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EDITED TRANSCRIPT

LPLA - Q2 2019 LPL Financial Holdings Inc Earnings Call

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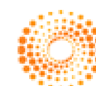

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PRESENTATION

Operator

Good afternoon, and thank you for joining the Second Quarter 2019 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, 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 strategies 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 risks and uncertainties that may cause actual results to differ materially.

The company refers listeners to the safe harbor disclosures contained under the caption Forward-Looking Statements in the earnings press release as well as the company's latest SEC filings to appreciate those important factors that may cause actual financial or operating results or the timing of matters to differ from those contemplated in such forward-looking statements.

During the call, the company will also discuss non-GAAP financial measures governed by SEC Regulation G. For a reconciliation of such non-GAAP 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.

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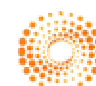

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Dan Hogan Arnold - *LPL Financial Holdings Inc. - President, CEO & Director*

Thank you, Carmen, and thanks to everyone for joining our call. As we discussed last quarter at our Investor Day, we believe a thoughtful strategy, combined with extraordinary execution and a mission-driven culture, will drive long-term growth and value. Working within this framework, we delivered another quarter of solid business and financial growth.

Let's review our second quarter results, starting with the drivers of our business. We continue to focus on delivering organic growth, and we are encouraged by the progress in the second quarter. Net new assets were $4 billion, reflecting solid performance across new store sales, same-store sales and adviser retention.

This organic growth, combined with higher equity markets, drove total brokerage and advisory assets to $706 billion exceeding $700 billion for the first time.

Turning to our financial results. We continue to generate top line growth as gross profit increased 11% year-over-year. While continuing to invest in the business, we stayed disciplined on expenses to drive operating leverage.

As a result, second quarter EPS prior to intangibles was $1.85, which was up 30% from a year ago. Looking more broadly at the marketplace, we continue to operate in an attractive market with supportive secular trends towards independence and advisory solutions.

Within this context, our market intelligence and our own adviser feedback indicate the best way to position our advisers to win in the marketplace is to help them enhance the value of their advice and their capacity to serve more clients. To address this opportunity and accelerate our growth, we have organized our efforts into 3 strategic plays, which I'll speak to now.

Our first strategic play involves expanding our affiliation models beyond our traditional independent and institutional model platforms. As a reminder, we are developing new advisory-oriented and independent employee models, which together more than double the size of our addressable market.

With respect to our advisory-oriented models, we're approaching the market in a differentiated way that moves beyond traditional models. Our vision is to deliver an integrated solution of custodial, advisory, brokerage and practice level services to make it easier for an adviser to enter and thrive in the independent channel. At the same time, we are further enhancing this offering by reengineering key advisory policies and workflows to drive simplicity and efficiency into the day-to-day operations of these practices.

While this offering is relatively new, we're encouraged by our growing pipeline of interested advisers. Regardless of the affiliation model, we will continue to deliver more capabilities and lower prices to help our advisers provide more value to their clients and differentiate and win in the marketplace. The secular trend towards advisory solutions and the capacity challenges that many advisers face are leading more advisers to leverage our centrally managed platforms in order to outsource time-sensitive investment management tasks.

That said, there is a population of advisers that wants to maintain control of portfolio construction, while also benefiting from the administrative efficiency of centrally managed platforms. In order to meet the needs of these advisers, we developed our Advisor Sleeve solution within our centrally managed platforms. This enables advisers to maintain control of investment models while saving time by outsourcing the trading and rebalancing work to us. And while we are in the first wave of the rollout of Advisor Sleeve with 1,500 initial advisers, we are seeing 2 positive trends thus far.

First, we are encouraged that these initial advisers have added approximately $600 million of assets into Advisor Sleeve. Second, while historical demand of centrally managed platforms has predominantly come from the corporate platform, about 30% of Advisor Sleeve flows are coming from hybrid advisers. Together, these early trends demonstrate that advisers appreciate the ability to retain the investment management component of their value proposition, while also achieving greater efficiency.

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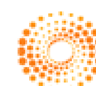

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Let's now turn to our second strategic play, where we are working to create an industry-leading service experience by driving continuous improvement, investing to differentiate ClientWorks and evolving into a client care model. With respect to ClientWorks, we continued to focus on version 2.0, which aims to provide advisers with more streamlined and intuitive experiences. In the second quarter, we enhanced the ability for advisers to personalize key dashboards and interfaces, so they have greater flexibility to configure their systems in a manner that is most efficient for them to serve their clients.

Additionally, within the new account opening process, we are simplifying workflows and more efficiently capturing the data required to open an account. Advisers tell us that these updates have significantly increased the simplicity and speed of opening new accounts, while enhancing the on-boarding experience for their clients.

Looking ahead, we will continue to focus on creating a more personalized and flexible experience for our advisers, while also improving their efficiency.

Our third strategic play is about establishing a new layer of value in the independent marketplace. We hear from advisers that macro challenges are making it harder for them to operate their businesses. At the same time, consumer experiences in other industries are raising client expectations. We are helping our advisers turn this challenge into an opportunity by offering them a portfolio of new services, including digitized workflows, virtual services and access to capital throughout their life cycle.

This quarter, we want to highlight our efforts on our Virtual CFO offering. Through a series of experiments, we found that a CFO is an important partner and makes a strong contribution to an adviser's business. But in many cases, advisers do not have access to a full-time CFO. As a result, we had partnered with more than 50 advisers in a pilot to innovate a solution that provides CFO capabilities in an affordable way. Consequently, we have hired and trained a group of CFOs to support the financial management of our adviser practices for a monthly subscription fee at a big discount to hiring a full-time CFO. By delivering real-time data, insights and strategic guidance, these CFOs help manage the day-to-day finances of our adviser's businesses, while also increasing practice value.

At the end of the day, advisers tell us their Virtual CFOs are helping them achieve outcomes that include lowering their cost, moving toward a more reoccurring revenue model and evaluating and executing on opportunities to acquire other practices.

Our Virtual CFO experience is consistent with the interest we see and the approach we're taking across the full portfolio of virtual services, including Virtual Admin, CMO and CTO. After working over the past year to validate that the value proposition of each of these services resonates with advisers, and that we can consistently execute with high quality, we are now offering these solutions more broadly to the marketplace.

Our jumping off point is the 400 subscribers we currently serve across our virtual services portfolio, which is up from 300 last quarter. We are excited about the prospects to help a growing number of advisers to better operate their practices, increase their efficiency and drive growth.

I also want to take a few moments to highlight our ongoing efforts to transform our culture, which we see as a fundamental to driving long-term growth and value. And as a reminder, we are taking a structured approach by instilling a client-centric mindset, logic-based thinking, and mission-driven alignment. Over the past quarter, we completed the first half of our rollout of a new set of behavioral base values that are guiding action and decision making in our daily work. Additionally, nearly 2/3 of our management level employees have now been through process-design training to help us apply Lean and Six Sigma principles in our work and with our teams.

As a result of these and other efforts, our advisers continue to tell us that they see the positive changes that our cultural transformation is driving most notably in their service experience.

In summary, we're pleased to deliver another quarter of business and financial growth. We remain focused on combining strategy, execution and culture to serve our advisers, drive profitable growth and create long-term shareholder value.

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

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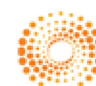

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Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Thank you, Dan. I'm glad to speak with everyone on today's call. We had another solid quarter in Q2. We grew assets and gross profit, invested to drive growth, delivered operating leverage and returned capital to shareholders. As a result, our Q2 EPS, prior to intangibles, was $1.85, up 30% from a year ago. We are pleased to deliver these results as we continue to execute on our strategy.

Let's now review our Q2 business results in greater depth, starting with total brokerage and advisory assets. We finished the quarter at $706 billion, up 3% sequentially, driven by a combination of organic growth and higher equity markets.

Total net new assets for Q2 were $4 billion, which translates to a 2.3% annualized growth rate. These results included $1.2 billion of outflows related to the hybrid firm we previously discussed that form their own broker-dealer and depart it. Prior to those outflows, total net new assets were $5.2 billion with 3% annualized growth rate.

Additionally, our pace of growth increased throughout the quarter with net new assets of $0.7 billion in April, $1.4 billion in May, and $1.9 billion in June. As for recruiting, we had a solid quarter with $8.5 billion of recruited AUM, which brought our trailing 4-quarter total to over $33 billion.

We also continue to see positive mix shifts in our business in Q2. Advisory assets increased to more than 46% of total assets, primarily driven by advisory inflows of $6.6 billion, our fastest pace of growth in over a year. These results included $1.2 billion of inflows on our centrally managed platforms, which are now 14% of total advisory assets.

Before moving on to our financial results, I want to provide an update on our acquisition of Allen & Company. As a reminder, they have around 30 advisers serving $3 billion in client assets and will affiliate through our new independent employee model. Since signing in May, our planning and integration work has gone well, and we now expect to close by the end of Q3, which is a quarter earlier than we originally anticipated.

As for the financial benefit, we continue to expect to reach an annual run rate EBITDA accretion of about $5 million in early 2020. I also want to share that the more time we spend with Allen and company, the more impressed we are with their culture and the high caliber of their team. We're excited to welcome them to LPL soon.

Now let's turn to our Q2 financial results, starting with gross profit. It was $536 million, down $20 million or 4% sequentially, primarily driven by production-based payout ramping as expected. Year-over-year, gross profit increased by $53 million or 11% primarily from higher client cash and asset-based revenues.

Looking at the components of gross profit, commission and advisory fees net of payout were $129 million in Q2, down $8 million from Q1. The decrease is driven by seasonally higher production bonus expense, partially offset by higher net commission advisory fees. As we look forward to Q3, I want to remind you that our production bonus payout rate increases throughout the year. As context from Q2 to Q3 last year, the production bonus payout rate increased by about 60 basis points or $6 million.

Before moving on, I want to highlight that we updated our management P&L this quarter to help make our results easier to follow. Historically, the mark-to-market revenue and expense related to our adviser deferred compensation program was recognized in 2 separate lines: production expense and other revenue.

While the mark-to-market movements had no net impact on our financial results, they did create large swings within those lines. Given this, we consolidated both of these items into other revenue where they now offset each other. We believe this change will provide a clearer view of our actual production payout rate, which is the metric we focus on as management. We also updated the historical management P&L file on our website, so you can see our past results with the same view.

Moving on to asset-based revenues. Sponsor revenues were $127 million in Q2, up $4 million from Q1. The increase was primarily driven by higher average asset levels as well as continued growth on our advisory no transaction fee platforms.

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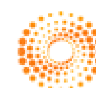

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Moving to client cash revenues. They were $162 million, down $11 million sequentially. The decrease was primarily driven by the typical seasonal decline in client cash balances due to tax payments in April. As we move beyond tax season, cash balances grew in both May and June.

Turning to client cash yields for Q2, our ICA yield was 249 basis points, roughly flat to last quarter.

Looking ahead to Q3, and assuming that Fed cuts interest rates by 25 basis points next week, we would expect our ICA yield to be around 240 basis points. This assumes our deposit betas are within our expectations of 25% to 50% and no further changes in interest rates or the mix of fixed versus floating rate balances.

Let's now move on to Q2 transaction and fee revenues. They were $118 million, down $4 million sequentially, primarily driven by seasonally lower transaction volumes and IRA fees.

Looking ahead to Q3, we expect transaction and fee revenue to be relatively in line with Q2 as we anticipate the seasonal decline in IRA fees and transaction volumes will likely be offset by fees generated from our national adviser conference.

Now let's turn to expenses starting with core G&A. It was $211 million in Q2, in line with our spending plans for the year. Looking ahead, as we are executing well on our investment and efficiency plan so far this year, we are tightening our 2019 core G&A range by $10 million. Additionally, given that we now anticipate closing our acquisition of Allen & Company in Q3, we are updating our guidance to include estimated integration and initial operating expenses of approximately $5 million.

Taken together, we expect our 2019 core G&A to be in the range of $860 million to $875 million, or an average of about $222 million per quarter for the second half of the year.

Moving on to Q2 promotional expenses. They were $41 million, down $10 million sequentially, as the key drivers for this area, transition assistance, marketing spend and conference expense were all down from Q1.

Looking ahead to Q3, we anticipate promotional expense will be in the low $60 million range. The increase is primarily driven by the timing of our national adviser conference, which occurs in Q3 each year. Additionally, June was our strongest recruiting month of the quarter, so the associated transition assistance expense will ramp in Q3.

Moving on to capital management. Our balance sheet remained strong in Q2. Cash available for corporate use was just under $300 million, and our credit agreement net leverage ratio was 1.99x.

Turning to capital deployment. Our priorities remain investing for organic growth first and foremost, taking advantage of M&A opportunities as they arise and returning capital to shareholders.

Looking at our organic growth, our investments are focused on recruiting new advisers, helping existing advisers grow and enhancing our technology. In addition to our investments for growth, we returned excess capital to shareholders in Q2. This included $125 million of share repurchases, in line with our plan to complete our $1 billion authorization over roughly 2 years. We also returned capital through $21 million of regular quarterly dividends in Q2.

In closing, we are pleased to have delivered another quarter of strong business and financial results. We remain focused on growing assets and gross profit, investing to drive organic growth, while staying disciplined on expenses and returning excess capital to shareholders.

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

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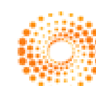

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question is from Craig Siegenthaler with Crédit Suisse.

Craig William Siegenthaler - *Crédit Suisse AG, Research Division - MD*

So it was nice to see the stronger recruited asset balances in the quarter, and also the 1% increase in adviser count before the IFP departures. But I was just wondering if you can give us an overall update on the recruiting pipeline? And have you seen activity improve this year just because when you think of how the year started with the government shutdown, it looked like it's slowed the break rate broker trend?

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

Yes. Craig, this is Dan. Let me take that one. I think on a headline basis, I would say, the results have been solid thus far. The environment for recruiting is kind of in what I might call a neutral place and then we think -- and are very supportive and excited about our pipeline. So let me give you a little color on each component. If you look at the results over the last quarter, $8.5 billion of recruited assets, as Matt pointed out in his remarks, which is what we think a solid outcome and if you look across the trailing 12 months, the $33 billion that we've recruited is the most we've ever achieved. And so again, we think those are reflective of solid results.

With respect to the recruiting environment, and getting to your point around what's our thinking on that post maybe some of the complexity at the beginning of the year, I think if you look at the year-to-date results, you've seen the amount of movement out in the marketplace of advisers looking or exploring a different affiliation to have been at stable to slightly down. So if you think about that sort of macro environment, you might have had a little bit of reduced opportunity over the past 6 months.

At the same time though we're seeing our competitive positioning strengthening, so we're actually seeing and getting swings at more opportunities, given those advisers that are exploring to affiliate. And so consequently, we think that, that's certainly driving a strong pipeline as we look forward. And you would expect that pipeline to exist within our traditional models, but we're also beginning to see it build in some of these new models we've talked about. So we're excited as we go forward and thinking about that pipeline. Hopefully, that gives you some helpful color.

Operator

Our next question is from Steven Chubak with Wolfe Research.

Steven Joseph Chubak - *Wolfe Research, LLC - Director of Equity Research*

So Dan, I wanted to start off just with a bigger picture question. You had another strong quarter of organic growth, good business momentum, just given the evolving macro interest rate landscape, how do you feel about the strategic implications for the business? And your level of confidence in the ability to sustain some of that momentum?

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

Yes. So maybe as we think about the macro, let's start there and then we'll pull through how we think about that. And if we don't cover all of that, Steven, then you can certainly follow up with any clarity. So as we think about the macro, I would -- my kind of headline on that would be, it's pretty solid and it remains in, what we might call, a supportive state. If -- then I gave you some additional color around that, we typically look at that through the macro through 3 lens. The first, the economy, right? And I think we see continued economic growth, notwithstanding, I think, some of the thinking as we move forward about potential headwinds there. We continue to see a good steady economic growth at a solid pace. And

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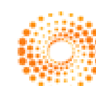

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certainly, coming along with that the low unemployment is certainly a contributor towards creating discretionary income, that -- then people can think about putting to work in terms of investments. So economy is moving along, and we think quite supportive to the macro.

The second element is the equity markets. And again, year-to-date, I think we've seen pretty strong performance in a low volatility type of environment. See you take the economy and that performance in the equity markets, and that typically leads to what we've seen, which is pretty solid engagement from investors and we don't necessarily see that changing as we move forward. So we feel pretty good about the opportunity set with respect to investor engagement.

When you look at those 2 economic factors though as they relate to advisers, it's probably a bit more of a neutral view. Certainly, the investor engagement is creating an opportunity for advisers to focus on gathering new assets and putting those assets to work. So that's favorable, but at the same time as we talked about, those types of conditions will have sometimes advisers delay, looking and exploring, affiliating with a new partner or thinking about their business strategically. And so consequently, when you look at those 2 things, they may balance each other out to more of a neutral view. So those are 2 components.

Maybe with respect to the third, which is interest rates, Matt, maybe you want to provide some color on that.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, sure. I mean I think, Steven, when we think about our position, I think we're positioned well for a range of macro environments, including I think the one that's most assumed today, which is interest rates going down. And I've highlighted a couple of dynamics there. First, and I think you know this well, but we've moved a fair bit of our portfolio, specifically the ICA portfolio, to fixed rate balances, right? We're at about 40% of fixed rates. So we have less of an impact from movements in short-term rates. And then second, I just highlight that the impact on the market when the interest rate sentiment makes its way into the equity markets, if you just look at the month of June, right, it's really where the interest rate curve and dynamic is really solidified. You saw that equity markets and specifically S&P go up by about 200 points.

And just a reminder on how that flows through our model, every 100 point move in the S&P is about a $25 million annual increase in pretax earnings, right? And you compare that to the impact of an interest rate cut, about 25 basis point interest rate cut or reduction will be about a $10 million to $20 million annual impact, right? So if you look at June, right, the market increase effectively offset more than the impact of 2 cuts. So I think we're pretty well positioned, but if you take that, right, the natural hedges in our market, you combine that with where the balance sheet is positioned, which is a position of strength, it really puts us in a position, in a place to focus on our clients, right?

So the core of your question, how does this position us for growth? Well, being in a place to focus on our clients and what's best for them, things like investing in capabilities, investing in technology, investing in service, we feel really good about being able to do that, especially when you're talking about across a range of macro environments, where not everybody is in a position to do that. So we feel like it could be a key differentiator to be able to drive growth over the long term.

Steven Joseph Chubak - *Wolfe Research, LLC - Director of Equity Research*

Helpful context. Maybe this is my follow-up for you, Matt. The gross profit ROA ex cash, it did decline sequentially. So maybe you can speak to some of the factors that drove this sequential decline? And whether you're still confident consistent with what you said at Investor Day, in your ability to maybe hold the line on that metric and possibly even deliver some expansion given increased adoption of growth in centralized managed platforms and some of the other additional services that you guys cited?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, sure. I mean I think we still feel good about it, right? We feel good about our investments in that area to drive profitable long-term growth. I think we feel good about our efforts on when you look at gross profit ROA ex cash. And if you look at it over the last couple of years, we've gone from a place where that was consistently declining to something that's now stable and starting to grow, right? When you look at this quarter, I

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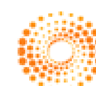

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think we continue to see positive trends, right? Both Dan and I talked about them in the prepared remarks: growth in advisory, growth in centrally managed. We're starting to see early signs of growth in virtual services. So we feel good about that. I think when you look at this metric, it's probably one best viewed on a trailing 12-month basis, right, versus a quarterly one. And I recognize the quarterly one is the one that we gave you. But doing it that way, you can have a little bit of noise. So just give me a couple of examples, right? When you look at advisory fees, right, those are mostly based off the prior quarters' balances and when you have a quarter of growth like we had, especially, in the last month of the quarter like we had in June, those economics are going to flow through in the following quarter, right? So you have a little bit of noise there. And then because it's a quarter, you end up annualizing that and kind of making the noise even a little bit louder. Similar context on the base payout rate, that can move up or down 50 basis points really from mix. We were at the higher end of that range this quarter, and again, you annualized it. So you get a little bit of noise there, but I'd say, just overall, I think we feel good about the results the strategy is driving. The positive mix shifts that we're seeing and the improvements that are really delivering and driving the return on assets, and that's what we're going to stay focused on.

Operator

Our next question comes from Bill Katz with Citi.

William R. Katz - *Citigroup Inc, Research Division - MD*

Just coming back to maybe a big picture question, Dan. As the business continues to migrate toward advisory, and then, within that, toward corporate and a greater use of centrally managed planning, what do you think the outlook is for cash as potential client assets? Are we -- is there a structural component here that might limit the cyclical snapback as we think longer term? And then, underneath that, does that create more pressure on the underlying yield for cash over time?

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

Yes, so Bill, a couple of thoughts. At the macro level, I think, certainly, the trends towards advisory have probably a contributory nature to them relative to overall average balances in an account. Just in terms of that allocation of the overall portfolio, having an access to and maintaining some cash balances in order to just do maintenance on the account itself, fees and things of that nature as well as just in terms of some of the flexibility on how you manage that portfolio is usually helpful. And that relative to brokerage would lead to a greater expectation around overall balances in cash. Centrally managed versus rep directed, I don't think we see a big difference in the amount of cash allocated to a portfolio. So just because someone might move or migrate from a rep directed to centrally managed, wouldn't necessarily expect an increase in cash balances with that transition.

But do believe from brokerage to advisory, you pick up a little bit of cash. With respect to -- then you got to remember a lot of the cash that we use and have on as part of cash balances that our clients use is more smaller balances. It's maintenance on the accounts and that's not going to vary significantly, relative to how one might think about investing. The securities within or portfolio construction within an account, and so don't think that we see a lot of fluctuation and/or influence, if you will, around one's allocation of those assets long term. Certainly, if you get volatility in the market and you get people adjusting quickly relative to big market swings, you might see some, but that's more noise around that overall transition of assets than it really is some structural change. So if I summarize that, I think you would see when you move from brokerage to advisory, you probably do see an increase in overall cash balances with respect to overall how one might then allocate those assets within an advisory account. We don't expect to see a whole lot of influence relative to our cash balance because the majority of ours are there from a maintenance on an account. I hope that got to the heart of your question.

William R. Katz - *Citigroup Inc, Research Division - MD*

That's very helpful. And then maybe one for Matt. And thanks for taking the complexity of these questions. So 2 more questions for you as well. In terms of your experience and maybe the answer is, having had it, how should we think about the core deposit beta assumption, potentially the client rate backdrop? Some of the other retail brokers that have reported earnings already have suggested much higher core deposit betas, which

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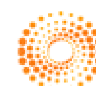

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suggest the ability to pass on a greater level of the pricing back to consumer, if you will. Obviously, you have less deposit beta on the upside, but I'm wondering if there's a little bit more asymmetric benefit to you on the downside? And then anyway to think about client behavior into the month of July just between month engagement versus cash balances?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, sure. I mean I think the deposit beta is on the way up and down. I mean our view is 25% to 50% is the right range. You can always have a wide range across different firms on individual moves, but I think at a high level, we think 25% to 50% is where it was on the way up and we were closer to the low end of that range. And I think that same logic would apply in our view on the way down.

With respect to July, I think what we've seen so far in July is really stability versus where the balances were in June. First month of every quarter, you always have the adviser fees that come out and reduce cash, and we've seen it offset with some inflows and kind of we're net neutral to where we ended in June.

Operator

Our next question comes from Alex Blostein with Goldman Sachs.

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

Question around Allen & Co. Just maybe now that you guys -- it seems like the deal is about to close a little bit sooner. I'm just curious to get your thoughts around similar type of deals going forward to kind of help you expand in this sort of newer employee sort of base channel? And then maybe you could remind us how the economics in that channel would work relative to the installed book? So any sort of metrics around maybe like EBIT, ROA or something like that will be helpful just to kind of contextualize what this could mean for you guys over time?

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

Yes. Let me take the first part of that Alex and then, Matt, you can follow-up on the question around the economics. So I think with respect to the M&A environment, I would take you right back to our strategy, as you know, and we would certainly look at that opportunity as a complement to first and foremost, our focus on organic growth. And with respect then to where we would tend to explore possibilities and opportunities, I think the couple of transactions we've done in the last 6 months are a good reflection of that. You see it with respect to enhancing or accelerating the development of our capabilities, and so AdvisoryWorld will be a good example of that. And then certainly, Allen & Co is one that is a transaction born out of the growth opportunities associated with it. And we continue to be active in the marketplace looking across both of those landscapes for opportunities that would certainly help drive out our strategy. And, of course, as you all have heard us say many times over, the rigor around which we will look at those opportunities, they've got to be strategically, operationally and financially aligned.

And so hopefully, that gives you the color in terms of just how a, we think about that M&A; and then b, we are active in the marketplace looking for opportunities in either one of those categories.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes. And then, Alex, to take the second part of your question. I think when we think about the economics to, kind of, building on how we talked about this a little bit at Investor Day, I think as a general principle in premise, right, the more services we provide or the more that we do on behalf of our advisers, the higher the ROAs would be. I think specific to this model, the ROAs, I think would be much higher. The expenses to support them as their employers would also be higher. And I think directionally, the net we would anticipate would be a little bit better. And if they were not an employer, we're providing less services. That being said, it's going to be impacted like any of our advisers would be by mix of brokerage versus

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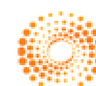

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advisory and things like that. So I think as these come on to our platform and as we, hopefully, are able to build these opportunities more and more, we'll get more specific on that but, hopefully, that helps you directionally?

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

Got it. Yes. No, that's helpful. And then one more specific question just, kind of, around the quarter and the outlook. So promotional expense feels like it was lighter this quarter than normally, despite the fact that you guys had quite a robust quarter of recruiting activity. I understand some of that happened later in June, but it was quite solid over the last couple of quarters now. So maybe help us understand really the drivers behind the ramp from kind of low $40 million to $60 million next quarter? And then just bigger picture, how do you guys think about promotional expense for the year? And kind of year-over-year growth, maybe beyond that?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, sure. I mean I think just to give you a little bit more color on the quarter, right, the items within promotional expense are areas that can actually move around in any given quarter, right? So if you go through each of them transition assistance being the most notable one, we had a stronger recruiting quarter this quarter than last quarter, and I would just emphasize that the strongest month within the quarter was June. So you see that transition assistance really pick up next quarter. The second is marketing, right? Marketing is an item by its nature that can move around a lot in an individual quarter. And this quarter, it's just a little bit lower than what we typically see. And then, third is conferences, right? We've got 3 major conferences that we usually talk about with all you on calls like this, but we run more than 30 overall, right? So there can be individual things that happen in a quarter. And for this quarter, it's just the conference spend was a little bit lower.

So when you take each of those items and you look to next quarter, the biggest driver really is our national adviser conference. That can be up to of $50 million of expense we talk through each year, that's the primary driver, but you also have transition assistance that will ramp and marketing that will seasonally as we get into the second half of the year will typically pick up, especially in Q4. So that's the drivers. I mean I think the second part of your question, Alex, on where transition assistance goes, I mean, it's really tied to recruiting. And I think we -- as Dan highlighted and I think the first question of the call, I think we feel good about the pipeline. I just wouldn't get more specific than that other than to say promotional is really going to trend with recruiting. Noting there can be quarterly to quarter noise depending on which month the recruiting happens in.

Operator

And our next question comes from Chris Harris with Wells Fargo.

Christopher Meo Harris - *Wells Fargo Securities, LLC, Research Division - Director and Senior Equity Research Analyst*

So you're at 3% organic asset growth, excluding IFP, I'm wondering if you guys can share your thoughts about how you feel that growth rate compared to the independent channel more broadly?

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

So Chris, this is Dan. I hate to speculate because I don't have visibility into exact results or outcomes from the independent channel more broadly. That said, I think, as we think about it, there's 3 key drivers to organic growth. One is new store sales or how we're doing from a recruiting standpoint relative to others. And based on the public data that we can see and then certainly from the own -- our own insight and feedback and perspective from the industry. We think that we've got strong momentum there, and we've got some outperformance on a relative basis from a recruiting standpoint. From a retention standpoint, I think, in the 96% range, including IFP ex that 97%, we think again that tends to be a pretty strong performance on a relative basis. Same-store sales were a little tougher, little harder to measure and see relative to others and a little bit tougher to get feedback and insight into what's exactly occurring. So I can't speak to that one. And then finally, on product mix, which is also a contributor, I think we've got nice trends relative to the trend towards advisory using the corporate RIA centrally managed. And I think we're seeing that type

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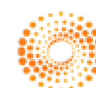

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of trend in other places, and so I think that's probably consistent relative to what we are seeing in other areas. So those are the maybe some of the drivers of the overall contributors to organic growth that maybe just give you a sense of a click down on how we think about that. I'm not sure if I answered your question enough.

Operator

Our next question comes from Devin Ryan with JMP Securities.

Devin Patrick Ryan - *JMP Securities LLC, Research Division - MD and Senior Research Analyst*

I guess, first question here just -- let me get some thoughts on your views of a private equity activity in the space? Clearly, it's picked up quite a bit over the past year, and I'm just curious, is that a good thing for LPL? Is it raising the bar competitively for talent or capabilities? And that's kind of part one. The other part is, I would think that the recruiting opportunities could be pretty material as a result of that to the extent any of these piggyback firms actually look to integrate some of the brokerages, which would create some breakage I would think, so just love to kind of think through that effect, because it seems like it could have some puts and takes, but maybe be beneficial to the firm?

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

Maybe some thoughts just on some of the principles that you raised, regardless of maybe perhaps who the buyer is. I think a couple of things, anytime you have a change in ownership that creates some questions and some uncertainty about the future that tends to lead to an increase in advisers exploring what their options are. And as you say if they are involved in some sort of consolidation, when they're actually going to have to go through some work to make that transition, well, that will -- that increases the percentage that look around materially. And so no doubt, some of the -- just change in ownership all the way down to then the consolidating activity that may occur, creates recruiting opportunity. It also creates that complementary M&A activity that we talked about as well. So I think your sort of assumptions or hypothesis there is spot on.

Relative to the new owner and how then they think about the business in the future? I think you've got to click down and look at the structure of the transaction itself. How much leverage are they using? How much leverage does that really then allow free cash flow to be created in the model that then allows for the ability to invest back in the model. One may want to, but if they can't create the cash flow necessary to do it, it creates complexity and even that aspiration or desire. And then I also think you got to look at what their view is from a timing standpoint and if their view is not a long-term one, but a short one -- shorter-term one, does not influence how they think about investing in that model, and ultimately, how they encourage leadership around that model. So that may speak to a bit around a deal structure, which is a knock-on effect to the actual activity on the front end. Then do you have the ability to invest in the model supported and the desire to do it on a go-forward basis, which obviously would have a influence on an adviser's experience and how they might think about the appeal of that particular model.

And then maybe your final point around talent. It's -- I think it's interesting to see the transition of talent out in the marketplace, and I'm not so sure that the buyer themselves is a big driver of the future of that talent or expectations around the talent or who they might even think is the right profile to lead. I think those are really fair questions. We think there is a big transformation going on in terms of the talent that is necessary to drive success going forward. We think the bar is much, much higher and you have to be much more thoughtful about that talent, their capabilities and how you ultimately go attract them and then position them to contribute going forward.

It's more complex than it used to be. And sometimes actually this consolidation or transition of ownership can actually be quite disruptive to ever getting some continuity around building a leadership team that's going to evolve and grow and work as a team and attract the right types of capabilities whether that's inside this industry or outside. So I think that's how I think about the leadership while that probably not so much is who, but is it disruptive to the ultimate building of a team that has great continuity and can lead the type of performance in a more complex world. I hope that answers your question.

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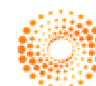

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Devin Patrick Ryan - *JMP Securities LLC, Research Division - MD and Senior Research Analyst*

Yes, again, I appreciate all that perspective. And just a quick follow-up. It looks like you guys had your best mutual fund sales-based commission quarter since 2016, that seems to be going in little bit different direction than what we're seeing at some of the peers, so I'm just curious what's driving that? And whether that's just a blip? Or if there's something else going on or that may be going in a different direction?

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

Yes. I might answer that more broadly rather than just specifically around mutual funds. I do think you saw some quarter-on-quarter and year-on-year lift in overall brokerage sales. You look to mutual funds, you actually look at variable annuities are kind of an interesting place to peel back. I think when you look at that particular product category you had some product innovation going on at the end of the year, where living benefits were enhanced in much of the spectrum of variable annuity offerings, which certainly make them then more appealing to investors. You couple that with a little bit of clarity around Reg BI and the regulatory environment around brokerage products in general.

We are making investments to enhance the overall, think about new account opening process in our systems and how we manage brokerage products, which we also think will help advisers then have more proclivity to use these solutions, right? You take some of the friction out both from the regulatory uncertainty and operational processes, you package that with a bit of product innovation. And I think it's encouraging to see it both inside this quarter, but also may create a platform to see some of that trend going forward, that's our hypothesis. I think it's logical, we've got to see that play out, but that's how we're thinking about sort of the commission sales or brokerage sales more broadly.

Operator

Our next question comes from Michael Cyprys with Morgan Stanley.

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

Just wanted to follow up on some of the color, you mentioned earlier, around the advisory recruitment pipeline, I was just hoping to dig in there a little bit more and just understand how that pipeline stacks up versus like last quarter and a year ago? And if you could talk a little bit about where you find yourself recruiting from these days, which channels you're seeing the most traction on recruitment? And how that sort of channel mix has evolved over the past couple of years?

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

Yes, so there's a lot there. If I don't get it all, please just ask for clarity in the follow-on. So I think, look, as we think about the recruiting pipeline and kind of the strength of it, there's 2 things that we continue to do: is make sure we're competitively positioned with an appealing solution and the investments that we're making in our capability set, we believe, are helping us create a more appealing solution to attract more advisers and increase our pace of recruiting. We've also been working hard to reengineer, retool our own capabilities around recruiting and materially change how we do that thus to improve our own performance. You put those 2 things together, and one would then hypothesize or believe you've got the tools or the makings to continue to increase your recruiting capabilities as you go forward and that's exactly what we're trying to do. And so I talked about the $33 billion of trailing 12 recruited assets over the last year. We look at that and say, okay, what do we do with those 2 things I just mentioned to continue to try to increase or enhance that.

And we challenge ourselves then to build pipelines that will help us do that, and so we, kind of, think about our pipeline when we think about and we say that it looks pretty good. I think it reflects kind of that pace of recruiting that you see us doing now.

With respect to the characterization of the recruiting or the mix, I think we continue to see real strength in recruiting from the independent space. As we invest in capabilities and further differentiate ourselves relative to independence, we think we've got an interesting appealing option and alternative that continues to fuel progress relative to our recruiting on the independent front. There are some changes that we're making whether

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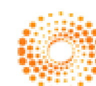

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that be new models or enhanced capabilities that are intended to help us increase our participation in recruiting from employee-based models and we're beginning, as I mentioned earlier, to see the pipeline build in some of our new models. And that's encouraging to see as a complement to our traditional models. So maybe that gives you a little feel for where we are recruiting from and also probably reflects how you should think about the pipeline and its makeup. I think I -- yes, go ahead.

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

Yes, I was just going to ask maybe just as a follow-on question around the adviser recruiting packages. Just any color you could share in terms of how that is evolving? And how that compares with others in the industry? I guess how much more attractive do you see your packages today versus others? How that's evolving? And as you look forward, given expectations for a falling rate environment, late economic cycle, how do you expect these sort of packages to evolve?

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

Yes. I think in principle, we take a return based focus on how we think about these packages, right? We look at it as capital we're investing to drive organic growth and we take a return based construct or principle of which to shape that. That said, let me let Matt give you the color as his group is involved in it on a daily basis in collaboration with our business development team.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, sure. I mean I think, Michael, we take -- as Dan said, we take a return-based approach. I think we are pretty conservative. We don't assume a benefit from the macro. And I think when you take the packages that we offer with those models, I think, they're quite competitive in the marketplace. And then I think when you start to think through the macro impact on that, I would just emphasize that the natural hedges in our model, right, the same hedges show up in the economics at an individual adviser level, right? So our model is well positioned to withstand, it has natural offsets to volatility in the macro. So I think if you combine that with being fairly conservative and disciplined on the underwriting, and you put those 2 things together, I think we make offers that we want to be able to be consistently in the market offering at levels that drive returns for our shareholders.

Operator

Our next question comes from Chris Shutler with William Blair.

Christopher Charles Shutler - *William Blair & Company L.L.C., Research Division - Research Analyst*

A couple on the ICA portfolio. So Matt, how much of the ICA portfolio comes up for renewal in 2020 and could be fixed if you wanted it to be? And then, with the yield curve where it's at, how does that change how much of the ICA you would want to move to a fixed rate structure?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes. I think Chris I am taking the second question, first, right? I think when we think about our goal for moving balances into fixed, it's really about enhancing the stability of our earnings, and really kind of supporting that strong balance sheet objective, right? So I think where the rate curve is, really doesn't change that goal. I think it does reduce and have less focus on any near-term tactical opportunities like to -- if we were to focus on renegotiating an existing contract, right? In a steep yield curve, that may be interesting versus with the one that we're in maybe not.

So I think when you go back to the goal that I think is unchanged, but we're focused on moving to that 50% to 75% range, right? So that's unchanged. I think from an opportunity standpoint, as we've said in the past, right, there's no opportunities in 2019. The next ones are in 2020. And I think if you remember, we walked through at Investor Day, which really hasn't changed, but if we took every contract that matured in 2020 and move

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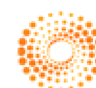

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those into fixed, right, that can get us into that kind of midpoint of that range of 50% to 75%. So probably pretty easy to do the math and balance off of that.

Operator

Our next question comes from Chris Allen with Compass Point.

Christopher John Allen - *Compass Point Research & Trading, LLC, Research Division - Analyst*

I have a couple of quick numbers questions. Just wanted to ask on the advisory revenues, I realize that's mostly based off the prior period-end asset levels, those are up 11% sequentially last quarter. This quarter the advisory fee revenues were about 6%. So I'm just wondering if there is something else underneath the surface there? Or it's not -- and not -- maybe it was less than 100%, so just a little bit of disconnect between the 2?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, Chris, the primary driver is just the timing, right? It's not -- not a 100% of the advisory assets are based on the prior quarter. There's portions that's priced throughout the quarter. Just the majority of them price at the beginning of the quarter, at the beginning of the last quarter. So it's just noise from that. When you look at the growth from market growth, and again, just emphasizing the asset level from a market standpoint really grew in the month of June. So you really don't see much of an impact to that. And that coupled with the NNA, those were the key drivers. So it's just the timing noise, that's all that's there.

Christopher John Allen - *Compass Point Research & Trading, LLC, Research Division - Analyst*

Understood. And then just 2 quick ones. Just other revenues, now with the, kind of, the payout adjustment there, is the $10.7 million a good run rate to think about moving forward? Or anything -- any seasonality to think about within that line? And also the tax rate, what's a good tax rate to assume moving forward?

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, so tax rate we expect in the 27% to 29% range. I think you've seen it hover a bit below that for the past couple of quarters, including this quarter. That was really driven from the tax benefits from stock-based compensation where you usually see if we're going to get a benefit for that, it's usually around the time that thinks best which is usually in the first half of the year, so I think that's why you saw that. I think when the other line items, I think, you're looking at the GAAP P&L on Page 6 of the release. I think that's a relatively stable line. I'd encourage you look at the management P&L on Slide 8, we kind of combined the interest income and other and the interest income line item is probably the one that might move a little bit more and that's just driven by the returns on our corporate cash, combined with any balance sheet lending we do most notably margin in a broker-dealer. So those will be the 2 things that will drive that. Both of those are relatively minor, so when you think about our P&L that we don't anticipate that line being that volatile. But if it did move, it will be based on the drivers I just highlighted.

Operator

And our next question is from Ken Worthington with JPMorgan.

Kenneth Brooks Worthington - *JP Morgan Chase & Co, Research Division - MD*

Maybe first financial planning software. We're seeing a landgrab for those sort of financial planning software assets. So maybe to start, talk about your capabilities here? Are you seeing demand for a greater, more sophisticated or better financial planning software? And then maybe Schwab

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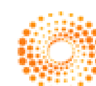

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has launched a subscription model for financial planning, does a differentiated pricing model like subscription makes sense for LPL? Either here in financial play and or maybe elsewhere in the business?

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

Yes, Ken, it's Dan. Maybe your first one with respect to financial planning solutions, we do think it's an important component of the value proposition of advisers. Starting with a planning orientation, gives you a bit context of which to create and add value over the long-term relationship with the clients. We do think it's important, and we want to make sure that we can enable our advisers to simply and easily leverage and use that capability across the spectrum of their clients. And 95% of the clients that we would see, a more simplified needs-based tool that understands someone's risk profiles or goals and objectives and helps them specifically try to solve something. For example, retirement or making a big purchase or something like that, is going to be the right tool and the adequate tool. And I think -- we think it's really important that integration into your workflow, simplicity in the access of that information, sharing data with a solution and providing that free of charge are the keys which to drive that type of utilization and give your adviser base a big leverage point there.

And so I think I'd say, you should think about 95% of the opportunity, certainly, where you have more of what I might call the high net worth plus client. You need more complex planning. We use WealthVision, which is a fully integrated version of e-money and give our advisers access to that, that they have to pay -- they pay a subscription fee to have access to. But it is certainly a tool that, as you know, was well known in the space, and in the industry, and has a good leverage point for those high net worth plus clients. So what we've tried to do is give a full spectrum of different tools and capabilities to our advisers depending on the complexity of their client. And so that they can have a tool that can a, solve the problems that, that client needs and do it really efficiently and cost-effectively. And so that was the first part of your question. Sorry, remind me the second one?

Kenneth Brooks Worthington - *JP Morgan Chase & Co, Research Division - MD*

Just seeing demand for a more sophisticated financial planning software. You kind of touched on that, and then the subscription model?

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

Yes, thanks. And with respect to the subscription model, I think, it's interesting. Not sure exactly how that plays out. In some cases, we have folks that use subscription models today relative to their planning value that they offer as an example. With respect to an overarching relationship, I think it's an interesting concept. We continue to assess it. We look at it and really understand, are you doing it as a way to level out fees across the relationship? Or are you doing it to create some sort of differentiated experience? I'm not sure yet if we've got a full view or a read on that, but I do think it's important that you position yourself with the flexibility to offer, whether that be asset-based, whether that be commissions-based or whether that be subscription based, that you empower your advisers to position themselves to offer whatever makes the most sense for their value proposition in the marketplace.

Kenneth Brooks Worthington - *JP Morgan Chase & Co, Research Division - MD*

And then just recruited assets. The number you are highlighting continues to look pretty good. Can you guys have a success rate there on the recruited assets? Like I assume there's some leakage when assets come over and do you measure yourself against any sort of leakage? And is that leakage -- where might that leakage stand? And is the leakage getting sort of better or worse over time?

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

Is that with respect to -- do you mean in the recruiting process, so you might have X amount of leads and how many do you close? Or do you mean once you've on-boarded them?

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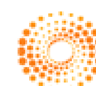

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Kenneth Brooks Worthington - *JP Morgan Chase & Co, Research Division - MD*

Once you've on-boarded them, and there is a book of business that they have that you would expect to come over. From that point, that's where I would assume that there is some leakage, that they will come over. They got a certain amount of assets, but not all the assets sort of make it over. So as we think about your recruited number, I assume that sort of what you would hope to come over, but maybe it doesn't all come over, if I'm thinking about the concept correctly. But I could be wrong and maybe it all comes over. But if it's not, how should we think about leakage?

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

Yes, got it. Thank you for the clarification. You want to start with that, Matt.

Matthew Jon Audette - *LPL Financial Holdings Inc. - CFO*

Yes, sure. So Ken just on the metric, I think, the -- we factor in the amount that we think is going to come over into that metric, right? So each recruit is not going to be exactly that number, some could be better, some could be a little bit worse. But the leakage as you described is already factored into that metric.

Operator

This concludes our Q&A session. I would like to turn the call back to Dan Arnold for his final remarks.

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

Yes. Thank you, operator, and thanks, everyone, for taking the time to join us this afternoon. And we look forward to speaking with you, again, next quarter. Have a great day.

Operator

And thank you, ladies and gentlemen, for participating in today's conference. You may all disconnect. Have a wonderful day.

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