LPL Financial share price tumbles to pre-hostile bid levels in atmosphere of eerie calm

10/21/2016 Originally Published Janice Kirkel, RIABiz

In business, as in matters of the heart, it's not hatred that kills you, it's indifference.

And so with the potential sale of LPL Financial, possibly to Hellman & Friedman, which purchased a controlling stake in LPL in 2005 but has been fully cashed out since 2013, it's the ho-hum reactions by the Boston-based IBD's investors -- and even some of its biggest, most loyal, advisors -- that stand out.

The latest chapter in the up-and-down fortunes of the nation's largest independent broker-dealer came early last week when Reuters reported that LPL had called on Goldman Sachs to explore options that included an outright sale. Industry publications, including this one, pounced. InvestmentNews then added to the fray, reporting that LPL had received an unasked-for, lowball, offer.

Such an offer usually indicates that a buyer smells weakness amid generous cash flow, according to **Dan Seivert**, CEO of **ECHELON Partners**, an M&A consultancy in Manhattan Beach, Calif.

"While the company has great EBITDA or profits, it is trading at a price-earnings ratio in the high single digits (around nine), which is commensurate with much smaller private companies," he says. "This spells good value for a PE firm to come in and buy."

The Casady factor

Advisors and analysts extended that train of thought to the further conclusion that a buyer is likely prepared to do what LPL can't stomach doing for itself --making wholesale management changes, starting with the ouster and replacement of its CEO, Mark Casady.

Doug Flynn, co-founder of Flynn Zito Capital Management LLC in Garden City, N.Y., and an LPL advisor for 20 years, says he presumes such a change is implicit in any deal. Flynn Zito has AUM of $231.5 million.

"New management brings in its own coaches."

That said, when Hellman & Friedman bought LPL, along with Texas Pacific Group, bought a controlling share for the first time in 2005, Casady kept his job.

There is a good reason for this kind of change, says Seivert. "When private equity investors are faced with the prospect of employing the same approach and expecting different results … they almost always change the approach.

Other analysts at places like Cerulli Associates and Aite Group declined to acknowledge requests for comment about this topic.

LPL itself renewed its no-comment of an earlier story, citing the rumor-like nature of the bid information.

Upon further review

Initially, it seemed as if the promise of an LPL buyer cheered Wall Street and its shares climbed 7%. But by Oct. 12, the shares gave back 5% and have continued to slump -- perhaps a vindication of Casady's tenure. The share drop would imply that switching CEOs alone does not assure that LPL can overcome more baked-in challenges. Today, Friday, LPL's shares were trading at $30.48, or down nearly 1% from their pre-sale-rumor price

Casady is on the record saying that LPL may benefit from the upcoming implementation of DOL fiduciary rules because its scale positions it to make systems changes faster and more effectively than smaller players.

But the publication Motley Fool has its doubts. "Further analysis of a possible sale suggested that it could be difficult for a buyer to deal with the regulations surrounding broker-dealers and registered investment advisors, especially in the wake of recent Department of Labor rules that will dramatically change the responsibilities of those who manage retirement funds.... Without the right partner, LPL Financial could end up losing all the ground it gained after the possibility of a buyout surfaced."

'I care but...'

Wall Street's indifference -- or sense of futility -- is surpassed perhaps only by some of the advisors who park assets at the firm.

John Hyland, founder and managing director, Private Advisor Group in Morristown, N.J., one of LPL's biggest advisors, says who owns LPL or who runs it will have little effect on his business.

"The majority of our advisor business is not flowing through the broker-dealer but through the RIA," says Hyland, whose firm manages$11 billion AUM and $10 billion to $15 billion of brokerage assets. "I care who owns the broker-dealer but at the end of the day most business is not conducted through there."

That's because, as a newly minted Nobel Laureate once wrote, the times, they are a-changing.

Hyland says: "We have seen the continued trend of less commissional brokerage asset management and more advisory fee-based business. That trend has been identifiable over the last five plus years."

The DOL, he says, will likely accelerate that whole process, with the percentage of brokerage business for the typical advisor continuing to decline. That, Hyland says, will put broker-dealers under continued pressure.

Consider me gone if...

Perhaps the apparent indifference to LPL's fate is simply a of crisis of exhaustion with the firm after a litany of bad news. LPL has had to shuffle the executive ranks, hiring a former SEC official as general counsel back in 2013, just weeks after being slapped with the largest-ever FINRA fine for email-related issues. It's had to freeze wages and contend with hedge funds gobbling up all their shares and then bossing them around. In reaction, Casady threatened to chop off the bottom 3% of the firm's book of business.

Yet Flynn says he's on a hair-trigger to bolt LPL if a buyer comes in that exudes any product-pushing vibe.

"The one thing for me is we are fiercely independent. A lot of people affiliated with LPL feel a similar way. I don't worry too much about who owns the company as long as our independence can be maintained. It could get swallowed up by a big company. They say they're not gonna change anything [but then they do] … that's a deal breaker for me."

Flynn adds with emphasis: "If there is even the slightest hint of anyone telling anyone here they need to sell something … we are gone."

Who might buy

If LPL has not put itself in play, the matter of a sale may be out of management's control. Asked why LPL might receive a hostile bid at this time if the company is in fact not pursuing a sale, Seivert says simply, "Other management teams believe they can do more with this asset. The board has to consider all offers and pretty much has to take offers that benefit shareholders."

On the other hand, Seivert cites several reasons why LPL could be actively seeking a buyer at this time.

"Being a public company carries with it the requirement to show growth and provide more money to shareholders each quarter. This is usually at the expense of investing in the long-term prospects of the company. After a while this adds up and the growth stops. The solution – go private."

Seivert even offers up a list of the most likely private equity buyers. Number one: Hellman & Friedman. Next up, Boston-based Summit Partners, whose portfolio includes Mutual Fund Store and Focus Financial Partners LLC. Then The Carlyle Group and New York-based Aquiline Capital Partners LLC. Rounding out Seivert's Most Likely to Buy are New York-based Lightyear Capital LLC, San Francisco-based Genstar Capital, TA Associates Management LP, Sequoia Capital, which is currently invested in First Republic Bank and Future Advisor; then New York-based Warburg Pincus LLC, and The Blackstone Group LP.