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LPLA.OQ - Q3 2024 LPL Financial Holdings Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good afternoon, and thank you for joining the third-quarter 2024 earnings conference call for LPL Financial Holdings Inc. Joining the call today are our Chief Executive Officer, Rich Steinmeier; and President and Chief Financial Officer, Matt Audette.

Rich and Matt will offer introductory remarks, and then the call will be open for questions. The company would appreciate if analysts would limit themselves to one question and one follow-up each.

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. Steinmeier.

Rich Steinmeier - *LPL Financial Holdings Inc - CEO*

Thank you so much, operator. As a long-time listener and first-time caller, it is great to speak to everyone on today's call. And for those that haven't met me, I'm Rich Steinmeier, and it is my privilege to serve as LPL's Chief Executive Officer.

I joined the firm in 2018, following roughly a decade working in wealth management at a couple of wirehouses, after having started my career in management consulting. I joined LPL with the mandate to accelerate our growth and, for the past six years, have worked closely with Matt and the rest of our leadership team to set our strategic vision and to build and execute on the plan to achieve that vision.

Looking forward, our opportunity is clear: to assert our leadership and shape both the advisor and institutional markets. Our focus is on creating the culture, strategy and capabilities to achieve sustainable outperformance by serving as an indispensable partner to our advisors and , while delivering long-term value to shareholders.

Okay. With introductions complete, let's turn to our results. In the quarter, total assets increased to a record $1.6 trillion as we attracted organic net new assets of $27 billion, representing a 7% annualized growth rate. This was on pace with the past 12 months, during which we brought on nearly $100 billion of organic net new assets, representing approximately 8% growth rate. Our third-quarter business results led to strong financial performance, with an adjusted EPS of $4.16.

Next, let's turn to our strategic plan and recent growth across our organic and inorganic initiatives. As a reminder, our long-term vision is to become the leader across the advisor-centered marketplace. To do that, our strategy to is to invest back into the platform, and provide unmatched flexibility in how advisors can affiliate with us, and to deliver capabilities and services to help maximize advisor success throughout the life cycle of their businesses. Doing this well gives us a path to sustainable industry leadership, not just in the independent and institution markets, but across all of wealth management.

In the third quarter, recruited assets were $26 billion, bringing our total for the trailing 12 months to $87 billion, both of which represent records, excluding periods where we've onboarded large institutions. In our traditional independent market, recruiting reached a new quarterly high of approximately $23 billion in assets, improving on our already industry-leading capture rates of advisors in motion, while also expanding the breadth and depth of our pipeline.

With respect to our new affiliation models, Strategic Wealth, Independent Employee, and our enhanced RIA offering, we delivered another solid quarter, recruiting roughly $3 billion in assets. And as we look ahead, we expect that the increasing awareness of these models in the marketplace and the ongoing enhancements to our capabilities will drive a sustained increase in their growth.

During the quarter, we also continued to make progress within the large institution marketplace, where we advanced our preparation to onboard the retail wealth management businesses of Prudential Financial and Wintrust Financial. Collectively, these two partnerships will add approximately $76 billion of brokerage and advisory assets by early 2025.

As a complement to our organic growth, earlier this month, we closed the acquisition of Atria Wealth Solutions, welcoming their approximately 2,200 advisors, 160 institutions, and home office staff to the LPL family. The transaction is progressing well, and we are on track to meet our 80% retention target.

And as an aside, I've had the opportunity to spend time with the Atria team over the past several months. And it is clearer than ever that their advisor-centric orientation and high-quality relationships with their advisors and institutions makes them a perfect fit for LPL.

As for our broader business, asset retention remains industry leading at 98% over the last 12 months. This is a testament to our continued efforts to enhance the advisor experience through the delivery of new capabilities and technology, and the evolution of our service and operations functions.

In that spirit, I would be remiss not to call out a driving force behind our improving advisor experience, which is the ongoing operational transformation of the firm spearheaded by Matt. Beyond his leadership as CFO, Matt has been at the helm of our Operations and Risk organizations, and in his expanded role as President, we've consolidated additional responsibilities for the day-to-day operations of the firm under his purview, including Customer Service and Supervision. It goes without saying that all of these critical functions are in very good hands.

In closing, I want to reiterate how honored I am to lead this amazing firm and to express my gratitude to our employees for the way they show up every single day, to our advisors and institutions for their partnership, and to our shareholders for continuing to place their support and trust in LPL Financial.

With that, I'll turn the call over to Matt who, I would like to point out, dressed up as Johnny Cash for our company Halloween event last Friday. And I just wanted you all to visualize that image as he dives into our results.

Matthew Audette - *LPL Financial Holdings Inc - President and CFO*

Are you telling me that was a Halloween event on Friday? That's what I normally wear. I figure the white onesie you were wearing is what you wore on Fridays. Who knew?

Well, thanks, Rich. I'm glad to speak with everyone on today's call. I, too, feel exceedingly fortunate to serve this great firm in an expanded capacity as LPL's President and CFO.

To echo Rich's sentiment, we have built an advantaged position in the advisor-mediated market and have a tremendous opportunity to extend our leadership. I look forward to partnering with Rich in continuing to enhance value for all the stakeholders we serve.

Turning to our results, in the third quarter, we remained focused on serving our advisors, growing our business, and delivering shareholder value. This focus led to another quarter of strong organic growth in both our traditional and new markets, and we are preparing to onboard the wealth management businesses of Prudential and Wintrust.

As a complement to our strong organic growth, we closed on the acquisition of Atria earlier this month. In addition, we entered into an agreement to acquire The Investment Center, which we plan to onboard in the first half of 2025. So as we look ahead, we remain excited by the opportunities we have to serve and support our growing advisor base, while continuing to deliver an industry-leading value proposition and drive organic growth.

With respect to our third-quarter business results, as Rich mentioned, it was another quarter of strong growth, with an annualized growth rate of approximately 7%, or 9% prior to the planned separation from misaligned large OSJs. On the recruiting front, Q3 recruited assets for $26 billion which, prior to large institutions, was a new quarterly high.

Looking ahead to Q4, in addition to the expected onboarding of one of our largest institutional partners, Prudential, we continue to have a strong pipeline. However, I would note the natural seasonal headwinds to advisor movement during the back half of December related to FINRA's shutdown and the holidays.

As for our Q3 financial results, the combination of organic growth and expense discipline led to adjusted EPS of $4.16. Gross profit was $1.128 billion, up $49 million sequentially. As for the components, commission advisory fees net of payout were $274 million, up $11 million from Q2. Our payout rate was 87.5%, up 20 basis points from Q2, due to typical seasonality.

With respect to client cash revenue, it was $372 million, up $11 million from Q2, driven by higher renewal rates on our fixed rate contracts. Overall client cash balances ended the quarter at $46 billion, up $2 billion sequentially, driven by organic growth.

Within our ICA portfolio, the mix of fixed rate balances was roughly 65%, within our target range of 50% to 75%. Looking more closely at our ICA yield, it was 332 basis points in Q3, up 14 basis points from Q2. As we look ahead to Q4, we expect the yields on our new fixed rate contracts to more than offset the impact of the two additional rate cuts expected by year-end. As a result, we expect our ICA yield to increase by approximately 5 basis points.

As for service and fee revenue, it was $146 million in Q3, up $11 million from Q2. Looking ahead to Q4, we do not have any large advisor conferences and expect seasonally lower IRA fees. However, given the acquisition of Atria earlier this month and the onboarding of Prudential later this quarter, we expect service and fee revenue to be roughly flat sequentially.

Moving on to Q3 transaction revenue, it was $59 million, flat compared to Q2. As we look ahead to Q4, based on activity levels to date, as well as the expected contribution from Atria and Prudential, we expect transaction revenue to increase by approximately $5 million sequentially.

Now, let's move on to Atria and Prudential. Starting with Atria, as mentioned, we closed on the transaction and continue to expect to onboard the advisors in mid-2025. Overall, the transaction is progressing well. We are on track to meet our estimate of 80% retention, but factoring in current asset levels, we now expect the run rate EBITDA benefit to be approximately $150 million, up from our original estimate of $140 million. That said, in the near term, given the timing of when synergies are realized, we anticipate our post-close, pre-conversion EBITDA to be roughly $40 million.

Moving on to Prudential, we are on track to onboard them during Q4. As for Prudential's financial contribution, given current asset levels which, at the end of Q3 were approximately $60 billion, as well as current cash balances, we now expect approximately $70 million of run rate EBITDA, up from our original $60 million estimate.

Now, let's turn to expenses, starting with core G&A. It was $359 million in Q3. Looking ahead, while there are variable costs associated with supporting our strong levels of organic growth, given our ongoing focus on efficiency, we are tightening our 2024 core G&A outlook to a range of $1.475 billion to $1.485 billion.

Additionally, now that we have closed our acquisition of Atria and expect to onboard Prudential by the end of the year, we are including those costs in our overall core G&A outlook. As such, we expect Prudential and Atria to add $35 million to $40 million of core G&A in 2024. As a result, our new core G&A outlook range is $1.510 billion to $1.525 billion.

Moving on to Q3 promotional expense, it was $176 million, up $28 million from Q2, primarily driven by conference spend as we hosted our annual Focus Conference, as well as increased transition assistance resulting from our strong recruiting. Looking ahead to Q4, we expect promotional expense to decrease by approximately $10 million, driven by lower conference spend, partially offset by transition assistance related to Atria.

As for regulatory expense, it was $25 million in Q3, up from Q2, as we recorded an $18 million charge related to a planned SEC settlement for anti-money laundering controls. Looking ahead, given the non-recurring nature of this item, we continue to expect regulatory expense to be roughly $10 million in the quarter.

Turning to depreciation and amortization, it was $78 million in Q3, up $7 million sequentially. This included approximately $3 million of technology development related to Prudential. Looking ahead, we continue to invest in technology and recently went live with two new internal data centers. As a result, we expect depreciation amortization to increase by approximately $10 million sequentially. I would just note that we don't expect this level of sequential increase going forward.

As for interest expense, it was $68 million in Q3, up $4 million sequentially, driven by the full-quarter impact of the May debt issuance. Looking ahead to Q4, given revolver balances following the close of the Atria transaction, we expect interest expense to increase by approximately $14 million sequentially.

Regarding capital management, we ended Q3 with corporate cash of $708 million, up $24 million from Q2. As for our leverage ratio, at the end of Q3, it was 1.6 times. Looking ahead, consistent with our expectations, following the closing of the Atria transaction earlier this month, we anticipate our Q4 leverage ratio to be near the midpoint of our target leverage range of 1.5 to 2.5 times. And we expect corporate cash to return to more normalized levels, near our management target range of approximately $200 million.

Moving on to 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 Q3, the majority of our capital deployment was focused on supporting organic growth, as well as M&A, where we allocated capital to our liquidity and succession solution and, on October 1, closed on the acquisition of Atria.

Specific to share repurchases, a reminder that we paused buybacks following the announcement of the Atria acquisition. Now that we closed on the transaction, we plan to restart share repurchases in Q4 and anticipate buying back $100 million of our shares in the quarter. To summarize, our balance sheet is strong and we are well positioned to drive value through our capital allocation frame.

In closing, we delivered another quarter of strong business and financial results. As we look forward, we remain excited about the opportunities we have 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) Alex Blostein, Goldman Sachs.

Alex Blostein - *Goldman Sachs & Company, Inc. - Analyst*

Hey. Good afternoon, everyone. Rich, Matt, congrats to both of you on new and expanded roles. That's good stuff.

Rich, I was hoping we could start with you, given this is your first opportunity to speak with a broader kind of investor and analyst group in your new role, obviously, the CEO of the firm. Maybe spend a couple of minutes on the key priorities for the business over the next one to two years. What are the key areas of focus likely for you to be? And is there going to be sort of any strategic change in direction for the business?

Rich Steinmeier - *LPL Financial Holdings Inc - CEO*

Great. Thanks, Alex. Thanks for congratulating Matt and I on the expanded roles. I actually really appreciate it.

So as we jump in as a newly formed management committee into moving the business forward, I'd say there are three top priorities that we're thinking about every day. The first are that we have got to maintain the client centricity that this firm is known for, and that is in serving our advisors, our institutions, and allowing them to serve their end clients with distinction. It's what the firm was built on. And so for us, that is one of the top priorities as we advance, making sure that we don't lose sight of what's made us special.

Second, which is a slight pivot, is to empower our employees. This is the ability to take the employees who sit at all levels of this firm, who are deeply connected with our clients, and empower them to take the decisions to help those clients achieve success in however they may define it. And so for us, that's about putting in place a decision-making framework and a control framework that allows all of our employees to have the authority to make better decisions in support of our clients. It'll allow us to feel nimbler and more direct in serving the clients.

The third priority is driving operating leverage. We have had the privilege of high levels of growth extended over the last couple of years. And as I mentioned in remarks, we have had Matt take over all of the operations, service, compliance, and supervision to try to drive and continue to drive operating leverage and value for our shareholders.

The one thing, Alex, that I would point out that is not going to change is actually our strategy. Our long-term vision is to become the leader across the advisor-centered marketplace, and that outlook remains positive. And as a reminder, that's driven by our conviction in three structural and durable trends: the growing demand for investor advice, the appeal to receive that advice from a financial professional, and the attractiveness of the independent model.

We actually sit in a privileged position in the marketplace. We have outsized gains in advisors that change firms, and that growth has enabled us to fuel our strategy of investing back in our platform and our capabilities. I think that strategy should persist, and it will give us the opportunity to outperform over the longer term.

And maybe if you'll allow me just one final thought, it's been three weeks where I have spent time meeting with hundreds of our clients. And what I've learned in those three weeks is that this firm is a very special place. In fact, the thing is, our clients actually -- when I reach out to them -- say, Rich how can we help you?

These relationships that we have with our clients have been built over years and decades. And in fact those relationships are built on foundations of relationships, but it's not relationships with me as the CEO. It's relationships with relationship managers, advisory consultants, branch managers, supervisory consultants, transition specialists. And what I've seen in the last three weeks are those employees have stepped up in a major way. Our clients are echoing that back to us.

And if you think about our ability to succeed in the future, it will be driven by our clients being the loudest advocates for our firm, and that's what I've seen. I give huge, huge kudos to our employee base.

Alex Blostein - *Goldman Sachs & Company, Inc. - Analyst*

Great. Thank you for that perspective. Very helpful.

Matt, I guess since you dressed up as Johnny Cash, let's talk about cash. You guys and the industry broadly put up really nice growth in cash balances for the first time in a while. Obviously, much, much welcome development for you guys in the space.

Maybe unpack a little bit what have been sort of the sources of growth, and totally understand the hesitation of sort of calling the bottom on cash balances. We've tried to do that before, and that hasn't played out yet. But are you starting to see a more durable kind of outlook just based on where recruited assets are and the outlook for growth on cash balances starting to grow over time from these levels?

Matthew Audette - *LPL Financial Holdings Inc - President and CFO*

Yeah. Alex, I think on your point about calling the bottom, it's always tough. But I think just to reiterate some things that we've talked a fair bit about in the past that I think are relevant now is you just start to hone in on when you're looking at cash sweep, those are cash balances that are largely operational. You're starting to get down to what is really the amount of cash necessary to do things like rebalancing, paying advisory fees, facilitating withdrawals, things of that nature.

And when we look at that as a cash as a percent of AUM, that has been coming down. We've stabilized the last couple of quarters in the just under 3% zone. But even if you look at the few quarters leading up to that, a big part of the driver -- the primary part of the driver was really the denominator. I mean, the market's going up so that percentage came down. So if you look at it just as cash balances on an average per account, they have stabilized for a few quarters at just over $5,000.

To your point, it's always tough to call the bottom. But I think when you look at where we are right now with the amount of cash that's in there, it really is the cash necessary to manage an account. Then, I think you pivot to really what does our growth outlook look like? Because as you bring in new accounts, if those on average are $5,000, you've got strong organic growth like we do, and you do couple that with a stabilization, you can start to be in a place where you can see cash balances start growing again.

It's hard to promise that. But I think the dynamics that would lead to that are there, and we'll see how that plays out.

Alex Blostein - *Goldman Sachs & Company, Inc. - Analyst*

Great. All right. Thank you both.

Operator

Steven Chubak, Wolfe Research.

Steven Chubak - *Wolfe Research - Analyst*

Hi. Good afternoon, Matt, and welcome, Rich. I guess echoing Alex's remarks, congrats to both of you on the new and expanded roles.

Rich, maybe just starting with you, since you've been the primary architect of the growth strategy these last six years, I thought it might be helpful if you could lay out your either strategic vision or growth priorities, specifically for the institutional and private wealth channels, just given those are much larger TAMs. You're increasing your share, but the penetration is still quite low. What does that success just look like for you over the next five years across both of those channels?

Rich Steinmeier - *LPL Financial Holdings Inc - CEO*

Thanks, Steven. I will take those each in turn.

Let's start with the institutional channel. As you know, we've had some nice success in the recent past, but maybe I'd start this discussion a little bit earlier. Because while we've had an acceleration, certainly in our participation in the institutional channel in the last five years, this story starts decades ago. This firm has always served community banks, credit unions, and built capabilities to actually serve them.

And as we built those capabilities and committed to the growth in that channel, we started to attract really progressive firms -- Old National Bank, SouthState, Webster, Simmons -- and we grew our sophistication in the ability to serve larger institutions. As we did that, we made a concerted effort probably around 2020 to say, there is a real opportunity inside the large bank channel. That opportunity for us is because the demands of serving and delivering a wealth business, which used to sit with lower thresholds to be able to participate, those were growing because of the expectations of regulatory changes, of the needs to deliver an outstanding platform, and the expectations of what end investors were requiring.

We had a pivotal moment around 2021 when we had a leader, in M&T, choose us. That was probably one of the first times that a firm above $20 billion in wealth had chosen to partner with an outsource firm. At that point, it actually changed the dynamic in the marketplace, from large firms being asked why on earth would you outsource to starting to ask the question of the leaders asking why aren't you considering outsourcing and partnering with a world-class partner.

That's not just the M&T, but it's the credibility of a Doris Meister and a Matt McAfee, the leaders at that firm, and the position that they held in the marketplace, where others actually really trusted their vision and trusted the decision that they made. From there, we saw us beginning to snowball into the larger bank segment in a material way. As a reminder, that's a $1 trillion market segment.

At this point, we've built capabilities where we are clearly the leader in the ability to deliver a world-class wealth management program in partnership with a financial institution. Beyond our capabilities, what happens is, in two weeks, we'll have a roundtable where you will see the leaders of the industry at the roundtable and they happen to be our clients. What happens in that scenario is that they are feeding from each other, learning from each other, pushing us and pushing each other. And so there are dynamics there that allow us to extend our leadership in that market.

In a similar way, we then realized there is an opportunity for us to integrate the data that sits inside of a product manufacturer and insurance firm with the wealth data that allowed us to have a distinctive offering in the marketplace. We began discussions and found a willing partner in Prudential. And as we progressed those discussions with Prudential and built towards this solution that we'll deliver in the last quarter of this year, we then realized that we now also have a distinctive offering in that marketplace in the integration of two different types of experiences, that being the insurance, as well as the wealth. Instead of having folks having to swivel chair back and forth, they now have a world-class integrated platform with end investor capabilities that is second to none.

Again, taking Caroline Feeney and Brad Hearn, the leaders of the wealth business there, taking a big bold step with us. And in fact, what that has led to is beginnings of conversations inside the marketplace around, I think, the pivot that M&T drove in the marketplace, which is not why on earth would you outsource, but why aren't you considering a partner to achieve the efficiency, the derisking, and the platform capabilities that would come with being with a world-class leader.

So we think we feel pretty good about our opportunity to continue to progress our momentum, not only in the bank segment, but as well as in that product manufacturer and insurance segment. And as a reminder, that segment is a $1.5 trillion market opportunity as well. So I think we're building momentum. It still feels like early days, and it feels great that we're a leader presenting an opportunity to continue to grow as the requirements of scale continue to increase in those markets.

If I turn the page, Steven, and talk about high net worth and private wealth, maybe I have to go backwards again to go forwards here. But a couple of years ago, we identified that we wanted to expand our participation in the wealth management market and we realized that our capabilities were really strong. And in fact, the independent movement and the offering that we could bring to market around independence was incredibly well regarded in the marketplace.

But we needed to build more capabilities to allow folks to get to independence. And that began our journey to introducing our strategic wealth services, which is the supported 1099 model; then we introduced our Linsco independent employee model. And now, more recently, what we've realized is, as we've built capabilities to support those more sophisticated advisors that are by and large coming out of the wires, or other regionals, we've built capabilities that allowed us to progress into a private wealth market.

And we've been able to introduce in that market a unique offering because it brings the principles of independence and book ownership. It brings higher payouts to the advisors while also providing all of the capabilities expected in a private wealth offering -- advanced planners, access to capital markets, partnership models to secure solutions for high net worth investors. And as you put that together, it feels like a second to none offering in the marketplace.

Now, there's a couple of things we'll have to build, more capabilities around our alt capabilities, integrated banking capabilities, and further progression inside of our advisory platforms, and we're on that journey. But as we progress those capabilities, married with our learning, what we've seen is early momentum that we feel really good about. And so, so far, since we launched that offering, November 3rd a year ago, we've had four teams join, serving over $2 billion in assets.

And as we expand our participation in that market, that's a $5 trillion market opportunity that we see ourselves at the beginning of a trend. And just like the Linsco offering and the strategic wealth offering that allowed us to penetrate wirehouse and regional advisors with greater distinction, we think that this is a distinctive offering that goes after those private wealth advisors and should lead us to sustained growth in this segment.

Steven Chubak - *Wolfe Research - Analyst*

Really helpful insights, Rich. Thanks for all the color.

Just a follow-up for Matt, over the past year, we've seen a pretty meaningful decoupling between the share price and NNA. Your stock currently trading at a pretty steep discount to wealth peers, despite generating much stronger NNA and in a consistent fashion, mind you. It clearly suggests the market is just not willing to capitalize that stronger organic flow momentum. I wanted to get your perspective just on what you believe the market's underappreciating first. And second, why not consider leaning more aggressively into buyback, just to take advantage of this valuation disconnect that exists today?

Matthew Audette - *LPL Financial Holdings Inc - President and CFO*

Yeah. Steven, I think there -- we certainly view the stock as undervalued, maybe hitting the leading into buybacks first, which we are restarting as I covered in the prepared remarks. I think one of the really important things that we are unwavering on is having a strong balance sheet. For many reasons, I think a lot of them are obvious, but maybe some of them are less obvious in that that is also a contributor to the driver of organic growth.

When you look at the businesses that we serve and support, being with a partner that's going to be able to withstand environments where interest rates go down or equity markets go down and not have to look inward and reduce their levels of investment, like some other firms that they've come from, that is a really important thing. So I think when we look at our capital allocation, it's all in a construct of being within that leverage target range.

And then I think when you click down within that, we continue to focus on driving returns, which include share purchases. I think the returns on organic growth are better, returns on M&A have been better, but the returns on share purchases are compelling. So I think we would anticipate allocating capital to all those areas.

I think to the first part of your question, I think from a market disconnect standpoint, I think there certainly is one. It's tough to understand how and why, other than I think our conviction on the investments we're making that are going to drive long-term value, that when you're doing things like bringing on a Prudential, and that certainly does require a lot of upfront investment, upfront capital, that not only is a compelling return for that particular opportunity, but opens up for broader market. These are all things that are an example of things that just drive long-term value.

Probably not the first time in the history of the markets where the long-term opportunity is perhaps underappreciated. Certainly not underappreciated by us, which is why we've got the conviction to keep doing what we're doing.

So hopefully that helps.

Steven Chubak - *Wolfe Research - Analyst*

No. Well said, Matt. Thanks so much for taking my questions.

Operator

Michael Cyprys, Morgan Stanley.

Michael Cyprys - *Morgan Stanley & Co. LLC - Analyst*

Great. Thanks, Rich, Matt. Good afternoon, and congratulations on the well-deserved expanded roles.

Maybe just one on liquidity and succession for you. Great to see your first off-platform deal. Maybe you could just update us on the traction you're seeing. Remind us how much capital you're putting into this and anticipate deploying into this over the next 12 months relative to, say, the last 12 months. And more broadly, strategically, how you're thinking about the opportunities that are unfolding as you look out over the next couple of years.

Rich Steinmeier - *LPL Financial Holdings Inc - CEO*

Hey, Michael. It's Rich. Thank you so much for the kind words at the beginning. I'm going to start, and then I'm going to hand it over to Matt around the capital deployment.

And so let's start with the momentum inside of liquidity and succession. I think you've got to start with the background of, "how big is the opportunity?" And so we think that over the next 10 years, we expect to see one-third of advisors retire in the industry. And as you look at the independent segment, which is the fastest growing segment in the marketplace, there really wasn't a mature set of solutions to help those advisors retire. In fact, in the past, those solutions largely were seller financed moving from one advisor to the next. But the risk was often borne by the advisor who was selling the business.

And so in 2022, with that backdrop, we came at this, I would say, from a different angle than many folks. We started -- we had, in fact, it was driven by our existing clients asking us, please provide us a solution because we want to stay with LPL. We don't want to have to sell away and we don't want to lose control of our business.

And in listening to those clients, like we do on so many different things, we comprise an offering that, one, helps those advisors monetize their business at a fair market rate. Two, it identifies and supports the next generation of advisors. We call those the G2 advisors, where we will build a relationship with those advisors to help finance them in buying back that practice from the founder or the practitioner as it stands. And in fact, 70% of those transactions that we're involved in have an identified G2 advisor already in place inside of the practice.

Three, we then move that business from that first generation to the second generation, but without changing the experience for the clients. It's the same office. It's the same brand. It's the same way that they deliver advice. Maybe it's a planning-based orientation to advice. And so the clients actually feel continuity in that progression and not a disruptive move from one firm to the next.

And then fourth, maybe oftentimes most important, those founders or those principals of the business, they want to see the legacy of their business protected. They're not in it for actually the top dollar. They want to see that what they built or maybe what their father or mother built continues into the next generation. And that's so important for them. And so as we built that solution, which I will tell you does not exist in the marketplace other than at this firm, we now see the proof in the pudding.

Our advisors who have gone through and entered into a liquidity and succession agreement with us are some of the happiest advisors that we have at this firm. Their NPSs are off the chart -- Net Promoter Score is off the charts. And I got a tangible experience of this. We had our Focus Conference not that long ago and we hosted a happy hour with a number, probably 15 of those teams and advisors that had entered into that agreement with us. And I felt like the bell of the ball.

I couldn't be -- I was spun like a top because every one of them said, thank you so much for derisking my business. Thank you so much for getting it to the next generation. Thank you so much for not making me sell to another firm that is going to whitewash my business, change the way my clients are served and shut my office down. And so that momentum we've seen internally, we have -- our most outspoken advisors are our largest advisors and our most influential advisors, and so many of them are already in partnership with us. And so I think you'll see a continuing momentum on that internal opportunity for liquidity and succession.

And what that's led to, first, in the external marketplace was that advisors who we were in discussions with to recruit them learned of how strong this program was, and it began to influence advisors consideration of our firm, not to necessarily go through a liquidity and succession event, but recognizing that this was a unique solution that would want them -- that would be attractive to them to join our firm. And I've been on so many HOVs with those large teams that are coming over specifically because they have optionality at some point to provide continuity into their staff and consistency into their clients.

But then it went probably a step further is obviously we're trafficking in a lot of conversations with advisors at all stages of their development and their progression. And so as you've seen in the last quarter, we've begun to move into having direct liquidity and succession transactions with external advisors to our firm.

We think that it works from two ways. One primarily is attractive to join this firm because then they have the L&S solution, which is unique in the marketplace available for them when they want to move towards transitioning to the next generation. But two, we also do see -- you can't look past that a third of advisors are going to retire in the next 10 years. That's not just at this firm. And with that offering, we think that it will be able to augment our way that we go to market in a way that will allow us to have an addressable market that is even larger than we have today.

I'll turn it over to Matt to think about -- to talk about the use of capital.

Matthew Audette - *LPL Financial Holdings Inc - President and CFO*

Yeah. Mike, I think the use of capital, I think on the external side, it's early, kind of hard to have a sharp estimate on where that goes from a capital allocation standpoint other than to underscore where Rich said the opportunity set there is quite large. But it's all volume dependent.

So I just go back to kind of the key metrics that we use on these deals. We're typically -- they're in the $10 million to $20 million zone if you look at those internal deals, per deal. And we're doing 6 to 8 times EBITDA, largely the zone that we land. We've done about 40 so far. And the purchase prices have kind of been in the middle of that zone, so call it $0.5 billion. So that's probably a good way to think about going forward from here.

And then I think external deals would just add on to that, probably at a lower multiple because you're getting not only -- you're basically getting two things. You're getting the recruiting economics, which are typically at 3 to 4 times, and you're doing the L&S transaction, which is at 6 to 8. So on average, it's probably a multiple that's a little bit lower than an internal one.

So hopefully that helps guide you.

Michael Cyprys - *Morgan Stanley & Co. LLC - Analyst*

Great. Thanks so much. And just a follow-up question, coming back to one of your strategic priorities was to drive operating leverage. I was hoping you could elaborate on some of the steps you might take to drive operating leverage in the business, what we might see there, what sort of magnitude do you think is achievable over the next couple of years, and what success might look like there?

Matthew Audette - *LPL Financial Holdings Inc - President and CFO*

Yeah. I mean, I think when you look at just the areas where we add costs as we grow, it's great insight to see where we can get more efficient and get more leverage and really drive down our cost to serve. So it's in the areas that have the largest headcount, and as Rich covered, kind of the areas that I'm largely responsible for now.

And I think when you look at what we're doing there is you've got a combination of investing in efficiencies, things like robotics. You've got opportunities as we improve our technology, as we improve our capabilities, the reasons that advisors may need to call our service center will decline, which allows you to grow this business without adding more heads there. So there's just a host of areas, Mike, where the more that we invest in efficiencies, the more that we improve our technology, the more that we get deeper and deeper into our expertise in all these different areas, the things that were driving costs will come down.

So I think it's a classic just cost to serve opportunity set that really has allowed us, if you just look at this year and this quarter, where we're delivering on quite strong levels of growth, but our core G&A guidance is really within the range of where we started the year. And the reason for that is our cost to serve is coming down. And I think that's the focus and the intent that we'll have going forward as well.

Rich Steinmeier - *LPL Financial Holdings Inc - CEO*

Hey, Mike. It's Rich. I'd love to add just one thing to that.

One thing I wouldn't overlook in the construct of how we improve operating leverage is actually our organizational alignment. So the guy sitting across from me, who has demonstrated that he is one of the best CFOs in wealth management with an eye towards making sure he understands how the business is put together, also now leads the largest components of cost for the firm. He understands how to responsibly deploy capital to build efficiencies, to achieve sustained improvement in our operating costs, while doing that inside of that environment of being both the CFO and President. And so I think there's a lot of harmony in that evolved organizational alignment that should allow us to continue to make progress against that operating leverage.

Matthew Audette - *LPL Financial Holdings Inc - President and CFO*

I don't think anybody heard that, if you mind repeating it.

Rich Steinmeier - *LPL Financial Holdings Inc - CEO*

Yeah. I do it every day and twice on Sunday.

Michael Cyprys - *Morgan Stanley & Co. LLC - Analyst*

Great. Thanks so much.

Operator

Craig Siegenthaler, Bank of America.

Craig Siegenthaler - *BofA Global Research - Analyst*

Rich, Matt, first, just want to offer you both a congrats on the expanded roles.

My question is on free cash flow conversion, and I'm looking at page 15 of the release. We saw positive sequential growth and year-over-year growth in corporate cash balances, although the growth was smaller after backing out the excess cash at the regulated subs. Given the return of the buyback, how should we think about your cash and liquidity objectives at the company and the whole co, and really, what metrics are you focused on?

Matthew Audette - *LPL Financial Holdings Inc - President and CFO*

Yeah. Craig, I think when you look at the two big metrics that we'll focus on, really it is overall leverage, so 1.5 to 2.5 times target range. I think we'll -- between the mix of cash flow that we generate and deploy and the borrowings that we use, which I think is a more efficient use of capital than equity, is really being in that range. And then allocating that capital to the areas that we've talked through, so organic growth, M&A, share purchases.

I think maybe specifically on your point on cash itself, that was elevated the last couple of quarters as we did opportunistically go to market in May when the markets were quite good to raise the cash to get ready to close on Atria. So when you go into Q4, you should expect to see that cash level, that corporate cash level, to come back down to where we typically operate, which is in that $200 million-plus zone, which is the amount of cash we typically like to keep around.

But then you'll see leverage more in that -- right in the middle of that range, kind of call it around 2 times. So that's where we like to anchor. And then based on where we are from a leverage standpoint, just take that liquidity and apply it to our capital allocation framework like we always have.

Craig Siegenthaler - *BofA Global Research - Analyst*

Thank you, Matt. My follow-up is on your alternative investment offering. I was wondering if you could remind us what the offering looks like today between both private market strategies and drawdown funds and also semi-liquid vehicles. And do you have plans to expand this offering further, which could enhance your recruiting effort?

Rich Steinmeier - *LPL Financial Holdings Inc - CEO*

Hey, Craig. It's Rich. I'll take that on. So let me start at the end of your question, which is, do we intend to expand this platform further? The answer is yes.

It goes to the journey that we've been on, which is that we started to serve really exceptional independent advisors. We then expanded our total addressable market by being very intentional at looking at wirehouse and regional advisors. And as we began to have success into those wires and regionals, the demand to join our firm continued to increase, but some of our capabilities were short of the absolute need that those advisors may have been used to at the other firms. And so that would center on alts, some of our banking capabilities, and as I mentioned, the further extension of our wealth management platform and specifically our UMA.

Inside of alts, over the last year, we've made significant progress in building towards a world-class platform. The first thing we did was expand our custodial and operational capabilities. And the second was then beginning the material expansion of our shelf of alts themselves. This is a multi-year effort. In fact, now, we have over 20 folks working full-time inside of the alts to go through diligence, as well as to position to our advisor base to help them understand solutions and help position them to their clients.

In addition to those capabilities, specifically this year, we've deployed a new alternative investment order entry system which we launched in the second quarter with a pilot set of advisors and have gotten a lot of feedback on. And in fact, we have used that launch in the second quarter to build and enhance what we call AIOE, our Alternative Investment Order Entry system, so that it's much more intuitive and has better capabilities in support of a broad deployment at the end of the fourth quarter.

The feedback that we've got from the advisors who went on the pilot has been incredibly positive. And as they've learned into our expanded capabilities in response to their feedback, it's only gotten stronger. So we look forward over the next year to finalizing that build reflective of the needs of those advisors and continue to expand that breadth of product offerings to achieve, not only the opportunity to support our existing advisors, but as you mentioned, make us more attractive inside of those high net worth oriented advisors that either sit as what we would call maybe high net worth dabblers inside of the wires and regionals or those that are inside of the private wealth channels themselves.

That goes to a little bit of maybe one of the earlier questions that I was answering. So you're spot on. This is a capability that is important to us that we have made investments in and will continue to make investments in until it becomes a world-class capability for us.

Craig Siegenthaler - *BofA Global Research - Analyst*

Thank you, Rich.

Operator

Mike Brown, Wells Fargo Securities.

Mike Brown - *Wells Fargo - Analyst*

Great. Thank you for taking my questions. I appreciate all the background, Rich, on the institutional side of the business and the momentum is clearly very strong there. Can you just speak to the constraints in growing in that channel? What is the kind of annual pace that you could tackle there when you're considering that $1.5 trillion opportunity? And as you onboard some of these bigger complex clients like Prudential, can that speed of onboarding begin to pick up?

Rich Steinmeier - *LPL Financial Holdings Inc - CEO*

Absolutely, Mike. Thank you for the question. Audette, I would note that Mike is the first person that has not congratulated you on your expanded role. I also feel the same way you do, Mike. I think he should have just been a little more humble. So let's get into that question as it is.

Mike Brown - *Wells Fargo - Analyst*

There's still time. I can congratulate you.

Rich Steinmeier - *LPL Financial Holdings Inc - CEO*

Okay. Let's talk about the constraints on the institutional segment. There's a couple of things. If you think about accelerating the pace in an institutional segment, one of the differences between an advisor segment and the institutional segment is that the sales and engagement process is quite a bit longer. If you think about our engagement with Prudential, we actually were in discussions for a couple of years before we got to contracting, which then led us to a pretty sizable build to build those capabilities.

Now, the good news is for incremental initiatives or incremental partnerships that we would have, for so many of them, we won't have that long build cycle because we will have built the capabilities certainly inside the product manufacturer segment. On the bank side, we're the leader in capabilities. And so that again -- that's going to have a longer sales cycle. That's not going to look like years. It's going to look like probably a nine-month sales cycle. You're going to see an RFI and an RFP, and they're going to go through decisioning, and then you've got contracting. And then you can think of anything between 6 months to 12 months as a timeframe for which we're preparing to onboard that.

And so what you'll get, Mike, is as you're building momentum, some of that you're not going to see in the short term is because as firms, I specifically mentioned inside of that product manufacturer space, as they see through the Prudential transition and successful Prudential transition, as they then raise their heads and start to get into an engagement process with us, you're going to have a pretty sizable lead time. And so that's one of the things you would see.

Now, you specifically asked about constraints, and so let's get back to constraints. A couple of years ago, as we would go through a major transition, we would think about having the capacity to do one a quarter. And I think that would have been a constraint at the time. And then we began to think about the ability to do one major transition a month. And I can tell you in the last year or so, we started to feel that that might be a constraint. And so we've built the capabilities and the capacity and the sophistication of our onboarding.

And that's probably a really important component that I didn't allude to earlier. Because we've done so many of these large transition events, we've invested pretty heavily in digitizing and automating those transitions themselves. And so when Matt was talking about driving that operating leverage up, part of that is ongoing, but part of it is actually reducing the cost and the friction to actually get those large firms over in a large event, either an M&A event or a partnership event.

And so as we've gone through that, we have built the capacity now to handle multiple events inside of even a single month. We had that happen not that long ago. We had two events across a three-week period, and we did not miss a beat. And so we've begun to take away the constraint around the ability to transition material events at a pace that feels a lot more accelerated than we would have had in the past.

But probably one of the things, Mike, is I'd probably lean more towards the first part of my answer, which is, as firms see us as a more attractive offering, there's a lot of due diligence to go through. And in many cases, there's some custom build that has to go on. And so that back and forth, there's a lot of complex solutioning that our team is engaged with to understand their operating environment, especially in those larger firms. And that timeframe is very hard to compress. You can compress the conversion, but it's harder to compress the sales cycle because of the complexity of so many of these really larger firms.

I hope that helps.

Mike Brown - *Wells Fargo - Analyst*

Yes. Yeah, very helpful. And then just for a follow-up, as you -- to build on the operating leverage comment, just hoping to maybe get a little sneak peek on to 2025. The annual core G&A growth for 2024 was 7.5% to 8.5% prior to Pru and Atria. I'm just trying to think through, is that perhaps the right range to consider for 2025? Or what's the puts and takes there, Matt?

Matthew Audette - *LPL Financial Holdings Inc - President and CFO*

Yeah. Mike, we're in that planning process now. So we'll come back like we normally do in the year-end call and give that guidance. But I think that maybe the higher level things I would hit is, one, just keeping in mind, we'll have Pru and Atria for the full year effect of that in 2025. So if you kind of put that aside, I think, and just reiterate what we talked about on this call, I think our focus will be continuing to invest to drive organic growth, but at the same time delivering that operating leverage.

And I think this year is a good example of those growth rates starting to come down and balance those two things versus '22 and '23, where we had more of an outsized investment. So we'll have that same perspective going into 2025, but we haven't landed those plans yet. It'll be guided by the opportunities we see to invest and drive growth and by the opportunities we see to invest and deliver operating leverage. But those principles will be the things that guides us.

Mike Brown - *Wells Fargo - Analyst*

Okay. Great. Thank you, and congrats to both of you.

Operator

Thank you. That's all the time we have for questions. I'd like to turn the call back over to Rich Steinmeier for closing remarks.

Rich Steinmeier - *LPL Financial Holdings Inc - CEO*

Thank you, operator. And thank you all for joining us. We look forward to speaking with you again in January. Have a great night, and have a safe and happy Halloween.

Operator

Thank you for your participation. You may now disconnect.
