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LPLA - Q3 2019 LPL Financial Holdings Inc Earnings Call

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PRESENTATION

Operator

Good afternoon, and thank you for joining the Third 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 in 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'll now turn the call over to Mr. Arnold.

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

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

As we discussed each quarter, 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 start with a review of the drivers of our business.

We continue to focus on delivering organic growth and are encouraged by the progress in the third quarter. Strength in new store sales and adviser retention as well as solid same-store sales drove organic net new assets of $7 billion, which translates to a 4% annualized growth rate. We also closed on our acquisition of Allen & Company, which added another $3 billion of assets that will transfer onto our platform later this year. The assets from organic growth and Allen & Company, combined with the higher equity markets, drove total brokerage and advisory assets to $719 billion, up 6% from a year ago.

Turning to our financial results. We had another quarter of solid top line growth as gross profit increased 10% year-over-year. We also continued to invest in the business while staying disciplined on expenses to drive operating leverage. As a result, third quarter EPS prior to intangibles was $1.71, which was up 30% from a year ago.

Looking more broadly at the marketplace, we continue to operate in a large and growing market with favorable secular trends towards independence and advisory solutions. In terms of the economic backdrop, while we see marketing sentiment driving volatility, many of the core drivers of the economy, such as unemployment and wages remain solid and supportive of economic growth and investor engagement. So while we remain flexible in the event of changes in the macro environment, the strength of our balance sheet and of our business model positions us well to continue investing to drive organic growth.

With that in mind, we thought it would be helpful to use our strategic framework to provide some color on where we are investing and the benefits we look to derive as a result.

Our first strategic play involves winning in our traditional independent and institutional markets while also expanding our affiliation models. With respect to our traditional markets, our business development team continues to innovate by reinvigorating recruiting partnerships with branches and third-party recruiters, enhancing referral programs for our advisers, and finally, leveraging data and analytics to increase pipeline transparency as well as to improve execution in sales and transitions.

As a result, we are generating more leads, winning at higher rates and onboarding assets more quickly. We see this reflected in our recruited AUM as our trailing 12-month total exceeded $30 billion for the third straight quarter. Looking ahead to Q4, we continue to be encouraged by our pipeline and expanding capabilities and efficacy of our business development team.

In addition to our business development efforts, adding differentiated capabilities is also one of the best ways to attract new advisers and to help existing advisers grow their business. In that spirit, as consumer expectations evolve to include omni-channel, customized and personalized interactions, we aim to deliver an enhanced digital investor experience that will help our advisers win in the marketplace.

As a part of that effort, this quarter, we are rolling out a new mobile app for our advisers' clients. This digital experience allows investors to customize and personalize the display of their account information to match their preferences. It is also integrated with our client goals functionality so investors can measure progress relative to their goals in real time. Next year, we will roll out version 2.0 that provides a more comprehensive view of a client's wealth through the aggregation of outside assets and offers enhanced client self-service capabilities.

In the short run, this overall effort will enhance investor experience with deeper connections and more frequent interactions. Longer term, we see the potential to create a competitively differentiated experience that is modeled after digital innovators from outside our industry and positions our advisers to increase client loyalty, attract new clients and increase share of wallet.

Let's now turn to our second strategic play where we are working to create an industry-leading service experience by continuing to invest in Clientworks and transforming our service model into a client care model.

With respect to Clientworks, we are focused on increasing the personalization and flexibility of the system to enhance our adviser service experience and help them gain efficiency in their practices. As part of these efforts, last quarter, we introduced a new library of applications. Much like consumers use the iPhone App Store, advisers can now choose applications from the library, add them to their Clientworks pages and arrange them in ways that align with how they run their practice.

For example, one of the new applications offers advisers a real-time view of key practice data and analytics that provide at-a-glance insights for managing and growing their practice. More broadly, advisers tell us that the additional ability to customize and personalize Clientworks is enhancing their service experience and efficiency.

As we develop our new client care model, one of the opportunities we see is expanding our digital capabilities. As part of these efforts, over the past 6 months, we experimented with artificial intelligence and machine learning in our new accounts organization by launching our first set of robots into our environment. We are seeing early benefits in the form of streamlining the process and expediting the time it takes to activate an account once it's been opened.

While our current process can take 24 hours to activate an account, the bots are enabling straight-through processing to activate accounts in minutes. These initial experiments are triggering further exploration across the enterprise in an effort to more broadly apply the power of artificial intelligence and machine learning to enhance the client experience and the scalability of our model.

Our third strategic play leads us to reimagine the support offered to advisers in the independent model. In this play, we are focused on helping advisers more efficiently and effectively operate and grow their businesses by providing outsourced business services, digitized workflows, adviser-focused capital solutions and lead-generation. Let me highlight our progress on one of these areas, outsourced business services.

Now through a series of experiments, we determined that areas of expertise, such as admin, marketing, CFO and technology services are valuable leverage points for our advisers in running their business. We then piloted these services over the past year to ensure that we could deliver them with high quality at an affordable price and make them easy to use. After completing the pilots in August, we rebranded this portfolio of services as LPL Business Solutions and officially rolled them out to our advisers at our national sales conference.

To illustrate the power and potential of these solutions, I want to share a story of one of our advisers, Jim Miller, and his practice is based in Charlottesville, Virginia with $100 million of assets, and he aspires to grow his business without compromising his clients' experience. That led Jim to initially seek help through our CFO solution. Through this partnership, his CFO helped him develop a new pricing strategy, build a segmented client service model and identify better ways to manage his expenses. Now Jim describes his CFO as one of the best resources he's ever had and thinks of her as a member of his management team. As a result of this experience with his CFO, Jim is now using our admin and marketing solutions as well.

Looking more broadly across our business solutions portfolio, we currently have over 600 subscribers, and we're excited to help many more advisers like Jim better operate their practices, increase their efficiency and drive their growth.

In summary, we are 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.

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

Thank you, Dan, and I'm glad to speak with everyone on today's call.

As we review our Q3 results, we thought it would be helpful to first walk through our framework for delivering long-term shareholder value, which is comprised of 4 objectives: growing assets organically and with complementary M&A, increasing our gross profit return on assets by expanding our services, investing to drive organic growth while staying disciplined on expenses and returning excess capital to shareholders.

Taking a step back and looking at our Q3 results through this lens, we made progress in all four areas. We delivered the highest quarter of organic growth in our history and closed on our acquisition of Allen & Company, all while investing to drive growth and returning excess capital to shareholders. We are pleased with this progress as we work to generate long-term shareholder value.

Now let's review our Q3 results in greater depth, starting with EPS prior to intangibles, which was $1.71, up 30% from a year ago. Turning to total brokerage and advisory assets, we finished the quarter at $719 billion, up 2% sequentially. This increase was primarily driven by organic growth as net new assets were $7 billion or a 4% annualized growth rate. We also added another $2.9 billion in net new assets from our acquisition of Allen & Company. We continue to expect to transfer these assets on to our platform by the end of the year and add roughly $5 million of run rate EBITDA by early 2020.

As for recruiting, we had another solid quarter, with $8.7 billion of recruited AUM in Q3 and $33 billion over the past year.

Looking at our business mix, we continue to see positive trends this quarter. Advisory assets increased to 47% of total assets, primarily driven by advisory inflows of $8.2 billion or a 10% annualized growth rate. Within our advisory platforms, centrally managed net new assets were $1.9 billion or a 17% annualized growth rate. This included greater use of our adviser sleeve capability, which we rolled out in Q2 and now has over $1 billion in assets.

Now let's move to our Q3 financial results, starting with gross profit. It was $543 million, up $7 million or 1% sequentially. The increase was primarily driven by higher advisory, sponsor and transaction and fee revenues, partially offset by the seasonal increase in production-based payout. Year-over-year, gross profit increased by $49 million or 10%, primarily from organic growth and higher client cash revenues.

These results contributed to our gross profit return on assets of 31.4 basis points over the last 4 quarters, which was up 0.3 basis points sequentially.

Looking at the components of gross profit, commission and advisory fees net of payout were $132 million in Q3, up $3 million from Q2. The increase was primarily driven by higher advisory fees, partially offset by seasonally higher production bonus expense.

Moving on to asset-based revenues. Sponsor revenues were $130 million in Q3, up $3 million or 2% sequentially, driven by the growth in average asset levels and greater usage of our no-transaction-fee mutual fund platforms.

Turning to client cash revenues. They were $163 million, up slightly from Q2 as higher client cash balances more than offset the decline in short-term interest rates.

Moving to client cash yields, our Q3 ICA yield was 241 basis points, down 8 basis points sequentially. The decline was primarily driven by lower average short-term rates following the Fed rate cuts in July and September.

Looking ahead to Q4, we will have the full quarter impact of the 2 Fed rate cuts in Q3. Additionally, it is widely expected that the Fed will lower rates by another 25 basis points next week. If this occurs, we would expect our Q4 ICA yield to be in the low 220 basis point range. This assumes our client deposit betas continue to be within our expectations of 25% to 50% and no further changes in interest rates or the mix of our fixed versus floating rate balances.

Let's now move on to Q3 transaction fee revenues. They were $121 million, up $3 million sequentially. The increase was primarily driven by our national sales conference in August, partially offset by seasonally lower transaction volumes and IRA fees. Looking ahead to Q4, we do not have any large advisor conferences, so we expect a $5 million decline in conference revenue.

Moving to interest income and other revenues, they were $14 million in Q3, down $2 million sequentially. These revenues are primarily driven by the interest we earn on our corporate cash balances as well as client margin balances. Looking forward to Q4, we anticipate they will decline by roughly $2 million, primarily driven by lower interest rates.

Now let's turn to expenses, starting with core G&A. It was $215 million in Q3, up $5 million sequentially, as we continued our planned investments in technology and service to drive long-term growth. As we look ahead to Q4, we feel good about the balance of our investing plans and the related efficiencies we are delivering. As a result, we are lowering the top end of our 2019 core G&A range by $5 million, bringing our outlook to a range of $860 million to $870 million.

As we look forward to 2020, I wanted to share some context on how we are thinking about investing for growth. Over the last few years, we have increased our investments and we are seeing positive results, including increasing levels of organic growth. Given this, we plan to continue growing our investments in 2020 at a similar pace to our growth rate in 2019. As we think about the mix of that growth, we will likely maintain our technology spend in the $150 million range, while slightly increasing our core G&A growth rate.

We will, of course, remain dynamic for changes in the macro environment. But based on what we see today, we are excited about our opportunities to invest. We look forward to sharing a more specific outlook with you after we finalize our plans later this year.

Moving on to Q3 promotional expenses. They were $62 million, up $20 million sequentially, driven by our national sales conference as well as higher transition assistance and marketing expense. Looking ahead to Q4, we anticipate promotional expense to decrease to the low $50 million range as we have no major conferences in Q4.

Moving on to capital management. Our balance sheet remained strong in Q3. Cash available for corporate use was $227 million, and our credit agreement net leverage ratio was 2.0x.

Turning to capital deployment. Our priorities remain investing for organic growth first and foremost, taking advantage of M&A opportunities, when appropriate and returning capital to shareholders. Looking at 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 Q3. This included $130 million of share repurchases, roughly in line with our plan to complete our $1 billion authorization over 2 years. We also returned capital through $20 million of regular quarterly dividends in Q3.

In closing, we are pleased to have delivered another quarter of strong business and financial results. We remain focused on growing assets, increasing our gross profit return on assets, 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.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Bill Katz with Citi.

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

Okay. And maybe to start off, Dan, where you sort of kicked off, on net new asset growth. And it's very nice to see that hitting sort of that mid-single digit level, particularly given some of the mix macro backdrop underneath that. So I appreciate you sort of laying that sort of 2 or 3 initiatives.

As you look out over the next 12 to 24 months, which of these probably will have the most impact in driving that net new growth? And then underneath that, is that still going to be more on the advisory side?

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

Yes. So thanks, Bill. Good question. Yes. So with respect to look, organic growth, as I think we both reinforced in our remarks, it's a big priority for us, and we're encouraged by the progress we've made over the last couple of years, but we absolutely have a focus and an aspiration to grow the results from here.

And I think when we think about that approach, we kind of look at it over 3 fronts. You've got new store sales, same-store sales and retention. And with respect to new store sales, we've got good momentum there. I think, as we mentioned, if you look back over the past 12 months, we've recruited roughly $33 billion of assets. If we went back to this time last year and looked at trailing 12 months from that period, you would have only seen about $26 billion of recruited assets. So that just reinforces, I think, the trajectory and the momentum we have.

I think going forward, to build on those results, I would think about primarily 2 to 3 things: one, we're focused on continuing to invest and enhance the efficacy of our own business development capabilities, that way we win at higher rates; two, we continue to invest in capabilities that help our advisers differentiate, and that helps us attract more advisers; and then finally, as we expand and add these new affiliation models, that helps us broaden our market opportunity. So those are the kind of the drivers of what I would call new store sales.

I think second, then, if you move to retention, that's been an interesting positive trend over the last 2 years, where we've actually improved our retention about 1.5%. It's steadily improved throughout 2019. And in fact, this past quarter, it's the best it's been over that period of time. And so again, encouraged about what progress we're making there. And that strategic play, where we're focused on delivering an industry-leading client experience, we think, is the key to continuing to improve retention and think we can continue to kind of enhance where we are today through investing in Clientworks and developing this new service model that I referenced.

And then finally, same-store sales. I think that's been kind of steady in a narrow range over the last couple of years. And we're really challenging ourselves to kind of rethink and innovate there. And that's what our third strategic play is all about, which is really challenging us to deliver some new capabilities, think about helping advisers digitize their practice, these business solutions that we've talked about. Capital allocation programs for advisers and even beginning to innovate around lead generation, all are meant to support same-store sales more systemically.

So those are the sort of the orders that we have in the water that are trying to ultimately drive that number up from where it is today. I hope that answered your question.

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

That's helpful. And then maybe one for Matt, just a follow-up, a little bit of a long-winded question, so I apologize. So as I look at the supplement and I look at the decomposition of the gross profit ROA, and I strip out the impact of client cash, that ratio has been about flat now for a number of quarters. So on the one hand, I hear the good growth, the pick-up in some of the gross profit ROA dynamics underneath that, but then I also hear a lot of spending going on.

So maybe a 2-part question. What gets the gross profit ROA to move up, all else being equal? And then how much flex do you have against that incremental spend as you look out to next year, if the revenue backdrop turns out to be a little bit weaker than maybe what your budget calls for?

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

Sure, Bill. So I think on the gross profit. I mean, I'd just emphasize when you look at the ROA overall, it is growing, right? 31.4 basis points, up from 31.1%. And you're right, that growth has been on the cash side. But I'd just keep in mind that, that cash growth is not -- doesn't come just from increases in short-term interest rates. When you look at a couple of things I would highlight. When we think about the shift from brokerage to advisory, and we have higher returns on the advisory side, a lot of that is from the cash balances, where you tend to have higher cash on the advisory side.

I'd also highlight the fixed rate balances, right? So we're getting to a lot more in a much stabler place from returns and that shows up in that cash line. So it's not subject to the short-term rate movement. So I would just keep that in mind.

When you do look at that subtotal, below cash, as you highlighted. I'd highlight a couple of things. We'd just look at quarter-over-quarter, it was down 0.1 basis points. And that was really from the transaction and fees line, which is not an AUM-based line, right? Transactions are based from activity, and the fees are really based on adviser count.

So from our standpoint and you take a step back, I mean, I think we feel good about the results that the strategy is driving, right? And Dan just covered a lot of it well in answering your first question from things like the growth in advisory, the growth we saw in the past few years and especially this quarter and centrally managed. And then the early results we're seeing on the business solutions side. I think just continued focus and success on those over time are, I think, what really serves our advisers well. It helps them grow, and we serve them well, and they grow, we grow. So I think that's how we think about that. And that's really what underpins the investment plans that I walked through in the prepared remarks for 2020.

And I think when we think about, if the macro is in a more challenging place, to the second part of your question, we've got a flexible cost structure, right? We can adjust in different market environments. But that being said, I think when you look at the investments we've been making, they really are driving organic growth. So I think we would think long and hard before pulling that back.

And then when you think about how our business model would operate in a challenging macro, which is -- which could likely be driven by interest rates as well as -- or the equity markets. And I know we've covered them several times. We've got a lot of natural hedges in our business model from things like when interest rates go down, you typically see the equity markets go up. And a good proxy for us is the S&P 500, where a 100-point improvement there equals or even more than offsets the impact from an interest rate decrease.

Then you add to that the strength of the balance sheet, where we are from a cash position, where we are from a leverage position at the low end of our range. We just feel like we're in a really good position to drive those investments and make those investments to drive growth.

And then maybe finally, I'd just highlight in an environment like that, those can be some of the best environments to really invest and drive growth in the long term. From things like recruiting and M&A opportunities, where advisers and smaller broker-dealers are going to seek a more stable place to be, the pricing of those in that environment, both recruiting and M&A could be more compelling for the buyer. And then finally, just the competitive advantage of being able to invest. And again, focus on our advisers, deliver capabilities and service that helps them compete in an environment where others would struggle to do so.

I think you can get the overall picture here. I think we feel passionate about the investments we're making. At the same time, we've got the ability to slow it down if we think it makes sense.

Operator

Our next question comes from Steven Chubak with Wolfe Research.

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

So I wanted to start off with a question on cash balances. Certainly encouraging to see the uptick in cash this quarter. I was hoping you could speak to your outlook for cash growth and confidence that the 4% cash flow you've cited in the past should continue to hold and whether we should expect to see any change in client behavior as the Fed continues to cut interest rates as a potential hedge.

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

Yes, Steven. I mean, I think - so this is Matt. I mean, I think the -- there's not a lot of rate sensitivity there. So I think that customer behavior is not something we see changing. I think it's more about just the natural amount of cash that you need and operational cash to manage the account.

And you see that move in that -- the low end of that range, as you referenced in your question, around 4%. And even as we're growing, we're still at that low end of the range at 4.3%.

So I think the rate environment doesn't cause us to have a different view on kind of cash balances. And they can ebb and flow, but I think we're probably sitting towards the low end of a historical range. So we don't feel a ton of pressure to the downside. We're not seeing anything new that would give us concern there.

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

Got it. And just for my follow-up, I just wanted to ask a question on the regulatory outlook. Given the uncertainty ahead of the upcoming election, how is the senior leadership preparing for potential changes in regulation, such as the DOL? And how do you foresee that impacting your business, whether positively or negatively?

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

Yes. So let me take that one. So maybe with respect specifically to the fiduciary rule, and I'll use that as a proxy for how we think about it more broadly. I think what you're asking is, "Hey, with the change in leadership in the government, you might have a different regulatory environment that you have to deal with. And in this case, perhaps the fiduciary rule or standard reemerges as something to think about or consider or utilize across all of our business."

And so though we think Reg BI is a better outcome for investors, if that scenario should emerge, we tend to think about that across 2 lens. One, we think about it more tactically, which is about how you prepare for something like that and the necessary investment to do that. And then I think we think about it strategically.

So again, using the fiduciary standard as an example, I think from a tactical standpoint, you would look at that and given the preparation that we went through for the prior version of the fiduciary rule. And then with Reg BI, I think we've done the vast majority of what's needed, so any remaining costs would be mostly contained in our run rate spend or in our sort of our planned approach to our capital allocation.

From a strategic standpoint, I think we believe that absolutely maintaining choice for advisers' clients is in their best interest. So you would see us continue to offer both advisory and brokerage solutions. And I think that leads, though, to some interesting potential trends with that strategic posture in that approach. I think, one, you would see more of our direct brokerage assets move on to our platform, you would see a higher use of advisory solutions, and ultimately, I think it serves potentially for industry consolidation that would likely be positive both from a recruiting and an M&A standpoint.

So when we step back and sort of look at that, I think it has some interesting possibilities of which would say, how do you think about your capital allocation relative to the regulatory space? And we always do that as a discipline in our capital investments. Two, it would probably reinforce the fact that you continue to make investments in your advisory platforms, which we are doing. And then finally, I think it further reinforces what Matt was saying earlier is that there could be an opportunity to accelerate market share growth in a scenario like that and having a strong and flexible balance sheet and business model to step into that would certainly make sense to explore.

So I think that's how we think about that potentially changing in the future. I hope that answers your question.

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

It does. Thanks for the helpful color.

Operator

Our next question comes from Gerry O'Hara with Jefferies.

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

I know it's still early, but with the Allen & Co deal now closed, perhaps, Dan, you could give a little context as to how you're thinking about further expansion, like employee channel or early feedback or any kind of additional data points, just to give us a sense of where that could trend.

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

Yes, yes, yes, happy to do that. And I think with respect to Allen & Company, we closed that in the third quarter, as we referenced, and we will be transitioning those assets onto our platform in the fourth quarter. So that's the focus now is making that successful transition over and positioning them to successfully operate on our core platform.

At the same time, we've continued to develop sort of -- and round out the capability set we need to enter into this employees-structured model. We've also had hired a leader for that business model to make sure that we continue to innovate around it, that we're packaging and pricing it in the right way and that we finalize our go-to-market strategy, such that I think in 2020 is when we begin to go to the marketplace with the new solution, both leveraging the Allen & Company acquisition and their footprint as well as bringing the model more broadly to the marketplace. And we think that has some really interesting possibility.

Our early research and surveying of the marketplace, certainly, I think, reinforces the concept and the hypothesis around the value. And in 2020, we'll work on taking that to the marketplace and executing on that. So we're excited about the opportunity set.

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

That's helpful. And then maybe one for Matt. Just with respect to the ICA fixed rate balances or I suppose the ratio of fixed to floating. I know the sort of target range of 50% to 75% has been illustrated for next year.

But kind of curious if you're - are you kind of set on getting into that midpoint of the range? Or are you sort of playing it kind of by ear with the market backdrop? And then if you could maybe give us any sort of sense of how those maturities might be kind of paced throughout the course of the year, that would be helpful.

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

Yes, sure. I mean, I think when you look at our fixed-rate balances now at about 40%, it's about $9 billion of balances. I think when we look at our target, right, I think we feel good and comfortable with our target range of 50% to 75%. And when forming that target, I think we thought about it in a range of different interest rate environments. So I think we certainly contemplated a lower interest rate environment and does that range make sense in that environment as well. And we think it does because you come back to kind of the core point, which is really just to reduce the volatility and increase the stability of our earnings, so putting us in a place to even further focus on our advisers and helping them serve their clients.

So that's the concept. So it's unchanged in this environment. I think when you look at next year, and just using in terms of dollars, we've got about roughly $5 billion of balances that will have the opportunity to move into fixed if we think that makes sense next year, which kind of puts you in that low 60% or mid-60% range. And I think I would think about the opportunity to do that is roughly evenly throughout the year. I mean, there'll be a little bit of ups and downs each quarter, but I think a good way to think about it is evenly over the year.

And we'll make judgments based on where we are at that time, what it makes sense to do. But I would say we're still focused on 50% to 75%, even in this environment is the right range to get to.

Operator

Our next question comes from Craig Siegenthaler with Crédit Suisse.

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

So just given that your recruited AUA balance has been so strong now for six quarters, can you just remind us how you've adjusted your transition assistance over the last couple of years? And also, how does the competitive environment evolve from other wealth managers as you compete for new financial advisers?

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

Yes. Matt, do you want to take the first part?

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

Yes, sure. Craig, the TA, I mean, we haven't made any changes really recently. I think the changes we made, maybe if you go back a year or 2 ago, really just about aligning the transition assistance to returns. And I think we've been doing that fairly consistently. We haven't really seen really rates change in really any meaningful way in the market. It's really just aligning to the assets that are coming on to our platform.

And I think one of the things that perhaps Dan will hit next is I think what we've seen in the recruiting success, is many things on both our business development team and the capabilities and the service experience on our platform.

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

Yes. No, well said, Matt. I don't know that I have anything to add to that other than you ask about the competitive landscape and I don't think we've seen a material systemic shift in the transition assistance rates across the board. You see certain companies doing certain things or trying to experiment and/or making pivots because of some other business circumstance. But I think systemically, we've seen it pretty stable over that period of time.

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

Got it. And just as my follow-up here, I have another one on gross profit ROA. I think we all know the accretive migrations, and you guys have covered them well. But can you just flesh out any uncertainty relating to pricing pressure, just given what we're seeing from some other competitors in wealth management -- in the wealth management segment that are in different channels here?

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

Yes. So let me start with, at least how we think about some of the pricing changes, and then I think that we certainly can pull it back or tie it back to how you think about the gross profit ROA.

So look, the pricing changes that are occurring in the marketplace, we look at those as, I think, just more about the world we live in and the industries. Most industries go through some type of trends and changes and evolution in terms of pricing. And in this case, I think we've seen this trend occurring in fits and starts over the past 25 years. You saw some in the late part of the last century, you saw it reemerge prior to 2008, and we've seen it, I think, in the last 4 to 5 years, where some of that had started out in passive investing. And then you've seen others make some changes most recently.

I think if you take the changes that occurred across your self-directed players I think, first and foremost, those have a much bigger impact across that self-directed marketplace and where perhaps the end client is much, much more price-sensitive there. And that has a really small impact on our business. There's more of it because we don't operate in that self-directed market. As you know, it has more of a residual impact on us serving RIAs that we custody their assets for.

So when we see something like that occur, and I'll use this as an example as to how we think about these pricing changes more going on across the entire industry, we look at pricing as a strategic lever and absolutely think about how to consider that across our 3 strategic plays and how to best position it to serve and support our advisers to help them differentiate and win.

And so if you look in the last couple of years, we've made pricing adjustments as a part of our strategy in order to help drive growth in areas like our advisory platforms and transaction costs, and that's been roughly on an order of magnitude or an average, about $15 million investment a year.

So I think as we go forward and we think about our strategy as we move into 2020, I would just give you a little color that we will likely approach it in a very similar way, i.e., we're likely to focus in those areas of the advisory platform and transaction charges. And secondarily, it would be at a similar magnitude or impact.

And so that's kind of how we think about pricing as absolutely a strategic lever. We always consider it as a part of executing our strategy and just gives you a little bit of a trend on how we've done it over the past 3 years and kind of how we're thinking about it as we move into 2020. I hope that was helpful.

Do you want to tie anything back to ROA or how it implies your gross profit ROA?

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

No, I think you summarized it well. The zone that we would be thinking about is the number that you said. So nothing to add. Hopefully, that was helpful, Craig.

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

Thanks, guys. Very comprehensive.

Operator

Our next question comes from Alex Blostein with Goldman Sachs.

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

So maybe just following up on the last question with respect to the e-brokers' decision to cut pricing to 0, the commissions for equities and ETFs. Any way we can think about the impact of ticket charges for you guys, if you could help us size that? And is that one of the sort of investments you're contemplating as you're looking at it next year?

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

Yes. So I think from a contract standpoint, again, it's -- the impact on us is more of around where we custody assets for RIAs. And so it's a smaller level of impact. And we absolutely have taken those data points and put them into our overall strategic considerations around how we would use pricing to best support our advisers. And as a part of that prioritization stack, I think you'll likely see us thinking about that and doing something to address that, that fits well inside that framework that I mentioned earlier.

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

Got it. And then a follow-up question for Matt. I understand it's still early, as you guys think about 2020 on expenses. But can you just talk a little bit about what kind of macro environment does that guide contemplate?

And when you talk about still obviously being nimble and aware of the environment and if things get a little bit tougher, you'll have the ability to pull back. What sort of growth algorithm are you solving for? Is that an EBITDA margin within a certain range or improving EBITDA margin? Kind of how can we put some sort of a framework around your thinking on how much you could pull back if the environment gets tougher?

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

Yes. I mean, I think the -- I just emphasized, right, we're giving you a little early indication as to where our thinking is, right? So we'll give you our finalized plans at a future date, likely on the next call.

I think the environment we're thinking through. We always look at a range of environments. I think every time we lay out our investing plans, we stage them so we have the ability to pause if the environment deteriorates. And we also -- I just emphasized when we look at the investments we're making, we look at them from a returns-based perspective. So when you're -- when you've got in front of you investments that can drive value for our advisers and help them serve their clients and drive organic growth and choose between that and just maintaining an op margin at a certain amount, right, when you're looking at those 2 things and you look at the returns, they're usually pretty clear what makes sense to do versus what doesn't.

So I think it's -- I'd put it in the bucket of a high-class problem where we've got investments that are really driving value and we just think long and hard about pulling those back.

That being said, the macro can be in a range of scenarios. And I would just emphasize, we've got the ability to adjust our spending plans. And at the same time, we're always focused on delivering efficiencies.

So we're in a -- you've got scenarios, like if you go back to 2016, as an example, where we kept expenses relatively flat, we were still investing. We were still growing the technology portfolio. So I'd just emphasize that as well.

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

Great. That's helpful context. Thanks.

Operator

Our next question comes from Devin Ryan with JMP Securities.

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

Great. Most of my questions have been asked. I just have one around just consolidation in the space. And it seems to be harder markets and interest rates may be bailed out some of the inferior or subscale broker models that you compete against.

And I'm curious, with rates turning here, whether you're seeing any early indications of more interest to sell the business or even would expect to see sellers picking up just as obviously their businesses face more pressure than maybe they had anticipated and so a combination would make more sense in that type of backdrop.

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

Yes. So with respect to M&A, we view it as a complement to our organic growth, and we're in the marketplace, exploring potential opportunities given that concept. Certainly Allen & Company is an example of some of the opportunity where you see, in that case, a very well-run smaller company who saw opportunity of which to leverage some of our scale and capabilities, of which to enrich just how they serve and support their clients.

Our hypothesis would be similar to yours, that as the environment gets tougher, you tease out probably some challenges of smaller organizations who have a harder time with respect to driving earnings and cash flow and being able to reinvest in the business, and hence, our reason for being in the marketplace and exploring those possibilities.

So we think the Allen & Company concept is a great example of how we think about that, and we continue to be in the market exploring potential possibilities. We'll also look at M&A. With respect to -- if we can accelerate our capabilities, development and evolution, then we also are looking for opportunities of which to enrich our value proposition. And again, the advisory world was a great example of that. So those are the 2 places I think we're most interested in the marketplace.

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

Okay, great. And then just going back to some of the comments on pricing evolution, I guess, we didn't touch on it on this call yet. But UBS just made an announcement on their SMA pricing. And I guess, it's not completely clear, all the nuance of it. But I'm curious whether you're seeing any potential, I guess, change or pressure in that part of the business as well.

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

Yes. And as you said, I don't know that we have exact clarity on what's been done. We have a hypothesis that they eliminated their SMA manager fee, where they were the manager versus a third party.

And to give you a little bit more color on that. Typically, within SMA, you've got an advisory fee that reflects the value that the adviser is providing, and then sometimes you can have a separate fee for the asset manager in those type vehicles. And I think it looks to us, they've just eliminated the manager fee, where they're the manager and haven't necessarily adjusted the adviser fee. Perhaps that gives the adviser some more flexibility then as to how they price that to the end client. That's what looks like occurred to us.

As I shared with you earlier, we've been investing over the last several years, from a pricing standpoint, focused around our advisory platforms and transactions. And I think it was roughly 2, maybe 3 years ago, we eliminated the management fee and/or strategist fee, where we were helping construct the portfolio. If LPL was helping do that, we went to 0 on that.

Some of our third parties have followed on that as well, which, again, we did it because we felt it was a great advantage for our advisers to be able to use that lower cost structure as a way to create more value for their clients and differentiate themselves.

So if that's what they've done, I think perhaps it makes logical since just where the marketplace is. And I don't think it would have a lot of impact on us because I think we've already made that move. That said, I may have wrong what they've done. I hope that helps.

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

Yes, very helpful. I appreciate that.

Operator

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*

Another question on pricing changes, pricing pressures. The 1% management fee rate roughly that you guys earn on fee-based accounts, certainly, not out of bounds with what other broker-dealers charge. But if you look at that rate and you think about that rate relative to other areas of financial services and just given the broader pressure -- pricing pressure in financial services more broadly, how much longer do you think that rate can hold, I guess, is the question? I mean, it's been remarkably stable, I think, over the last, call it, 3, 4 years. It doesn't seem to be impacted by some of the pricing changes you've implemented. So if you can give us some -- your thoughts on that, that would be appreciated.

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

Yes, sure. Let me take a bigger stab at that. If I don't get it all, please follow-up.

So look, I think with respect to that price as it exists today, one place you do as you look across your competitive set. And where the majority of our advisers operate in the mass affluent and affluent segments of the marketplace. It seems to be a very competitive offering, and as you said, has had good stability over the years. I think for the most part, if advisers have had to deal with any pricing sensitivity, it's been more as a one-off, and they've used an adjustment to passive investments as a way to try to solve for that. So I do think from a competitive standpoint and where things exist today, it's a competitive offering.

That said, as we go forward, I think it's always a fair way to think about price. And I think in the advice space, value drives price. And what I mean by that is your -- the sensitivity and the appeal around the value that you can deliver someone. If you can help me set up a plan to help me achieve my life goals and dreams, if you can help me solve problems along life's journey, if you can make sure that you execute my plan so I don't make a misstep because I didn't do what needed to be done and you're there to make sure I execute well, those are really valuable opportunities for our advisers to deliver and maintain really important value.

And some of that you might be able to automate. Some of that, it's harder to automate. But we all ought to be saying, how do we make it more efficient and effective to deliver that? And then at the same time, I think you got to be constantly looking for can I expand my value proposition? Can I focus somewhere and solve unique problems that others can? And we actually believe advisers that do that -- we're trying to help as many advisers that have a desire and an appetite to do that. We think that they will protect most of their pricing power.

And again, at the end of the day, the advice space, we believe, is driven by value. We believe that all segments of the marketplace up to this point have demonstrated they prefer to have a human that they can trust that is a professional to help and support them to do that. And then if we wrap technology around them to help enrich their value proposition, personalization, easier access, solving more complex problems and making them more efficient, we think ultimately, it's a really compelling and interesting opportunity set that can preserve most of their pricing power. And where they can't, we can drive efficiencies into their overall operations. I hope that helps.

Operator

Our next question comes from Michael Cyprys with Morgan Stanley.

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

Okay. Just wanted to follow-up on some of the strength in the recruited assets. I know you guys had touched on that a little bit earlier, but just hoping for a little bit more color in terms of which specific channels or parts of the industry you guys are seeing more success than others.

Is it from the IBD space or more from the wires? And any particular color you're able to share on the pipeline in terms of where that stands today versus, say, a year ago?

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

Yes, good question. So look, I think the headline is the -- we see the recruiting environment for us, healthy, and we feel good about our pipeline. I think if I add some color to that for you, we certainly see the continued trend towards independents remaining consistent and strong.

The adviser movement or we call adviser churn has been stable but slightly below average. But we've kind of stepped into that and challenged ourselves to just improve our win rates, right, and improve how we do things. And if we're better at that then that only makes it an opportunity as those churn rates maybe return to the norm.

And then I think we see opportunities to continue to win in the independent space where advisers who are looking for more capabilities are attracted to our model and our solution. We see the opportunity to continue to win from leaving the employee-based model coming to the independent model. And it's the reason we're rolling out our 2 new affiliation models to better position us there, right? Those that are kind of advisory-centric and those that are -- kind of have that feel of an employee-based model.

So to summarize, we feel good about both the performance of our business development team and their continued evolution as a high-performing team. We like how we're positioned well in the independent space, and we like with our new affiliation models, we'll be able to, we believe, compete for a full spectrum of advisers leaving the employee model.

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

Okay. Just maybe a quick follow-up question. Hearing you guys describe and talk about the growth outlook, certainly interesting, just given some of the structural trends benefiting the overall industry.

I guess, what key risks do you see into that outlook? Is it more about rates going lower or political regulatory risk? Is it pricing? How are you thinking about that relative to the broader structural trend and growth opportunity?

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

Yes, I think that we think about that in a couple of places. Certainly, the regulatory environment is always a question, as we covered earlier, that you've got to pay attention to. And I think not knowing exactly what that looks like, it's -- it makes preparation a little tougher. It doesn't mean that you just don't set up several different sort of options and how you consider and try to best prepare for that. But we do believe it will require continued investment to improve the efficiency and efficacy of which we manage risk.

We actually then flip that on its size and say, how do we turn that into an opportunity. If it's hard, it doesn't mean it's a problem. If you can flip it on its side and you can use robotics or artificial intelligence to do that more effective than others at a lower price, then you can use that advantage and push that down through your model as an example. But that's certainly one of them.

I think another one is just the pace of change and having the agility and the nimbleness to execute well in a place where I believe you're only going to see change go faster and faster. And the magnitude of that change is going to be bigger and bigger. So you have to be adept at filtering out that which is not important, focus on what is and make sure your organization has the ability to make the pivots and focus on continuous improvement and always be pulling more and more technology automation and digital capabilities into its environment.

We think that's really important for scalability. And I think that is what our cultural transformation is all about is trying to position our enterprise to do well in an environment like that.

But I think that's in a challenging environment. So we think that's an important thing to think about. And if you don't do that well, I think that emerges as a risk to your point earlier. So I'll pause there, but those are a couple.

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 of quick ones. So first on the commentary around the outsourced business services. Dan, can you just give us a little more detail on how you're pricing those services, how much revenue you're generating per adviser?

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

Yes, so those are subscription-based services. And just as -- again, as a reminder for everyone, these are what we were calling the old virtual services that we've branded as Business Solutions. And this is where we found that if we can provide that expertise at an affordable enough way, then we can give access to that expertise to our advisers where they heretofore may not have been able to tap into that. Just think about having a CFO as a leverage point to help you think about your business as an example.

And so our concept would be, first and foremost, we want to do that to set them up to improve and enhance their growth rates. And to the extent that we're successful at systemically doing that, that probably is the biggest return, Chris, on that effort.

That said, what we have done is looked at these as stand-alone business solutions and looked at the economics of them to say, "Hey, can we generate a contribution for that incremental value?" And so one of the things that we've done is our principle has been, let's go in and experiment where the affordability levels are for those advisers, where is there a great leverage point for them to get access to this solution and this service, and then challenged ourselves to operate underneath that in a way that creates a profitable contribution.

So the pricing around those, on average, you should think about is -- think about that as like $1,500 a month to $2,000 a month for any of those services or an individual service. So if I can get access to a CFO for $20,000 to $24,000 a year, and I can get that expertise, and I'm only paying for the portion of the CFO that I need, I don't need a whole one, that's the concept. It may cost me $100-plus to afford a CFO for my business, and if I can get access to it for $20,000 to $24,000, that ends up being a really good trade for them. And if we can operate that then profitably, that creates some incremental earnings contribution for us from that incremental value. But the biggest gain comes from helping that adviser grow their business. I hope that helps.

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

Yes, that's definitely helpful, Dan. And then on a separate topic, I'm just thinking about gross profit ROA here. Would you say the advisers that you've been adding over the last year or so pulled a similar, higher or lower amount of cash on average than your core base of advisers? Just trying to understand if that is a material part of when you talked about recruiting more profitable advisers, if that's a key component of it or not.

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

I don't think we have the exact answer to that. Here's the way I would think about that, and then Matt, you add whatever. Look, what we do know is that our recruiting classes, on average, their mix of advisory business to brokerage business mirrors our average. And if that's the case, then that mix of business has a big determinant on their cash balances.

So I would think they would look more like what our average is today than necessarily a big variance from there. But I don't know, Matt, if you want to add some color to that.

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

Yes. I mean, I'd just emphasize the brokerage versus advisory is really the driver of the difference in cash, right? So the more -- the higher percentage of advisory then are likely higher cash balances you're going to have due to the nature of that.

So I think that's probably the thing I would look at, Chris, as opposed to the timing of when the advisers came on board.

Operator

Thank you. I'm showing no further questions in the queue at this time. I would now turn the call back to over to Mr. Dan Arnold for any closing remarks.

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

Yes, hey, I just want to thank everyone for taking the time to join us this afternoon. We know you're busy, and we appreciate it, and we look forward to speaking with you again next quarter. Thanks.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.