Q3. We expect conference expense will increase by approximately $8 million, driven by our Focus conference. Additionally, we see positive momentum building in our recruiting pipeline, which could increase transition assistance in Q3. I would also note that we have been recruiting larger advisers who tend to receive transition assistance as forgivable loans. That trend could drive transition assistance higher in the future, as the impact would be expensed over the period of the loan, which is typically several years.

Turning now to regulatory expenses. They totaled $8 million in Q2, up $2 million sequentially, primarily driven by captive insurance deductibles related to our state blue sky settlements, which we discussed last quarter. As a reminder, we expect most of the settlement expense will be covered by our captive insurance company or existing spending plans.

Given that we expect all the jurisdictions to participate in this matter, the small individual deductibles added up to drive the overall increase in regulatory expense this quarter. Looking forward, the nature of regulatory expenses continues to make them inherently difficult to predict. Our actual expense could move up or down in any given quarter or year based on the size and timing of matters and available captive coverage.

Looking at depreciation expense. It was $22 million in Q2, up $2 million sequentially, driven by our increased investments in technology. Going forward, we expect depreciation to continue to grow as we invest in more -- in technology.

Turning to taxes. Our Q2 effective rate was 27%, in line with our expected annual rate of 27% to 29%.

Moving on to capital management. Our balance sheet remained strong in Q2, and our net leverage ratio declined to 2.3x. Cash available for corporate use was $446 million, down $28 million from Q1.

Turning to capital deployment. We continued to invest in organic growth and returning capital to shareholder. For capital returns, we paid $22 million in regular quarterly dividends in Q2. We also increased our share repurchases to $117 million, roughly double our Q1 amount. Looking forward, we plan to continue investing to drive organic growth, M&A, where appropriate and returning capital to shareholders. Specific to share

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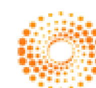

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repurchases, just note that the actual amount we repurchased could vary in any given quarter, depending on the size and timing of our buyback program and the movement in our stock prices.

In closing, we are pleased to have delivered another quarter of strong business and financial results. We remain focused on growing assets and gross profit, staying disciplined on expenses to create operating leverage and deploying capital to drive growth and shareholder returns.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Bill Katz with Citigroup.

William R. Katz - *Citigroup Inc, Research Division - MD*

I appreciate the enhanced disclosure. Just maybe starting there. So look at sort of the FA count consequentially, that was modestly lower and continue to see much better trends elsewhere. So I was wondering if you could help sort of triangulate between some of that lead indicator you highlighted in terms of recruited AUM, how that might spill into FAs and then within that. And how much was maybe desired attrition versus just sort of undesired attrition?

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

And so, Bill, it's Dan. Thanks. Let me take a couple of those, and then, certainly, Matt, you provide any color around that. And if I didn't get it all, Bill, just come back. It's not on purpose. So let's take the assets for a minute inside the quarter, I think the question around net new assets for the quarter. I think when you look at second quarter, they came in around $1 billion, which were a little lighter than our average for the last couple of quarters, where you saw that more in line around $3.5 billion. So the key drivers of that $2.5 billion differential, one was the $1 billion of tax preferred payments in April, and then you had about $1.5 billion of outflows of assets associated with a small group of hybrid RIAs. And as we went through strategic changes last year, I think for purposes of aligning both the corporate RIA and the hybrid RIA for profitable growth, which we've seen continued growth in both, we teased out just some -- where we didn't have alignment with a small group of hybrid RIAs, and they are the group that are driving those outflows in this quarter. You're likely to see that same level of outflows in both the next 2 quarters. That said, I think we're obviously committed strategically to offering both the corporate RIA and the hybrid platforms. We'll continue to invest in both and make sure that our advisers can differentiate and win. So hopefully that answered your question around maybe some of the NNA and questions around desirable assets that may have -- where [we tell] outflows. If I missed any -- rest of your question, just please fill it in.

William R. Katz - *Citigroup Inc, Research Division - MD*

Yes. I was actually more interested -- and that's very helpful but more interested in sort of the FA count just having some minus 18 or so quarter-to-quarter decline and assuming it was related to, I guess, the RIA outflows. Maybe my other follow-up and (inaudible) talk offline. My other follow-up still goes back to capital management. So maybe a two-part question, Matt. First one is, is there a way we should be thinking about some kind of combined payout ratio of either adjusted earnings or free cash flow, [let's say], to help model repurchase? And then the broader question is, as you think about M&A, how does the pipeline look if you will? And how has that changed if at all, given that it seems like a large property went for what looks like to be a pretty big multiple to a private equity sponsor?

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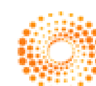

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Matthew Audette - *LPL Financial Holdings Inc. - MD & CFO*

Yes. So I'd take a bulk of this. So I think with respect to share repurchase, I don't think there's a classic payout rate to think about in forecasting that going forward. I think when we think about where we want to deploy capital, it's, first and foremost, for organic growth. I think you've seen us do a lot of that this quarter. Dividends are something that, I think, are a lot more stable, not just for us but for most folks. You're typically flat to a little bit up. And share repurchases are naturally just going to move more up and down on an individual quarter basis, just depending on what's going on that quarter. So I think I will just emphasize we think returning capital to shareholders through share repurchases is a good use of our capital, but it's just tough to predict on an individual quarter basis on how that would go. I think on the M&A side, I think just to emphasize what Dan said in the prepared remarks, I think when we look at M&A, we think it's a good use of our capital, and it's a good way to grow the platform. But it's going to be a good match financially, strategically and operationally. And if it's not a match there, I don't think we're interested. And if it is, we are. I think that'll be our philosophy now and going forward.

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

And, Bill, let me just add to your FA question. I missed that in the first part of your question. I apologize. I think, yes, we were down 18 advisers within the second quarter. When you back out NPH, we had a net gain of 35 advisers. Obviously, that's driven through both recruiting and then any advisers that may have left the platform to get to that net number. I think when you look at the NPH advisers, they were down 53, and most of that is just noise around your typical post-transaction cleanup. A great example of that would be reclassifying some of the advisers' license that came over to admin status. So I think you'll see that as more just noise around the cleanup. So perhaps that ex NPH number is the way to think about the quarter growth in advisers and reflective of the recruiting effort.

Operator

Our next question comes from Ann Dai with KBW.

Matthew Gruseke - *KBW - Analyst*

Yes, this is actually Matthew Gruseke on the call for Ann. I know we talked about the deposit betas being -- coming in at about 25%. I think prior guidance was a 25% to 50% range long term. Do you anticipate further rate hikes? Any kind of color on what you might see coming forward?

Matthew Audette - *LPL Financial Holdings Inc. - MD & CFO*

Yes, sure. This is Matt. I mean, I think our long-term view on a 25% to 50% beta is unchanged, right? And I think when you look at this rate cycle, we've averaged about 10% through the cycle overall, and the last 2 have been at 25%. So you've kind of seen that building up. And I think I'd also highlight that the 25% is an average, right? So we do -- we price deposits based on the amount of deposits. When you look at it across that spectrum, smaller accounts are a much lower beta in the 5% range versus the much larger balances, they're more like 50% to 60%. So there's certainly a range of betas. But on average, we've seen it at 25% for the last couple. And our view on the long term is really unchanged at 25% to 50%.

Operator

Our next question comes from Craig Siegenthaler with Crédit Suisse.

Craig William Siegenthaler - *Crédit Suisse AG, Research Division - MD*

It's Craig Siegenthaler here. So the brokerage to advisory migration just slowed a little bit in the quarter. And in the quarter, it also looks like the DOL rule has probably died here. I'm just wondering if you think the brokerage to advisory migration will continue to decelerate or this is more of just a 1 quarter blip.

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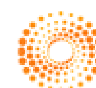

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Dan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Yes. So it's Dan. I wouldn't read too much into a 1 quarter and try to draw any conclusions or trends associated with that. I think you do have the ongoing dynamic of a general transition from brokerage to advisory. And I think about that as more of the macro demand at the in-client level. We do believe that as we get clarity around the regulatory environment associated with brokerage products and solutions and commissions, that, that does make it more predictable and probably a bigger utilization of brokerage than we'd probably see it today. But I wouldn't read too much into the quarterly blip. I think you have those 2 dynamics ongoing, and we believe those dynamics will stay in place. And the ultimate outcome of that mix will be very similar to the dynamics we've seen over the last year.

Operator

Our next question comes from Christian Bolu with Bernstein.

Chinedu Bolu - *Sanford C. Bernstein & Co., LLC., Research Division - Equity Analyst*

Dan, Matt, just a follow-up on the M&A question. Can you just speak to the broader competitive landscape for M&A deals? I think in addition to the large property that was referenced earlier on, we've seen other private equity-led deals that have happened. Just trying to understand your thought process in passing up on these deals. Was it a financial issue, operational or something else? Just trying to understand how you're evaluating deals here.

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

Yes. So maybe I'll give a little color and then Matt, please add anything to it. So look, we can't speak to any specific deal. That said, from a conceptual standpoint, we continue to see opportunity associated with M&A to add assets to our platform. We also think because of our vertical integration, our assets are worth more ultimately on our platform. And we think our opportunity to pull through both revenue, synergies and expense synergies create a compelling scenario for us and an opportunity. And again, if we can find that right strategic alignment, operational alignment and financial, then we think that we have interesting prospects and opportunities of which to capitalize on any potential property that may be available in the space. And so we continue to explore those possibilities out in the market. And to the extent that we have something that's interested, then I think we would ultimately look to try to pursue it. I don't know, Matt, if you want to add anything to that.

Matthew Audette - *LPL Financial Holdings Inc. - MD & CFO*

No. Well said. I mean, I would just emphasize around all of that. We're going to continue to be disciplined and patient. And if something is a match, I think we'll be interested.

Chinedu Bolu - *Sanford C. Bernstein & Co., LLC., Research Division - Equity Analyst*

Okay. Just a quick follow-up. Client cash as a percentage of client asset continues to reach new lows for you guys and, I guess, the industry as a whole. I guess your competitor is speaking to yield-seeking behavior as one of the drivers. Curious if you're seeing that at LPL also. And then given, Matt, you're going to forecast it, can you just -- do you have any sort of framework to help us think about how low client cash could go?

Matthew Audette - *LPL Financial Holdings Inc. - MD & CFO*

Yes. I mean, I think, Christian, I mean, you said it well, right? We're seeing it across our space. And we don't -- what we see is investor engagement, right? When you look at the money and where it's going, I mean, the levels of net buying we see in the last -- as we've moved into this rate cycle, have been nearly double what we saw before that. So we see it going into the market. I don't have a forecast or prediction for you on where it's

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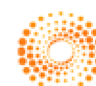

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going. I just -- I would just emphasize that, overall, it's a good thing, like high levels of investor engagement in deploying the money is a positive overall.

Operator

Our next question comes from Chris Shutler with William Blair.

Christopher Charles Shutler - *William Blair & Company L.L.C., Research Division - Research Analyst*

On the NPH, you reached the $90 million annual run rate of EBITDA in Q2. Is that -- how much of that is because the -- there's kind of a new run rate, that the run rate is actually higher than that? And how much of it is just timing? Because I guess that -- I'm guessing that the higher rates have helped quite a bit.

Matthew Audette - *LPL Financial Holdings Inc. - MD & CFO*

Yes, Chris. I mean, it's really -- so the June hike was really -- had really a minor impact on NPH in the quarter. I'd put it at, say, maybe $1 million, right, [some said at] $92 million. Prior to that move, you'd be at $91 million. It was really about the NPH advisers just ramping up on our platform and getting to work for their clients earlier than we thought. So there's more about that.

Christopher Charles Shutler - *William Blair & Company L.L.C., Research Division - Research Analyst*

So is the run rate higher then, other than the rate hike or not?

Matthew Audette - *LPL Financial Holdings Inc. - MD & CFO*

No. I think -- well, I'd say broadly, the run rate is $92 million. There'll be a little bit of benefit as the second -- the rest of the benefit from the rate hike comes in the next quarter. That's included, though, in our overall guidance on ICA yields for next quarter. I would emphasize that the opportunities on NPH are similar to the opportunities we have in our business overall of continuing to have assets move from brokerage to advisory, continuing to move within advisory onto the corporate platform or centrally managed platforms. I think those are all opportunities at NPH, but from a current run rate standpoint, it's $92 million plus with the benefits of the rate hike that are in that overall guidance we gave.

Christopher Charles Shutler - *William Blair & Company L.L.C., Research Division - Research Analyst*

Okay. And then, Matt, on the transaction of fee line in Q2, can you give us some sense or quantify how much the trading-related revenue came in higher than your expectation?

Matthew Audette - *LPL Financial Holdings Inc. - MD & CFO*

I think so. I mean, I think when you look at it flat quarter-over-quarter, you had some of the NPH benefit in there that drove that line up about 3%. We also had some of the conference revenue. We had one of our larger conferences in the quarter that moved it up 1%. And then transactions, we're down to offset that so down by 4%. So I think that's still a little bit higher than we would have typically seen in Q2, so that's why we expect a little bit of a decline next quarter. But hopefully that helps give you some idea of the changes there.

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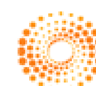

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Operator

Our next question comes from Devin Ryan with JMP Securities.

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

Maybe first question here. So as you mentioned in the prepared remarks, so the new kind of Head of Business Development was a former Chief Digital Officer. And then I'm curious, I know technology integration is on a new theme here, but it's important for the company. So, I guess, what changes with the perspective that comes from someone with that background? Or I'm just trying to think about if this is a strategy change or what to read into it.

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

Yes, this is Dan. I wouldn't read anything into it. I think we went into that with a very clear [portfolio] that we're looking for, which is a general manager framework, and that's what we were after. And I think if you look at his diversity, his skills and his track record of success, you begin to see someone who does have strategic agility, someone who solves problems and is very accountable, someone who operationally can get you from point A to B and then someone who can lead people very effectively. And that's the general management framework that I look for. And he has those attributes, and that's what attracted us to him. We want someone who's an extraordinary leader, a big [athlete] who can help us think about doing things in a different way to drive better results going forward. So hopefully that provides you some helpful color.

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

Yes, it was great. And then just a follow-up here just on expenses. I appreciate some of the commentary on kind of the back half of the year and the full year kind of range that you provided today. How should we think about maybe the base heading into next year? I don't want to get too far ahead of ourselves, but it seems like there's a little bit of a step-up into the back half. And so is that kind of a good way to think about the launching point with some of the technology initiatives that are now starting to flow through the P&L? Or -- I'm just trying to think about some of the moving parts here from 1H to 2H.

Matthew Audette - *LPL Financial Holdings Inc. - MD & CFO*

Yes, Devin. I mean, I think we'll give 2019 guidance at a later point. And I think the individual quarters, we've always had some seasonality in moving individual quarters. So I think you just have to wait and see, and we'll give guidance on 2019 later in the year.

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

Okay, great. And I figured I'd try there. But just one more quick one. The securities-based loans, I'm curious where you guys think you are in education with advisers on that product. I know there's been a recent initiative with Goldman. I'm curious if that changed the trajectory at all there. And I'm just trying to think about the long-term opportunity, just given that it has been a product that the industry has embraced and has done reasonably well for some of your peers.

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

Yes. I think we certainly, and thinking through that opportunity set, sort of assess the marketplace and the success that it -- that we were seeing in certain parts of the industry. So we are optimistic that by providing that additional service, not only does it create a better experience for the end investor and a leverage point for our advisers but, as you say, drives additional economics. I think it's very early in terms of the overall educational process and opportunity. And we're certainly having dialogue with advisers as they're using it and trying to experiment with it and learn with it,

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and I think it will be something that we sort of learn into. But we are optimistic that there is an opportunity for advisers to leverage that to better serve their clients and because of that value, drive economics with it.

Operator

Our next question comes from Ken Worthington with JPMorgan.

William V. Cuddy - *JP Morgan Chase & Co, Research Division - Analyst*

This is Bill Cuddy filling in for Ken. So first, core managed portfolio continues to grow. As we think about the long-term growth potential for that portion of your business, what would be the upper limit for managed -- centrally-managed portfolio, [that percent] of total advisory assets?

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

Yes. It's a fair question. Look, I think we don't necessarily -- I think -- think about it in that way. I think one of the things that we continue to do is invest in our overall advisory platform because it's $7 out of every $10 are going to the advisory platform. We see that as a place for advisers to differentiate and continue to win. And we look at the centrally managed platform as a great leverage point for our advisers when they want to outsource certain components of the overall administrative and operational efforts around managing the portfolio, right? And we'll -- we are continuing to invest and continue to enhance this. So we'll deliver new capabilities in the second half of the year that continue to enrich its value and, I think, appeal to our advisers. That said, we're also investing in our rep-driven platforms. And so I would look at it more from a macro advisory standpoint. And again, I think as we continue to enhance the capabilities associated with these platforms and find more ways of which to offload administrative and operational tasks from our advisers, they're going to use these platforms more robustly. And so I think with the pricing changes and the enhancements we've made to investment content and features within the centrally managed platform, that's where you've seen the growth over the last 2 years. And so there's -- we believe there's no reason to continue if we create more value. We continue to leverage our scale to drive down lower prices that you don't continue to get a healthy mix and utilization of those platforms. I know that's more of a macro sort of qualitative directional way to think about it but hopefully that gives you some color.

William V. Cuddy - *JP Morgan Chase & Co, Research Division - Analyst*

Yes, that's helpful, recognizing that it's a hard question to actually [complain] number on. And then so my second question, could you just elaborate on how the recruiting pipeline looks for this year relative to last year? So Matt had mentioned larger advisers. Are there other metrics such as production or advisory to brokerage mix changing over time? And relatedly, Dan, you had mentioned the -- your temporary transition assistance initiative. Is that driving a change in the types of advisers that you're seeing in your recruiting pipeline?

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

Yes. Let me take that one first. I think we obviously offered that as a way to experiment and challenge our own strategic agility relative to an opportunity set. And so that was time-bound, and we've had some early interest on that. And I think it's too early to draw any conclusions from it. I think we'll see more clarity in activity in the third quarter so probably have a better point of view on that at the end of next quarter relative to your question. That said, we offered that in a broad way across the board to the industry. So I don't necessarily see that as a changer relative to the overall mix of advisers that we would attract. I think it more helps us understand the elasticity of demand if you will, relative to utilization of transition assistance and simplified pricing. I think relative to your question around the pipeline and maybe the characteristics around it, my word, not yours, so if I don't get it right, please guide me differently, but, look, we continue to recruit both in the independent space for those advisers who may be looking for a broader set of capabilities, the benefits of vertical integration, the benefits of our own advisory platform, better pricing in that advisory space. And so we continue to recruit in the independent space. We also recruit in that employee-based model to independent model structural trends so whether that's from the [wires] or the regionals. And we continue to see opportunity and progress occurring from those places. And those are 2 of the historically consistent places we pull from. And -- so we don't see a big difference in the overall historical mix in terms of the

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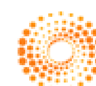

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advisers that we're attracting. I think we -- as Matt said, we're seeing a mix of larger advisers, and I think that's more just coincidental to opportunity out in the marketplace. And I wouldn't read anything into a shift in our strategy or something that's really driven that. I think we're casting a broad net and think we've got broad appeal in our model, and we like how it's positioned. We continue to test our own go-to-market strategy just to try to optimize it. But I think those things are leading to a pipeline that will look similar to what we've had in the past in terms of the advisers that are in it. I do think we've worked on picking a good team and continually trying to make it better. With respect to new training, giving them new techniques and capabilities, like data or new selling systems to enrich how they perform in their own roles, we want to take up the opportunity and try to maximize it and put them in a position of executing extraordinarily well. So we continue to invest there. And we do believe that's beginning to have some benefit on the growing pipeline. So that was probably more than you look for but hopefully that was helpful.

Operator

Our next question comes from Michael Cyprys with Morgan Stanley.

Zachary Noah Feierstein - *Morgan Stanley, Research Division - Research Associate*

It's Zac Feierstein filling in for Mike. Just a quick question on the advisers brought out from NPH. How are you thinking about the stickiness of those advisers maybe, say, 3 years out? We saw 53 leave this quarter. How should we think about that going forward? Should we think about some softness? Or just some color on that will be great.

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

Yes. So I would be careful concluding 53 left. As I said earlier, I think most of that was just a customary post-transaction cleanup and, as we say, reassigning some of those licenses to administrative roles, of which they should have been put in when they first came over. So I wouldn't read anything into that. We think that we have a compelling value proposition. We think if we serve them well, give them the capabilities they need to solve the problems and challenges and opportunities for their clients and do that all at a good price, then we think we have a good chance to have high retention rates, just like we do in our core business. Remember, these advisers' profile were very similar to the LPL advisers' profile. So we think we're well positioned to continue to serve them and support them going forward.

Zachary Noah Feierstein - *Morgan Stanley, Research Division - Research Associate*

And Matt, just going back to the cash levels. If they continue to flow as they have across the industry, would you consider maybe changing your pricing or making the sort of changes there to attract more cash? Or any color there will be great.

Matthew Audette - *LPL Financial Holdings Inc. - MD & CFO*

Sure. I mean, I think our pricing is -- and we set our deposit pricing in line with the market. And I would just emphasize, it's not a cash rate or an interest rate-sensitive product, right? This is about whether cash is deployed in the market or not. I don't think it's focusing in there trying to get a higher rate. So I think we feel good about our deposit betas and where we're positioned. And just a reminder, it's a range. It's a 25% to 50% range. And we're right now at the lower end. So I'd just encourage you to think about it that way.

Operator

This concludes our question-and-answer session, so I'd like to turn it back over to Mr. Arnold for closing remarks.

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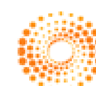

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Dan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Thank you, James. And I just want to thank everyone for taking time to join us this evening, and we look forward to speaking with you again next quarter. Have a good day.

Operator

Ladies and gentlemen, that does conclude today's conference. Please disconnect now, and have a great day.

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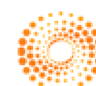

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