LPL Financial

LPL Financial
Q2 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, the amount and timing of the onboarding of brokerage and advisory assets from People's United Bank ("People's") and CUNA Mutual Group ("CUNA"), and the expected timing, costs and benefits of the shift of our sweep overflow to client cash accounts, 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 August 2, 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 August 2, 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 August 2, 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 August 23, 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, we remained focused on our mission of taking care of our advisors, so they can take care of their clients. Amid persistent market volatility and geopolitical uncertainty, our advisors reinforced the value they provide to their clients by helping them navigate through times of uncertainty. In that spirit, I want to recognize our advisors for their continued care and dedication to their clients, especially when they need it most.

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

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

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

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

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 second quarter and 98 percent over the past twelve months.

Our second quarter business results led to solid financial outcomes, of $2.24 of EPS prior to intangibles and acquisition costs, an increase of 21 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 to expand our addressable markets.

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

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

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

Our second strategic play is focused on providing capabilities that help our advisors differentiate in the marketplace and drive efficiency in their practices. As part of that focus, we continue to enhance ClientWorks, our core operating platform, with the expansion of digitized workflows. For example, in the second quarter, we introduced enhancements to our Move Money solution which make it easier and more automated for advisors to support deposits and withdrawals within client accounts. Separately, we also enhanced the client management workflow for advisors by integrating goal-planning data into our Meeting Manager solution which facilitates more efficient preparation for, and more value added dialogue within, client reviews. These enhancements help advisors operate more effectively and increase their scalability to serve more clients.

Let’s next move to our third strategic play, which is focused on creating an industry-leading service experience that delights advisors and their clients and, in turn, helps drive advisor recruiting and retention. As a reminder, over the past two years we have transformed our service model into an omni-channel, Client Care Model which includes voice, chat, and digital support thus giving advisors flexibility for when and how they access service. We continue to fine tune this model to drive additional efficiency and an enhanced experience for our advisors.

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

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

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

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

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

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

Matt Audette, CFO

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

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

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

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

Now let's turn to our Q2 financial results. The combination of organic growth, rising interest rates, higher client cash balances, and expense discipline, led to EPS prior to intangibles and acquisition costs of $2.24. This was up 21 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 $711 million, up $42 million or 6 percent sequentially. Looking at the components, commission and advisory fees net of payout were $205 million, down $22 million from Q1. The decrease was primarily driven by the seasonal increase in production bonus expense and lower advisory fees following the Q1 equity market decline.

In Q2, our payout rate was 87.0 percent, up about 90 basis points from Q1 due to typical seasonality. Looking ahead to Q3, we anticipate our payout rate will increase to roughly 88 percent, driven by the typical seasonal build in the production bonus as well as the onboarding of CUNA.

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

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

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

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

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

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

Now let's turn to Service and Fee revenue, which in Q2 was $113 million, unchanged from Q1.

Within our Services Group, we ended the quarter with nearly 3,900 subscriptions, which is up about 300 from last quarter. Our Services Group now generates roughly $32 million of annual revenue, while also contributing to organic growth by helping drive recruiting, same store sales, and retention.

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

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

Now let's turn to expenses, starting with Core G&A. It was $286 million in Q2. Looking ahead, we plan to stay disciplined on expenses, while continuing to invest to drive growth. Given the increase in interest rates to date, including the rate hikes last week, we are poised to generate significant additional capital. Our framework for allocating this capital remains aligned with the returns we generate, which first and foremost, is investments to drive and support organic growth. Now that we are deeper into the rate cycle, we plan to accelerate some of these investments, and anticipate up to $20 million of additional Core G&A in 2022. This increases our 2022 core G&A outlook to a range of $1 billion $170 million to $1 billion $195 million.

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

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

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

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

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

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

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

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

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.