

LPL Financial Holdings Inc.
Form 10-Q
April 28, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the quarterly period ended March 31, 2014

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-34963

LPL Financial Holdings Inc.

(Exact name of registrant as specified in its charter)

Delaware

20-3717839

(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization)

Identification No.)

75 State Street, Boston, MA 02109

(Address of Principal Executive Offices) (Zip Code)

(617) 423-3644

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller
reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of Common Stock, par value \$0.001 per share, outstanding as of April 17, 2014 was 100,558,687.

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WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly, and current reports, proxy statements and other information required by the Securities Exchange Act of 1934, as amended (the "Exchange Act"), with the Securities and Exchange Commission (the "SEC"). You may read and copy any document we file with the SEC at the SEC's public reference room located at 100 F Street, N.E., Washington, D.C. 20549, U.S.A. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. Our SEC filings are also available to the public from the SEC's internet site at <http://www.sec.gov>. On our internet site, <http://www.lpl.com>, we post the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the SEC: our annual reports on Form 10-K, our proxy statements, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act. Hard copies of all such filings are available free of charge by request via email (investor.relations@lpl.com), telephone (617) 897-4574, or mail (LPL Financial Investor Relations at 75 State Street, 24th Floor, Boston, MA 02109). The information contained or incorporated on our website is not a part of this Quarterly Report on Form 10-Q.

When we use the terms "LPLFH," "we," "us," "our" and the "Company," we mean LPL Financial Holdings Inc., a Delaware corporation, and its consolidated subsidiaries, taken as a whole, unless the context otherwise indicates.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Statements in Item 2 - "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other sections of this Quarterly Report on Form 10-Q regarding the Company's future financial and operating results, growth, business strategy, plans, liquidity, ability, and plans to repurchase shares and pay dividends in the future, including statements regarding projected savings, projected expenses, and anticipated improvements to the Company's operating model, services, and technology as a result of the Service Value Commitment, as well as any other statements that are not related to present facts or current conditions or that are not purely historical, constitute forward-looking statements. These forward-looking statements are based on the Company's historical performance and its plans, estimates, and expectations as of April 25, 2014. The words "anticipates," "believes," "expects," "may," "plans," "predicts," "will" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Forward-looking statements are not guarantees that the future results, plans, intentions, or expectations expressed or implied by the Company will be achieved. Matters subject to forward-looking statements involve known and unknown risks and uncertainties, including economic, legislative, regulatory, competitive and other factors, which may cause actual financial or operating results, levels of activity, or the timing of events, to be materially different than those expressed or implied by forward-looking statements. Important factors that could cause or contribute to such differences include: changes in general economic and financial market conditions, including retail investor sentiment; fluctuations in the value of assets under custody; fluctuations in levels of net new advisory assets and related impact on fee revenue; effects of competition in the financial services industry; changes in the number of the Company's financial advisors and institutions, and their ability to market effectively financial products and services; changes in interest rates and fees payable by banks participating in the Company's cash sweep program, including the Company's success in negotiating agreements with current or additional counterparties; changes in the growth of the Company's fee-based business; the Company's success in integrating the operations of acquired businesses; execution of the Company's plans related to the Service Value Commitment, including the Company's ability to successfully transform and transition business processes to third party service providers; the Company's success in negotiating and developing commercial arrangements with third party service providers that will enable the Company to realize the service improvements and efficiencies expected to result from the Service Value Commitment; the performance of third party service providers to which business processes are transitioned from the Company; the Company's ability to control operating risks, information technology systems risks and sourcing risks; the effect of current, pending and future legislation, regulation and regulatory actions, including disciplinary actions imposed by self-regulatory organizations; and the other factors set forth in Part I, "Item 1A. Risk Factors" in the Company's 2013 Annual Report on Form 10-K, as may be amended or updated in our Quarterly Reports on Form 10-Q. Except as required by law, the Company specifically disclaims any obligation to update any forward-looking statements as a result of developments occurring after the date of this quarterly report, even if its estimates change, and you should not rely on statements contained herein as representing

the Company's views as of any date subsequent to the date of this quarterly report.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Income

(Unaudited)

(In thousands, except per share data)

	Three Months Ended March 31,	
	2014	2013
REVENUES:		
Commission	\$534,574	\$485,572
Advisory	327,253	281,226
Asset-based	114,674	103,766
Transaction and fee	89,985	89,378
Interest income, net of interest expense	4,761	4,408
Other	16,184	10,446
Total net revenues	1,087,431	974,796
EXPENSES:		
Commission and advisory	744,543	659,553
Compensation and benefits	106,348	98,780
Promotional	27,183	23,665
Depreciation and amortization	22,281	19,774
Occupancy and equipment	22,081	16,798
Professional services	18,874	14,510
Brokerage, clearing and exchange	12,175	10,170
Communications and data processing	10,659	9,492
Regulatory fees and other	8,411	7,419
Restructuring charges	7,320	6,037
Other	7,169	5,887
Total operating expenses	987,044	872,085
Non-operating interest expense	12,840	12,160
Total expenses	999,884	884,245
INCOME BEFORE PROVISION FOR INCOME TAXES	87,547	90,551
PROVISION FOR INCOME TAXES	34,412	35,834
NET INCOME	\$53,135	\$54,717
EARNINGS PER SHARE (Note 11):		
Earnings per share, basic	\$0.52	\$0.51
Earnings per share, diluted	\$0.51	\$0.51
Weighted-average shares outstanding, basic	101,279	106,347
Weighted-average shares outstanding, diluted	103,339	107,297
See notes to unaudited condensed consolidated financial statements.		

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income

(Unaudited)

(In thousands)

	Three Months Ended March 31,	
	2014	2013
NET INCOME	\$53,135	\$54,717
Other comprehensive income, net of tax:		
Unrealized gain on cash flow hedges, net of tax expense of \$675 and \$0 for the three months ended March 31, 2014 and 2013, respectively	1,062	—
Total other comprehensive income, net of tax	1,062	—
TOTAL COMPREHENSIVE INCOME	\$54,197	\$54,717

See notes to unaudited condensed consolidated financial statements.

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Financial Condition
(Unaudited)
(Dollars in thousands, except par value)

	March 31, 2014	December 31, 2013
ASSETS		
Cash and cash equivalents	\$470,305	\$516,584
Cash and securities segregated under federal and other regulations	461,312	512,351
Receivables from:		
Clients, net of allowance of \$633 at March 31, 2014 and \$588 at December 31, 2013	340,341	373,675
Product sponsors, broker-dealers and clearing organizations	146,120	174,070
Others, net of allowance of \$7,390 at March 31, 2014 and \$7,091 at December 31, 2013	284,653	272,018
Securities owned:		
Trading — at fair value	12,388	8,964
Held-to-maturity	4,847	6,853
Securities borrowed	8,264	7,102
Fixed assets, net of accumulated depreciation and amortization of \$275,059 at March 31, 2014 and \$263,321 at December 31, 2013	200,071	189,059
Debt issuance costs, net of accumulated amortization of \$8,831 at March 31, 2014 and \$7,751 at December 31, 2013	15,201	16,281
Goodwill	1,361,361	1,361,361
Intangible assets, net of accumulated amortization of \$276,002 at March 31, 2014 and \$266,285 at December 31, 2013	454,806	464,522
Other assets	169,027	139,991
Total assets	\$3,928,696	\$4,042,831
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Drafts payable	\$180,648	\$194,971
Payables to clients	564,649	565,204
Payables to broker-dealers and clearing organizations	30,624	43,157
Accrued commission and advisory expenses payable	125,240	135,149
Accounts payable and accrued liabilities	244,208	301,644
Income taxes payable	24,794	4,320
Unearned revenue	79,317	73,739
Securities sold, but not yet purchased — at fair value	536	211
Senior secured credit facilities	1,532,387	1,535,096
Deferred income taxes, net	90,044	89,369
Total liabilities	2,872,447	2,942,860
Commitments and contingencies		
STOCKHOLDERS' EQUITY:		
Common stock, \$.001 par value; 600,000,000 shares authorized; 117,691,335 shares issued at March 31, 2014 and 117,112,465 shares issued at December 31, 2013	118	117
Additional paid-in capital	1,318,823	1,292,374
Treasury stock, at cost — 17,141,172 shares at March 31, 2014 and 15,216,301 shares at December 31, 2013	(606,474)	(506,205)
Accumulated other comprehensive income	1,177	115

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Retained earnings	342,605	313,570
Total stockholders' equity	1,056,249	1,099,971
Total liabilities and stockholders' equity	\$3,928,696	\$4,042,831

See notes to unaudited condensed consolidated financial statements.

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LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Stockholders' Equity
(Unaudited)
(In thousands)

	Common Stock		Additional Paid-In	Treasury Stock		Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders' Equity
	Shares	Amount	Capital	Shares	Amount			
BALANCE — December 31, 2012	115,714	\$ 116	\$ 1,228,075	9,422	\$(287,998)	\$ —	\$ 199,827	\$ 1,140,020
Net income and other comprehensive income							54,717	54,717
Treasury stock purchases				155	(4,921)			(4,921)
Cash dividends on common stock							(14,374)	(14,374)
Stock option exercises and other	358		7,108					7,108
Share-based compensation			5,801					5,801
Excess tax benefits from share-based compensation			1,634					1,634
BALANCE — March 31, 2013	116,072	\$ 116	\$ 1,242,618	9,577	\$(292,919)	\$ —	\$ 240,170	\$ 1,189,985
BALANCE — December 31, 2013	117,112	\$ 117	\$ 1,292,374	15,216	\$(506,205)	\$ 115	\$ 313,570	\$ 1,099,971
Net income and other comprehensive income						1,062	53,135	54,197
Issuance of common stock to settle restricted stock units, net	34	1		11	(585)			(584)
Treasury stock purchases				1,923	(100,000)			(100,000)
Cash dividends on common stock							(24,097)	(24,097)
Stock option exercises and other	545		13,747	(9)	316		(3)	14,060
Share-based compensation			8,287					8,287
Excess tax benefits from share-based compensation			4,415					4,415
BALANCE — March 31, 2014	117,691	\$ 118	\$ 1,318,823	17,141	\$(606,474)	\$ 1,177	\$ 342,605	\$ 1,056,249

See notes to unaudited condensed consolidated financial statements.

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LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

	Three Months Ended March 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$53,135	\$54,717
Adjustments to reconcile net income to net cash provided by operating activities:		
Noncash items:		
Depreciation and amortization	22,281	19,774
Amortization of debt issuance costs	1,080	1,121
Share-based compensation	8,287	5,801
Excess tax benefits related to share-based compensation	(4,444)	(1,634)
Provision for bad debts	330	(374)
Deferred income tax provision	—	(8,384)
Net changes in estimated fair value of contingent consideration obligations	—	(1,023)
Loan forgiveness	6,436	334
Other	175	206
Changes in operating assets and liabilities:		
Cash and securities segregated under federal and other regulations	51,039	177,500
Receivables from clients	33,289	28,413
Receivables from product sponsors, broker-dealers and clearing organizations	27,950	(28,705)
Receivables from others	(19,356)	(27,171)
Securities owned	(3,593)	725
Securities borrowed	(1,162)	1,690
Other assets	(27,431)	(11,427)
Drafts payable	(14,323)	(65,511)
Payables to clients	(555)	(166,814)
Payables to broker-dealers and clearing organizations	(12,533)	1,140
Accrued commission and advisory expenses payable	(9,909)	(3,538)
Accounts payable and accrued liabilities	(55,701)	(15,734)
Income taxes receivable/payable	24,889	39,675
Unearned revenue	5,578	6,702
Securities sold, but not yet purchased	325	(201)
Net cash provided by operating activities	\$85,787	\$7,282

Continued on following page

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows - Continued

(Unaudited)

(In thousands)

	Three Months Ended	
	March 31,	
	2014	2013
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	\$(23,012)	\$(13,738)
Proceeds from disposal of fixed assets	1,000	—
Purchase of securities classified as held-to-maturity	—	(2,495)
Proceeds from maturity of securities classified as held-to-maturity	2,000	1,000
Release of restricted cash	132	—
Purchases of minority interest investments	—	(1,000)
Net cash used in investing activities	(19,880)	(16,233)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of senior secured credit facilities	(2,709)	(10,725)
Payment of contingent consideration	(3,300)	—
Tax payments related to settlement of restricted stock units	(584)	—
Repurchase of common stock	(100,000)	(4,921)
Dividends on common stock	(24,097)	(14,374)
Excess tax benefits related to share-based compensation	4,444	1,634
Proceeds from stock option exercises and other	14,060	7,108
Net cash used in financing activities	(112,186)	(21,278)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(46,279)	(30,229)
CASH AND CASH EQUIVALENTS — Beginning of period	516,584	466,261
CASH AND CASH EQUIVALENTS — End of period	\$470,305	\$436,032
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid	\$13,047	\$12,016
Income taxes paid	\$9,531	\$4,547
NONCASH DISCLOSURES:		
Fixed assets acquired under build-to-suit lease	\$8,114	\$—
See notes to unaudited condensed consolidated financial statements.		

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Organization and Description of the Company

LPL Financial Holdings Inc. (“LPLFH”), a Delaware holding corporation, together with its consolidated subsidiaries (collectively, the “Company”) provides an integrated platform of brokerage and investment advisory services to independent financial advisors and financial advisors at financial institutions (collectively “advisors”) in the United States of America. Through its custody and clearing platform, using both proprietary and third-party technology, the Company provides access to diversified financial products and services enabling its advisors to offer independent financial advice and brokerage services to retail investors (their “clients”).

2. Summary of Significant Accounting Policies

Basis of Presentation — The unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). These unaudited condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. These adjustments are of a normal recurring nature. The Company’s results for any interim period are not necessarily indicative of results for a full year or any other interim period.

The unaudited condensed consolidated financial statements do not include all information and notes necessary for a complete presentation of results of income, comprehensive income, financial position, and cash flows in conformity with generally accepted accounting principles in the United States of America (“GAAP”). Accordingly, these financial statements should be read in conjunction with the Company’s audited consolidated financial statements and the related notes for the year ended December 31, 2013, contained in the Company’s Annual Report on Form 10-K as filed with the SEC.

The Company’s significant accounting policies are included in Note 2. Summary of Significant Accounting Policies in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. There have been no significant changes to these accounting policies during the first three months of 2014.

Consolidation — These unaudited condensed consolidated financial statements include the accounts of LPLFH and its subsidiaries. Intercompany transactions and balances have been eliminated. Equity investments in which the Company exercises significant influence but does not exercise control and is not the primary beneficiary are accounted for using the equity method.

Use of Estimates — The preparation of the unaudited condensed consolidated financial statements in conformity with GAAP requires the Company to make estimates and judgments that affect the reported amounts of assets and liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. These estimates are based on the information that is currently available and on various other assumptions that the Company believes to be reasonable under the circumstances. Actual results could vary from these estimates.

Reportable Segment — The Company’s internal reporting is organized into two service channels: Independent Advisor Services and Institution Services. These service channels qualify as individual operating segments and are aggregated and viewed as one reportable segment due to their similar economic characteristics, products and services, production and distribution processes, and regulatory environment.

Fair Value of Financial Instruments — The Company’s financial assets and liabilities are carried at fair value or at amounts that, because of their short-term nature, approximate current fair value, with the exception of its indebtedness. The Company carries its indebtedness at amortized cost. The Company measures the implied fair value of its debt instruments using trading levels obtained from a third-party service provider. Accordingly, the debt instruments qualify as Level 2 fair value measurements. See Note 4. Fair Value Measurements, for additional detail regarding the Company’s fair value measurements. As of March 31, 2014, the carrying amount and fair value of the Company’s indebtedness was approximately \$1,532.4 million and \$1,530.3 million, respectively. As of December 31, 2013, the carrying amount and fair value was approximately \$1,535.1 million and \$1,533.3 million, respectively.

Recently Issued Accounting Pronouncements — There are no recent accounting pronouncements that would impact the Company’s condensed consolidated statements of income, comprehensive income, financial condition, or cash flows.

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

3. Restructuring

In February 2013, the Company committed to an expansion of its Service Value Commitment (the “Program”), an ongoing effort to position the Company for sustainable long-term growth by improving the service experience of its advisors and delivering efficiencies in its operating model. The Program is expected to be completed in 2015. The Company estimates total charges in connection with the Program to be approximately \$65.0 million. These expenditures are comprised of outsourcing and other related costs, technology transformation costs, employee severance obligations and other related costs, and non-cash charges for impairment of certain fixed assets related to internally developed software.

The following table summarizes the balance of accrued expenses and the changes in the accrued amounts for the Program as of and for the three months ended March 31, 2014 (in thousands):

	Accrued Balance at December 31, 2013	Costs Incurred	Payments	Non-cash	Accrued Balance at March 31, 2014	Cumulative Costs Incurred to Date	Total Expected Restructuring Costs
Outsourcing and other related costs	\$1,424	\$2,873	\$(3,985)	\$—	\$312	\$18,155	\$30,000
Technology transformation costs	1,753	3,251	(3,060)	—	1,944	12,520	23,000
Employee severance obligations and other related costs	820	792	(435)	—	1,177	3,250	11,000
Asset impairments	—	—	—	—	—	842	1,000
Total	\$3,997	\$6,916	\$(7,480)	\$—	\$3,433	\$34,767	\$65,000

4. Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Inputs used to measure fair value are prioritized within a three-level fair value hierarchy. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies, and similar techniques that use significant unobservable inputs.

There have been no transfers of assets or liabilities between these fair value measurement classifications during the three months ended March 31, 2014.

The Company’s fair value measurements are evaluated within the fair value hierarchy, based on the nature of inputs used to determine the fair value at the measurement date. At March 31, 2014, the Company had the following financial assets and liabilities that are measured at fair value on a recurring basis:

Cash Equivalents — The Company’s cash equivalents include money market funds, which are short term in nature with readily determinable values derived from active markets.

Securities Owned and Securities Sold, But Not Yet Purchased — The Company's trading securities consist of house account model portfolios established and managed for the purpose of benchmarking the performance of its fee based advisory platforms and temporary positions resulting from the processing of client transactions. Examples of these

securities include money market funds, U.S. treasury obligations, mutual funds, certificates of deposit, and traded equity and debt securities.

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LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Unaudited)

The Company uses prices obtained from independent third-party pricing services to measure the fair value of its trading securities. Prices received from the pricing services are validated using various methods including comparison to prices received from additional pricing services, comparison to available quoted market prices and review of other relevant market data including implied yields of major categories of securities. In general, these quoted prices are derived from active markets for identical assets or liabilities. When quoted prices in active markets for identical assets and liabilities are not available, the quoted prices are based on similar assets and liabilities or inputs other than the quoted prices that are observable, either directly or indirectly. For certificates of deposit and treasury securities, the Company utilizes market-based inputs including observable market interest rates that correspond to the remaining maturities or the next interest reset dates. At March 31, 2014, the Company did not adjust prices received from the independent third-party pricing services.

Other Assets — The Company's other assets include: (1) deferred compensation plan assets that are invested in money market and other mutual funds, which are actively traded and valued based on quoted market prices; (2) certain non-traded real estate investment trusts, which are valued using quoted prices for identical or similar securities and other inputs that are observable or can be corroborated by observable market data; and (3) cash flow hedges, which are measured using quoted prices for similar cash flow hedges, taking into account counterparty credit risk and the Company's own non-performance risk.

Accounts Payable and Accrued Liabilities — The Company's accounts payable and accrued liabilities include contingent consideration liabilities, which are measured using Level 3 inputs.

The following table summarizes the Company's financial assets and financial liabilities measured at fair value on a recurring basis at March 31, 2014 (in thousands):

	Level 1	Level 2	Level 3	Total
At March 31, 2014:				
Assets				
Cash equivalents	\$246,058	\$—	\$—	\$246,058
Securities owned — trading:				
Money market funds	243	—	—	243
Mutual funds	6,556	—	—	6,556
Equity securities	106	—	—	106
Debt securities	—	3,234	—	3,234
U.S. treasury obligations	2,000	—	—	2,000
Certificates of deposit	—	249	—	249
Total securities owned — trading	8,905	3,483	—	12,388
Other assets	59,706	4,611	—	64,317
Total assets at fair value	\$314,669	\$8,094	\$—	\$322,763
Liabilities				
Securities sold, but not yet purchased:				
Equity securities	\$523	\$—	\$—	\$523
Debt securities	—	13	—	13
Total securities sold, but not yet purchased	523	13	—	536
Total liabilities at fair value	\$523	\$13	\$—	\$536

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

The following table summarizes the Company's financial assets and financial liabilities measured at fair value on a recurring basis at December 31, 2013 (in thousands):

	Level 1	Level 2	Level 3	Total
At December 31, 2013:				
Assets				
Cash equivalents	\$254,032	\$—	\$—	\$254,032
Securities owned — trading:				
Money market funds	170	—	—	170
Mutual funds	7,291	—	—	7,291
Equity securities	103	—	—	103
U.S. treasury obligations	1,400	—	—	1,400
Total securities owned — trading	8,964	—	—	8,964
Other assets	47,539	3,072	—	50,611
Total assets at fair value	\$310,535	\$3,072	\$—	\$313,607
Liabilities				
Securities sold, but not yet purchased:				
Mutual funds	\$63	\$—	\$—	\$63
Equity securities	127	—	—	127
Debt securities	—	10	—	10
Certificates of deposit	—	11	—	11
Total securities sold, but not yet purchased	190	21	—	211
Accounts payable and accrued liabilities	—	—	39,293	39,293
Total liabilities at fair value	\$190	\$21	\$39,293	\$39,504

Changes in Level 3 Recurring Fair Value Measurements

As of December 31, 2013, the Company had a contingent consideration obligation related to the acquisition of National Retirement Partners, Inc. (“NRP”). This obligation was based on the achievement of certain revenue-based targets for the twelve-month period ending November 30, 2013, in aggregate for those advisors joining LPL Financial LLC (“LPL Financial”) subsequent to the NRP acquisition for whom retirement plans comprise a significant part of their business. As of December 31, 2013, the Company had finalized the determination of the amount of contingent consideration to be paid to the former shareholders of NRP, resulting in a total payment of \$39.3 million, which was made on February 19, 2014.

The Company determines the fair value for its contingent consideration obligations using an income approach whereby the Company assesses the probability and timing of the achievement of the applicable milestones, which are based on contractually negotiated financial or operating targets that vary by acquisition transaction, such as revenues, gross margin, EBITDA and assets under custody. The contingent payments are estimated using a probability weighted, multi-scenario analysis of expected future performance of the acquired businesses. The Company then discounts these expected payment amounts to calculate the fair value as of the valuation date. The Company's management evaluates the underlying projections and other related factors used in determining fair value each period and makes updates when there have been significant changes in management's expectations.

The principal significant unobservable input used in the valuations of the Company's contingent consideration obligations is a risk-adjusted discount rate. Whereas management's underlying projections adjust for market penetration and adoption rates, the discount rate is risk-adjusted for key factors such as advisor attrition, advisor recruitment, expenses and overhead costs, average client assets, revenue generation of client assets and credit risk. An increase in the discount rate will result in a decrease in the fair value of contingent consideration. Conversely, a decrease in the discount rate will result in an increase in the fair value of contingent consideration.

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

5. Held-to-Maturity Securities

The Company holds certain investments in securities, primarily U.S. government notes, which are recorded at amortized cost because the Company has both the intent and the ability to hold these investments to maturity. Interest income is accrued as earned. Premiums and discounts are amortized using a method that approximates the effective yield method over the term of the security and are recorded as an adjustment to the investment yield.

The amortized cost, gross unrealized loss or gain and fair value of securities held-to-maturity were as follows (in thousands):

	March 31, 2014	December 31, 2013
Amortized cost	\$4,847	\$6,853
Gross unrealized loss	(42) (58
Fair value	\$4,805	\$6,795

At March 31, 2014, the securities held-to-maturity were scheduled to mature as follows (in thousands):

	Within one year	After one but within five years	After five but within ten years	Total
U.S. government notes — at amortized cost	\$2,251	\$2,096	\$500	\$4,847
U.S. government notes — at fair value	\$2,252	\$2,077	\$476	\$4,805

6. Derivative Financial Instruments

In May 2013, in conjunction with its commitment to expand its Service Value Commitment, the Company entered into a long-term contractual obligation (the “Agreement”) with a third-party provider to enhance the quality, speed and cost of processes by outsourcing certain functions. The Agreement enables the third-party provider to use the services of its affiliates in India to provide services to the Company. The Agreement provides for the Company to settle the cost of its contractual obligation to the third-party provider in U.S. dollars each month. However, the Agreement provides that on each annual anniversary date, the price for services (denominated in U.S. dollars) is to be adjusted for the then-current exchange rate between the U.S. dollar (“USD”) and the Indian rupee (“INR”). The Agreement provides that, once an annual adjustment is calculated, there are no further modifications to the amounts paid by the Company to the third-party provider for fluctuations in the exchange rate between the USD and the INR until the reset on the next anniversary date. The third-party provider bears the risk of currency movement from the date of signing the Agreement until the reset on the first anniversary of its signing, and during each period until the next annual reset. The Company bears the risk of currency movement at each of the annual reset dates following the first anniversary. To mitigate foreign currency risk arising from these annual anniversary events, the Company uses derivative financial instruments consisting solely of non-deliverable foreign currency contracts, all of which have been designated as cash flow hedges.

The details related to the non-deliverable foreign currency contracts at March 31, 2014 are as follows (in millions, except foreign exchange rate):

	Settlement Date	Hedged Notional Amount (INR)	Contractual INR/USD Foreign Exchange Rate	Hedged Notional Amount (USD)
Cash flow hedge #1	6/3/2014	560.4	65.96	\$8.5
Cash flow hedge #2	6/2/2015	560.4	69.35	8.1
Cash flow hedge #3	6/2/2016	560.4	72.21	7.8
Cash flow hedge #4	6/2/2017	560.4	74.20	7.5
Total hedged amount				\$31.9

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Unaudited)

The fair value of the derivative instruments included in other assets in the unaudited condensed consolidated statements of financial condition were as follows (in thousands):

	March 31, 2014	December 31, 2013
Cash flow hedges	\$1,939	\$187

7. Goodwill and Other Intangible Assets

Goodwill and intangible assets were a result of various acquisitions. See Note 9. Goodwill and Other Intangible Assets, in the Company's 2013 Annual Report on Form 10-K for a discussion of the components of goodwill and additional information regarding intangible assets.

8. Debt

Senior Secured Credit Facilities — On May 13, 2013, the Company entered into the First Amendment and Incremental Assumption Agreement (“Credit Agreement”) with its wholly owned subsidiary, LPL Holdings, Inc., and other parties thereto. The Credit Agreement amended the Company's previous credit agreement, which was dated as of March 29, 2012.

The Credit Agreement includes a Term Loan A, a Term Loan B, and a revolving credit facility (“Revolving Credit Facility”). Term Loan A had an initial principal amount of \$459.4 million maturing on March 29, 2017; Term Loan B had an initial principal amount of \$1,083.9 million maturing on March 29, 2019; and the Revolving Credit Facility has a borrowing capacity of \$250.0 million maturing on March 29, 2017.

At the time the Company entered into the Credit Agreement, all mandatory payments required under Term Loan A were prepaid, with the remaining principal and accrued interest due upon maturity. Term Loan B includes quarterly payments at an annual rate of 1.0% of principal per year, with the remaining principal and accrued interest due upon maturity.

Borrowings under Term Loan A and Term Loan B bear interest at a base rate equal to either one-, two-, three-, six-, nine-, or twelve-month LIBOR (the “Eurodollar Rate”) plus the applicable interest rate margin, or an alternative base rate (“ABR”) plus the applicable interest rate margin. The Eurodollar Rate with respect to Term Loan B shall in no event be less than 0.75%. The ABR is equal to the greatest of (a) the prime rate in effect on such day; (b) the effective federal funds rate in effect on such day plus 0.50%; (c) the Eurodollar Rate plus 1.00%; or (d) solely in the case of Term Loan B, 1.75%. The Company may repay outstanding loans under its Credit Agreement at any time without premium or penalty, other than customary “breakage” costs with respect to Eurodollar Rate loans.

As of March 31, 2014, borrowings under the term loans bore interest at the Eurodollar Rate with an applicable interest rate margin of 2.50%. The Company's outstanding borrowings were as follows (dollars in thousands):

	Maturity	March 31, 2014		December 31, 2013	
		Balance	Interest Rate	Balance	Interest Rate
Senior secured term loans:					
Term Loan A	3/29/2017	\$459,375	2.65 % ⁽¹⁾	\$459,375	2.67 % ⁽³⁾
Term Loan B	3/29/2019	1,073,012	3.25 % ⁽²⁾	1,075,721	3.25 % ⁽⁴⁾
Total borrowings		1,532,387		1,535,096	
Less current portion		10,839		10,839	
Long-term borrowings — net of current portion		\$1,521,548		\$1,524,257	

(1) As of March 31, 2014, the variable interest rate for Term Loan A was the one-month LIBOR, designated at an interest rate of 0.15%.

(2) As of March 31, 2014, the Company elected the six-month LIBOR, which was less than 0.75%; as a result, the variable interest rate for Term Loan B was the minimum Eurodollar Rate of 0.75%.

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(3) As of December 31, 2013, the variable interest rate for Term Loan A was the one-month LIBOR, designated at an interest rate of 0.17%.

(4) As of December 31, 2013, the Company elected the six-month LIBOR, which was less than 0.75%; as a result, the variable interest rate for Term Loan B was the minimum Eurodollar Rate of 0.75%.

As of March 31, 2014, the Revolving Credit Facility was being used to support the issuance of \$21.4 million of irrevocable letters of credit for the construction of the Company's new San Diego office building and other items, with an applicable interest rate margin of 2.50%. An irrevocable letter of credit for \$20.7 million matures on March 29, 2015, while the remaining letters totaling \$0.7 million mature on various dates through April 6, 2015. The remaining available balance of \$228.6 million was undrawn at March 31, 2014.

The Credit Agreement subjects the Company to certain financial and non-financial covenants. As of March 31, 2014, the Company was in compliance with such covenants.

Bank Loans Payable — The Company maintains three uncommitted lines of credit. Two of the lines have unspecified limits, which are primarily dependent on the Company's ability to provide sufficient collateral. The third line has a \$200.0 million limit, and allows for both collateralized and uncollateralized borrowings. The lines have not been utilized in 2014, but were utilized in 2013; however, there were no balances outstanding at March 31, 2014 or December 31, 2013.

The following summarizes borrowing activity in the revolving and uncommitted line of credit facilities (dollars in thousands):

	Three Months Ended		
	March 31,		
	2014	2013	
Average balance	\$—	\$12,406	
Weighted-average interest rate	—	% 1.80	%

9. Commitments and Contingencies

Leases — The Company leases office space and equipment under various operating leases. These leases are generally subject to scheduled base rent and maintenance cost increases, which are recognized on a straight-line basis over the period of the leases. Total rental expense for all operating leases was approximately \$8.8 million and \$5.0 million for the three months ended March 31, 2014 and 2013, respectively.

In March 2014 the Company entered into a lease agreement for additional office space in Charlotte with a lease commencement date of March 1, 2014 and an expiration date of February 28, 2017. Future minimum payments for this lease commitment are \$0.5 million, \$1.0 million, \$1.1 million, and \$0.2 million, for the years 2014, 2015, 2016, and 2017, respectively.

Service Contracts — The Company is party to certain long-term contracts for systems and services that enable back office trade processing and clearing for its product and service offerings.

Guarantees — The Company occasionally enters into certain types of contracts that contingently require it to indemnify certain parties against third-party claims. The terms of these obligations vary and, because a maximum obligation is not explicitly stated, the Company has determined that it is not possible to make an estimate of the amount that it could be obligated to pay under such contracts.

The Company's subsidiary, LPL Financial, provides guarantees to securities clearing houses and exchanges under their standard membership agreements, which require a member to guarantee the performance of other members. Under these agreements, if a member becomes unable to satisfy its obligations to the clearing houses and exchanges, all other members would be required to meet any shortfall. The Company's liability under these arrangements is not quantifiable and may exceed the cash and securities it has posted as collateral. However, the potential requirement for the Company to make payments under these agreements is remote. Accordingly, no liability has been recognized for these transactions.

Loan Commitments — From time to time, LPL Financial makes loans to its advisors, primarily to newly recruited advisors to assist in the transition process, which may be forgivable. Due to timing differences, LPL

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

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Financial may make commitments to issue such loans prior to actually funding them. These unfunded commitments are generally contingent upon certain events occurring, including but not limited to the advisor joining LPL Financial. LPL Financial had no such significant unfunded commitments at March 31, 2014.

Disputed & Regulatory Matters — The Company maintains insurance coverage for client claims. With respect to these matters, the estimated losses on the majority of pending matters are less than the applicable deductibles of the insurance policies. The Company is also subject to extensive regulation and supervision by U.S. federal and state agencies and various self-regulatory organizations. The Company and its financial advisors periodically engage with such agencies and organizations, in the context of examinations or otherwise, to respond to inquiries, informational requests, and investigations. From time to time, such engagements result in regulatory complaints or other matters, the resolution of which can include restitution, fines, and other remedies. As of April 25, 2014, the Company believes, based on the information available at this time, consideration of amounts accrued, insurance, if any, and indemnifications provided by the third-party indemnitors, if any, that the outcomes of any such pending claims or matters with estimated losses in excess of applicable deductibles will not have a material impact on the unaudited condensed consolidated statements of income, financial condition, or cash flows.

Certain former owners of Concord Capital Partners, Inc. (“CCP”), a subsidiary that the Company acquired in June 2011, have filed lawsuits with claims related to contingent consideration under the stock purchase agreement relating to the Company's acquisition of CCP and employment-related claims. As of April 25, 2014, after consideration of amounts accrued and applicable insurance, the Company does not believe that the outcomes of these matters, individually or in the aggregate, will have a material impact on its condensed consolidated statements of income, financial condition, or cash flows.

Other Commitments — As of March 31, 2014, the Company had received collateral primarily in connection with client margin loans with a market value of approximately \$368.9 million, which it can re-pledge, loan, or sell. Of these securities, approximately \$28.8 million were pledged with client-owned securities to the Options Clearing Corporation as collateral to secure client obligations related to options positions. Additionally, approximately \$141.2 million was held at banks in connection with unutilized secured margin lines of credit; these securities may be used as collateral for loans from these banks. The remainder of \$198.9 million had not been re-pledged, loaned, or sold, and as of March 31, 2014 there were no restrictions that materially limited the Company's ability to re-pledge, loan, or sell the remaining \$340.1 million of client collateral.

Trading securities on the unaudited condensed consolidated statements of financial condition includes \$2.0 million and \$1.4 million pledged to clearing organizations at March 31, 2014 and December 31, 2013, respectively.

Brokerage, clearing, and custody services are provided by LPL Financial on a fully disclosed basis. LPL Financial also has a multi-year agreement to provide its investment advisory programs, platforms, technology, and additional processing and related services to the advisors of the broker-dealer subsidiary of a large global insurance company and the clients of such advisors. Termination fees may be payable by a terminating or breaching party depending on the specific cause of termination.

10. Stockholders' Equity

Share-Based Compensation

Certain employees, advisors, institutions, executive officers, and non-employee directors of the Company participate in various long-term incentive plans, which provide for granting stock options, warrants, restricted stock awards, and restricted stock units. Stock options and warrants generally vest in equal increments over a three- to five-year period and expire on the tenth anniversary following the date of grant. Restricted stock awards and restricted stock units generally vest over a two- to four-year period.

On November 17, 2010, the Company adopted a 2010 Omnibus Equity Incentive Plan (the “2010 Plan”), which provides for the granting of stock options, warrants, restricted stock awards, restricted stock units, and other equity-based compensation. The 2010 Plan serves as the successor to the 2005 Stock Option Plan for Incentive Stock Options, the 2005 Stock Option Plan for Non-qualified Stock Options, the 2008 Advisor and Institution Incentive

Plan, the 2008 Stock Option Plan and the Director Restricted Stock Plan (collectively, the “Predecessor Plans”). Upon adoption of the 2010 Plan, awards were no longer made under the Predecessor Plans; however, awards previously granted under the Predecessor Plans remain outstanding until exercised or forfeited.

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There are 12,055,945 new shares available for grant under the 2010 Plan. As of March 31, 2014, there are 6,208,095 of authorized unissued shares reserved for issuance upon exercise and conversion of outstanding awards granted under the 2010 Plan.

Stock Options and Warrants

The following table presents the weighted-average assumptions used by the Company in calculating the fair value of its employee, officer and director stock options with the Black-Scholes valuation model that have been granted during the three months ended March 31, 2014:

Expected life (in years)	6.01	
Expected stock price volatility	44.34	%
Expected dividend yield	1.75	%
Risk-free interest rate	2.19	%
Fair value of options	\$20.77	

The fair value of each stock option or warrant awarded to advisors and financial institutions is estimated on the date of the grant and revalued at each reporting period using the Black-Scholes valuation model with the following weighted-average assumptions used during the three months ended March 31, 2014:

Expected life (in years)	7.20	
Expected stock price volatility	42.53	%
Expected dividend yield	1.83	%
Risk-free interest rate	2.17	%
Fair value of options	\$28.11	

The following table summarizes the Company's stock option and warrant activity for the three months ended March 31, 2014:

	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Outstanding — December 31, 2013	7,016,521	\$28.45		
Granted	693,089	54.81		
Exercised	(543,458)) 25.30		
Forfeited	(46,098)) 30.81		
Outstanding — March 31, 2014	7,120,054	\$31.24	7.05	\$151,626
Exercisable — March 31, 2014	3,482,681	\$26.96	5.83	\$89,089

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

The following table summarizes information about outstanding stock options and warrants at March 31, 2014:

Range of Exercise Prices	Outstanding		Exercisable		
	Total Number of Shares	Weighted-Average Remaining Life (Years)	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
\$1.35 - \$2.38	38,952	0.61	\$1.89	38,952	\$1.89
\$10.30 - \$19.74	354,080	4.71	17.91	354,080	17.91
\$21.60 - \$22.08	861,781	5.20	22.02	662,781	22.01
\$23.02 - \$29.99	2,045,265	6.30	27.39	1,228,152	26.81
\$30.00 - \$32.26	1,829,612	8.40	31.83	519,651	31.89
\$32.33 - \$39.60	1,297,275	6.90	34.55	677,372	34.39
\$40.00 - \$54.81	693,089	9.91	54.81	1,693	54.81
	7,120,054	7.05	\$31.24	3,482,681	\$26.96

The Company recognizes share-based compensation for stock options awarded to employees, officers and directors based on the grant date fair value over the requisite service period of the award, which generally equals the vesting period. The Company recognized share-based compensation related to the vesting of these awards of \$3.8 million and \$3.5 million during the three months ended March 31, 2014 and 2013, respectively, which is included in compensation and benefits on the unaudited condensed consolidated statements of income. As of March 31, 2014, total unrecognized compensation cost related to non-vested share-based compensation arrangements granted to employees, officers and directors was \$35.7 million, which is expected to be recognized over a weighted-average period of 2.64 years.

The Company recognizes share-based compensation for stock options and warrants awarded to its advisors and to financial institutions based on the fair value of the awards at each interim reporting period. The Company recognized share-based compensation of \$3.2 million and \$1.9 million during the three months ended March 31, 2014 and 2013, respectively, related to the vesting of stock options and warrants awarded to its advisors and financial institutions, which is classified within commission and advisory expense on the unaudited condensed consolidated statements of income. As of March 31, 2014, total unrecognized compensation cost related to non-vested share-based compensation arrangements granted to advisors and financial institutions was \$20.0 million, which is expected to be recognized over a weighted-average period of 2.86 years.

Restricted Stock

The Company grants restricted stock awards and restricted stock units to its employees, officers, and directors. A restricted stock unit represents the right to receive one share of common stock upon vesting. The Company recognizes share-based compensation for restricted stock awards and restricted stock units granted to its employees, officers, and directors by measuring such awards at their grant date fair value. Share-based compensation is recognized ratably over the requisite service period, which generally equals the vesting period.

The following summarizes the Company's activity in its restricted stock awards and restricted stock units for the three months ended March 31, 2014:

	Restricted Stock Awards		Restricted Stock Units	
	Number of Shares	Weighted-Average Grant-Date Fair Value	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested at December 31, 2013	39,153	\$ 33.20	256,684	\$ 32.12
Granted	5,610	53.47	171,841	52.80
Vested	(9,300)) 32.26	(34,352)) 30.57

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Forfeited	(4,550) 32.96	(2,361) 29.24
Nonvested at March 31, 2014	30,913	\$ 37.19	391,812	\$ 41.35

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LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Unaudited)

The Company recognized \$1.2 million and \$0.4 million of share-based compensation related to the vesting of restricted stock awards and restricted stock units during the three months ended March 31, 2014 and 2013, respectively, which is included in compensation and benefits on the unaudited condensed consolidated statements of income. As of March 31, 2014, total unrecognized compensation cost for restricted stock awards and restricted stock units granted to employees, officers, and directors was \$13.8 million, which is expected to be recognized over a weighted-average remaining period of 2.62 years.

Dividends

The payment, timing, and amount of any dividends permitted under the Company's credit facilities are subject to approval by the Board of Directors.

On February 10, 2014, the Board of Directors declared a cash dividend of \$0.24 per share on the Company's outstanding common stock. The dividend of \$24.1 million was paid on March 10, 2014 to all stockholders of record on February 24, 2014.

On February 5, 2013, the Board of Directors declared a cash dividend of \$0.135 per share on the Company's outstanding common stock. The dividend of \$14.4 million was paid on March 4, 2013 to all stockholders of record on February 18, 2013.

Share Repurchases

The Board of Directors has approved several share repurchase programs pursuant to which the Company may repurchase its issued and outstanding shares of common stock from time to time. Repurchased shares are included in treasury stock on the unaudited condensed consolidated statements of financial condition. Purchases may be effected in open market or privately negotiated transactions, including transactions with affiliates, with the timing of purchases and the amount of stock purchased generally determined at the discretion of the Company's management.

For the three months ended March 31, 2014 and 2013, the Company had the following activity under its approved share repurchase programs (in millions, except share and per share data):

Approval Date	Authorized Repurchase Amount	Amount Remaining at March 31, 2014	Three Months Ended March 31, 2014		2013			
			Shares Purchased	Weighted-Average Price Paid Per Share	Shares Purchased	Weighted-Average Price Paid Per Share	Total Cost	
September 27, 2012	\$ 150.0	\$ —	—	\$ —	\$ —	155,289	\$ 31.69	\$4.9
May 28, 2013	\$ 200.0	—	1,306,288	52.00	67.9	—	—	—
February 10, 2014	\$ 150.0	117.9	616,788	52.00	32.1	—	—	—
		\$ 117.9	1,923,076	\$ 52.00	\$ 100.0	155,289	\$ 31.69	\$4.9

See Note 13 for details regarding the repurchase of shares from related parties.

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

11. Earnings Per Share

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding during the period. The computation of diluted earnings per share is similar to the computation of basic earnings per share, except that the denominator is increased to include the number of additional shares of common stock that would have been outstanding if dilutive potential shares of common stock had been issued. The calculation of basic and diluted earnings per share for the three months ended March 31, 2014 and 2013 is as follows (in thousands, except per share data):

	Three Months Ended March 31,	
	2014	2013
Net income	\$53,135	\$54,717
Basic weighted-average number of shares outstanding	101,279	106,347
Dilutive common share equivalents	2,060	950
Diluted weighted-average number of shares outstanding	103,339	107,297
Basic earnings per share	\$0.52	\$0.51
Diluted earnings per share	\$0.51	\$0.51

The computation of diluted earnings per share excludes stock options, warrants, and restricted stock units that are anti-dilutive. For the three months ended March 31, 2014 and 2013, stock options, warrants, and restricted stock units representing common share equivalents of 941,406 shares and 5,039,942 shares, respectively, were anti-dilutive.

12. Income Taxes

The Company's effective income tax rate differs from the federal corporate tax rate of 35.0%, primarily as a result of state taxes, settlement contingencies and expenses that are not deductible for tax purposes. These items resulted in effective tax rates of 39.3% and 39.6% for the three months ended March 31, 2014 and 2013, respectively. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

13. Related Party Transactions

The Company has related party transactions with TPG Capital, one of the Company's significant stockholders, as well as certain portfolio companies of TPG Capital. During the three months ended March 31, 2014 and 2013 the Company recognized revenue for services provided to these portfolio companies of \$0.1 million and \$1.1 million, respectively. During the three months ended March 31, 2014 and 2013, the Company incurred expenses for services provided by TPG Capital or these portfolio companies of \$0.2 million and \$0.8 million, respectively. As of March 31, 2014 and 2013, receivables from related parties were \$0.1 million and \$1.0 million, respectively. As of March 31, 2014 and 2013, payables to related parties were not in excess of 0.1 million.

On February 12, 2014, the Company entered into a share repurchase agreement with an investment fund associated with TPG Capital, pursuant to which the Company repurchased 1.9 million shares of its common stock at a price of \$52.00 per share, for total consideration of \$100.0 million. The share repurchase was effected in a private transaction and was contingent on the closing of a registered sale of 1.9 million shares of the Company's common stock by TPG Capital to a private investor. The repurchase transaction closed on February 19, 2014.

14. Net Capital and Regulatory Requirements

The Company operates in a highly regulated industry. Applicable laws and regulations restrict permissible activities and investments and require compliance with various financial and customer-related regulations. The consequences of noncompliance can include substantial monetary and non-monetary sanctions. In addition, the Company is also subject to comprehensive examinations and supervision by various governmental and self-regulatory agencies. These regulatory agencies generally have broad discretion to prescribe greater limitations on

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

the operations of a regulated entity for the protection of investors or public interest. Furthermore, where the agencies determine that such operations are unsafe or unsound, fail to comply with applicable law, or are otherwise inconsistent with the laws and regulations or with the supervisory policies, greater restrictions may be imposed.

The Company's registered broker-dealer, LPL Financial, is subject to the SEC's Uniform Net Capital Rule (Rule 15c3-1 under the Exchange Act), which requires the maintenance of minimum net capital, as defined. Net capital and the related net capital requirement may fluctuate on a daily basis. LPL Financial is a clearing broker-dealer and had net capital of \$180.2 million with a minimum net capital requirement of \$6.5 million and net capital in excess of the minimum requirement of \$173.7 million as of March 31, 2014.

The Company's subsidiary, The Private Trust Company N.A. ("PTC"), operates in a highly regulated industry and is subject to various regulatory capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have substantial monetary and non-monetary impacts to PTC's operations.

As of March 31, 2014 and December 31, 2013, LPL Financial and PTC met all capital adequacy requirements to which they are subject.

15. Financial Instruments with Off-Balance-Sheet Credit Risk and Concentrations of Credit Risk

LPL Financial's client securities activities are transacted on either a cash or margin basis. In margin transactions, LPL Financial extends credit to the advisor's client, subject to various regulatory and internal margin requirements, collateralized by cash and securities in the client's account. As clients write options contracts or sell securities short, LPL Financial may incur losses if the clients do not fulfill their obligations and the collateral in the clients' accounts is not sufficient to fully cover losses that clients may incur from these strategies. To control this risk, LPL Financial monitors margin levels daily and clients are required to deposit additional collateral, or reduce positions, when necessary.

LPL Financial is obligated to settle transactions with brokers and other financial institutions even if its advisors' clients fail to meet their obligation to LPL Financial. Clients are required to complete their transactions on the settlement date, generally three business days after the trade date. If clients do not fulfill their contractual obligations, LPL Financial may incur losses. In addition, the Company occasionally enters into certain types of contracts to fulfill its sale of when, as, and if issued securities. When, as, and if issued securities have been authorized but are contingent upon the actual issuance of the security. LPL Financial has established procedures to reduce this risk by generally requiring that clients deposit cash and/or securities into their account prior to placing an order.

LPL Financial may at times hold equity securities that are recorded on the unaudited condensed consolidated statements of financial condition at market value. While long inventory positions represent LPL Financial's ownership of securities, short inventory positions represent obligations of LPL Financial to deliver specified securities at a contracted price, which may differ from market prices prevailing at the time of completion of the transaction.

Accordingly, both long and short inventory positions may result in losses or gains to LPL Financial as market values of securities fluctuate. To mitigate the risk of losses, long and short positions are marked-to-market daily and are continuously monitored by LPL Financial.

16. Subsequent Event

On April 22, 2014, the Board of Directors declared a cash dividend of \$0.24 per share on the Company's outstanding common stock to be paid on May 20, 2014 to all stockholders of record on May 6, 2014.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are the nation's largest independent broker-dealer, a top custodian for registered investment advisors ("RIAs"), and a leading independent consultant to retirement plans. We provide an integrated platform of brokerage and investment advisory services to more than 13,700 independent financial advisors, including financial advisors at more than 700 financial institutions (our "advisors") across the country, enabling them to provide their retail investors ("clients") with objective financial advice through a lower conflict model. We also support approximately 4,400 financial advisors who are affiliated and licensed with insurance companies with customized clearing, advisory platforms, and technology solutions.

Fortigent Holdings Company, Inc. and its subsidiaries ("Fortigent") are a leading provider of solutions and consulting services to RIAs, banks, and trust companies servicing high-net-worth clients, while The Private Trust Company, N.A. ("PTC") manages trusts and family assets for high-net-worth clients.

Our singular focus is to provide our advisors with the front-, middle- and back-office support they need to serve the large and growing market for independent investment advice. We believe we are the only company that offers advisors the unique combination of an integrated technology platform, comprehensive self-clearing services, and open-architecture access to leading financial products, all delivered in an environment unencumbered by conflicts from product manufacturing, underwriting, or market making.

For over 20 years, we have served the independent advisor market. We currently support the largest independent advisor base and we believe we have the fourth largest overall advisor base in the United States based on the information available as of the date this Quarterly Report on Form 10-Q has been issued. Through our advisors, we are also one of the largest distributors of financial products in the United States. Our scale is a substantial competitive advantage and enables us to more effectively attract and retain advisors. Our unique business model allows us to invest in more resources for our advisors, increasing their revenues and creating a virtuous cycle of growth. We have 3,267 employees, with primary offices in Boston, Charlotte, and San Diego.

Our Sources of Revenue

Our revenues are derived primarily from fees and commissions from products and advisory services offered by our advisors to their clients, a substantial portion of which we pay out to our advisors, as well as fees we receive from our advisors for the use of our technology, custody, clearing, trust, and reporting platforms. We also generate asset-based revenues through our platform of over 11,000 financial products from a broad range of product manufacturers. Under our self-clearing platform, we custody the majority of client assets invested in these financial products, for which we provide statements, transaction processing and ongoing account management. In return for these services, mutual funds, insurance companies, banks, and other financial product manufacturers pay us fees based on asset levels or number of accounts managed. We also earn interest from margin loans made to our advisors' clients.

We track recurring revenue, a characterization of net revenue and a statistical measure, which we define to include our revenues from asset-based fees, advisory fees, trailing commissions, cash sweep programs, and certain other fees that are based upon accounts and advisors. Because certain recurring revenues are associated with asset balances, they will fluctuate depending on the market values and current interest rates. These asset balances, specifically related to advisory and asset-based revenues, have a correlation of approximately 60% to the fluctuations of the overall market, as measured by the S&P 500. Accordingly, our recurring revenue can be negatively impacted by adverse external market conditions. However, recurring revenue is meaningful to us despite these fluctuations because it is not dependent upon transaction volumes or other activity-based revenues, which are more difficult to predict, particularly in declining or volatile markets.

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The table below summarizes the sources of our revenue, the primary drivers of each revenue source and the percentage of each revenue source that represents recurring revenue:

	Sources of Revenue	Primary Drivers	Three Months Ended March 31, 2014		
			Total (millions)	% of Total Net Revenue	% Recurring
Advisor-driven revenue with ~85%-90% payout ratio	Commission	- Transactions - Brokerage asset levels	\$535	49%	42%
	Advisory	- Advisory asset levels	\$327	30%	99%
	Asset-Based - Cash Sweep Fees - Sponsorship Fees - Record Keeping	- Cash balances - Interest rates - Client asset levels - Number of accounts	\$115	11%	97%
Attachment revenue retained by us	Transaction and Fee - Transactions - Client (Investor) Accounts - Advisor Seat and Technology	- Client activity - Number of clients - Number of advisors - Number of accounts - Number of premium technology subscribers - Margin account balances	\$90	8%	65%
	Other	- Alternative investment transactions	\$20	2%	28%
	Total Net Revenue		\$1,087	100%	67%
	Total Recurring Revenue		\$724	67%	

Commission and Advisory Revenues. Commission and advisory revenues both represent advisor-generated revenue, generally 85-90% of which is paid to advisors.

Commission Revenues. We generate two types of commission revenues: transaction-based sales commissions and trailing commissions. Transaction-based sales commission revenues, which occur whenever clients trade securities or purchase various types of investment products, primarily represent gross commissions generated by our advisors from commissions earned on purchases by clients of various financial products and securities such as mutual funds, variable and fixed annuities, alternative investments, equities, fixed income, insurance, group annuities, and options and commodities. The levels of transaction-based commissions can vary from period to period based on the overall economic environment, number of trading days in the reporting period, and investment activity of our advisors' clients. We earn trailing commission revenues (a commission that is paid over time, such as 12(b)-1 fees) primarily on mutual funds and variable annuities held by clients of our advisors. Trailing commissions are recurring in nature and are earned based on the current market value of investment holdings in trail-eligible assets.

Advisory Revenues. Advisory revenues primarily represent fees charged on our corporate RIA platform provided through LPL Financial LLC ("LPL Financial") to clients of our advisors based on the value of advisory assets. Advisory fees are typically billed to clients quarterly, in advance, and are recognized as revenue ratably during the quarter. The value of the assets in an advisory account on the billing date determines the amount billed, and accordingly, the revenues earned in the following three month period. The majority of our accounts are billed using values as of the last business day of each calendar quarter. Advisory revenues collected on our corporate RIA platform generally average 1.1% of the underlying assets, and can range anywhere from 0.5% to 3.0%.

In addition, we support independent RIAs who conduct their advisory business through separate entities by establishing their own RIA ("Independent RIAs") pursuant to the Investment Advisers Act of 1940, rather than through LPL Financial. The assets held under these investment advisory accounts custodied with LPL Financial are included in our advisory and brokerage assets, net new

advisory assets and advisory assets under custody metrics. The advisory revenue generated by an Independent RIA is earned by the Independent RIA, and accordingly is not included in our advisory revenue. However, we charge administrative fees to Independent RIAs for clearing and custody of these assets, based on the value of assets within these advisory accounts. The administrative fees collected on our Independent RIA platform vary, and can reach a maximum of 0.6% of the underlying assets.

Furthermore, we support certain financial advisors at broker-dealers affiliated with insurance companies through our customized advisory platforms and charge fees to these advisors based on the value of assets within these advisory accounts.

Asset-Based Revenues. Asset-based revenues are comprised of fees from cash sweep programs, our sponsorship programs with financial product manufacturers and omnibus processing and networking services. Pursuant to contractual arrangements, uninvested cash balances in our advisors' client accounts are swept into either insured deposit accounts at various banks or third-party money market funds, for which we receive fees, including administrative and record-keeping fees based on account type and the invested balances. In addition, we receive fees from certain financial product manufacturers in connection with sponsorship programs that support our marketing and sales-force education and training efforts. Our omnibus processing and networking revenues represent fees paid to us in exchange for administrative and record-keeping services that we provide to clients of our advisors. Omnibus processing revenues are paid to us by mutual fund product sponsors and based upon the value of custodied assets in advisory accounts and the number of brokerage accounts in which the related mutual fund positions are held. Networking revenues on brokerage assets are correlated to the number of positions we administer and are paid to us by mutual fund and annuity product manufacturers.

Transaction and Fee Revenues. Revenues earned from transactions and fees primarily consist of transaction fees and ticket charges, subscription fees, Individual Retirement Account ("IRA") custodian fees, contract and license fees, conference fees and other client account fees. We charge fees to our advisors and their clients for executing certain transactions in brokerage and fee-based advisory accounts. We earn subscription fees for various services provided to our advisors and on IRA custodial services that we provide for their client accounts. We charge administrative fees to our advisors and fees to advisors who subscribe to our reporting services. We charge fees to financial product manufacturers for participating in our training and marketing conferences. In addition, we host certain advisor conferences that serve as training, sales and marketing events, for which we charge a fee for attendance.

Other Revenues. Other revenues include marketing allowances received from certain financial product manufacturers, primarily those who offer alternative investments, such as non-traded real estate investment trusts and business development companies, mark-to-market gains or losses on assets held by us for the advisors' non-qualified deferred compensation plan and our model portfolios, revenues from our Retirement Partners program, interest income from client margin accounts and cash equivalents, net of operating interest expense, and other items.

Our Operating Expenses

Production Expenses. Production expenses are comprised of the following: base payout amounts that are earned by and paid out to advisors based on commission and advisory revenues earned on each client's account (collectively, commission and advisory revenues earned by LPL Financial are referred to as gross dealer concessions, or "GDC"); production bonuses earned by advisors based on the levels of commission and advisory revenues they produce; the recognition of share-based compensation expense from equity awards granted to advisors and financial institutions based on the fair value of the awards at each reporting period; a mark-to-market gain or loss on amounts designated by advisors as deferred commissions in a non-qualified deferred compensation plan at each reporting period; and brokerage, clearing and exchange fees. Our production payout ratio is calculated as production expenses excluding brokerage, clearing and exchange fees, divided by GDC.

We characterize components of production payout, which consists of all production expenses except brokerage, clearing and exchange fees, as either GDC sensitive or non-GDC sensitive. Base payout amounts and production bonuses earned by and paid to advisors are characterized as GDC sensitive because they are variable and highly correlated to the level of our commission and advisory revenues in a particular reporting period. Payout characterized as non-GDC sensitive includes share-based compensation expense from equity awards granted to advisors and financial institutions based on the fair value of the

awards at each reporting period, and mark-to-market gains or losses on amounts designated by advisors as deferred commissions in a non-qualified deferred compensation plan. Non-GDC sensitive payout is correlated either to market movement or to the value of our stock. We believe that discussion of production payout, viewed in addition to, and not in lieu of, our production expenses, provides useful information to investors regarding our payouts to advisors.

Compensation and Benefits Expense. Compensation and benefits expense includes salaries and wages and related employee benefits and taxes for our employees (including share-based compensation), as well as compensation for temporary employees and consultants.

General and Administrative Expenses. General and administrative expenses include promotional fees, occupancy and equipment, communications and data processing, regulatory fees, professional services, and other expenses. General and administrative expenses also include expenses for our hosting of certain advisor conferences that serve as training, sales, and marketing events.

Depreciation and Amortization Expense. Depreciation and amortization expense represents the benefits received for using long-lived assets. Those assets consist of intangible assets established through our acquisitions, as well as fixed assets, which include internally developed software, hardware, leasehold improvements, and other equipment.

Restructuring Charges. Restructuring charges primarily represent expenses incurred as a result of our expansion of our Service Value Commitment announced in 2013 (see Note 3. Restructuring, within the notes to unaudited condensed consolidated financial statements) and costs arising from our 2011 consolidation of UVEST Financial Services Group, Inc. (“UVEST”). For 2013, restructuring charges also include costs arising from our 2009 consolidation of Mutual Service Corporation, Associated Financial Group, Inc., Associated Securities Corp., Associated Planners Investment Advisory, Inc. and Waterstone Financial Group, Inc. (collectively referred to herein as the “Affiliated Entities”).

How We Evaluate Our Business

We focus on several business and key financial metrics in evaluating the success of our business relationships and our resulting financial position and operating performance. Our business and key financial metrics as of and for the three months ended March 31, 2014 and 2013 are as follows:

	March 31, 2014	2013	% Change	
Business Metrics				
Advisors	13,726	13,377	2.6	%
Advisory and brokerage assets (in billions)(1)	\$447.1	\$394.0	13.5	%
Advisory assets under custody (in billions)(2)(3)	\$158.0	\$130.2	21.4	%
Net new advisory assets (in billions)(4)	\$4.4	\$3.0	46.7	%
Insured cash account balances (in billions)(3)	\$16.6	\$15.6	6.4	%
Money market account balances (in billions)(3)	\$7.1	\$7.5	(5.3)%
			Three Months Ended	
			March 31,	
			2014	2013
Financial Metrics				
Revenue growth from prior period		11.6	% 8.1	%
Recurring revenue as a % of net revenue(5)		66.6	% 65.4	%
Net income (in millions)		\$53.1	\$54.7	
Earnings per share (diluted)		\$0.51	\$0.51	
Non-GAAP Measures:				
Gross margin (in millions)(6)		\$330.7	\$305.1	
Gross margin as a % of net revenue(6)		30.4	% 31.3	%
Adjusted EBITDA (in millions)				