LPL Financial

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Participants:

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Alexander Blostein: Great. Well, good morning, everybody, and welcome again. If everyone can just settle in, we'll get started with our next session. It's my pleasure to welcome Dan Arnold, President and CEO of LPL Financial.

With over $1 trillion in client assets and 21,000 financial advisors, LPL has emerged as one of the fastest growing companies in the wealth management industry over the last several years. LPL's meaningfully been expanding its capabilities as well into new affiliation options and creating much larger addressable market to sustain the type of growth that we've seen over the last couple years. Interest rates obviously been very helpful as well, positioning the firm through their earnings quite substantially over the next couple years.

So Dan, welcome. It's great to see you here. We saw each other only a couple of weeks ago at your Investor Day, but good to see you again. Definitely look forward to spending time on how do you see the marketplace evolving and ultimately the role that LPL will play in that market. So thanks for being here.

Dan Arnold: Good. Thank you.

Alexander Blostein: Great. Why don't we start with a couple of questions around organic growth. As you imagine, that's probably going to dominate a good chunk of our discussion here. In terms of just the overall, based on your pipeline and current market conditions, can you give us your latest thoughts about what your expectations for net new asset growth is into 2023? And more importantly, what channels do you expect to be the most kind of material contributors to that net new asset growth?

Dan Arnold: Yes. So it's a great question. Maybe I can give you a little context that then sets up a bit more insight on how we think about the specific question. Look, organic growth is a core component of our strategy, and that growth opportunity is really borne out of what we believe are three big structural trends out in the marketplace: the ongoing demand for advice, the preference to receive that advice through a financial professional, and then finally, the appeal of the independent model.

At that intersection point, there's a tremendous amount of opportunity, and we believe we're well positioned to capitalize on that opportunity. If you think about us being a market leader in the independent model, you think about the featurerich, appealing platform or capability set that we have today, and then our capacity and commitment to continue to invest to evolve it, to further differentiate it, we think when you look at that combination, it sets up a real durable differentiation strategy and an opportunity for us then to capitalize and best position with sort of a right to win.

Now that said, how does that manifest itself then into organic growth, and Alex, specifically your question? Look, I think if you look back just in 2020 and 2021, 7% organic growth in 2020, 13% in 2021. It sets up sort of a nice framework of bookends, as I call it, around what we think the potential growth is. And that variance within that range could be impacted by the macro. It certainly could be impacted by if we win a large enterprise that can create some lumpiness in the short term around growth rates. And I think if you look back just in the last 12 months, you'd see us at a growth rate of about 9% from an organic growth standpoint. And if you reflect on that a bit, that's a timeframe where 3/4 of that timeframe, where 3/4 has been under pretty difficult macro conditions. So I think it kind of reinforces how we think about that range and the performance within that.

So going forward, specifically to Alex's question, I think, look, there are three primary drivers of that organic growth. One's new store, which is really driven by recruiting new advisors to our platform. And as we look out over that landscape, we continue to invest in the platform or the model which is helpful to all of our different affiliation models. That sort of creates this sort of lift that you get across all of our different types of solutions that we offer in the marketplace.

Then you couple that with the accelerated momentum and the accelerated growth that can come from some of our newer affiliation models. They all have been delivered or gone to the market in the last 2 to 3 years. So they're still seasoning in. You have market awareness that is building. You have credibility that is growing with happy clients that are using those type of models. You have sort of the iterative fast-paced innovation that occurs once you've got clients giving you feedback. And so those versions of those models now 2 years later all look more appealing than they did before. And now we've got the benefit of a community of clients who are happy with the solution that establishes the credibility and this growing awareness in the marketplace. So that's helpful as you think about that recruiting opportunity going forward.

And then finally, look, we continue to challenge our own selves with respect to how we execute in any different marketplace. So with each year, we get to learn and think about how we improve and do it a little bit better. So you have our own continuous improvement meets these new models and the emerging growth associated with them, the ongoing investment in our platform and the expanded TAM in our enterprise marketplace. And so we think about new store sales being set up to continue to deliver inside that range of growth that I talked about earlier. You also have same store sales, which is we believe a continuing, ongoing constructive driver to that organic growth. Year-on-year it's been a little tough, the macro environments, taking away some of those swings in the batter's box for advisors. But I will say, as the year's gone on, they get more acclimated to it and where that market turbulence is sort of giving away now to opportunities. And I think we'll continue to work with them to help them pivot into that.

And then finally, it's that retention. I think if we can keep that in that low 2% range where we are today just by investing in the capabilities and enhancing the service model, we think that all adds up to that ability to drive that potential growth in that 7% to 13% range.

Alexander Blostein: Great. No, that was really helpful way to set this up. As we think about some of the newer things you guys are doing, I want to unpack some of the channels you talked about at the Investor Day. When we were going through the slides, I guess comparing the addressable market opportunity today versus the last Investor Day from a couple years ago, it looks like the employee channel, which I guess now you guys call Linsco, that expansion is one of the largest incremental areas we're kind of comparing now versus then. Maybe can you give us a little more color into what gives you confidence that LPL can compete effectively in that market and a more holistic view of how big that part of the franchise is going to be?

Dan Arnold: Yes, it's a great question. I'm really excited about our Linsco model. If you go back a couple of years, it was borne out of a -- created out of a really different premise. This concept of how do you take the attributes of an employee-based model, but make sure then they fit inside the framework of an independent model. So we were actually solving for something different than what historically I think the traditional employee-based models did. And so we've delivered that to the marketplace over the last 2 years. That has helped us attract roughly 25 teams. And so you've got, again, that growing credibility and that now community that's giving us really high NPS scores, that's giving us great feedback on how we should improve the model or enhance the model, which we're doing in an accelerated way.

And then I think here's where the awareness is a bigger opportunity for us because people just didn't see LPL as offering this type of model. I think as we build on that awareness, meets -- hey, the credibility to do this, the growing geographical and physical presence that we're building in this model, we're really optimistic on that we've got a differentiated solution that checks all the boxes of someone that's looking for an employee type of model and does it with the attributes of the independent model. And now that I think we've got some seasoning around how to execute it and we're growing that presence, it creates an interesting platform of which to expand and grow.

That's really the driver of the additional available market. When we started, we were targeting probably a certain subsection of the employee-based model, knowing that we didn't have the right experience yet, the right IP and maybe the not right capability set. And so as we've expanded that capability set over the last 2 years, we now realize we can compete for most of that sort of employee-based model asset, which is the biggest part of our wealth management space.

Alexander Blostein: So if you think about the typical advisor and in an employee model, whether it's one of the big wires, et cetera, that's ultimately type of a thing that you feel like you can go after.

Dan Arnold: That's right. I think our learning has been it's not just the wires, it's the regionals. It's even an advisor who's an independent that's tired of running everything themselves that, again, wants to keep the attributes of the independent model, but we can surround them with that employee-based service. So it's an interesting draw across the marketplace.

Alexander Blostein: If we keep going down the list and the way you framed the addressable market, the other large area was enterprise expansion. And really with respect to larger financial institutions, which again, kind of comparing then and now chart from the Investor Day, really stood out to us. Can you spend a couple minutes on I guess a few examples of the type of financial institutions that are attracted to this model within LPL? And if you look out over the next 1 to 2 years, what does the pipeline look like for especially those larger deals as you look out into next year?

Dan Arnold: Yes. And this has been an interesting area of innovation. If I just took you back, again, 2 years and sort of how we got here, originally, the question we were trying to solve for is, hey, can we take the merits of an outsourced solution and deliver them to the larger bank space where this total outsourcing solution wasn't available? Historically, they had just done it themselves, and so it wasn't a logical or a natural place to offer this type of solution. Now, it had to be tweaked and adjusted and modified to make sure that it set up for more of an enterprise type institution than a smaller business, but that's the work we did a couple years ago.

And then we had the good fortune of winning some clients and, again, working with them over the past 2 years. Feedback on how to best position it, how to brand it around an enterprise and make sure that it is sort of fit for purpose. We also learned a lot about that change management effort of these larger institutions and how to bring them successfully on board in an efficient and effective way that sets them up for success as they go forward. And then just learning how to work with a larger enterprise. So we've collected a lot of what I'll call pragmatic experience or IP over the last couple of years. We've tweaked the model to make it more compelling for an enterprise.

And so to your question I think, Alex, what's happening with that, well, you're seeing more and more demand for larger banks that want to explore and open up that possibility. And then what we did was simply ask the question, well, if we've got the solution that resonates for this sort of set of larger enterprises, let's look into other channels and say, could we take the same model, tweak it a little bit and perhaps apply it to, think about insurance companies that run wealth management solutions. That's what we would mean by another channel. And that expands the TAM or the available market. And we've begun to have those discussions, which we think have some interesting possibilities associated with it. And you can go through other channels as well within the enterprise marketplace, but that's a good example, I think, to answer your question. So you take your available market from $3 trillion to $5 trillion, as an example, by expanding into other channels.

Alexander Blostein: Yes. I guess when you look at these markets and the success you are having, I think the natural question is like, why can't others do the same thing? So as you expand into the enterprise solution, into that enterprise part of the market, how do you see the competitive landscape evolving? What are you offering that others can't in that market?

Dan Arnold: Yes, it's a great question. And look, anytime you sort of create what is practically a new solution in an area, and if it gains traction, it creates opportunity, and logically, others would follow that sort of first adapter move. I think that said, the hard part is you really have to have a vertically integrated solution with the right capability set to take that on. You've got to have some IP and real understanding around how to operate, in this case in the banking credit union world is what we leverage to then take it to more larger enterprises. And then that pragmatic experience that we've learned over the last couple of years is really important as well, especially around change management. And so the bar is high.

Will folks follow? Absolutely. Will we win them all? No. But we think with our long history of serving banks and credit unions, now learning how to do that with larger enterprises in a really compelling, vertically integrated platform, and with clients to give us credibility in the space, we think that's an interesting package that will create a durable growth opportunity as we go forward in a sizeable $5 trillion marketplace.

Alexander Blostein: I guess one of the sort of competitors in the space is really just the internal resources that people are using. And when you look at the current macro backdrop, inflation, et cetera, and costs are kind of going up everywhere, presumably, there's a win-win for the enterprise, whether it's a bank or insurance company as well as you guys. Any examples you could share in terms of the savings that financial institution could realize on the back of doing something like this?

Dan Arnold: Yes. And I think that's, if you go and look at the value proposition, one is a different risk profile, which is many times important when this solution isn't necessarily your core offering as in an insurance company or a bank, as an example. The second thing you get is typically a lower cost to operate that solution, because we can take out a lot of the middle and back office and replace that with an outsourced solution that creates better economics and a better service experience and a better capability set.

Then you add to that just the profile with the right platform to attract better advisors and also give them more tools that will support and drive growth. The conversion from brokerage to advisory. There are a lot of opportunities to not just lower the cost, but also drive the growth. Those two things create much better returns and more meaningful contributions from these offerings that necessarily aren't inside their core offering.

And that's the appeal. Shift in risk profile, better economics, better growth, better experience for the end client. That adds up to an appealing solution. And the economics could be different for any institution, depending on how they operate them. I think directionally speaking, most of these programs aren't necessarily a tremendous earnings contributor inside an overall bank, as an example. So if we can make a material improvement in it, you can create some meaningful additional earnings contribution that can come from it.

Alexander Blostein: Yes, that makes sense. Shifting gears. Why don't we spend a couple minutes on LPL Services Group. It's one of the newer and more innovative solutions you rolled out as well over the last couple years. I think you have about nine offerings now, and you talked about $34 million of annualized revenue run rate from the services. What's the addressable market within LPL as we think about for the growth for these services? And then more importantly, as you think about an opportunity to roll that out more broadly outside of the LPL's financial advisor channel, is that an opportunity we should be thinking about over the next few years?

Dan Arnold: Yes, it's a great big strategic question, and one I think we are really excited about the possibilities. We've got to certainly execute and deliver on that, so let me give you a little color on that. This services portfolio was a question we began to challenge ourselves with is you had sort of the traditional value proposition of an RIA, a broker-dealer or a clearing firm. And what we realized was there are a lot of services and support that an advisor needs to be both a great advisor, give great advice to their clients, but to also run their own business. And historically speaking, inside the wealth management model, we just hadn't traditionally delivered that type of value.

And so what we did was begin to explore, okay, what is that opportunity set?

What type of services are advisors using? So if you take our 21,000 advisors, we estimate roughly they spend $2 billion a year in local level services just to, again, to help them, whether it be something that adds to their ability to service for the clients or running their own practice or running their own small business.

And so we began to go in and explore, okay, could we do those services? Could we do them cheaper? Could we do them a higher quality? Could we do them in an integrated way? And just open up what I'll call a new services portfolio, a new way of which to add value to them, but also a new way for us then to get -- to generate economics from that value that looks different than our traditional economics. It's more a service type of subscription-based ongoing fee for the services themselves, and hence the reason we call it our services portfolio.

And so after being at this roughly 3 years, we have nine solutions. Those were mainly what I'll call professional services. So think like a CFO type of role, a CMO type of role, an admin. They were almost borne out of the gig economy sort of concept. And predictably, those weren't going to be relevant to all 21,000 advisors. They actually were going to be probably more relevant to larger practices who, A, needed a bit more of the expertise and could afford to pay for what might be more expensive type of services. But we wanted to start there to understand, could we deliver services with value? Could we do it in a sustainable way? Could we pivot and learn how to be a services company as well as an RIA, broker-dealer, clearing firm, et cetera?

And I think that's what we've done over the last 3 years with these nine solutions. We now have 3,000 advisors that have about 4,300 subscriptions. And we believe that the available market is the entire 21,000 advisors we serve and support because, again, fundamentally, we're just trying to help them run a better business and/or be a better advisor so their solutions that presumably would be relevant to all of them. And as now we go on our own sort of product development and innovation to add to those nine services, I think we'll expand out to being more relevant across our entire advisor base.

And so that's the concept. We've got nine today. We'll add four next year, four more services next year. And again, we've got an incubation pipeline that we're being very intentional about developing so that we can continue to expand the services and sort of expand the available market.

And the final question you asked, I think as we deliver more of these services that solve for discrete needs, think like a bookkeeping or payroll, things of that nature, you can begin to look at that and say, hey, wow, do some of these make a lot of sense to even go outside just our 21,000 advisors and try to apply them inside the wealth management space more broadly. I think that's a logical question when we get there to challenge ourselves to try to answer.

Alexander Blostein: Got it. But not quite there yet because plenty to do in terms of --

Dan Arnold: We have plenty of opportunity internally.

Alexander Blostein: I got you. Maybe following up on a couple other questions that came up from the Investor Day and shifting gears. I was hoping to spend a couple minutes on just the expense philosophy. You gave initial guidance of 15% core G&A growth for 2023. It's a bit higher than what we've seen recently. So maybe give us a sense of sort of key areas where you're spending incrementally more to support these organic growth initiatives. And what's the flex around that 15% if market conditions remain challenging, because clearly we've been in pretty choppy markets this whole year.

Dan Arnold: Yes. And I think the headline here is, just to start with, is our cost strategy hasn't changed. We still are very committed to delivering margin expansion. We still are very committed to prioritizing growth-oriented investments. We're still very committed to making sure we're using continuous improvement and scale to drive efficiency and productivity gains. And I think we continue to be very committed to remain agile and nimble so that if the market or macro backdrop changes, given our shorter term strategy and/or plan, that we can be agile and nimble and adjust to it to accomplish those things that I just listed out.

So no change in our overall strategy. In fact, our outlook for next year is borne out of that framework, which is we believe there's opportunity to accelerate some of the investments that will drive growth, while at the same time, given the backdrop of the interest rate environment, still drive margin expansion. And then maintain the agility and nimbleness to adjust, if need be, given some shift or change in the macro backdrop.

And so when you think about those investments we're making, you're pulling forward technology investments. You're pulling forward expanding services or capabilities. We were just talking about our services portfolio. Perhaps it helps us just accelerate the innovation on new solutions and services. So that's how you should think about how we're trying to deploy additional spend.

Alexander Blostein: I got you. Another interesting element that came out of the Investor Day is the introduction of this liquidity and succession offering that you rolled out, which in a way, doesn't necessarily expand the TAM the way you talk about the TAM, but perhaps gives you another avenue to go at that TAM. Maybe spend a couple minutes on what that is in the background of developing this new capability, and now how effective do you think that's going to be over the next few years.

Dan Arnold: Yes, you set it up well. It's a new capability that would help us just attract more of that market that's already there. So here's the concept. A third of the advisors are projected to be at retirement age over the next 10 years. So we were trying to solve this industry-wide challenge and turn it into an opportunity by innovating in how do we help advisors solve for that challenge. And we turned to our services portfolio, back to that dot connection, and I think challenge ourselves, hey, can we create a service that ultimately would help advisors better solve for this, that would heighten the probability that assets move to our platform and/or stay on our platform was the big strategic question.

And in doing that work, I think the initial service we came up with was what we rolled out a year and a half ago called M&A Solutions, which was this concept of, hey, advisor needs or wants to retire. We've got access to a lot of advisors on our platform. How do we create a service that helps heighten the probability they connect, that they've got an efficient way of which to get that transaction done, and that we could even be supportive or helpful with the capital requirements around that? And there were over 50-plus transactions done through M&A on our platform last year, as an example, through this M&A Solutions where this advisor is buying another advisor's practice. And that continues to be a valuable way of which for advisors to solve this.

But in doing that, we also I think again learned, wow, there could be a Part B to this solution, and that is what we call Liquidity & Succession Solutions, which is a new service. It's a service, which was simply just meant to go in, and for an advisor that can't find a successor or doesn't have one in their practice, but still has this need to sunset and exit the business, then in this Part B solution, we actually will acquire that practice for a period of time. Think about that as a bridge to their retirement. 3 to 5 years typically would be the timeframe to think about. And during that period of time, we would own that practice. The economics around that practice shift materially and get much more advantageous during that period of time for us.

And then at the end of that period of time, we would ultimately then take that practice and make sure we sell it to the next independent practice or model to preserve that it stays in the hands of an entrepreneur. But that now by doing that, not only have we been able to create value during that bridge period of time and get paid for that, we sell the business back to the next owner that then will start the cycle over for another 20 years on our platform. So that was the concept that is sort of the Part B solution.

Now we've done two of these deals this year. I think by the end of Q1, you'll end up somewhere in the 8 to 10 range. So you can call this the first round where we're learning and understanding into it. We're leveraging a lot of the services portfolio that we have and some of the infrastructure we've put in place for our Linsco model. So it's kind of cool that these other affiliation models are making this option or Part B of helping them with retirement possible.

And we're pretty bullish on what that could mean as we go forward, because it's a more complete solution for the advisor than just, hey, we've got a monetization event for you. By doing that, we're actually able to make sure that we're taking care of that transition of their teams and of their clients, which is really important as an entrepreneur and someone that's exiting the business that that's successfully done. So we think it's differentiated from many of the other solutions out there in the marketplace because of that and will be interesting as we go forward if we can continue to do that and learn to do that at scale.

Alexander Blostein: It's interesting when you play this out, and I know you said you own the practice for 3 to 5 years. But transitioning that practice back, do you think it's likely to end up in the more traditional IBD channel, or it's likely to be more in the employee model where the advisor that's kind of growing up through your ownership is probably more accustomed to more services that are being provided. So is there a better kind of margin and better economics that could go along with that once you go through that transition?

Dan Arnold: I think you're exactly right. I think it'll be interesting to see how it plays out. But your hypothesis of a mix shift to more of a Linsco type of model certainly is reasonable and logical to us, which could be an interesting outcome as you make that transition from what was a traditional independent model to more of a Linsco type model. And so we've just done it internally now. I think your other question was, we also see it, though, as then an ability to take the solution to the external marketplace and attract new assets to the platform.

Alexander Blostein: That's right. I have one more question maybe before we turn it over to the audience. We spend a lot of time talking through net new assets, organic growth, and the economics around it. We talked about expenses. Obviously you guys have been fixing out the maturities on the ICA that should make the model a lot less volatile. The question that we get a lot is how to think about the EPS growth algorithm for the business over time and kind of through the cycle when you kind of put all these pieces together. So was wondering if you could opine on that.

Dan Arnold: Yes. So as I think about the growth algorithm, I start with the work we're doing to drive organic growth. And then if you couple that with just some marginal incremental sort of constructive backdrop to the macro, and then package that with good expense discipline that drives margin expansion, and then couple that with I think our capital light model, that creates a framework for dynamic allocation where we can then complement the organic growth with M&A and/or returning capital to shareholders. We think that combination creates a pretty interesting and compelling growth algorithm over time. And so I think that's how we think about generating what are interesting outcomes. And certainly that 7% to 13% growth range we think lands at a really interesting and appealing outcome.

Alexander Blostein: Yes. If that's a starting point, that by definition has to --. Great. Okay. So we've got a couple minutes. If anybody has questions in the room, let us know. We'll send a mic your way. One up here in the middle, please.

Unidentified Participant: Thank you for the presentation. Shing Li from Diameter Capital Partners. Was curious if you are aware of some of the latest discussion around the return of the

DOL fiduciary rule. Thank you.

Dan Arnold: Yes. So question around the sort of the ongoing regulatory landscape and the evolution of the old DOL rule, which I think was somewhat in question back in the 2014 to 2015 timeframe. And just to bring you back to that, the real question was, do we make brokerage so tough to do that everything will shift to advisory. And consequently, what does that mean to the marketplace? And you know, when we were going through that, we were actually advocates of a higher standard. I think that's always good for the end client if you come back with a higher standard of care for the clients. And we think Reg BI ended in actually a good place. You've got a higher standard of care, but we still preserved choice between advisory and brokerage, because an advisory solution is not always better for every single client. In fact, we could all come up with a number of scenarios to where that would not be the case. That was, again, promulgated by the SEC, which we think is the right place to do that because that covers both qualified and non-qualified solutions.

We think it's in the best interest of the regulators to continue to let that play out and see how Reg BI's doing, see how firms are doing and what the outcome and change is occurring in the overall marketplace, both in terms of the care of the investor meets the ability for industry participants to manage through that change and believe that that ultimately will be the sort of the evolving outcome. And though the DOL well may continue to think about some things around the edges, I think we should think about sort of Reg BI being the driver over the next couple years as we all pragmatically learn into that, and think it was a good outcome for the industry. And typically when you have good outcome and then participants are able to execute on it, you build some stability around that and some growing conviction around that and some growing conviction around that.

But I do think the regulatory question will continue to be asked and explored. I think the industry does a good job of educating, at least with respect to any legislative change, educating on what the pros and cons are associated with the solution. If we can keep it at that pragmatic level and really understand what we're solving for, I think logic will prevail and we end up in good outcomes.

Look, if for some reason brokerage no longer becomes a choice or an option in the marketplace, I think that's okay, too. We have a platform that we've seen significant growth in the advisory business and believe we offer a really compelling solution there that's quite differentiated. And so if that were to occur, I'm not sure it has really changes in our overall business performance as much as it is. I just don't think it's good for the end investor. I hope that helps.

Alexander Blostein: That's great. Thanks for the question. Well, I think we're at time. Dan, thank you so much. It was great to see you.

Dan Arnold: Good to see you.

Alexander Blostein: Thanks for being here.

Dan Arnold: Thanks for having us. Thanks, everyone.