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LPLA.OQ - Q2 2023 LPL Financial Holdings Inc Earnings Call

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OVERVIEW:

Company reported adjusted EPS of $3.94, gross profit of $990 million, cash of $50 billion.

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PRESENTATION

Operator

Good afternoon, and thank you for joining the Second Quarter 2023 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 and Head of Business Operations, Matt Audette.

Dan and Matt will offer introductory remarks, and then the call will be open for questions. (Operator Instructions)

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

Today's call will include forward-looking statements, including statements about LPL Financial's future financial and operating results, outlook, business strategy 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 known and unknown risks and uncertainties that may cause actual results or the timing of events to differ materially from those expressed or implied in such forward-looking statements.

For more information about such risks and uncertainties, the company refers listeners to the disclosures set forth under the caption, Forward-looking Statements, in the earnings press release as well as the risk factors and other disclosures contained in the company's recent filings with the Securities and Exchange Commission.

During the call, the company will also discuss certain non-GAAP financial measures. For a reconciliation of such non-GAAP financial 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 Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Thank you, Tanya, and thanks to everyone for joining our call today.

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Over the past quarter, our advisors continued to provide their clients for personalized financial guidance on the journey to help them achieve their life goals and dreams. To help support that important work, we remain focused on our mission, taking care of our advisors so they can take care of their clients.

This quarter, we continued to see the appeal of our model growth due to the combination of our robust and feature-rich platform, the stability and scale of our industry-leading model and our capacity and commitment to invest back into the platform. As a result, we continue to make progress toward our vision of becoming the leader across the advisor-mediated marketplace.

In that spirit, we remain focused on helping advisors and enterprises solve challenges and capitalize on opportunities better than anyone else and thereby serve as the most appealing player in the industry.

With respect to our performance, we delivered another quarter of solid results while also continuing to make progress on the execution of our strategic plan. I'll review both of these areas, starting with our second quarter business results.

In the quarter, total assets increased to $1.2 trillion, as continued solid organic growth was complemented by higher equity markets. With respect to organic growth, second quarter organic net new assets were $22 billion, representing 7.4% annualized growth or approximately 8% when adjusted for seasonal tax payments. This contributed to organic net new assets over the past 12 months of $84 billion, representing approximately an 8% organic growth rate.

In Q2, recruited assets were $19 billion, which represents a quarterly record, excluding periods when onboarding large enterprises. This outcome was driven by the ongoing enhancements to our model as well as our expanded addressable markets.

Looking at same-store sales, our advisors remain focused on serving the clients and delivering a differentiated experience. As a result, our advisors are both winning new clients and expanding wallet share with existing clients, a combination that drove solid same-store sales in Q2.

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

Our second quarter business results led to solid financial outcomes of $3.94 of adjusted EPS, an increase of 76% from a year ago.

Let's now turn to the progress we made on our strategic plan. Now, our long-term vision is to become a 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.

To bring this vision to life, we are providing the capabilities and solutions that help advisors deliver personalized advice and planning experiences to their clients. And, at the same time, through human-driven, technology-enabled solutions and expertise, we're 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 organize our work around 2 primary categories: horizontal expansion, where we look to expand the ways that advisors and enterprises can affiliate with us, such that we can compete for all 300,000 advisors in the advisor-mediated market; and vertical integration, where we focus on providing capabilities that solve for a broader spectrum of advisor needs and, in doing so, create durable, differentiated value.

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

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Now, over the quarter, we saw strong recruiting in our traditional independent market, reaching a new quarterly high of approximately $14 billion in assets. At the same time, due to the appeal of our model and the efficacy of our business development team, we maintained our industry-leading win rates while also expanding the breadth and depth of our pipeline.

With respect to our new affiliation models, Strategic Wealth, Employee and our enhanced RIA offering, we delivered our strongest quarter to date, recruiting roughly $4 billion in assets in Q2. And in each of these models, we continue to experience growing demand and expanding pipelines, which position them for increased contribution to our organic growth.

Looking ahead, we expect to carry this recruiting momentum into Q3 for both our traditional independent market and our new affiliation models.

Now, as a complement to our organic growth, we also recently announced the planned acquisition of Crown Capital, a California-based firm with approximately 260 advisors and $6.5 billion in client assets. This transaction will give Crown Capital's advisors access to our differentiated capabilities, technology and service, and we look forward to onboarding them early next year.

With respect to large enterprises, we recently onboarded Bank of the West and are on track to onboard Commerce Bank in August. Looking ahead, we are encouraged by our growing momentum and strong pipeline across the broader enterprise market, including in our traditional bank and credit union space.

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

In that spirit, this quarter, we launched a new performance optimization solution called Practice Hub. This capability delivers comprehensive data in a structured format, so advisors can better understand their performance on an absolute and relative basis. And over the coming months, we will further expand the functionality by enabling it to generate personalized insights around additional services, technology and solutions we offer in order to help advisors enhance the overall performance of their practice. Over time, we see Practice Hub becoming a key tenet of our advisor experience, leveraging the power of artificial intelligence to operate as a co-pilot for our advisors. And while we're still in early innings, we're excited about the growth opportunities that this innovation unlocks and how it will serve as an additional leverage point to help advisors run thriving businesses.

Now, in a separate play within our vertical integration strategy, we continue to expand and enhance our services portfolio and are encouraged by the evolving appeal of our value proposition and the seasoning of this business. As a result of demand in Q2, the number of advisors utilizing our Services Group continued to increase, and we ended the quarter with approximately 3,500 active users, up roughly 30% year-over-year.

As we work with advisors to increase the utilization of existing services, we're also continuing to create new services, such as our Tax Planning solution, which is part of our broader suite of comprehensive advice and planning services. This new solution helps enable tax-intelligent advice that can deliver material savings to clients and help further differentiate advisor's value proposition. This service is receiving positive early feedback and demand in the marketplace, while also unlocking interesting synergies with our existing services portfolio.

Now, as we continue to evolve our services portfolio, we are leveraging our structured approach to innovation in order to address the needs of our broader advisor base. In that spirit, we are creating streamlined versions of existing solutions to help advisors who may have less complex practices. Examples of these solutions include CFO Essentials, Digital Marketing and Payroll, all of which are progressing through our innovation pipeline. As we move forward, we remain focused on enhancing and expanding our services portfolio to better support our advisors and enterprises and to drive growth.

In summary, in the second quarter, we continued to invest in our 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 to 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.

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Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO & Head of Business Operations*

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. This focus led to strong organic growth in both our traditional and new markets, and we continued to build momentum in our Liquidity and Succession offering. In addition, we entered into an agreement to acquire the wealth management business of Crown Capital, onboarded Bank of the West earlier this month and are preparing to onboard Commerce Bank later this quarter. We accomplished all of this while continuing to invest in our industry-leading value proposition. So as we look ahead, we continue to be excited by the opportunities we have to help our advisors differentiate and win in the marketplace.

Now let's turn to our second quarter business results. Total advisory and brokerage assets were $1.2 trillion, up 6% from Q1, as continued organic growth was complemented by higher equity markets. Total organic net new assets were $22 billion or a 7.4% annualized growth rate.

Our Q2 recruited assets were $19 billion, which prior to large enterprises was a new record. This included $4 billion of recruited assets from our new affiliation models, which is also a new record.

Looking ahead to Q3, our momentum continues, and we are on pace to deliver another strong quarter of recruiting.

As for our Q2 financial results, the combination of organic growth, rising interest rates and expense discipline led to adjusted EPS of $3.94.

Looking at gross profit, it was $990 million, down $30 million or 3% sequentially. As for the components, commission and advisory fees net of payout were $218 million, up $3 million from Q1, primarily driven by organic growth and higher advisory fees.

In Q2, our payout rate was 86.7%, up about 50 basis points from Q1 due to typical seasonality. Looking ahead to Q3, we anticipate our payout rate will increase to 87.5%, driven by typical seasonality as well as the onboarding of Commerce Bank and Bank of the West.

With respect to client cash revenue, it was $396 million, down $42 million from Q1, driven by a sequential decline in cash balances.

Looking at overall client cash balances, they ended the quarter at $50 billion, down $5 billion from Q1. The primary driver of the decrease was typical April seasonality when the majority of quarterly advisory fees and tax payments hit. As we moved beyond April, the pace of declines moderated in both May and June.

Within our ICA portfolio, the mix of fixed rate balances increased to roughly 60%, within our target range of 50% to 75%. Our ICA yield averaged 322 basis points in the quarter, up 2 basis points from Q1 as the increase in short-term rates was partially offset by a decline in higher-yielding floating rate balances.

As for Q3, based on where client cash balances and interest rates are today, we expect our ICA yield to decline by a few basis points as the mix impact of lower floating rate balances is partially offset by the benefit of higher short-term interest rates.

As for service and fee revenue, it was $123 million in Q2, up $4 million from Q1, primarily driven by strong organic growth. Looking ahead to Q3, we expect service and fee revenue to increase by a few million sequentially, driven by revenues from our National Advisor Conference.

Moving on to Q2 transaction revenue. It was $47 million, down $2 million sequentially due to decreased trading volume. As we look ahead to Q3, we expect transaction revenue to be relatively flat with Q2.

Now let's turn to expenses starting with core G&A. It was $337 million in Q2. Looking ahead, given our strong levels of organic growth and the variable costs associated with supporting that growth, we are increasing the lower end of our 2023 core G&A range by $10 million. We now expect

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our 2023 core G&A to be in a range of $1.345 billion to $1.370 billion. To give you a sense of the near-term timing of the spend, in Q3, we expect core G&A to increase by $5 million to $10 million sequentially.

Moving on to Q2 promotional expense. It was $107 million, up $5 million sequentially, primarily driven by increased transition assistance resulting from strong recruiting and large enterprise onboarding. In Q3, we expect promotional expense to increase to approximately $125 million to $130 million, primarily driven by conference spend as we will host our largest advisor conference of the year next week as well as the onboarding of 2 large enterprises, Bank of the West and Commerce Bank.

Looking at share-based compensation expense. It was $17 million in Q2, down $1 million from Q1. In Q3, we expect share-based compensation expense to be roughly flat sequentially.

Turning to depreciation and amortization. It was $58 million in Q2, up a modest $2 million sequentially given it was a low deployment quarter. Looking ahead to Q3, our plans for technology spend have not changed. We expect more deployments in the quarter. As a result, we expect depreciation and amortization to be roughly $65 million.

Regarding capital management. Our balance sheet remained strong. We ended Q2 with corporate cash of $325 million, up $91 million from Q1. Our leverage ratio was 1.2x, down from 1.3x in Q1, driven by a combination of our continued growth and a higher interest rate environment, both of which have meaningfully improved our earnings power.

I would also note that earlier this month, we increased the size of our parent revolver from $1 billion to $2 billion. Given the significant growth of our business in recent years, the added capacity enables us to operate comfortably within our target range of 1.5 to 2.5x and leaves us well positioned to capitalize on growth opportunities.

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 across our entire framework. We continued to invest to drive and support organic growth. Specific to our liquidity and succession offering, momentum is building, and we continue to have a solid pipeline. To date, we've closed 15 deals for approximately $200 million, including 4 deals for around $50 million in Q2. With regards to capital return, we increased our share repurchases to $350 million in Q2 as we took advantage of the pullback in our share price.

As we look ahead to Q3, we plan to repurchase $250 million of our shares, consistent with our plan to execute on our $2 billion authorization over 2 years.

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.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from Alex Blostein of Goldman Sachs.

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Alexander Blostein - *Goldman Sachs Group, Inc., Research Division - Lead Capital Markets Analyst*

Dan, why don't we start with the kind of broader discussion around organic growth. We've obviously seen a very steady improvement in recruited assets from you guys over the last few quarters, 2Q of north of $18 billion. I think that was a record outside of the larger kind of enterprise recruitment that you've done. So maybe a little bit of color on what are you seeing on the ground in terms of various affiliation options that are driving this improvement? And how does this inform your net new asset growth expectations for the rest of the year?

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

Yes. Thanks, Alex. So look, as a jumping off point, as you said, we saw 7.4% growth during the quarter. And I think prior to seasonal tax payments, you get closer to the 8% is probably more appropriate without the tax, if you think about the remainder of the year. And look, we also saw that momentum build over the last week where the growth has nearly doubled the 3 preceding quarters, excluding the impact of large enterprises. So as you said and quite proactively, really strong momentum in that traditional independent model and then our new affiliation models.

Drivers of Q2 results or outcomes, I think you got to look at the 1% attrition rate or versus 99% for retention rates and look at that as a really solid and really consistent outcome over the past 3 quarters. And then that's complemented by the strong recruiting inside of the quarter that we talked about.

I think if you look then into Q3 as we go sort of short term out into the next quarter, you saw good solid momentum building throughout the quarter across again, additional models and the affiliation models. So we expect to see that momentum pull into Q3. And then that certainly then is complemented by the larger enterprises that are being onboarded in third quarter. So that sets up what we think is a really interesting and solid quarter of growth. It's driven both by recruiting as well as low retention rates. And then we're also seeing that steady contribution from same-store sales, especially in a marketplace where we've had higher rates and equity markets moving up, advisors are getting opportunities to better deploy capital, as you can see in our net buys from sales. And so we think that sets up well as we look forward to the rest of the year. I hope that gives you some context.

Alexander Blostein - *Goldman Sachs Group, Inc., Research Division - Lead Capital Markets Analyst*

I gotcha. And, Matt, a follow-up for you just around cash dynamics. So you guys are currently, I think, at about 60% fixed portion of the ICA portfolio, sort of well inside your long-term range, but that's been largely a function of outflows that are coming out of the variable balances. So as you look at the maturity ladder here over the next, call it, 12 months or so, and assuming the curve will stay kind of in line with the forward rate, what is your appetite to maybe reinvest some of these balances into floating rates to be at the lower range of your 50% to 75% allocation fixed? And then within that, maybe just a quick update on where July balances stand as well?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO & Head of Business Operations*

I think that was 2 follow-ups, Alex. 2, but we'll hit them. We'll hit them for you. So on the target range, I think we feel good where we are, which is right in the middle of the range at 60%. And I think you know this well, but just to reiterate, we did a lot of work on setting that target range and to be a range that we're comfortable with and a range of interest rate environments and primarily focused on stability of earnings and not trying to be clairvoyant on picking spots and moments to invest when we think the curve's good from an interest rate standpoint. So really like where we're positioned.

I think the specific of your point, as those balances mature, we would intend to maintain that middle of the range. So I don't think we need to move. But to the extent your question was when things mature, would you redeploy them, that would be -- yes, that would be our perspective today. But it's really about being right in the middle of that range and being comfortable with that spot.

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I'd highlight, too, in the environment for placing those cash sweep balances from a fixed rate has continued to improve. So the demand is there. The pricing has improved, meaning the spread above where whatever term you are on the curve. We see a similar thing on the floating rate side. So we've got a good environment to place those deposits to the extent that we want to do so. But headline is we like where we are on the fixed rate.

As far as how are things are going in July, I'd say the headline is consistent with the broad advisor and investor engagement we've been seeing as well as the seasonality you would typically see in the month 1 of a quarter. So specifically on those cash balances, we have advisory fees primarily hit in the first month of the quarter, those are about $1.1 billion, so that will reduce cash in the month of July. And then beyond that, we've seen, again, continued strong levels of investor engagement, continued elevated levels of net buying activity. I'd say consistent with the pace in Q2, if you look at our trends there, we really peaked on net buying in Q1, so July is looking more like the pace that we saw in Q2.

And I think the cash balance declines themselves coming from that just continue to moderate lower than we saw earlier in the year. And I think so far where we are in July, it's about a $600 million decline above the advisory fees of $1.1 billion.

And maybe just to put that in context, when you look at the pace of decline we've seen since the moderation, which would be starting in May, it's about 1/5 the pace of decline that we saw earlier in the year, earlier in the year being January to April. So we're seeing that moderation. Balance is still coming down slightly, but a much, much, much slower pace.

And while we're talking to you all, I know you didn't ask about it, but I'll give you an answer to the fourth question you didn't ask, which is how's organic growth is going in the month of July. And kind of building on Dan's comments, the momentum, especially from a recruiting standpoint, just continues into July that we saw in the first and second quarter. So prior to bringing on Bank of the West, we're tracking in the 6% to 6.5% growth -- organic growth zone for July, which compare that to July of last year, which was in the low 4% range, so it's a nice improvement there.

And then just under $5 billion of assets for Bank of the West will come on in July. When you add that, we're looking at organic growth of around 11% for the month.

So taking a step back, we'd describe July as just the momentum we saw in Q2 just continuing in a real positive way.

Operator

And our next question will be coming from Devin Ryan of JMP Securities.

Devin Patrick Ryan - *JMP Securities LLC, Research Division - MD, Director of Financial Technology Research & Equity Research Analyst*

Just want to start on the enterprise channel. Obviously, LPL now has a number of large validating wins there. And data that's built here with partners that you can now show to potential partners in the future. And so I'd just love to talk about how the narrative has changed with enterprises where you can really explicitly show them the value prop. And at the same time, it seems like the bar just around your regulatory and scale, which is only moving higher and higher for enterprises to operate through a broker-dealer. So just love to maybe hash it out a little bit and then what that means, if anything, for your pipeline there.

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

Devin, well, your hypothesis is right. Obviously, as the business model has seasoned in and we have the clients who have experienced real results, right, the evolution of the dialogue is sort of a natural one as you suggested. And I think -- so first and foremost, you start out with capabilities and make sure that hypothetically, they're going to enhance the economics; they're going to streamline and enhance the client experience; they're going to create a more scalable model and a more competitive one for even attracting and obtaining better advisors. And then I think as we've been -- you can ultimately make sure that you've got the capabilities to do that, and you can pull through those results and that creates then the

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opening and the white space to focus more time on then how do you help them to flow that business through the expansion of advisors in the practices as well as build productivity rates.

And I think that's sort of the rhythm that we're finding where you produce those positive outcomes of enhanced risk management, operational efficiency and enhanced economics. And now we're in that stage of very intentionally working to help them grow organically their ultimate results within their wealth management programs and platform.

I think the other thing that we've been able to do just with the seasoning is completely reimagine and transform the onboarding or changing management effort to bring these programs onto the platform. That's always somewhat of an obstacle to work through any time as part of the value proposition. And I think the easier and lower we can make that hurdle, and then with the experience of being able to reference prior outcomes, that certainly then is helping, I think, streamline hopefully now and make the model more appealing, but also make it sort of more regional accessible, right? And so that's where we are in the dialogue is being able to use those outcomes, have a dialogue with larger enterprises, traditionally the banks, but also expanding that value proposition outside of just banks to that broader enterprise by marketplace.

And so as we do that, it's a longer sales cycle, but the pipeline continues to grow. And we feel really confident as we go forward because it's a real contributor to organic growth.

Devin Patrick Ryan - *JMP Securities LLC, Research Division - MD, Director of Financial Technology Research & Equity Research Analyst*

Okay. Dan, appreciate the color there. Just a follow-up on some of the technology initiatives. So I think last year, you guys have spent $270 million on technology. That's clearly growing again this year, and that's going to be many multiples of really the vast majority of your peers. And so I'd love to just maybe dig in a little bit deeper. And if you can frame just the degree and importance of kind of this technology differentiation that you think you're building at LPL from those peers. And you touched on AI, Dan, in the prepared remarks and application there. So just kind of interplay with that and maybe how you're thinking about AI applications just more broadly to improve the experience for advisors and also help reduce costs at the firm over time.

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

Yes, absolutely. So we do think that the quality of the capability set, if you think about that vertical integration concept that we described to you, we think that is one of the most important elements of creating the model and driving organic growth. So with that as context then, we think investing in that vertical integration strategy or reinvesting in that platform to enhance capabilities is a significant priority and we should allocate the capital appropriately relevant to that priority.

So if I gave you a bit of a framework to think about where we invest there, I give it to you over kind of 6 elements. One would be the end plan experience. So that's the advisor helping them with holistic advice to continue to enrich one of the key elements of the art of being a financial advisor is the quality of advice.

Third one is the wealth management platform and that's been important for how they solve the needs of clients and execute on their advice. And then the other 3 elements are more about helping them operate successful and thriving advising businesses. So think about flexibility in building the perfect practice for them. That's where you get the affiliation models. That's where you also get the investment in service -- business services portfolio that we've been talking a lot about. That's where you also get the investment in our operating platform, right? We want to make sure that we create a favorable and efficient platform, which all of these advisors can practice on. And then ultimately, I think we've got an enhancement of our overall services. Those are the 6 categories that I call them, the commercial categories or in the context of needs for our clients that we're investing both technology capital for technology purposes and then also non-technology investing, think about services.

And if we're creating an integrated platform, that creates better workflows and better services wrapped around that technology that ultimately help these advisors to train advisors and run thriving businesses and we think that's a winning formula to continue to create a more appealing platform that drives more successful outcomes for advisors.

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With respect to your question around AI and where we sprinkle that in, in terms of that investment, along the operating platform itself and within our service model, we're already using AI, both in terms of think about robotics, machine learning as a way to scale predictable and foreseeable operating processes. We're using AI in terms of enhancing the efficacy of our data analytics and determining next best action associated with our risk management efforts within our operating platform. We've created new digital capabilities that are now taking as much as 15% to 20% of the volume that has traditionally come into our service model to help folks with a better digital experience to incorporate some AI into that.

And I think with generative AI, where you get into using AI for more creative activities, we see the interesting opportunity to continue to enhance both the advisor and the investor experience, an uber chance of personalization. I think also we see it as an opportunity to create efficiency in our own models where you think about those creative jobs, take marketing, take engineers, big again in service and operations, and you begin to really think about enhancing the scalability of the model.

So that's the reason we invest. It gives you a little flare for kind of how we're allocating that investment and then how we're beginning to explore and utilize AI. We've been using it for a couple of years, but I think with this new generative AI or NAI, it opens up some interesting possibilities. We're just in the early innings of imagine. We like to ask and challenge ourselves. Imagine if we could create AI as an additional team member for every single practice, which is a highly efficient scale of the team and that's a pretty cool initiative being to solve for. I hope that helps.

Operator

Our next question will come from Steven Chubak of Wolfe Research.

Michael Anthony Anagnostakis - *Wolfe Research, LLC - Research Analyst*

This is Michael Anagnostakis on for Steven. I did want to start off going back maybe to the organic growth side. Certainly nice to see the ramp there through the end of the quarter. I did want to ask on the competitive dynamics. A larger independent player is planning to undergo a rather substantial restructuring effort. Looks like some of the resulting attrition has been a relatively significant contributor to your recruiting year-to-date. Can you help us size how significant of a tailwind that's been? And how sustainable is this source of organic growth?

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

Yes. So look, I think if you look at the marketplace, right, and what you're really getting at is how do we think about sizing of the marketplace, and at least up through second quarter, if you look at the opportunity set, advisor movement has largely remained pretty flat at around 5% turnover for the last year, which is a lower level movement than historical norms, as you well know.

That said, there has been a mix shift in that sort of turnover, but we're seeing positive movement or more positive movement in the traditional independent market and there's been a slowdown from the wires. As we look out sort of and look forward at some of what competition is doing, whether it be through integrations, restructurings, et cetera, those things can create more churn or more turnover in the marketplace. And we think we are well positioned across all of our different affiliation models to make sure that we can capitalize should that opportunity increase and more turnover occur in the marketplace that we're well positioned, capitalized and win much greater share of that opportunity that made a move.

So we do think about structurally our opportunity, but we're always trying to position for different market opportunities that may emerge within the structural strategy.

Michael Anthony Anagnostakis - *Wolfe Research, LLC - Research Analyst*

Very helpful. And then just switching over to expenses. Understanding it's a bit early maybe to be thinking about 2024 as we think about rate cuts coming down the pike and the strong organic growth you're seeing, how should we be thinking about core G&A growth beyond '23? It sounds like 4% to 5% is the first building block to run the business, but how much incremental investment should we be anticipating?

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Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO & Head of Business Operations*

Yes. I mean I think that we're -- as you could imagine, we're in the midst of planning for '24 right now, and we'll share our thinking on it later in the year as we typically do. But I think to your question and maybe just highlight a little bit of how we're approaching it, which is, as we normally do, is focusing first on the investments really to drive and support organic growth. And at the same time, making sure that we're delivering appropriate and compelling operating leverage and really balancing those 2 things.

And I think when you look at '23, the macro environment provided an opportunity for us to accelerate investments that we otherwise would have done in '24 and beyond. And that was driven by the opportunity that, that macro represented. So I think when we're planning for '24, it will all depend on what that macro outlook looks like. Of course, there's a scenario as you described that the rates could start to come down.

So we will certainly factor that in, and we've got -- I think our history demonstrates we've got the flexibility to adjust based on that environment. And we've also got, I think, the confidence to invest in things that -- where we have the confidence they're going to drive growth. So we'll focus on balancing those things. And we'll share more color on those plans as we typically do at our year-end earnings call. But the headline would be our principles and our approach are going to remain the same.

Michael Anthony Anagnostakis - *Wolfe Research, LLC - Research Analyst*

Great. And if I could just squeeze a quick housekeeping one in here. Tax rate was elevated during the quarter. What drove that? And if you could provide an update on what the go-forward outlook for tax, that would be helpful.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO & Head of Business Operations*

Yes. I think about tax rate just as a kind of a core normalized tax rate in the 26% to 27% zone. We've been running below that for a while, primarily from tax benefits from employee stock sales and deductions that have come from that. And there were just fewer in the quarter. And that's why it kind of moved back up to that -- closer to that normalized 26%, 27%. So I think all else equal, if you're looking for a placeholder for going forward. I think 26% to 27% is the best way to think.

Operator

And our next question will be coming from Dan Fannon of Jefferies.

Daniel Thomas Fannon - *Jefferies LLC, Research Division - Senior Equity Research Analyst*

In addition to strong organic growth, you've also been active on the inorganic side. So was hoping you could talk about just the pipeline and conversations and how we should think about inorganic uses of -- or for growth as we think about the remainder of this year and kind of the current backdrop of what's out there.

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

Yes. So as we go forward, we'll continue to use M&A as a complement to our organic growth. So no change there as you suggested. And I think, look, as we -- in order to do that or execute well on that, we're consistently assessing the marketplace and the landscape and are typically focused on 3 categories of opportunity, the first are transactions to grow in our markets where we can capitalize on our market leadership and add scale. In those cases, we're able to create value for the advisors and those practices when they transition onto our platform. And we look across the landscape of, well, think about anywhere from smaller broker-dealers and RIAs upward. Examples of that is bidding Boenning & Scattergood, Waddell & Reed and, of course, most recently, Crown Capital.

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So again, I think we remain focused on the marketplace. We do think there will be ongoing consolidation, and we remain positioned to explore those opportunities.

I think a complement to that, we also look to places or transactions that could add capabilities, right, where we can create value for advisors and ultimately, help them drive efficiency into their practices or enhance growth. Any time we think about that type of transaction, we'll, of course, look at it through the lens of build, buy or partner as capabilities and transactions include advisory world employees and those in that boat. We continue to really evolve how we think about investing back into those capabilities and how they ultimately create value in unintended places when we originated those transactions. So we like that type of opportunity.

And then finally, the third is just deploying capital against the Liquidity and Succession needs that are out in the marketplace. And certainly, this gives us a pathway to put capital to work that meets our disciplined return thresholds and solving a really important question for advisors in the marketplace in a rather differentiated or unique way. And we've got a continued opportunity internally with respect to helping our advisors that are already on a platform with that question and we're beginning to see external exploration as well as how we help advisors take part on the platform with that type of need. So that's the framework. That's kind of where we've got our focus, and we continue to assess the marketplace for those opportunities that are meanwhile.

Daniel Thomas Fannon - *Jefferies LLC, Research Division - Senior Equity Research Analyst*

That's helpful. And then, Matt, just a follow-up on the promotional spend guide, the step-up, which you cited associated with the onboarding as well as the conference. Can you separate out that so we get a sense of kind of the economics associated with some of these larger onboarding enterprise customers?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO & Head of Business Operations*

Yes. Well, directionally. I mean, I think when you look at the guide for Q3, it's really driven by 3 factors. Conference timing is the biggest. Second's onboarding of the 2 large enterprises. And third is really supporting organic growth. So I think when you look at conference spend, that is -- that first bucket, that is the biggest driver. As a reminder, it's our largest conference. It happens in Q3 every year. We've got over 8,000 attendees coming, which is a new record for us, which we're excited about, just the engagement from our clients and their guests and being in person with us. So it's our largest conference and the largest that that conference has been. So that's the biggest component of the sequential change.

Now we do have 2 large enterprises that we are onboarding in 1 quarter, right? So that would typically be elevated, both Bank of the West and Commerce.

And then the last thing I would hit is just overall recruiting momentum. When you look at the strong quarters we had in Q1 and Q2 and the strength of our pipeline coming into Q3, the related transition assistance that would come from that would also be a driver.

But broadly, that first bucket, conferences, is going to be the largest piece of it.

Operator

And our next question will come from Michael Cyprys of Morgan Stanley.

Michael J. Cyprys - *Morgan Stanley, Research Division - Executive Director and Senior Research Analyst*

You guys have had some early success with your newer RIA-only model. I was hoping you could talk about your competitive positioning there, how your offering and pricing differs from others in the marketplace on the RIA-only model. And as you look out over the next 12 to 24 months, what sort of enhancements that you might be able to make to that offering to further accelerate growth from here?

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

Yes. Thanks for the question, Michael, and happy to provide some color on our enhanced RIA model. So headline is, look, the RIA market, as you know, is large and fast growing, which presents some interesting strategic opportunities. So we have been investing to position ourselves for outsized share gains there. And how we think about allocating those investments, well, first and foremost, it's created a differentiated offering in the marketplace. And while at the same time, improving our awareness that we are a competitive and credible alternative to more of the incumbents in the marketplace.

So as we do this, our right to win continues to increase, and we believe that positions us well as we go forward, both in the near term and the long term.

And if I give you a little bit more color, as you asked on sort of how we think about enhancing the value proposition. Certainly, the flexibility in our model to handle all assets in a more integrated way on our platform continues to be an advantage. Certainly, then that's complemented by the vertical integration strategy where we're able to provide value not just at the traditional clearing and custody level within the ecosystem, but also with respect to technology operating platforms, wealth management platforms, all the way down into if you think about the business services that we've been innovating over the last 3 years. And so it's an end-to-end values play that we think makes for the most interesting differentiation for RIAs that are out there. So they don't have to build that or if they have built that stuff and have operated it in an inefficient way or one that doesn't add value, we can do it in a more efficient expected way. We think that's an appealing angle to take to the marketplace.

And then finally, as we grow in both the results, the solutions, the success and then greater awareness for our presence in the marketplace, we think those things position us well to continue to drive more growth from here. And I think we've seen good progress over the last year and a half. We're encouraged by that.

Michael J. Cyprys - *Morgan Stanley, Research Division - Executive Director and Senior Research Analyst*

Great. And just a follow-up question on the centrally managed assets. That continues to grow in line with the rest of the business holding steady, about 15% of advisory assets, it looks like. So hoping you could talk about some of the initiatives as you think about expanding penetration of centrally managed assets there. How are you thinking about building out the product set here as you look out over the next year or two?

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

Yes, it's a really interesting question. As you said, there's some cool opportunities, we think, to continue to enhance the feel of that model and reduce the cost in both that combination ultimately, I think, drives greater and greater utilization. So with the evolution of models-based practices, our continued ability to enhance our platform that really sets up for that efficient models-based practice and even then partnering with our sponsors to integrate their capabilities within that model's marketplace is where some cool innovation and work is going on. And that not only adds value for our advisors; it also creates value for our sponsors that will then create economic opportunities for us.

I think as you look at continued what I might call interest value for an end investor, think self-indexing or individual indexing and/or tax overlay. And I think we're deploying some of those capabilities in the second half of this year, they just further strengthen the value of the advice that the advisor is providing to their clients, but also to the sense that we can do that in the centrally managed platform in a highly efficient and integrated way for the advisor creates greater feel and usage of the model. And then finally, just the expansion of the investment content available there, we've really expanded our SMAs this year. On the equity side, we're adding fixed income SMAs in the second half of this year. And so ultimately, that turns it into a true UMA, which will only drive further utilization.

So those are the ways we think about some of the ways of enhancing the capabilities to continue to drive the appeal of that model and thus the better yields.

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Operator

Our next question will be coming from Kyle Voigt of KBW.

Kyle Kenneth Voigt - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Maybe a few follow-ups for me. Matt, you had record EBITDA margins in the first half of the year at 54%. I guess my question's not as much about 2024, but more of a longer-term question about margins. If we think about LPLA continuing to kind of gain scale and drive growth over the coming years, do you think there's still significant operating leverage left in the model from where you sit today at 54%. And if so, can you kind of help quantify how you think about those longer-term incremental margins?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO & Head of Business Operations*

Yes. I mean I think when you -- if you look at operating margins and history here is very helpful and the macro environment, the interest rate environment, of course, is going to inform those. But I think when you've looked historically, I think not only us, but our industry, when you're in periods where interest rates are near their lows, like running in the -- which we, in our recent past, of course, have seen, when you're running with margins in the 35%, 40% range, you're doing somewhat well in that environment. And when you're in an environment like we're in now, with interest rates high, getting up to that 50% and above, I think it's just running at a good level as well. And I think those are just good bookends to think about in general.

I think as far as what we can deliver in the future, I think, ultimately, it's going to be connected to our ability to deliver a compelling value proposition to clients, our ability to continue to expand and grow across our affiliation models as we get scale in each of those areas. We're able to balance delivering not only a great experience for those clients, but also doing it in an efficient way that allows us to deliver earnings to the bottom line and always balancing how much of that to then reinvest to drive further growth from here.

So I think the opportunity, if we're successful in all those areas, is indexing to the macro environment point that I made to most certainly drive more operating leverage. And I think ultimately, the balance and judgment about how much of that to reinvest to further expand our value proposition and further drive growth are judgement calls that we'll make. But I think the opportunity's there if we're successful.

Kyle Kenneth Voigt - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Understood. And then just a follow-up on the cash discussion. You've previously noted that 4% as being around a floor level on cash as a percentage of assets. It sounds like you're now slightly below that 4% level in July to date. But it seems, as you said, you're continuing to see that slowing, cash declines, excluding those fee billings. I just wanted to reconfirm whether anything has changed at all from an advisor behavior standpoint over the past months or quarters that would lead to a different view in terms of defining that floor level of cash at around 4%.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO & Head of Business Operations*

No. I mean, I think keep in mind, month 1 of any quarter, you typically see a cash balance decline. But I think as we maybe take a step back and the nature of the cash that we have in these accounts is largely operational, it's typically small balances for rebalancing, paying fees, facilitating customer withdrawals. And I think when we just look at our experience, when clients are fully deployed into the market, cash does typically bottom out at those levels required to manage the account. And that's typically meant a natural floor around 4%. And I think when we look at the market we're in now, I think it's fair to say that advisors and their clients are especially engaged when you've got a strong fixed income market that we've been in for quite some time, that's now getting coupled with a strengthened equity market. And that's leading to net buying activity and levels that are roughly double historical levels.

So I think as we sit here, at least looking at the end of the quarter, which is where I'd focus at roughly 4% of AUM, I think the dynamics of our cash and the transactional nature hasn't changed. I think we're getting pretty close to what we would think would be full levels of deployment and kind

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of reaching a point of natural resistance on moving much lower. Now could it go below 4%? Of course. But I think based on what we see in our analysis, we don't think it would go below 4% by a substantial amount.

Operator

Our last question will come from Brennan Hawken of UBS.

Brennan Hawken - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Financials*

I've just got one left. Most of mine have been asked and answered. Any way or guidance you can provide for thinking about how the upcoming deals, the deals that you've announced and we have coming down the pike could impact the payout rate? I know in the past, sometimes, some of the deals have had an impact. Anything coming from these upcoming deals?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO & Head of Business Operations*

Yes. And you're -- Brennan, you talked about the large enterprise onboardings, Bank of the West and Commerce?

Brennan Hawken - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Financials*

Exactly.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO & Head of Business Operations*

Yes. Yes. I think as a general point, those larger enterprises have a higher payout rate. We have a lower -- from an AUM standpoint, we've got an advantage in serving them from a scale standpoint on the cost side. So operating margins are always compelling or compelling on those. But yes, the payout rate would, all else equal, go up. So if we -- I did give a little color on payout rate for next quarter at 87.5%, and that would be driven by a handful of things, but primarily, the seasonal build in the production bonus, but also bringing on those large enterprises that, in general, have a higher payout than the average.

Brennan Hawken - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Financials*

Okay. So the 87.5% would fully bake in the impact of those 2 deals?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO & Head of Business Operations*

No, it would be the following quarter would because they're going to be joining during the quarter, but it's just as a headline point when we bring on large enterprises, they'll typically buy us up to pay out a little bit, not dramatically, but a little.

Operator

And I'm showing no further questions. At this time, I would like to turn the call back to Dan Arnold for closing remarks.

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

Thanks to everyone for taking the time to join us this afternoon. We look forward to speaking with you again next quarter.

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Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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