LPL Financial

LPL Financial
Q4 2022 Earnings
Prepared Remarks

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Statements in this presentation regarding LPL Financial Holdings Inc.'s (together with its subsidiaries, the "Company") future financial and operating results, growth, priorities, business strategies and outlook, including forecasts and statements relating to the Company's future advisory and brokerage asset levels and mix, organic asset growth, deposit betas, core G&A expenses (including outlook for 2023), promotional, share-based compensation and depreciation and amortization expenses, Gross Profit* benefits, EBITDA* benefits, target leverage ratio, client cash balances and yields, service and fee revenue, transaction revenue, investments, capital returns and planned share repurchases, as well as any other statements that are not related to present facts or current conditions or that are not purely historical, constitute forward-looking statements. They reflect the Company's expectations as of February 2, 2023 and are not guarantees that the expectations or objectives expressed or implied will be achieved. The achievement of such expectations and objectives involves risks and uncertainties that may cause actual results, levels of activity or the timing of events to differ materially from those expressed or implied by forward-looking statements. Important factors that could cause or contribute to such differences include: changes in general economic and financial market conditions, including retail investor sentiment; changes in interest rates and fees payable by banks participating in the Company's client cash programs, including the Company's strategy and success in managing client cash program fees; changes in the growth and profitability of the Company's fee-based offerings; fluctuations in the levels of advisory and brokerage assets, including net new assets, and the related impact on revenues; effects of competition in the financial services industry and the success of the Company in attracting and retaining financial advisors and enterprises; whether the retail investors served by newly-recruited advisors choose to move their respective assets to new accounts at the Company; the effect of current, pending and future legislation, regulation and regulatory actions, including disciplinary actions imposed by federal and state regulators and self-regulatory organizations; the costs of settling and remediating issues related to regulatory matters or legal proceedings, including actual costs of reimbursing customers for losses in excess of our reserves; changes made to the Company's services and pricing, and the effect that such changes may have on the Company's Gross Profit* streams and costs; the execution of the Company's plans and its success in realizing the synergies, expense savings, service improvements and efficiencies expected to result from its initiatives, acquisitions and programs; and the other factors set forth in the Company's most recent Annual Report on Form 10-K, as may be amended or updated in the Company's Quarterly Reports on Form 10-Q or other filings with the Securities and Exchange Commission. Except as required by law, the Company specifically disclaims any obligation to update any forward-looking statements as a result of developments occurring after February 2, 2023 and you should not rely on statements contained herein as representing the Company's view as of any date subsequent to February 2, 2023.

Actual remarks made on the Company's earnings conference call could vary from the prepared remarks presented here. A webcast replay of the Company's earnings conference call will be available on the Investor Relations section of the Company's website, investor.lpl.com, until February 23, 2023. Please refer to the Company's earnings release for additional information.

*Notice to Investors: Non-GAAP Financial Measures

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

Dan Arnold, President and CEO

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

Over the past quarter and throughout 2022, our advisors remained a source of support and guidance for their clients, against a backdrop of increased market volatility. In doing so, they reinforced the value of their advice and the important role they play for their clients. We thank them for their continued commitment and dedication as we focus on our mission of taking care of our advisors, so they can take care of their clients.

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

In the quarter, total assets increased to $1.1 trillion, as continued solid organic growth was complemented by higher equity markets. With respect to organic growth, fourth quarter net new assets were $21 billion, representing 8 percent annualized growth. This contributed to net new assets for the year of $96 billion, representing an 8 percent organic growth rate.

Recruited Assets were $15 billion in Q4, bringing our total for the full year to $82 billion. These results were driven by the ongoing enhancements to our model, and our expanded addressable markets.

Looking at same store sales, our advisors remain focused on serving their clients and delivering a differentiated experience. As a result, our advisors are both winning new clients, and expanding wallet share with existing clients, a combination which drove solid same store sales in the fourth quarter.

With respect to Retention, we continue to enhance the advisor experience through the delivery of new capabilities and technology, as well as the ongoing modernization of our service and operations functions. As a result, Asset Retention for the fourth quarter and full year was approximately 98 percent.

Our fourth quarter business results led to solid financial outcomes of $4.21 of EPS prior to intangibles and acquisition costs, which brought our full-year total to $11.52, an increase of 64 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 advisor-centered marketplace which, for us, means being the best at empowering advisors and enterprises to deliver great advice to their clients and to be great operators of their businesses. Now, to bring this vision to life, we are providing the capabilities and solutions that help our advisors deliver personalized advice and planning experiences to their clients. At the same time, through human-driven, technology-enabled solutions and expertise, we are supporting advisors in their efforts to be extraordinary business owners. Doing this well gives us a sustainable path to industry leadership across the advisor experience, organic growth, and market share.

Now to execute on our strategy, we have organized our work into four strategic plays, which I’ll review in turn.

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

In our traditional markets, ongoing enhancements to our platform and the efficacy of our business development team led to continued improvement to our win rates and an expansion of the depth and breadth of our pipeline, despite advisor movement in the industry remaining at lower levels. As a result, Q4 was our strongest quarter of recruiting in 2022 in our traditional markets with approximately $11 billion in assets. Looking ahead, we expect to carry this recruiting momentum into Q1.

With respect to our new affiliation models, Strategic Wealth, Employee, and our enhanced RIA offering, we recruited over $1 billion in assets in Q4. In each of these models, we continue to see growing demand and expanding pipelines, which position them for increased contributions to our organic growth.

With respect to large enterprises, they remained a meaningful source of recruiting in 2022, including the additions of CUNA and People's United Bank. Looking ahead, we expect to onboard Commerce Bank around the middle of this year, and continue to see our pipeline build as demand for our model grows. Now, at the same time, we continued to have success recruiting in our traditional enterprise channel, including the addition of BancorpSouth in Q4.

Within this strategic play, we are also seeing positive early momentum with our most recent innovation, our Liquidity & Succession capability, where we are providing a differentiated offering to meet the succession needs of advisors. Over the next decade, it is estimated that up to a third of advisors will be retiring, and will likely address the succession needs of their practices. To solve for this need, our first innovation was providing M&A support as a service to help facilitate the transition of practices from advisor to advisor. Our key learning from that experience, there are many instances, due to factors like large practice size, or lack of an identified successor, that would require a different solution. Now, it was out of this need, we created our differentiated Liquidity & Succession offering, in which LPL will step in to purchase an advisor's business, and serve as a bridge to the next entrepreneurial successor, all while preserving the principles of independence. The offering has been well received and we are encouraged by our early momentum, having already executed on a handful of transactions with advisors on our platform. This year, we plan to take the capability to the external marketplace, and look forward to sharing our progress.

Our second strategic play is to provide capabilities that help our advisors, differentiate in the marketplace, and drive efficiency in their practices.

In 2023, we will focus our development of new capabilities and solutions within this play across four key areas. First, we will continue to enhance our wealth management platforms to help advisors provide their clients with differentiated advice, products, and pricing. Second, we will continue to advance ClientWorks, our core operating platform, with additional digitized workflows, to help advisors operate more efficiently and increase their scalability to serve more clients. Third, we will expand our banking and lending services to help advisors address a broader spectrum of their clients' financial needs and thus deepen their role as an essential partner. And the final area, is to enrich the end-client experience with additional digital solutions that increase personalization and self-service and enable advisors to create customized experiences for their businesses. We believe these evolving capabilities will help drive increased advisor growth, productivity, and retention.

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

As a reminder, over the past couple of years, we’ve been on a journey to transform our service model into an omni-channel Client Care Model, including voice, chat, and digital support. Now, as part of this journey, we have evolved the technology and instrumentation of our traditional voice channel, and also made meaningful enhancements to our always-on, digital support capabilities. As a result, approximately 75% of engagements with our digital channel fully resolve their service request and don’t necessitate a phone call to complete their task. As we continue to expand and refine our digital support channel, we believe that an increasing share of advisors will leverage digital-first support for a more flexible and efficient service experience.

Now, as we continue to evolve our service interface, we are also transforming the operational processing that takes place behind that interface. For example, last year we began automating much of the processing for our core clearing functions, including money movement, account opening, and account transfers, which collectively drive the majority of our operational processing.

With the learnings from our transformation in service and operations, we are re-engineering other areas of the business, including our compliance and risk management functions. To that end, we’ve applied robotics and AI capabilities to a number of our compliance review workflows, which has improved both the efficiency of the reviews, as well as the efficacy of the overall risk management. Efforts on this front, include automating the reviews of client communications, marketing materials, and transactions. By automating more workflows, we continue to increase the scalability of our platform, while also enhancing the client experience.

Our fourth strategic play is focused on developing a services portfolio that helps advisors and institutions run thriving businesses and deliver comprehensive advice to their clients.

As we discussed last quarter, we are encouraged by the seasoning of this business and the evolving appeal of our value proposition. As a result of solid demand in Q4, the number of advisors utilizing our Services Group continued to increase and we ended the year at over 3,000 active users, up more than 30 percent year-over-year, and generating run rate revenue of $36 million.

Now, when we started our Services Group, we focused on addressing some of the most complex challenges facing our advisors, which were often more acute for advisors with larger practices. With the insights and learnings from this initial client segment, we are now expanding our Services portfolio to address the needs of our broader advisor base.

As we continue to evolve the offering in 2023, we are focused on several key opportunities for our Services Group. First, addressing additional channels, specifically building solutions that solve for needs of enterprise partners. Second, leveraging our structured approach to innovation in order to continue to develop new services and evolve our existing portfolio. Third, contributing to the growth of our new affiliation models, Strategic Wealth and Linsco, as well as expanding our ability to serve high-net-worth oriented advisors.

In summary, in the fourth quarter and throughout the year, 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.

Before I review our fourth quarter results, I would like to highlight our progress during 2022. Against an evolving market backdrop we maintained our focus on supporting our advisors and their clients while executing on our strategic priorities. We continued to grow assets organically in both our traditional and new markets, successfully onboarded new enterprise clients, developed and piloted our new liquidity & succession capability, and announced two strategic acquisitions. We accomplished this all while continuing to invest in our industry leading value proposition, and delivering record earnings per share.

Now let’s turn to our fourth quarter business results. Total advisory and brokerage assets were $1.1 trillion, up 7% from Q3, as continued organic growth was complimented by higher equity markets. Total net new assets were $21 billion, or an 8% annualized growth rate.

Our Q4 recruited assets were $15 billion. I would note this included $11 billion from our traditional independent model, which was the highest quarter of the year. Looking ahead to Q1, our overall pipelines continue to remain strong. In particular, I would highlight that within our traditional models, the momentum we saw in Q4 has continued into Q1, and we are on pace to deliver one of our strongest first quarters in what is typically our slowest quarter of the year.

As for our Q4 financial results, the combination of organic growth, rising interest rates, and expense discipline, led to EPS prior to intangibles and acquisition costs of $4.21, the highest in our history.

Looking at our top line growth, Gross Profit reached a new high of $972 million, up $135 million or 16% sequentially. As for the components, commission and advisory fees net of payout were $172 million, down $10 million from Q3, primarily driven by the seasonal increase in production bonus.

In Q4 our payout rate was 88.4%, up about 50 basis points from Q3 due to the seasonal build in the production bonus. Looking ahead to Q1 we anticipate our payout rate will decline to approximately 87% as the production bonus resets at the beginning of each year.

With respect to client cash revenue, it was $439 million, up $136 million from Q3, as the impact of higher short-term interest rates more than offset a sequential decline in balances.

Looking at overall client cash balances, they ended the quarter at $64 billion, down $3 billion, driven by record net buying of $25 billion. Within our ICA portfolio, we added $4B of new fixed rate contracts, bringing our fixed rate balances to roughly 45% of the ICA portfolio, up from 25% a year ago.

Our ICA yield averaged 291 basis points in the quarter, up 79 basis points from Q3, primarily driven by the increase in short-term rates during the quarter.

As for Q1, we expect our ICA yield to increase to approximately 315 basis points, which includes yesterday's 25 basis point hike, at an assumed deposit beta of 25%.

As for Service and Fee revenue, it was $120 million in Q4, down $2 million from Q3. This decline was primarily driven by lower conference revenue following our largest advisor conference of the year in Q3.

Looking ahead to Q1, we expect typical seasonal increases in IRA fees to be offset by lower conference revenue. So, we anticipate Service and Fee revenue to be roughly flat to Q4.

Regarding Q4 transaction revenue, it was $47 million, up $4 million sequentially as trading volume increased. Based on what we have seen in Q1 to-date, we would expect transaction revenue to be roughly flat with Q4.

Turning to expenses, our Core G&A was $327 million in Q4, bringing our full year Core G&A to $1 billion $192 million. This was in the middle of our outlook range and for the full year, represents approximately 13% growth.

As for our outlook for 2023, our long term cost strategy remains unchanged. We plan to continue to prioritize investments that drive organic growth, and create incremental operating leverage in our core business. As we shared at our Investor & Analyst Day, the current environment is creating opportunities to accelerate our investment plans. As such, we expect to grow our investments at a similar pace this year. More specifically, we plan to grow our 2023 Core G&A in the range of 12% to 15%.

To share a little more color on where our investments are focused, this expense growth spans the following three broad categories, with each driving approximately 4 to 5% growth in Core G&A. First, to support our core business growth, including investments in technology and capabilities, second, to support growth in our expanded addressable markets and to scale our new services, and third, to accelerate the timing of investments that advance our strategy.

To give you a sense of the near term timing of this spend, as we look ahead to Q1, we would expect Core G&A to be in the range of $320 to $325 million. As always, we will remain flexible and can adjust to shifts in the operating environment.

Turning to promotional expense, in Q4 it was $84 million, down $15 million sequentially, primarily driven by lower conference spend.

In Q1, we expect promotional expense will increase by approximately $25 million, as we have two of our largest conferences of the year during the quarter.

Looking at share-based compensation expense, it was $12 million in Q4, up $1 million from Q3. As we look ahead, we anticipate this expense will increase by approximately $5 million sequentially in Q1, as it tends to be our highest quarter of the year, given the timing of our annual stock awards.

As for interest expense, it was $37 million in Q4, up $4 million sequentially as higher LIBOR rates increased the cost of our floating rate debt.

Regarding capital management, our balance sheet remained strong in Q4 with corporate cash at $459 million, up $35 million from Q3. Our leverage ratio was 1.4 times, down from 1.7 times in Q3. This decline was driven by a combination of our continued growth and a higher interest rate environment, both of which have meaningfully improved our earnings power.

As 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.

As we look ahead to 2023, the strength of our balance sheet leaves us with ample capacity to allocate capital across our entire framework. Specific to organic growth, we see opportunities in recruiting and continued investment in our technology platform. On M&A, we see opportunities in the market place overall, and within our Liquidity & Succession offering, where we are emerging from the pilot phase, and closed 4 deals in 2022 for around $50 million. With regards to capital return, we plan to increase our share repurchases to roughly $250 million in Q1. And lastly, we plan to increase our quarterly dividend by 20% beginning in Q1. To summarize, our balance sheet is strong and we are well positioned to drive value through our capital allocation framework.

In closing, we delivered another quarter of strong business and financial results. As we look forward, we remain excited about the opportunities we see to continue investing to serve our advisors, grow our business, and create long-term shareholder value.

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