REFINITIV STREETEVENTS

EDITED TRANSCRIPT

LPLA.OQ - Q1 2021 LPL Financial Holdings Inc Earnings Call

EVENT DATE/TIME: APRIL 29, 2021 / 9:00PM GMT

OVERVIEW:

Co. reported 1Q21 gross profit of $579m and 1Q21 EPS (prior to intangibles and acquisition cost) of $1.77.

REFINITIV

CORPORATE PARTICIPANTS

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

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

CONFERENCE CALL PARTICIPANTS

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

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

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

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

Gerald Edward O'Hara *Jefferies LLC, Research Division - Equity Analyst*

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

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

William Raymond Katz *Citigroup Inc., Research Division - MD & Global Head of Diversified Financials Sector*

PRESENTATION

Operator

Good afternoon, and thank you for joining the first quarter 2021 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.

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 opening (sic) [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 known and unknown risks and uncertainties, as that may cause actual results or the timing of events to differ materially from those expressed or implied in such forward-looking statements.

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 the other disclosures contained in the company's recent filings with Securities and Exchange Commission for more information about such risks and uncertainties.

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 the investor.lpl.com.

With that, I will now turn the call over to Mr. Arnold.

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

Thank you, Kirby, and thanks to everyone for joining our call today. Over the past quarter, our advisors continue to be a source of extraordinary support and guidance for their clients. And at the same time, we remain focused on our mission of taking care of our advisors so they can take care of their clients. This combination positions us to deliver another quarter of solid results while also continuing to make progress on our strategic plan.

I'd like to review both of these areas, starting with our first quarter business results. In the quarter, total assets reached a new high of over $950 billion, up more than 40% from a year ago. This increase was primarily driven by continued organic growth and equity market appreciation. With respect to organic growth, first quarter net new assets were $29 billion, which included $12 billion from BMO Harris Financial Advisors. This result translated to double-digit annualized growth of 13%, driven by continued strength across new store sales, same-store sales and retention. First quarter recruited assets were $24 billion, which includes $15 billion from BMO. This result brought our total recruited assets over the past year to a new high of $56 billion.

Our continued progress on recruiting is primarily driven by the appeal of our model, our ongoing innovation for the future and the expanded flexibility of our platform. At the same time, we further enhanced the advisor experience through continued delivery of new capabilities and technology as well as the ongoing modernization of our service and operations functions. As a result, asset retention remained solid at 98% in the first quarter and Net Promoter Scores increased year-over-year.

Our first quarter business results led to solid financial outcomes with $1.77 of EPS prior to intangibles and acquisition cost. Let's now turn to the progress we have made executing our strategic plan. As a reminder, we have evolved our long-term vision. We aspire to expand beyond our old vision of extending our leadership in the independent space and redefine the independent model over time, and by doing so, become the leader across the entire advisor centered marketplace. Now our approach is to build a platform that is simple and straightforward for advisors to use with the flexibility to construct the perfect practice for themselves and their clients. This approach breaks down the walls between traditional market segments and instead focuses on creating total empowerment for LPL advisors to thrive and that is the heart of our mission.

Doing this well gives us a sustainable path to higher levels of organic growth, increased market leadership and long-term shareholder value creation. Now to execute on our strategy, we have organized our work into 4 strategic plays, which I'd like to review with you in turn. Our first strategic play involves meeting advisors where they are in the evolution of their practice. By winning in our traditional markets, while also leveraging new affiliation models to expand our addressable markets. Strategically, we believe this combination positions us to not only deliver sustainable and repeatable organic growth, but to also increase our growth rate over time. In our traditional markets, while overall industry advisor movement remained at lower levels in the first quarter, we continue to gain share and grow our pipeline.

Looking more specifically at the regional bank segment of our financial institution channel, we onboarded BMO Harris Financial Advisors in late March. We continue to prepare for M&T to join in the next few months and we advanced conversations with additional prospects. With respect to the expansion of our addressable markets, we continue to see momentum building in our new affiliation models. Earlier this month, we onboarded 2 new practices to Strategic Wealth Services, bringing us to a total of 7 on the platform. And earlier this week, we added another advisor to our employee-based model. Looking ahead, we feel good about our pipeline for both of these models.

Another key component of this strategic play is using M&A as a complement to organic growth. With respect to our acquisition of Waddell & Reed's wealth management business, we now have commitments from Waddell & Reed advisors who serve approximately 95% of client assets. We are engaging closely with these advisors to help them prepare to transition to LPL and begin leveraging our platform to serve their clients and grow their businesses.

Our second strategic play is focused on providing capabilities that help our existing advisors differentiate in the marketplace and drive efficiency in their practices. One of the key components of this play is enriching the end client experience. Advisory platforms are increasingly at the center of the end-client experience as the secular trend towards advisory continues in our business and across the industry.

Given this, we remain focused on providing our advisors with an industry-leading advisory platform, including a number of recent enhancements. Within the quarter, we introduced simplified pricing and lowered account minimums on our centrally managed platforms. We also expanded our no-transaction-fee ETF product offering, which now serves about 40% of ETF assets in advisory accounts. At the same time, we are introducing new platform capabilities in the spirit of creating a differentiated UMA offering that combines multiple centrally managed portfolios within a single account. These enhancements increase the appeal, accessibility and flexibility of our advisory offering, which in turn supports our advisors' efforts to serve their clients and win in the marketplace.

Let's next move to our third strategic play, which involves creating an industry-leading service experience to delight advisors and their clients and that, in turn, helps drive advisor retention. A key component of this strategic play is transforming our service model into an omnichannel client care model that provides our advisors with differentiated service.

In Q1, we completed the rollout of live chat as a complement to our voice channel. Advisors now have a choice of either voice or chat to efficiently connect with a service professional who is trained and certified to answer their specific question. Our next step is completing the rollout of our digital self-service experience, which, together with voice and chat will position advisors to access industry-leading service at a time and in a manner that works best for them. We also continue to automate and streamline key elements of our service operations.

In Q1, our area of focus included enhancing the administrative support around tax season, digitizing forms and automating account transfers. Enhancements in these areas are helping strengthen the advisor experience and the scalability of our platform as our business grows.

By remaining focused on the transformation of our service model into a client care model and continuous improvement through the automation and streamlining of our service operations, we believe we are making positive contributions to the service experience, advisor retention and Net Promoter Scores.

Our fourth strategic play is focused on helping advisors run the most successful businesses in the independent marketplace. One of the key components of this play is our portfolio of business solutions, which help advisors operate their businesses so they can focus on serving their clients and growing their practices. As we discussed last quarter, we see several pathways for continued business solutions growth, including partnering with more of our advisors, introducing new solutions to the portfolio and experimenting with serving advisors outside LPL.

In the first quarter, our subscription base continued to scale to about 1,700 monthly subscriptions, that generated annualized revenue of approximately $19 million. This growth was primarily driven by our ongoing expansion and evolution of the value proposition of our existing portfolio.

Looking at our product road map, we continue to enhance our existing portfolio of solutions, while expanding into new offerings. In Q1, we launched M&A solutions, which is generating solid demand, including over 50 advisors who are leveraging this offering today. In Q2, we plan to introduce our seventh business solution, Client Engage. Now this is -- this evolved from our existing marketing offering and is focused on providing advisors with a digital approach to effectively and efficiently stay connected with their clients.

As we look outside LPL, we plan to begin marketing M&A solutions later this year. By experimenting with this scalable technology-driven solution, we can efficiently learn from serving outside advisors, while continuing to focus our resources and investments on delivering business solutions to LPL advisors.

Now before closing, I also want to highlight that we released our 2021 sustainability report last week. We believe operating a sustainable business is good for all of our stakeholders. We hope this report provides helpful insight into our practices and performance.

In summary, in the first quarter, we continued to invest in the value proposition for advisors and their clients, while driving growth and increasing our market leadership. As we look ahead, we remain focused on executing our strategy to help our advisors further differentiate and win in the marketplace, and as a result, drive long-term shareholder value.

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

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

All right. Thank you, Dan, and I'm glad to speak with everyone on today's call. As we move into 2021, we remain focused on serving our advisors, growing our business and delivering shareholder value. This focus led to the highest quarter of organic growth in our history. And in addition, we are in the midst of onboarding what will become 3 of our largest partners in BMO, M&T and Waddell & Reed. We expect these 3 partners to collectively add approximately $100 billion of AUM to our platform, bringing our total AUM to over $1 trillion.

Now let's turn to our first quarter business results. Total advisory and brokerage assets increased to a new high of $958 billion, up 6% from Q4, driven by continued organic growth and higher equity markets. Looking at organic growth, total net new assets were $29 billion, which translates to a 12.8% annualized growth rate. Prior to large bank onboarding, organic growth was 7.6%.

Moving on to recruiting and retention. We continue to produce strong results in the first quarter. Recruited assets in Q1 were the strongest in our history at $24 billion, which included $15 billion from large bank onboarding. These results brought our 12-month recruiting total to a new high of $56 billion.

Looking at retention, it remained strong at 98.1%. I would also note that we updated our retention metric to reflect asset retention rather than our previous method of production retention. We believe this change will be more helpful in evaluating our business results, and we have provided historical data in our Key Metrics presentation, so you can see both the old and new metric.

Moving on to our business mix. We continue to see positive trends in Q1. Advisory net new assets were $23 billion or a 20% annualized growth rate. With this growth, our advisory assets are now 52% of total assets as we continue to deliver differentiated advisory capabilities and benefit from the secular trend towards advisory.

Now let's turn to our Q1 financial results. Strong organic growth combined with expense discipline led to EPS prior to intangibles and acquisition costs of $1.77. Looking at our top line growth. Gross profit reached a new high of $579 million, up $46 million or 9% sequentially. Looking at the components, commission and advisory fees net of payout were $184 million, up $31 million from Q4, primarily driven by organic growth and seasonally lower production expense.

Moving on to asset-based revenues. Sponsor revenues were $168 million in Q1, up $14 million sequentially as average assets increased driven by organic growth and higher equity markets.

Turning to client cash revenues. They were $97 million, down $8 million from Q4, driven by lower client cash yields. Looking at client cash balances, they remained elevated at $48 million, roughly flat with last quarter. As for client cash yields, our Q1 ICA yield was 99 basis points, down 9 basis points from Q4. The decrease during the quarter was primarily driven by fixed rate and LIBOR-based contracts that matured and lower short-term interest rates.

Looking ahead to Q2, we will have the full quarter impact of the $0.5 billion of fixed rate contracts that matured in Q1 as well as another $1 billion of fixed rate contracts maturing in Q2. Given these factors and where interest rates, client rates and cash balances are today, we would expect our Q2 ICA yield to be in the mid-90 basis point range. I would also note, we have no additional fixed rate contracts maturing in the second half of this year.

Moving on to Q1 transaction and fee revenues. They were $141 million, up $11 million sequentially, driven by trading volume that increased throughout the quarter. Looking ahead to Q2, trading activity in April has declined from the elevated levels we saw in Q1. And if this trend continues through the quarter, we would expect transaction revenue to decline by about $10 million.

Turning to Business Solutions. They continue to scale with 1,700 subscriptions at the end of Q1. This is up 300 from last quarter and more than double a year ago. These offerings now generate roughly $19 million of annual revenue, up from $17 million last quarter. And more importantly, they help free up additional time for advisors to spend on more valuable activities, including serving their clients and growing their practices.

Now let's turn to expenses, starting with core G&A. It was $236 million in Q1. Looking ahead, we continue to anticipate full year 2021 core G&A to be in a range of $975 million to $1 billion. As a reminder, this includes cost to support BMO and M&T, but is prior to expenses associated with Waddell & Reed.

Moving on to Q1 promotional expenses. They were $54 million, up $6 million sequentially, primarily driven by increased transition assistance from higher recruiting and large bank onboarding expenses.

Turning to Q2, we anticipate promotional expense will increase by approximately $5 million prior to Waddell & Reed, primarily driven by increased transition assistance and large bank onboarding expenses.

Looking at share-based compensation expense, it was $11 million in Q1, up from $8 million in Q4. Looking ahead to Q2, we expect share-based compensation expense to be at a similar level to Q1.

Turning to depreciation and amortization. It was $35 million in Q1, up $7 million sequentially as several improvements to our advisory platform and end-client experience were rolled out sooner than anticipated. Looking ahead, we expect depreciation in Q2 to be in line with Q1 levels.

Now let's move to Waddell & Reed. The transaction is progressing better than we originally estimated across multiple fronts. As mentioned, Waddell & Reed advisor is serving approximately 95% of client assets have committed to join our platform. Factoring in this higher level of retention and current asset levels, we expect the run rate EBITDA benefit from Waddell & Reed to be at least $80 million, up from our original $50 million estimate. As a result of the higher retention, we now expect $110 million of acquisition costs, up from our original estimate of $85 million. These updates bring our estimated purchase multiple to 5x EBITDA, an improvement from our original estimate of 6.5x EBITDA.

Now I want to provide an update on our expected close timing. Over the past several months, we have had strong collaboration with Waddell & Reed and Macquarie, and we have received the required regulatory approvals. As a result, we are pleased to share that we anticipate closing the acquisition of Waddell & Reed's wealth management business as early as tomorrow. And we continue to expect to onboard the advisors a few months after closing.

Looking ahead, we are focused on providing transparency on the progress we are making on the transaction. With this in mind, we will share Waddell & Reed financial results in 2 primary categories. First, to provide more clarity around our results, we have added an acquisition cost line item to our management P&L. Looking at Q2, we expect roughly 1/3 of our total acquisition costs to be incurred during the quarter. Second, we will keep you updated each quarter on how we expect EBITDA to build as we progress towards hitting the full run rate benefit by the middle of 2022. In Q2, we expect annualized negative run rate EBITDA of approximately $10 million as we add resources to prepare to support Waddell & Reed.

Moving on to capital management, starting with our debt refinancing. Given the continued strength of our business, combined with the low interest rate environment, we were able to refinance our highest cost debt from 5.75% to 4%, reducing our annual interest expense by $13 million. We were also able to increase the size of our revolver from $750 million to $1 billion.

As for capital deployment, our framework remains focused on allocating capital aligned with the returns we generate, investing in organic growth first and foremost, pursuing M&A where appropriate and returning excess capital to shareholders. In the near term, we continue to expect the majority of our capital deployment to be focused on organic growth and M&A as we onboard BMO, M&T and Waddell & Reed.

Once we have completed these transitions, we plan to reassess our capital deployment opportunities. And if at that time, we have excess capital to deploy beyond organic growth and M&A, we would anticipate restarting share repurchases. That said, we will have to see what our options look like at that time.

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

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from the line of Bill Katz from Citigroup.

William Raymond Katz - *Citigroup Inc., Research Division - MD & Global Head of Diversified Financials Sector*

So maybe, Dan, to start off with you. It seems like I'm seeing from the headlines in your comments that the -- there's been acceleration in both Strategic Wealth Services and building so on sort of the independent play side. What's changing at the margin here? Is it just time or maybe a sense of maybe peel back a layer sort of what's been the incremental change in the marketplace that's resonating better?

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

Yes, Bill, thanks for the question. And as a reminder, we just launched these last year, SWS in April and then the employee model in the second half of last year. And as you know, it takes a bit of positioning in the marketplace, seasoning, iterating on your value proposition as you learn and you get feedback, bringing on clients and then having a good experience and being able to use them as a reference to future prospects and considerations. We've also continued to invest and enhance in the talent on our business development team.

So a combination of those things are driving a bigger pipeline, better positioning out in the marketplace from a competitive standpoint, building on existing clients who are having a good experience and then finally using that quality talent to ultimately help go execute. So that's a similar concept for both. SWS, or Strategic Wealth Services, is a bit ahead of the independent employee model only because it started several months earlier, but you can see them on a similar trajectory. I hope that helps.

William Raymond Katz - *Citigroup Inc., Research Division - MD & Global Head of Diversified Financials Sector*

Yes. And then maybe one just for Matt. I guess one of the themes that's been coming out is sort of this excess liquidity in the system overall. I think you mentioned in the last quarter as well. Can you sort of maybe update us your thinking on how to sort of track through fixed to float or float to fix, I should say, and so the ability to sort of drive the third-party sweep opportunity?

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

Yes. Sure, Bill. I think that -- maybe just starting with our strategy and goals here, which are really unchanged, specifically on the fixed rate deposit side, which is really to get to a place where 50% to 75% of the portfolio is fixed. So I think from a long-term perspective, that's where we're headed. But I think to the point of your question and similar to last quarter is when you look at the amount of liquidity in the system right now, there's really just very little demand for deposits. That said, I think you're starting to see some early indicators of that changing and maybe really early indicators, but things like the yield curve starting to steepen, right? The 10-year moving up, where there's a -- for those banks that are on the demand side of these deposits, there's some economics in the spread for them to invest it. Consumer spending picking up, right? There's trillions of dollars in savings and checking accounts that's built up over the pandemic. And as that spending picks up, that going back into the market is one of the things that could lead to that demand.

So if those trends continue, I think those are some of the things that could start to change and improve that demand. But I'd emphasize we're not seeing that pick up today. But I'd just end with, I think, our long-term strategy of moving into that 50% to 75% fixed zone. When there is demand, we feel really good about being able to execute it then.

Operator

Next question comes from the line of Steven Chubak of Wolfe Research.

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

So I wanted to start off with a question on M&A and the appetite for more transformational deals. In August '17, you announced the NPH transaction. You retained about 70% of the assets as part of the deal. Since then, you've made a lot of enhancements, whether it's investments in digital or just to the platform more broadly and fast forward to Waddell and now you've retained 95%. So just given that much stronger retention and the favorable experience with Waddell, given all the metrics you have in cited. I'm just curious whether that increases your appetite to do more transformational deals as a much higher retention significantly impact some of the future deal math?

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

Yes. So Steven, it's Dan. So look, I think we continue to see M&A from a strategy standpoint as a complement to our organic growth and as you know, we look across the lens of growth opportunities or acceleration of capabilities. And so that hasn't changed in our overall strategy. We do believe that if we're good at executing on these transactions, then that becomes an interesting differentiator and an opportunity for us in terms of how we might structure a deal, value a deal, et cetera. And so we are staying disciplined on making sure with every acquisition that we learned from those and we apply those insights and learnings such that we can execute better the next time.

If you look at the drivers of the difference in these 2 transactions, I think most of it were activities that we control or drive, where we maybe didn't do them as well back in 2017, '18 and we did them much better today. Things like being able to automate and streamline the transition of asset and advisors moving from one place to the next. You take the friction out and help them continue to focus on their clients, that's a pretty appealing scenario. Our ability to take a strategy and go deliver it in a simple articulate manner to help advisors understand what that experience would be like, what their structure, what their economics will be like on the other side of that transaction and do it at pace and clear, you begin to create the right dialogues very quickly that lead to good outcomes. And so those are things that as examples that we continue to learn and evolve and get better in terms of our ability to execute.

So as we go forward, to your point, do we think there's continued consolidation, both in what I might call the smaller transactions across the entire spectrum, the larger transactions? Yes. Would we continue to have an opening and exploring and potentially participating in some of that consolidation? I think based on our strategy, the absolute answer would be yes. And to the extent that we get better and better at executing on these, we will use that insight perspective and advantage to think about how we consider approaching them.

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

Thanks for that color, Dan. And just for my follow-up, I wanted to ask on the centrally managed platform. I mean the assets grew organically at a very impressive 47% rate. It looks like the bulk of the increase in the quarter was tied to the BMO onboarding. I was hoping you could speak to what drove such strong demand for the centrally managed product just from those advisors. And should we expect a higher ROA on those assets given the more attractive economics of centrally managed?

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

Yes. Steven, it's great observation in that you did see solid growth in centrally managed platforms. And you're continuing to see that underlying strong baseline growth and utilization of that platform increase, right? So that didn't change in the first quarter across our entire platform. And as we invest and add capabilities, investment content, lower price, we think those centrally managed solutions only become that much more appealing.

And then you complement that or add that to, in this case, BMO's utilization of centrally managed solutions and that creates a really interesting opportunity not only for us to think about how we expand and grow our centrally managed platform, but even unique capabilities, we may put inside of it that are helpful and supportive of large institutions.

And then all the way finally to large institutions or users of models-based approach and our robust centrally managed solution with MWP enables them to leverage both the growing momentum their advisors have in this space, the great talent they have to serve and support their clients, matched with a platform that is really well aligned with their needs and the way they serve their clients. And that is a pretty interesting formula that certainly drives higher ROA with the more advisory they do and then the utilization of those centrally managed platforms.

Today, BMO's business is about 1/3 advisory, 2/3 brokerage. So as we go forward, we think our platform is a nice tool and a leverage point to help them as they evolve their business in order to serve their clients in the best way possible.

Operator

Next question comes from the line of Alex Blostein of Goldman Sachs.

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

I was hoping to zone in on the retention stats you guys provided, not just for Waddell, but obviously for the book as a whole. It looks like you guys are running at about 98% overall retention on the assets. It's quite a bit above from where we've been historically. And I think, Dan, you talked about the pandemic being sort of one of the reasons why retention might be strong, albeit maybe temporarily. It feels like it's sticking around. So I just wanted to get your updated thoughts on whether or not we sort of entering a bit of a new paradigm with the retention of the assets being as high as it's been recently.

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

Yes, absolutely. As you say, if you look back historically, 3 years, you saw more of a retention rate in the 96% range. We saw -- if you look over the last 12 months, a retention range in the 97.5% level. So as you've said, we've seen some good stability in that 97% to 98% range for the better part of the last 3 quarters, which would indicate there's good staying power beyond the pandemic as you return to what I might call normal movement of advisors in the marketplace. And so we're encouraged by that.

We continue to invest in the model to improve that service experience, expand the capabilities and deliver those to our advisors such that it helps support them operate an efficient practice and effective practice, serve their clients and grow their business, and you would expect retention rates to be pretty sticky. For us, we're trying to manage in that 97% to 98% range and think that's a pretty good solid outcome and a good sustainable place to operate in if we're doing our job of investing in our model, ensuring it's delivering the right value for our clients.

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

Got you. And Matt, a follow-up for you around expenses, I was just hoping to unpack that a little bit. So it sounds like the guidance obviously does not include any expenses related to Waddell & Reed, whether it's kind of their expenses coming on or I guess, expenses that you anticipate to kind of facilitate the transition, if I'm hearing that correctly? So kind of like the $10 million annualized EBITDA drag, for instance, that you're highlighting in the second quarter. That expense is not in your full year expense guide. I just want to, I guess, confirm that. And also, maybe you can help us think through expenses, core G&A inclusive of Waddell. And I guess, secondarily, as you guys pointed out in the slide, first quarter core G&A run rate is below the full year guide. So you anticipate a bit of a ramp. So maybe just kind of walk us through the sources of that ramp.

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

Alex, I think that was a 3-part question. I'll answer. I think -- so you're correct. I think that the guidance of $975 million to $1 billion core G&A, that's excluding Waddell. And the reason for that is just as we ramp up both on the EBITDA side as well as the acquisition costs, I think our perspective was the way to give you the most clarity on that is to really keep them separate. Knowing that Waddell between both the revenues and gross profit and expenses, we're going to be ramping over roughly a year period to that $80 million run rate. So I think that's the way to think about it. I think obviously, when we get to the other side, everything will be put together from a dialogue and a guidance standpoint. I think -- we think that will be the most clear path and way to understand the core or existing business, if you will, as well as how and when, Waddell comes on board. So I think that covers questions 1 and 2.

Question 3, on how the existing business is ramping. And it's really pretty similar to what you've seen in prior years, which is you kind of steadily ramp throughout the year, meaning that Q1 run rate, I think probably the premise of your question or the genesis of your question is where our run rate right now is kind of below the low end of that range. And it's just that natural ramping during the year. And I think you saw that last year as well. So that would be our expectation this year.

Operator

Next question comes from the line of Craig Siegenthaler of Crédit Suisse.

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

I had a follow-up on Steve's earlier question on the centrally managed platform. We know this business is highly gross profit ROA and ROCA accretive, but can you walk us through the math relative to your advisory assets that are not on the centrally managed platform?

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

Yes, Craig, I think the dynamics haven't really changed. I think centrally managed usually adds about 10 basis points. I think we've got good disclosures in our investor deck on that. So I think the dynamics there are really pretty similar to what we have there. I think what I would add and note specific to BMO, just to build on Dan's comments earlier because that was a big driver in centrally managed for the quarter. When you look at those large financial institutions, right, those are contracts that are negotiated overall. And specific to large financial institutions, they typically start with a high percentage of brokerage, which brokerage assets overall are in that 15 to 20 basis point range. And just given the positive mixes at BMO that Dan highlighted, 1/3 of the assets in advisory and then a lot of that going into centrally managed. I think it's pretty reasonable to assume that BMO will be at the higher end of that range.

The only thing I would add is similar to M&A, those contracts, usually, there's some ramping, right? The first couple of years usually have some incentives, not dissimilar from what we're just talking about on the ramp for Waddell & Reed. So as that ramp occurs, just as an overall point on BMO really coming out of the high concentration in advisory and centrally managed, you've got a really accretive from a margin standpoint versus our current margin on that business. So hopefully that helps.

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

And just circling back on cash sweep. How should we think about the near term opportunity to reinvest the $6 billion of overflow balances?

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

Yes. I think when you look at the kind of the floating side of the sweep dynamic, it's really pretty similar to what's going on in the fixed contract side and that there's just not a lot of new demand. So if you think about those contracts in a normalized environment, you typically see them at a spread of 20 to 30 basis points versus Fed funds. And in this environment, you're really seeing them kind of Fed funds flat to Fed funds minus 5%. So I think that's kind of how I think of the marginal investment rates there. And this maybe give you just a little bit of color on those as those things mature, right? When you think about floating rate contracts, the nature of those are usually a 1- to 2-year contracts that typically roll into new periods pretty often.

So just to give you context for us for the rest of the year, if you look past the Q2 guidance I gave on ICA overall, so kind of looking in the second half of the year. And if the contracts that mature in that period, if they -- if we invest -- reinvest all of them, Craig, to your question in current rates, that would bring the overall ICA yield down by just a couple of basis points by the end of the year. So it's a relatively small reinvestment risk there. And then add to that with no additional fixed maturities in the second half of the year, it kind of gives you, I think, a good perspective on overall ICA rates. There's not a lot of downside risk, at least in the current environment in the second half of the year. You're talking mid-90s to low 90s is just the way to think about it.

Operator

Next question comes from the line of Michael Cyprys of Morgan Stanley.

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

I just wanted to circle back on the Business Solutions, I think you had quoted about $19 million of revenue annualized. I was just hoping you could maybe help us appreciate the profit margin on that, the gross profit contribution to that. And then just also maybe you can elaborate a little bit on some of the initiatives you have in place on expanding that out and growing the penetration within the existing advisor base?

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

You want to take the economics on the first half, and I'll get the second.

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

Yes, you got it. Mike, I think that when you look at Business Solutions, I think that there's 2 ways to think through it. First is on the economics. And I would think of it as a capability and a product that's generating fee revenue like we discussed. And then in addition to that, I think probably one of the more interesting parts of Business Solutions is really what that positions advisors that are utilizing them to do, right? It's about us helping them really run their small business in a really efficient and effective way that frees them up to be focused on the wealth management side, right, to deliver same-store sales and grow their practices or position them to do acquisitions with our new M&A solution. So I would really view that the financial benefits of Business Solutions really in a holistic way for the entire firm given the different types of dynamics that, that can drive.

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

Yes. And maybe to build on your product road map question, as we look at our different options and alternatives to expand the portfolio and thus reach either more LPL advisors and/or sell existing advisors additional services, this, again, is based on the premise that they are engaging in many of these services at a local level. So our concept is we can offer them at a higher quality and perhaps at a cheaper cost, a pretty appealing combination.

And so if you think about our road map today, you've got the original 3 offerings, which were admin solution, a CFO solution and a marketing solution. So what we're doing with each one of those is we're exploring, can we create new variations of those offerings, of which might have a narrower value proposition, a lower price point and solve a specific problem or challenge that an advisor has to address on a weekly, monthly reoccurring basis. And so we are working inside our product portfolio across that entire spectrum of offerings to come up with new iterations on that. And you'll see a couple under the CFO solution, one that we're about to begin to go to pilot in Q2 that I mentioned earlier, and that was a derivative of our marketing solutions. And so that's kind of innovation area #1 of the road map.

The second one is we continue to experiment with new capabilities or new solutions. A great example of that would be experimenting with paraplanning, if you will. A whole new offering with respect to the professional services portfolio, but one that we're testing right now out in the marketplace, learning, iterating and potentially will become a whole new solution, if you will, to that portfolio. So that would be an example of a new solution. M&A solution would fit into that category of new offerings. And so those are the 2 primary places that we tend to explore, how do we expand the product road map and thus create more and more value that our advisors can leverage to replace that spend that we estimate is close to $1.5 billion a year that they spend on local level services. So that's what's driving that road map. I hope that helps.

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

Got it. And maybe just a quick follow-up here just on the expense side. It looked like the share-based comp and D&A were both up meaningfully on a sequential and year-on-year basis. I know you gave some guidance into the second quarter. But just curious, I guess, any color on what's driving that and how you would expect this to sort of trend over the next couple of years? Should these lines grow in line with AUM growth or something else or some multiplier to that?

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

Yes. On share-based comp, and you see the dynamic Q1 is typically the highest quarter, Q2 kind of close and then it drops down in the second half of the year. And it's really about the timing of those grants that kind of drives that dynamic. So that's on share-based comp.

On depreciation, I think a little bit of context there. The depreciation and amortization is largely driven by our technology spend. And obviously, that's the area where we're focused on developing capabilities that are key drivers of organic growth. And I think the key P&L dynamic to note that you probably know, but I'll highlight anyways, is that the expense really changes when you deploy the technology, not when you're spending the money. And when you look at Q1, we just had some larger projects that we deployed and rolled out. Dan covered a few of them in his prepared remarks. So that really started the depreciation and expense associated with that.

So if you look at the few quarters leading up to this quarter, you saw relatively low or small increases in depreciation, and we would expect a similar dynamic in the next few quarters. So it's really just that kind of concentrated deployment. The overall tech spend trends have been pretty consistent and unchanged from our overall expectations. So I hope that helps.

Operator

Next question comes from the line of Chris Harris of Wells Fargo.

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

So you guys are -- I mean LPL is just growing so incredibly fast right now. Can you maybe talk a bit about how you guys are feeling about the platform from a capacity perspective? In other words, you have the capacity in place, the services in place to be able to support all the incremental growth you're seeing and expected to see.

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

Yes, it's a great question. And I think it goes back to the start of our mission, right? We got to take care of our advisors, so they can take care of their clients, which means we've got to make sure that we're there for them day in, day out from a service experience standpoint, that our platform has the stability necessary to leverage it and utilize it and then ultimately we're providing them the capabilities to create efficient workflows and capabilities to help them differentiate with their clients and continue to win. And we've got to make sure that we give them the tools necessary to pivot their businesses into a multichannel service business, where it's no longer just in person. They got to do it in a combined digital and in-person way.

So there's a tremendous opportunity for this platform to show up and support and help them and add value every single day, and that comes first and foremost for them. So our -- we've got to be diligent around making sure that we understand and plan for that growth, well, that we've got the technology and engineering capabilities of which to build the tools that are necessary and scale the platform.

We've got to make sure that we've got the fine-tuning, the testing, the utilization of AI to help us with respect to the risk management of our overall platform and stability, privacy, et cetera, associated with it. So that operating muscle to be really strong to execute on our plan comes first and foremost for us. I'd love to tell you we're perfect at it. We also have to have the humility to constantly listen to feedback. And if we're not getting something right to quickly focus on addressing it and iterating and then ultimately getting better because of it. And so I think that's a principle and the foundation of how we operate and execute.

Then we got to make sure that we're investing in the right people, attracting the right talent that we've got the right size talent that is well aligned and positioned to collaborate and execute together to deliver on our expectations. So that comes number two, what are our operating metrics, how do we observe, measure, how we operate not on a weekly or a monthly basis, but on a daily basis. So it's that we can take that data, learn from it, fine-tune, revise, iterate, et cetera, to make sure that we can be the best that we can be every day.

And then finally, we got to be investing in technology and automation that helps us scale. So you can scale into bursts of growth or you can constantly with consistent sustainable growth that you are constantly improving and enhancing your performance because you're able to digitize and automate it from end to end throughout the ecosystem, not to mention the benefits that you get from a scalability from an economic standpoint by doing that. So we continue to work on that. Introducing robotics, deploying AI and machine learning throughout our ecosystem in order to do that. And so we've got a lot of passion for doing it. We're not perfect. We hold ourselves uber accountable to our NPS scores. We've got room to improve, and it's priority one for the firm. I hope that helps.

Operator

Next question comes from the line of Gerry O'Hara from Jefferies.

Gerald Edward O'Hara - *Jefferies LLC, Research Division - Equity Analyst*

Maybe circling back to Business Solutions. Just curious if you have tracked or have kept any data points around the overlap amongst advisors as it relates to the various different solutions. It almost strikes me as though if you could kind of get the adoption of one such as admin solution or CFO solution that could work as a gateway to additional, but not sure if you sort of track that or seen that metric develop?

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

I think that's great strategic utility. And I think that is a good hypothesis and a premise that we are seeing trend once someone is engaged in a service, if they're having good success and it's a good leverage point, there's a higher propensity to use another one. I think as we iterate on the portfolio and expand the different offerings and you create, as an example, not just a holistic CFO offering, but you can take elements of what a CFO's role might be, bookkeeping as an example, or FP&A work, and you're able to create discrete products out of things like that. I think your premise of sort of a land-and-expand strategy makes even more sense. And so there's more to play out on that as we evolve our product road map. But we are trying to also be digital first and use data of which to learn and understand how our clients are engaging with us, both so that we can improve our offering, better -- deliver a better service experience to them across this portfolio. It's a good question.

Gerald Edward O'Hara - *Jefferies LLC, Research Division - Equity Analyst*

Okay. Fair enough. And then perhaps you can remind us what the mix on the $100 billion of assets that's going to be onboarded across the 2 banks and Waddell as it relates to fee-based advisory versus more traditional commission-based business. I think you just sort of highlighted earlier, the BMO mix. But if you could just kind of remind us what that aggregate split is that would be helpful.

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

Yes. Gerry, I think, well, we can be directional here. I think to the point on BMO, they're a little bit higher on the advisory side than your typical large financial institution, right, meaning M&T would be more focused on the brokerage side. And then Waddell, I think as we're near closing and then onboarding, I think we'll give you more specifics on that in the near future.

Operator

Next question comes from the line of Brennan Hawken from UBS.

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

Great. This one, you might -- it might be -- have been answered by the last question on Waddell and the fact that more details are coming. But I wanted to follow up on Alex's question earlier to see whether or not we could get some -- maybe some more granularity on the profile of what it will look like? Are FAs going to ramp over time over that year? Or is there -- how should we assume that will come on board, both the revenues and the expenses when we think about modeling it? Or was your last comment basically to say that you're not really in a position to say and we got to hold our horses for these questions?

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

Yes, I think I liked it a little bit between those 2 points. So I think if you look at -- we did some updated disclosures in our key metric materials if you have those handy, I'll speak to them on Pages 7 and 8. But I think you've got the mix of Waddell at the time we announced the deal, which is a little bit over 50% brokerage, so 45% advisory, 55% brokerage. At least you can see what it looked like back then.

I think on the ramp, I'd highlight a few things. And this is where we added some detail on Slide 8, just to think about our path from closing, which could be as early as tomorrow to hitting that run rate EBITDA of $80 million. And there's really, I think, 3 broad steps that are happening that would drive it. And that's why I was giving a little bit of color on earlier. It's first and foremost is really adding the resources and technology and expenses, maybe to build a little bit on the question Dan was just answering just to make sure that we are in a position to receive Waddell the company at closing and to onboard the advisors a few months after that.

So the expenses start first. I think then onboarding, we think it will happen a few months after closing, so call it a few months from now. And that's really where the gross profit synergies start, right? Once the advisors and their assets are on our platform, and then following that, it's really your classic M&A integration work to get the expense synergies. And we think that will take about a full year from close. So you kind of put all that together. And that's, I think, a pretty good road map from here till hitting that run rate EBITDA and using that time line that I just walked through kind of by the end of Q2 of next year of 2022.

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

Yes. In that maybe one helpful comment. Relative to your gross profit point because this is an acquisition, the ramp of the advisors is different than a normal recruiting scenario. So the assets and the advisors will all come over in mass. So let's say, we close tomorrow, let's just say, 3 months later, the assets come over a weekend and the advisors come over a weekend. And so they will be all on our platform. So your ability to begin ramping from that point is solid and a little different from recruiting where you ramp in over time. So hopefully, that gives you a little more color.

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

It does. It almost sort of suggests it's more like a step function than a ramp to some degree. Also kind of curious about thinking about the impact of the reopening of the economy and the idea that people are going to start getting more comfortable with face-to-face meetings with vaccines rolling out as successfully as they have been. How should we think about -- there's a couple of different perspectives I'm curious about. Number one, from a recruiting perspective, is that going to put a bit more expense back into the recruiting effort versus before? Or are -- have you learned that you can be so much more efficient recruiting in a Zoom world that you'll keep a lot of the recruiting efforts to Zoom, that's one angle.

And then from another angle, thinking about the advisors and the net new assets over the past year, how much of those -- has the amount that normally comes from an advisor's existing book of business been impacted by the fact that they can't do prospecting, dinners or seminars or what have you. And do you expect that, that might start to kick back in now that people will be coming back to restaurants and whatnot? And maybe what kind of an impact do you think that could have? Sorry for the multi-parter.

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

No, there's a lot there. So let me give you a directional answer of that, just I think to give you some guideposts and in some places, not to try to be overly precise on something we don't exactly know, right? So with respect to recruiting, your first part of your question, I think the short answer is it does not go back to what it was before, but it doesn't necessarily stay what it is today. And I do believe that we've continued to recruit throughout. We've had some people doing some travel throughout. We've been incurring some expense relative to our business development activities, right, the sort of the core G&A expenses associated with that.

But we have used technology and learn to use technology in a much, much more creative way, and we've broken through and set new paradigms, if you will, on how to do that in acceptable ways to do that and gotten better at it over the years. So I actually think you'll see a mix where we'll use technology where it's more efficient, it's less wear and tear. And quite frankly, it's more appealing for the advisors or the prospect as well as for our business development resources as an example.

And then where we do need to travel and where we do make a difference in face-to-face, we will absolutely do that. So if we do this well, we should find both improved efficiency and efficacy in our business development efforts. So that's how I would answer that one. Again, not trying to be really precise about exactly where the dial goes back to. But I think it's some middle ground. I hope that was helpful to you on the recruiting.

On -- with respect to our advisors, a couple of things. Their baselines changed significantly in the first 90 days when the country shut down. But the pace of reopening, as you know, has been very, very different at a local level across the country. And many of our advisors are doing a lot more face-to-face than what we might -- would expect living in bigger cities. And so consequently, I think you've already seen a pivot for a lot of advisors, probably more back to that baseline way they did business. But I think the cool part about our advisors being in businesses for themselves, they've got to be quite innovative and have that entrepreneurial spirit, right, of a small business owner. And most have added this digital capability to their repertoire.

So now they've got 2 ways of which to serve clients, which again, opens up the aperture of their opportunity to increase the size of their book, find more efficient ways to engage with clients, and then ultimately provide a mix of those that would rather meet in person versus those that are good doing it over the video. And you now redefine geography for them by doing that as well. And so we actually think this becomes a really interesting opportunity for our advisors as a catalyst to enhance the service experience, expand the flexibility around it and ultimately use that as a catalyst for growth. Do I think they're going to get back to doing dinners full time like they used to? No, but I do think that dial will go back to what is -- how that advisor uniquely wants to run their practice. So you'll see probably a spectrum of different outcomes depending on the advisor themselves and their clients. I'll stop there.

Operator

And there are no further questions at this time. I will turn it back to Mr. Arnold.

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

Yes. Thanks, everyone, for taking the time to join us this afternoon, and we look forward to speaking with you again next quarter. Stay safe.

Operator

Thank you so much to our presenters and to everyone who participated. This concludes today's conference call. You may now disconnect. Have a great day.