10 Reasons Why LPL Could Pull Off a Hot IPO

Originally Published By Brook Southall RIABiz

Brooke's Note: The recruiting market for advisors is off from last year. The stock market is off from last month. And the IPO market, though recovering from the deep trough of 2009, is uncertain at best. So why is LPL Financial gearing up for an IPO in the face of these three headwinds? The company itself wouldn't comment because it is meeting SEC requirements for staying quiet prior to selling shares. But the company's S-1 filing of Friday reads like a pitch for why LPL is a hot investment. I wrote this article based largely on what I culled from it.

The recent past has not been great for LPL. Since the end of the first quarter, the stock market has been skidding in reverse – rarely good for brokerage firms. And LPL recruited 490 brokers for the 12 months ended March 31, which was 40% down from the 630 advisors it nabbed for the 12 months ended Dec. 31, according to an earlier InvestmentNews article.

But IPOs aren't built out of a few months' results. LPL's stock pitch is based on the long-term patterns – which in the Boston and San Diego-based broker's case apparently impressed investment bankers at Goldman Sachs and Morgan Stanley. They have signed on as lead underwriters for its initial public offering, which could net the company $600 million – helpful for a company with $1.4 billion of debt.

The willingness of Wall Street investment banks to embrace an LPL IPO is helped along by its compelling storyline, according to Charles Roame, managing principal of Tiburon Strategic Advisors.

"I think LPL will do well as they will have a 'story' for the street," he says. "They will be able to talk up their independent model at a time that Wall Street is perceived to have made mistakes."

SEC regulations allow a company to complete all the groundwork for an IPO and then move on it when the market conditions are favorable. That may be what LPL is doing, said one expert. It may also be what Envestnet is up to. See: 10 reasons why the Envestnet IPO filing is for real.

"You have seen a ton of articles stating that LPL is going public. To my knowledge, all they have done is place a shelf registration," said **Dan Seivert**, CEO of **ECHELON Partners**, an investment bank in Manhattan Beach, Calif.

1. LPL's banner recruiting year in 2009 came after Merrill Lynch, UBS Morgan Stanley and Smith Barney pushed brokers out the door in a desperate attempt to bring overhead down. LPL scooped many of them up. To read about one example of a wirehouse broker finding a home at LPL, read: Two years later, A Merrill Lynch breakaway team has no regrets Many of the 630 advisors it nabbed came in the first six months of the year, when wirehouses were most intensively pushing out low producers. The recruiting could improve once the company trades publicly, according to Roame. "This is a huge milestone for IBDs. I think ten years ago, LPL only had about 3,000 to 4,000 financial advisors and were looked down upon by many wirehouse financial advisors," he says. "That is changing, not fully changed, but more wirehouse brokers will respect the firm as a public company and that may boost LPL's recruiting of larger teams."

2. The recruiting run and the improved stock market both helped to send LPL's earnings skyrocketing in the first quarter of this year to $25.6 million, up from $14.8 million during the same period of 2009 — a jump of more than 70%. LPL's highest annual earnings in recent years came in 2007, when it earned $61.1 million or 62 cents per share. It earned 25 cents a share in the first quarter of 2010 alone.

3. LPL serves 12,000 independent financial advisors with technology, brokerage and investment advisory services. A handful of those advisors are RIAs. See: "LPL's hybrid RIA platform is fast off the mark and names new leaders for 2010". As of the end of 2009, LPL had $7.3 billion of RIA assets from 92 firms. The average RIA on the platform has nearly $80 million of assets.

4. Among its 12,000 advisors, it supports more than 2,400 advisors at more than 750 banks and credit unions. It also provides support to over 4,000 additional financial advisors who are affiliated and licensed with insurance companies. These outsourcing arrangements provide customized clearing, advisory platforms and technology solutions that enable financial advisors at these insurance companies to efficiently provide a breadth of services to their client base.

5. The company seeks to win customers in the mass affluent realm who have $100,000 to $1,000,000, according to the filing.

6. LPL does a lot of business: As of March 31, 2010, advisory and brokerage assets totaled $285 billion, of which $81 billion was in advisory assets i.e. its corporate RIA. In 2009, brokerage sales were over $28 billion, including over $10 billion in mutual funds and $14 billion in annuities. Advisory sales were $23 billion, which consisted primarily of mutual funds. As a result of this scale and significant distribution capabilities, it can offer leading products and services with attractive economics to our advisors, according to the filing. As a point of comparison, Raymond James has total client assets are approximately $246 billion, of which approximately $32.8 billion are managed by the firm's asset management subsidiaries. The comparison is imperfect because RJ also has a full-service brokerage arm.

7. Here's how LPL explains that its size alone gives it a leg up on the IBD competition: "The independent channels pay advisors a greater share of brokerage commissions and advisory fees than the captive channels — generally 80-90% compared to 30-50%. Because of our scale and efficient operating model, we offer our advisors the highest average payout ratios among the five largest U.S. broker-dealers, ranked by number of advisors. We believe our superior technology and service platforms enable our advisors to operate their practices at a lower cost than other independent advisors. As a result, we believe owners of practices associated with us earn meaningfully more pre-tax profit than owners of practices affiliated with other independent brokerage firms. We attribute this difference in profitability, in part, to lower fixed costs driven by the need for fewer staff at our associated practices."

Its research team consists of more than 25 professionals with an average of 12 years of industry experience, it adds. This size also makes it a difficult act to follow. "I do not believe that there are many other IBDs, if any, who have the scale to follow any time soon," Roame says. "This is a defining moment for IBDs and for LPL. And this announcement is another threat to the dominance of the wirehouses."

8. Here is LPL's pitch to potential investors for why the company is positioned to succeed: "We believe we are the only company that offers advisors the unique combination of an integrated technology platform, comprehensive self-clearing services and full open architecture access to leading financial products, all delivered in an environment unencumbered by conflicts from product manufacturing, underwriting or market making." In addition it has the largest independent investment advisor base and it has the fifth-largest force of brokers overall. It has 2,400 employees in Boston, Charlotte and San Diego.

9. The size and growth of LPL's business benefited from its focus on advisors. Its advisor base has grown from 3,569 advisors in 2000 to 12,026 as of March 31, 2010, representing a compound annual growth rate of more than 14%. "With our focus and scale, we are not only a beneficiary of the secular shift among advisors toward independence, but an active catalyst of this trend. Between 2004 and 2008, our number of advisors increased at a CAGR of 20%, while according to Cerulli Associates, the total number of advisors across all channels remained flat," its filing reads.

10. LPL's advisor base includes independent reps, RIAs and advisors at small and mid-sized financial institutions. Advisors that join LPL have more than 15 years of industry experience on average. "This substantial industry experience allows us to focus on enhancing our advisors' businesses without the need for basic training or subsidizing advisors that are new to the industry. We are also rigorous in our initial advisor screening and diligence as well as our ongoing monitoring through our internal risk management and compliance functions," the filing reads.

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