LPL Financial Holdings Inc.
Form 10-Q
October 30, 2018

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

or

o **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 incorporation or organization)	*(I.R.S. Employer 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. x Yes o 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). x Yes o No

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

Large accelerated filer x Accelerated filer o

Non-accelerated filer o (Do not check if a smaller reporting company)

Smaller reporting company o

Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes x No

The number of shares of Common Stock, par value $0.001 per share, outstanding as of October 22, 2018 was 86,711,957.

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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 ("Exchange Act"), with the Securities and Exchange Commission ("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, 22nd 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, outlook, growth, plans, business strategies, liquidity, future share repurchases and future dividends, including statements regarding future resolution of regulatory matters, legal proceedings and related costs, future revenues and expenses, and projected savings and anticipated improvements to the Company's operating model, services, and technologies as a result of its initiatives, programs and/or acquisitions, 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 October 30, 2018. 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; 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; the Company's strategy in managing cash sweep program fees; fluctuations in the levels of brokerage and advisory assets, including net new assets, and the related impact on fee revenue; effects of competition in the financial services industry; the success of the Company in attracting and retaining financial advisors and institutions, and their ability to market effectively financial products and services; changes in the growth and profitability of the Company's fee-based business; the effect of current, pending, and future legislation, regulation, and regulatory actions, including with respect to retail retirement savings and disciplinary actions imposed by federal and state regulators and self-regulatory organizations; the costs of settling and remediating issues related to past, pending or future regulatory matters or legal proceedings; changes made to the Company's offerings and services in response to current, pending, and future legislation, regulation, and regulatory actions, and the effect that such changes may have on the Company's gross profit streams and costs; execution of the Company's capital management plans, including its

compliance with the terms of its credit agreement and the indenture governing its senior notes; the price, the availability of shares, and trading volumes of the Company's common stock, which will affect the timing and size of future share repurchases by the Company; execution of the Company's plans and its success in realizing the synergies, expense savings and service improvements and efficiencies expected to result from its initiatives and programs, including its acquisition of the broker-dealer network of National Planning Holdings, Inc. and its expense plans and technology initiatives; the performance of third-party service providers to which business processes are transitioned; the Company's ability to control operating risks, information technology systems risks, cybersecurity risks, and sourcing risks; and the other factors set forth in Part I, "Item 1A. Risk Factors" in the Company's 2017 Annual Report on Form 10-K, as amended by Amendment No. 1 on Form 10-K/A filed on

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February 27, 2018 (collectively, the "2017 Annual Report on Form 10-K"), as may be amended or updated in the Company's 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.

PART I — FINANCIAL INFORMATION

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

Business Overview

We are a leader in the retail financial advice market and the nation's largest independent broker-dealer. We serve independent financial advisors and financial institutions, providing them with the technology, research, clearing and compliance services, and practice management programs they need to create and grow their practices. We enable them to provide objective financial guidance to millions of American families seeking wealth management, retirement planning, financial planning and asset management solutions.

We believe that objective financial guidance is a fundamental need for everyone. We enable our advisors to focus on what they do best—create the personal, long-term relationships that are the foundation for turning life's aspirations into financial realities. We do that through a singular focus on providing 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 that 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 a wide range of non-proprietary products, all delivered in an environment unencumbered by conflicts from product manufacturing, underwriting, and market-making.

We believe investors achieve better outcomes when working with a financial advisor. We strive to make it easy for advisors to do what is best for their clients, while protecting advisors and investors and promoting independence and choice through access to a wide range of diligently evaluated non-proprietary products.

Executive Summary

Financial Highlights

Net income for the third quarter of 2018 was $106.9 million or $1.19 per share, which compares to $58.1 million, or $0.63 per share, in the third quarter of 2017. Increased advisory fee revenue and cash sweep revenue contributed to the earnings per share growth.

Asset Growth Trends

Total brokerage and advisory assets served were $681.0 billion as of September 30, 2018, up 22% from $560.0 billion as of September 30, 2017. Total net new assets were $4.4 billion for the three months ended September 30, 2018, compared to $2.9 billion for the same period in 2017.

Net new advisory assets were $5.1 billion for the three months ended September 30, 2018, compared to $6.9 billion in the same period in 2017. As of September 30, 2018, our advisory assets had grown to $306.1 billion from the prior year balance of $250.2 billion and represented 45% of total brokerage and advisory assets served.

Net new brokerage assets were an outflow of $0.8 billion for the three months ended September 30, 2018, compared to an outflow of $4.0 billion for the same period in 2017. As of September 30, 2018, our brokerage assets had grown to $374.9 billion from $309.8 billion as of September 30, 2017.

Gross Profit Trends

Gross profit, a non-GAAP financial measure, was $493.2 million for the three months ended September 30, 2018, an increase of 27.5% in comparison to $386.9 million for the quarter ended September 30, 2017. Management presents gross profit, which is calculated as net revenues less commission and advisory expenses and brokerage, clearing, and exchange fees, because we believe that measure may be useful to investors in evaluating the Company's core operating performance before indirect costs that are general and administrative in nature. See footnote 8 to the Financial Metrics table within the "How We Evaluate Our Business" section for additional information on gross profit. The increase in period-over-period gross profit was primarily due to increases in cash sweep revenue from the impact of the increases in the target range for the federal funds effective rate in 2017 through September 2018, increases in advisory revenues resulting from net new assets, and market gains as represented by higher levels of the S&P 500 index.

Shareholder Capital Returns

We returned $144.4 million of capital to shareholders during the three months ended September 30, 2018, including $21.9 million of dividends and $122.5 million of share repurchases, representing 1,849,027

shares.

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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 cash sweep program and the access we provide to a variety of product providers with the following product lines:

- Alternative Investments
- Annuities
- Exchange Traded Products
- Insurance Based Products
- Mutual Funds
- Retirement Plan Products
- Separately Managed Accounts
- Structured Products
- Unit Investment Trusts

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 regularly review various aspects of our operations and service offerings, including our policies, procedures, and platforms, in response to marketplace developments. We seek to continuously improve and enhance aspects of our operations and service offerings in order to position our advisors for long-term growth and to align with competitive and regulatory developments. For example, we regularly review the structure and fees of our advisory programs, including related disclosures, in the context of the changing regulatory environment for retirement accounts.

How We Evaluate Our Business

We focus on several key operating and financial metrics in evaluating the success of our business relationships and our resulting financial position and operating performance. Our key operating and financial metrics are as follows:

Operating Metrics (dollars in billions) (balances may not foot due to rounding)	**Nine Months Ended September 30,**		
	2018	**2017**	**% Change**
Advisory assets(1)(2)	$306.1	$250.2	22 %
Brokerage assets(1)(3)	374.9	309.8	21 %
Total Brokerage and Advisory Assets served(in billions)(1)	**$681.0**	**$560.0**	**22 %**
Net new advisory assets(4)	$22.6	$18.8	n/m
Net new brokerage assets(5)	23.2	(12.9)	n/m
Total Brokerage and Advisory Net New Assets	**$45.8**	**$5.9**	**n/m**
Insured cash account balances(1)	$21.0	$21.9	(4 %)
Deposit cash account balances(1)	3.9	4.1	(5 %)
Money market account balances(1)	3.3	2.3	43 %
Total Cash Sweep Balances	**$28.2**	**$28.3**	**— %**
Advisors	16,174	14,253	13 %

Financial Metrics (dollars in millions, except per share data)	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
	2018	**2017**	**2018**	**2017**
Total net revenues	$1,331.0	$1,064.1	$3,871.4	$3,165.0
Recurring gross profit rate (trailing twelve months)(6)	85.0 %	82.2 %	85.0 %	82.2 %
Pre-tax income	$147.4	$96.6	$430.2	$284.7
Net income	$106.9	$58.1	$319.2	$174.8
Earnings per share, diluted	$1.19	$0.63	$3.49	$1.90
Non-GAAP Financial Measures(7)				
Gross profit(8)	$493.2	$386.9	$1,439.9	$1,151.6
Gross profit growth from prior period(8)	27.5 %	11.5 %	25.0 %	9.9 %
Gross profit as a % of net revenue(8)	37.1 %	36.4 %	37.2 %	36.4 %

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(1) Brokerage and advisory assets are comprised of assets that are custodied, networked, and non-networked and reflect market movement in addition to new assets, inclusive of new business development and net of attrition. Insured cash account balances, money market account balances, and deposit cash account balances are also included in brokerage and advisory assets served.

(2) Advisory assets consists of total advisory assets under custody at our broker-dealer subsidiary, LPL Financial LLC (“LPL Financial”), consisting of total assets on LPL Financial's corporate advisory platform serviced by investment advisor representatives of LPL Financial and total assets on LPL Financial's independent advisory platform serviced by investment advisor representatives of separate investment advisor firms (“Hybrid RIAs”) rather than of LPL Financial. See “Results of Operations” for a tabular presentation of advisory assets.

(3) Brokerage assets consists of assets serviced by advisors licensed with LPL Financial.

(4) Net new advisory assets consists of total client deposits into custodied advisory accounts less total client withdrawals from custodied advisory accounts. We consider conversions from and to brokerage accounts as deposits and withdrawals, respectively.

(5) Net new brokerage assets consists of total client deposits into brokerage accounts less total client withdrawals from brokerage accounts. We consider conversions from and to advisory accounts as deposits and withdrawals, respectively.

(6) Recurring gross profit rate refers to the percentage of our gross profit, a non-GAAP financial measure, that was recurring for the trailing twelve months ended September 30, 2018 or September 30, 2017, as applicable. We track recurring gross profit, a characterization of gross profit and a statistical measure, which is defined to include our revenues from asset-based fees, advisory fees, trailing commissions, cash sweep programs, and certain other fees that are based upon the number of client accounts and advisors, less the expenses associated with such revenues and certain other recurring expenses not specifically associated with a revenue line. We allocate such other recurring expenses, such as non-GDC sensitive production expenses, on a pro-rata basis against specific revenue lines at our discretion. Because certain sources of recurring gross profit are associated with asset balances, they will fluctuate depending on the market values and current interest rates. Accordingly, our recurring gross profit can be negatively impacted by adverse external market conditions. However, we believe that recurring gross profit is meaningful 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.

(7) We believe that presenting certain non-GAAP financial measures by excluding or including certain items can be helpful to investors and analysts who may wish to use some or all of this information to analyze our current performance, prospects, and valuation. We use this non-GAAP information internally to evaluate operating performance and in formulating the budget for future periods. We believe that the non-GAAP financial measures and metrics presented above and discussed below are appropriate for evaluating the performance of the Company.

(8) Set forth below is a calculation of gross profit (in millions), calculated as net revenues less commission and advisory expenses and brokerage, clearing, and exchange fees. All other expense categories, including depreciation and amortization of fixed assets and amortization of intangible assets, are considered general and administrative in nature. Because our gross profit amounts do not include any depreciation and amortization expense, we consider our gross profit amounts to be non-GAAP financial measures that may not be comparable to those of others in our industry. We believe that gross profit amounts can provide investors with useful insight into our core operating performance before indirect costs that are general and administrative in nature.

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
Gross Profit (in millions)	**2018**	**2017**	**2018**	**2017**
Total net revenues	$1,331.0	$1,064.1	$3,871.4	$3,165.0
Commission and advisory expense	822.0	663.8	2,384.3	1,971.9
Brokerage, clearing, and exchange fees	15.8	13.4	47.2	41.5
Gross profit	**$493.2**	**$386.9**	**$1,439.9**	**$1,151.6**

Legal & Regulatory Matters

As a regulated entity, we are subject to regulatory oversight and inquiries related to, among other items, our compliance and supervisory systems and procedures and other controls, as well as our disclosures, supervision and reporting. The environment of additional regulation, increased regulatory compliance obligations, and enhanced regulatory enforcement has resulted, and may result in the future, in additional operational and compliance costs, as well as increased costs in the form of penalties and fines, investigatory and settlement costs, customer restitution, and remediation related to regulatory matters. In the ordinary course of business, we periodically identify or become aware of purported inadequacies, deficiencies, and other issues. It is our policy to evaluate these matters for potential securities law or regulatory violations, and other potential compliance issues. It is also our policy to self-report known violations and issues as required by applicable law and regulation. When deemed probable that matters may result in financial losses, we accrue for those losses based on an estimate of possible fines, customer restitution, and losses related to the repurchase of sold securities and other losses, as applicable. Certain regulatory and other legal claims and losses may be covered through our wholly-owned captive insurance

subsidiary, which is chartered with the insurance commissioner in the state of Tennessee. Assessing the probability of a loss occurring and the timing and amount of any loss related to a regulatory matter or a legal proceeding is inherently difficult and requires judgments based on a variety of factors and assumptions. There are particular uncertainties and complexities involved when assessing the potential liabilities that are self-insured by our captive insurance subsidiary.

Our accruals, including those established through the captive insurance subsidiary at September 30, 2018, include estimated costs for significant regulatory matters, generally relating to the adequacy of our compliance and

supervisory systems and procedures and other controls, for which we believe losses are both probable and reasonably estimable. For example, on May 1, 2018, we agreed to a settlement structure with the North American Securities Administrators Association related to our historical compliance with certain state “blue sky” laws. We are in the process of entering into separate administrative orders with 53 jurisdictions, which would result in aggregate fines of approximately $26.4 million. As part of the settlement structure, we agreed to engage independent third party consultants to conduct a historical review of certain equity and fixed income securities transactions, as well as an operational review of our systems for complying with blue sky securities registration requirements. We also agreed to offer remediation to customers who purchased certain equity and fixed-income securities since October 2006. We expect to incur costs related to this matter over the next few years, and we expect the majority of these costs to be covered by our captive insurance subsidiary or expense plans as of September 30, 2018.

The outcome of regulatory matters could result in legal liability, regulatory fines, or monetary penalties in excess of our accruals and insurance, which could have a material adverse effect on our business, results of operations, cash flows, or financial condition. For more information on management’s loss contingency policies, see Note 9. *Commitments and Contingencies*, within the notes to the unaudited condensed consolidated financial statements.

In June 2018, the U.S. Court of Appeals for the Fifth Circuit issued a mandate invalidating regulations previously enacted by the U.S. Department of Labor (“DOL”) that expanded the definition of “fiduciary” and would have resulted in significant new restrictions on our servicing of certain retirement plan accounts subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and individual retirement accounts (“IRAs”), including compliance with expanded prohibited transaction requirements under section 4975 of the Internal Revenue Code (the “DOL Rule”). However, in April 2018, the SEC introduced a proposal for a best interest standard for retail brokerage accounts (the “SEC Rule”). Certain state securities and insurance regulators have adopted or are considering adopting similar laws and regulations. In addition, it is unclear how and whether other regulators – including FINRA, banking regulators, and the state securities and insurance regulators – may respond to or attempt to enforce similar issues addressed by the former DOL Rule and the proposed SEC Rule.

Because ERISA plans and IRAs comprise a significant portion of our business, we continue to expect that compliance with current and future laws and regulations governing retail retirement savings, including reliance on prohibited transaction exemptions under such laws and regulations, will require increased legal, compliance, information technology, and other costs and could lead to a greater risk of class action lawsuits and other litigation. Moreover, uncertainty regarding the status of further guidance or rulemaking from the DOL, as well as pending and future laws and regulations, including the SEC Rule and state rules, relating to the standards of conduct applicable to both retirement and non-retirement accounts, impacts on our business in ways which cannot be anticipated or planned for, and which may have further impact on our products and services, and results of operations.

Acquisitions, Integrations, and Divestitures

From time to time we undertake acquisitions or divestitures based on opportunities in the competitive landscape. These activities are part of our overall growth strategy, but can distort comparability when reviewing revenue and expense trends for periods presented.

On August 15, 2017, LPL Financial entered into an asset purchase agreement (the “Asset Purchase Agreement”) with National Planning Holdings, Inc. (“NPH”), and its four broker-dealer subsidiaries (collectively with NPH, the “NPH Sellers”) to acquire certain assets and rights of the NPH Sellers, including business relationships with financial advisors who became affiliated with LPL Financial (the “NPH Acquisition”). We paid $325 million to the NPH Sellers at closing, which occurred on August 15, 2017, and agreed to a potential contingent payment of up to $122.8 million. The conversion period under the Asset Purchase Agreement concluded in the first quarter of 2018, and no resulting contingent payment was due to the NPH Sellers. We incurred increased costs related to this transaction, including compensation and benefits expense related to the additional staffing, as well as contingent labor costs, needed to support the onboarding of NPH advisors and their clients to our systems, and fees for account closure and transfers

that we agreed to pay on behalf of NPH advisors under the Asset Purchase Agreement. Although these onboarding costs were substantially complete prior to the third quarter of 2018, we expect to continue to incur increased costs related to providing ongoing support to the increased numbers of advisors, clients, and total assets served on our platform, as well as financial assistance costs for advisors that joined LPL Financial. See Note 4 *Acquisitions*, within the notes to the unaudited condensed consolidated financial statements for further detail.

Economic Overview and Impact of Financial Market Events

Our business is directly and indirectly sensitive to several macroeconomic factors and the state of the U.S. financial markets. In the United States, economic data continued to point to steady economic growth through September 30, 2018. According to the most recent estimate by the Bureau of Economic Analysis, real gross domestic product ("GDP") grew at an annualized rate of 4.2% in the second quarter of 2018 and 3.0% compared to the second quarter a year ago. Data received in the third quarter suggest continued steady growth with a healthy labor market, stable consumer spending, signs of improved business investment, and low interest rates relative to historical rates. U.S. business and consumer confidence remained elevated, with only modest declines since the run-up following the U.S. elections in November 2016. Inflation picked up with improved economic growth but remained contained. While the overall data were largely positive, concerns about U.S. trade policy increased, with some anecdotal evidence that uncertainty led some businesses to scale back capital spending plans. The Federal Reserve's ("Fed") most recent median projection for 2018 GDP put growth at 3.1%, with slower but still above-trend 2.5% growth in 2019. Growth in this range could further tighten the labor market, push wages higher, and increase the probability the Fed will follow through on its median projection of four rate hikes in total in 2018 and three in 2019.

U.S. stocks returned 7.7% during the third quarter, based on the S&P 500 Index, bringing the year-to-date total return for the index to 10.6% through September 30, 2018. U.S. stocks outpaced international developed and, in particular, emerging market stocks as measured by MSCI indexes. Emerging market stocks fell over the quarter and entered bear market territory (a price decline of more than 20%) in September. Bonds were flat during the quarter in the face of rising interest rates, based on the Bloomberg Barclays Aggregate Bond Index. The 10-year Treasury yield continued to push higher, ending the third quarter above 3.0%. At the same time, credit spreads for high yield corporate bonds finished the quarter near their tightest of the expansion, signaling investor confidence in the ability of bond issuers to meet their obligations.

Our business is also sensitive to current and expected short-term interest rates, which are largely driven by Fed policy. Please consult the Risks Related to Our Business and Industry section within Part I, "Item 1A. Risk Factors" in our 2017 Annual Report on Form 10-K for more information about the risks associated with significant interest rate changes, and the potential related effects on our profitability and financial condition. Following the conclusion of its September 25-26, 2018 policy meeting, the Fed's policy arm, the Federal Open Market Committee ("FOMC") raised the target range of the federal funds rate to 2.00 - 2.25%, its third hike of 2018 and eighth of the expansion. Projection materials that accompanied the statement indicated a median expectation of one additional rate hike in 2018 and three in 2019. Growth expectations rose slightly from the prior set of forecasts for 2018 and 2019, while inflation expectations were largely unchanged. The policy statement indicated that the current policy of gradual rate increases was expected to continue but would remain data dependent.

Results of Operations

The following discussion presents an analysis of our results of operations for the three and nine months ended September 30, 2018 and 2017. Where appropriate, we have identified specific events and changes that affect comparability or trends, and where possible and practical, have quantified the impact of such items.

	Three Months Ended September 30,			Nine Months Ended September 30,		
(In thousands)	**2018**	**2017**	**% Change**	**2018**	**2017**	**% Change**
REVENUES						
Commission	$486,875	$403,011	20.8 %	$1,449,771	$1,244,881	16.5 %
Advisory	458,087	356,945	28.3 %	1,319,391	1,033,319	27.7 %
Asset-based	248,895	183,953	35.3 %	706,834	514,626	37.3 %
Transaction and fee	118,941	103,999	14.4 %	352,045	321,522	9.5 %
Interest income, net of interest expense	10,512	6,162	70.6 %	28,426	17,931	58.5 %
Other	7,687	10,038	(23.4)%	14,891	32,760	(54.5)%
Total net revenues	1,330,997	1,064,108	25.1 %	3,871,358	3,165,039	22.3 %
EXPENSES						
Commission and advisory	821,950	663,765	23.8 %	2,384,266	1,971,874	20.9 %
Compensation and benefits	128,007	113,659	12.6 %	373,884	337,170	10.9 %
Promotional	52,628	42,935	22.6 %	163,462	111,595	46.5 %
Depreciation and amortization	22,838	21,996	3.8 %	65,759	63,933	2.9 %
Amortization of intangible assets	15,676	9,352	67.6 %	44,580	28,296	57.5 %
Occupancy and equipment	30,308	22,803	32.9 %	84,848	70,989	19.5 %
Professional services	23,129	16,438	40.7 %	61,223	50,732	20.7 %
Brokerage, clearing, and exchange	15,844	13,491	17.4 %	47,154	41,567	13.4 %
Communications and data processing	12,334	10,866	13.5 %	34,546	32,525	6.2 %
Other	29,219	24,376	19.9 %	88,175	71,140	23.9 %
Total operating expenses	1,151,933	939,681	22.6 %	3,347,897	2,779,821	20.4 %
Non-operating interest expense	31,705	26,519	19.6 %	93,267	78,131	19.4 %
Loss on extinguishment of debt	—	1,268	(100.0)%	—	22,407	(100.0)%
INCOME BEFORE PROVISION FOR INCOME TAXES	147,359	96,640	52.5 %	430,194	284,680	51.1 %
PROVISION FOR INCOME TAXES	40,494	38,498	5.2 %	111,033	109,915	1.0 %
NET INCOME	$106,865	$58,142	83.8 %	$319,161	$174,765	82.6 %

Revenues

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers: Topic 606*, to supersede nearly all existing revenue recognition guidance under accounting principles generally accepted in the United States ("GAAP"). We adopted the provisions of this guidance on January 1, 2018 using the modified retrospective approach. The adoption did not have a material impact on the timing or amounts of our revenue recognition but impacted the disclosures within the notes to the consolidated financial statements.

Commission Revenues

We generate two types of commission revenues: sales-based commissions and trailing commissions. Sales-based commission revenues, which occur when clients trade securities or purchase various types of investment products, primarily represent gross commissions generated by our advisors. The levels of sales-based commission revenues 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. Trailing commission revenues (commissions that are paid over time, such as 12(b)-1 fees) are recurring in nature and are earned based on the market value of investment holdings in trail eligible assets. We earn trailing commission revenues primarily on mutual funds and variable annuities held by clients of our advisors. See Note 3. *Revenues,* within the notes to the unaudited condensed consolidated financial statements for further detail regarding our commission revenue by product category.

The following table sets forth our commission revenue, by sales-based and trailing commission revenue (dollars in thousands):

	Three Months Ended September 30,				
	2018	**2017**	**$ Change**	**% Change**	
Sales-based	$193,545	$160,098	$33,447	20.9	%
Trailing	293,330	242,913	50,417	20.8	%
Total commission revenue	$486,875	$403,011	$83,864	20.8	%

The increase in sales-based commission revenue for the three months ended September 30, 2018, compared with the same period in 2017 was primarily due to the impact of the NPH Acquisition. The remaining increase was attributable to growth in the brokerage environment, which includes product innovation in annuities related to rising interest rates.

The increase in trailing revenues for the three months ended September 30, 2018, compared with the same period in 2017 was due to additional assets onboarded from NPH advisors, improved investor engagement, and market appreciation resulting in an increase in the market value of the underlying assets.

The following table sets forth our commission revenue, by sales-based and trailing commission revenue (dollars in thousands):

	Nine Months Ended September 30,				
	2018	**2017**	**$ Change**	**% Change**	
Sales-based	$577,308	$528,516	$48,792	9.2	%
Trailing	872,463	716,365	156,098	21.8	%
Total commission revenue	$1,449,771	$1,244,881	$204,890	16.5	%

The increase in sales-based commission revenue for the nine months ended September 30, 2018, compared with the same period in 2017 was primarily due to the impact of the NPH Acquisition. The remaining increase was attributable to growth in the demand for variable and fixed annuities and fixed income products as a result of market volatility and rising interest rates.

The increase in trailing revenues for the nine months ended September 30, 2018, compared with the same period in 2017 was due to additional assets onboarded from NPH advisors, improved investor engagement, and market appreciation resulting in an increase in the market value of the underlying assets.

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The following table summarizes activity in brokerage assets for the periods presented (in billions):

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2018	**2017**	**2018**	**2017**
Balance - Beginning of period	$367.5	$305.2	$342.1	$297.8
Net new brokerage assets	(0.8)	(4.0)	23.2	(12.9)
Market impact(1)	8.2	8.6	9.6	24.9
Balance - End of period	$374.9	$309.8	$374.9	$309.8

(1) Market impact is the difference between the beginning and ending asset balance less the net new asset amounts, with such difference representing the implied growth or decline in asset balances due to market changes over the same period of time.

Advisory Revenues

Advisory revenues primarily represent fees charged on our corporate RIA platform provided through LPL Financial to clients of our advisors based on the value of their advisory assets. Advisory fees are billed to clients on either a calendar quarter or non-calendar quarter basis of their choice, at the beginning of that period, and are recognized as revenue ratably during the quarter. The majority of our accounts are billed in advance using values as of the last business day of each immediately preceding calendar 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. Advisory revenues collected on our corporate advisory platform are proposed by the advisor and agreed to by the client and average 1.0% of the underlying assets with a maximum of 3.0% of the underlying assets as of September 30, 2018.

We also support Hybrid RIAs, through our independent advisory platform, which allows advisors to engage us for technology, clearing, and custody services, as well as access to the capabilities of our investment platforms. The assets held under a Hybrid RIA's investment advisory accounts custodied with LPL Financial are included in our brokerage and advisory assets, net new advisory assets, and advisory assets under custody metrics. However, we charge separate fees to Hybrid RIAs for technology, clearing, administrative, oversight, and custody services. The administrative fees collected on our independent advisory platform vary and can reach a maximum of 0.6% of the underlying assets as of September 30, 2018.

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.

The following table summarizes activity in advisory assets (in billions):

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2018	**2017**	**2018**	**2017**
Balance - Beginning of period	$291.5	$236.8	$273.0	$211.6
Net new advisory assets	5.1	6.9	22.6	18.8
Market impact(1)	9.5	6.5	10.5	19.8
Balance - End of period	$306.1	$250.2	$306.1	$250.2

(1) Market impact is the difference between the beginning and ending asset balance less the net new asset amounts, with such difference representing the implied growth or decline in asset balances due to market changes over the same period of time.

Net new advisory assets for the three and nine months ended September 30, 2018 and 2017 had a limited impact on our advisory fee revenue for those respective periods. Rather, net new advisory assets are a primary driver of future advisory fee revenue. The revenue for any particular quarter is primarily driven by the value of each of the prior quarter's month-end advisory assets under custody.

The growth in advisory revenue for the three and nine months ended September 30, 2018 compared to the same period in 2017 was due to net new advisory assets resulting from our recruiting efforts, the NPH

Acquisition, and strong advisor productivity, as well as market gains as represented by higher levels of the S&P 500 index.

The following table summarizes the composition of total advisory assets as of September 30, 2018 and 2017 (in billions):

	September 30,			
	2018	**2017**	**$ Change**	**% Change**
Corporate platform advisory assets	$184.8	$145.0	$ 39.8	27.4 %
Hybrid platform advisory assets	121.3	105.2	16.1	15.3 %
Total advisory assets(1)	$306.1	$250.2	$ 55.9	22.3 %

(1) Balances may not foot due to rounding.

Asset-Based Revenues

Asset-based revenues are comprised of our sponsorship programs with financial product manufacturers, omnibus processing and networking services, collectively referred to as recordkeeping, and fees from our cash sweep program. We receive fees from certain financial product manufacturers in connection with sponsorship programs that support our marketing and sales education and training efforts. Omnibus processing revenues are paid to us by mutual fund product sponsors and are based on 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. Pursuant to contractual arrangements, uninvested cash balances in our advisors' client accounts are swept into either insured cash accounts at various banks or third-party money market funds, for which we receive fees, including administrative and recordkeeping fees based on account type and the invested balances.

Asset-based revenues for the three and nine months ended September 30, 2018 increased compared to the same periods in 2017 primarily due to increased revenues from our cash sweep program and recordkeeping and sponsorship programs.

Cash sweep revenue for the three and nine months ended September 30, 2018 increased compared to the same periods in 2017 due to the impact of increases in the target range for the federal funds effective rate. For the three months ended September 30, 2018, our average cash sweep balances increased slightly as compared to the same period in 2017, with balances of $28.2 billion and $28.0 billion, respectively. For the nine months ended September 30, 2018, our average cash sweep balances remained unchanged compared to the same period in 2017, with balances of $28.7 billion as of the end of both periods.

Revenues for our recordkeeping and sponsorship programs for the three and nine months ended September 30, 2018, which are largely based on the market value of the underlying assets, increased compared to the same periods in 2017 due to the impact of market appreciation on the value of those underlying assets and additional assets onboarded from NPH advisors.

Transaction and Fee Revenues

Transaction revenues primarily include fees we charge to our advisors and their clients for executing certain transactions in brokerage and fee-based advisory accounts. Fee revenues primarily include IRA custodian fees, contract and licensing fees, and other client account fees. In addition, we host certain advisor conferences that serve as training, education, sales, and marketing events, for which we charge a fee for attendance.

Transaction and fee revenues increased for the three and nine months ended September 30, 2018 compared to the same periods in 2017 primarily due to a higher volume of fixed income transactions related to the federal funds rate increases and higher transaction volumes in trades in advisory accounts that generate transaction-based revenue, which resulted from an increase in brokerage to advisory conversions by our existing advisors as well as the impact from the NPH Acquisition.

Interest Income, Net of Interest Expense

We earn interest income from client margin accounts and cash equivalents, net of operating expense. Period-over-period variances correspond to changes in the average balances of assets in margin accounts and cash equivalents as well as changes in interest rates.

Interest Income, net of interest expense increased for the three and nine months ended September 30, 2018, compared to the same periods in 2017 primarily due to the impact of rising interest rates.

Other Revenues

Other revenues primarily include mark-to-market gains and losses on assets held by us for our advisor non-qualified deferred compensation plan and model research portfolios, 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, and other miscellaneous revenues.

Other revenues decreased for the three and nine months ended September 30, 2018 compared to the same periods in 2017 primarily due to unrealized losses on assets held in our advisor non-qualified deferred compensation plan, which are based on the market performance of the underlying investment allocations chosen by advisors in the plan, offset by increases in dividend income on assets held in our advisor non-qualified deferred compensation plan.

Expenses

Commission and Advisory Expenses

Commission and advisory expenses are comprised of the following: base payout amounts that are earned by and paid out to advisors and institutions based on commission and advisory revenues earned on each client's account (referred to as gross dealer concessions, or "GDC"); production bonuses earned by advisors and institutions 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; and the deferred commissions and advisory fee expenses associated with mark-to-market gains or losses on the non-qualified deferred compensation plan offered to our advisors.

The following table shows the components of our production payout and total payout ratios, each of which is a statistical or operating measure:

	Three Months Ended September 30,		Change	Nine Months Ended September 30,		Change
	2018	2017		2018	2017	
Base payout rate(1)	83.02%	83.01%	1 bps	82.87%	82.98%	(11 bps)
Production based bonuses	3.36 %	3.04 %	32 bps	2.75 %	2.44 %	31 bps
GDC sensitive payout	86.38%	86.05%	33 bps	85.62%	85.42%	20 bps
Non-GDC sensitive payout(2)	0.60 %	1.29 %	(69 bps)	0.48 %	1.13 %	(65 bps)
Total payout ratio	86.98%	87.34%	(36 bps)	86.10%	86.55%	(45 bps)

(1) Our base payout rate is calculated as commission and advisory expenses, divided by GDC (see description above).

(2) Non-GDC sensitive payout includes share-based compensation expense from equity awards granted to advisors and financial institutions and mark-to-market gains or losses on amounts designated by advisors as deferred.

Our total payout ratio, a statistical or operating measure, decreased for the three and nine months ended September 30, 2018 compared with the same periods in 2017 primarily due to a decrease in non-GDC sensitive payout, which includes advisor deferred compensation and advisor share-based compensation.

Compensation and Benefits Expense

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
Average number of employees	4,078	3,508	16.2%	3,947	3,397	16.2%

Compensation and benefits expense increased for the three and nine months ended September 30, 2018 compared with the same periods in 2017 due to an increase in salary and employee benefit expenses resulting from an increase in headcount.

Promotional Expense
Promotional expenses include costs related to our hosting of certain advisor conferences that serve as training, sales, and marketing events, as well as business development costs related to recruiting, such as transition assistance and amortization related to forgivable loans issued to advisors.
The increase in promotional expense for the three and nine months ended September 30, 2018 compared with the same periods in 2017 was primarily driven by increases in costs associated with advisor transition assistance, recruiter and advisor promotions related to the onboarding of NPH advisors, and increases in business development expenses associated with broker training and education.
Depreciation and Amortization Expense
Depreciation and amortization expense represents the benefits received for using long-lived assets. Those assets consist of fixed assets, which include internally developed software, hardware, leasehold improvements, and other equipment.
Depreciation and amortization expense remained relatively flat for the three and nine months ended September 30, 2018 compared with the same periods in 2017, as increases in internally developed software were offset by decreases in leasehold improvements.
Amortization of Intangible assets
Amortization of intangible assets represents the benefits received for using long-lived assets, which consist of intangible assets established through our acquisitions.
The increase in amortization of intangible assets for the three and nine months ended September 30, 2018 compared with the same periods in 2017 was due to the intangible assets recorded as part of the NPH Acquisition.
Occupancy and Equipment Expense
Occupancy and equipment expense includes the costs of leasing and maintaining our office spaces, software licensing and maintenance costs, and maintenance expenses on computer hardware and other equipment.
The increase in occupancy and equipment expense for the three months ended September 30, 2018 compared with the same period in 2017 was primarily due to an increase in costs related to repairs and maintenance and software licensing fees in support of our service and technology investments.
The increase in occupancy and equipment expense for the nine months ended September 30, 2018 compared with the same period in 2017 was primarily due to an increase in costs related to non-capitalized software and software licensing fees in support of our service and technology investments.
Professional Services
Professional services includes costs paid to outside firms for assistance with legal, accounting, technology, regulatory, marketing, and general corporate matters, as well as non-capitalized costs related to service and technology enhancements.
The increase in professional services for the three months ended September 30, 2018 compared with the same period in 2017 was primarily due to increases in costs related to our service and technology projects during the period.
The increase in professional services for the nine months ended September 30, 2018 compared with the same period in 2017 was primarily due to an increase in costs related to our service and technology projects, offset by decreases in outsourced service and technology projects during the period.
Brokerage, Clearing, and Exchange Fees
Brokerage, clearing, and exchange fees include expenses originating from trading and clearing operations as well as any exchange membership fees. Changes in brokerage, clearing and exchange fees fluctuate largely in line with the volume of sales and trading activity.
The increase in brokerage, clearing, and exchange fees is relatively consistent with the volume of sales and trading activity for the three and nine months ended September 30, 2018, compared with the same periods in 2017.

Communications and Data Processing
Communications expense consists primarily of the cost of voice and data telecommunication lines supporting our business, including connectivity to data centers, exchanges, and markets. Data processing expense consists primarily of customer statement processing and postage costs.
The increase in communications and data processing expense for the three and nine months ended September 30, 2018 compared with the same periods in 2017 was primarily due to an increase in costs related to customer statements.
Other Expenses
Other expenses include the estimated costs of the investigation, settlement, and resolution of regulatory matters (including customer restitution and remediation), licensing fees, insurance, broker-dealer regulator fees, and other miscellaneous expenses. We expect other expenses to increase in 2018 compared to 2017, including as a result of the greater size and scale of our business resulting from the NPH Acquisition. Our other expenses in 2018 will depend on the size and timing of resolving regulatory matters and the availability of self-insurance coverage, which depends in part on the amount and timing of resolving historical claims. There are particular uncertainties and complexities involved when assessing the potential costs and timing of regulatory matters, including whether loss reserves at our captive insurance subsidiary will be adequate to cover such losses.
The increase in other expenses for the three and nine months ended September 30, 2018 compared with the same periods in 2017 was primarily driven by higher costs associated with the investigation, settlement, and resolution of regulatory matters.
Non-Operating Interest Expense
Non-operating interest expense represents expense for our senior secured credit facilities and senior unsecured notes issued in March and September 2017 (the "Notes"). Period over period increases correspond to higher LIBOR rates and the issuance of the Notes during 2017.
Loss on Extinguishment of Debt
On September 21, 2017, we entered into a second amendment (“the Amendment”) which amended and restated the existing credit agreement of our subsidiary LPL Holdings, Inc. In connection with the execution of the Amendment, we accelerated the recognition of $1.3 million of unamortized debt issuance costs as a loss on extinguishment of debt in our unaudited condensed consolidated statements of income in the third quarter of 2017.
In March 2017, we closed a refinancing of our senior secured credit facilities with a new seven year Term Loan B facility. The refinancing led to the extinguishment of the previous Term Loan A and B facilities, which required that we accelerate the recognition of $21.1 million of related unamortized debt issuance costs as a loss on extinguishment of debt in our unaudited condensed consolidated statements of income in the first quarter of 2017.
Provision for Income Taxes
On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (H.R. 1), the tax reform bill (the "Tax Act"), was signed into law. The Tax Act provided a permanent reduction in our federal corporate income tax rate from 35% to 21%, effective January 1, 2018. We will continue to analyze the Tax Act to determine the full effects that the new law, including the new lower corporate tax rate, has on our financial statements.
We estimate our full-year effective income tax rate at the end of each reporting period. This estimate is used in providing for income taxes on a year-to-date basis and may change in subsequent interim periods. The tax rate in any quarter can be affected positively and negatively by adjustments that are required to be reported in the quarter in which resolution of a particular item occurs. The effective income tax rates reflect the impact of state taxes, settlement contingencies, tax credits, and other permanent differences in tax deductibility of certain expenses.
Our effective tax rate was 27.5% and 39.8% for the three months ended September 30, 2018 and 2017, respectively.
Our effective tax rate was 25.8% and 38.6% for the nine months ended September 30, 2018 and 2017, respectively.

The decrease in our effective income tax rate for the three and nine months ended September 30, 2018 compared with the same periods in 2017 was primarily due to the tax benefit associated with the federal rate reduction under the Tax Act, stock option exercises under ASC 718, and the reduction of settlement contingencies.

Liquidity and Capital Resources

Senior management establishes our liquidity and capital policies. These policies include senior management's review of short- and long-term cash flow forecasts, review of capital expenditures, and daily monitoring of liquidity for our subsidiaries. Decisions on the allocation of capital are based upon, among other things, projected profitability and cash flow, risks of the business, regulatory capital requirements, and future liquidity needs for strategic activities. Our Treasury Department assists in evaluating, monitoring, and controlling the business activities that impact our financial condition, liquidity, and capital structure. The objectives of these policies are to support our corporate business strategies while ensuring ongoing and sufficient liquidity.

A summary of changes in our cash flow is provided as follows (in thousands):

	Nine Months Ended September 30,	
	2018	2017
Net cash flows (used in) provided by:		
Operating activities	$196,063	$123,608
Investing activities	(86,353)	(413,554)
Financing activities	(341,937)	109,206
Net decrease in cash, cash equivalents and restricted cash	(232,227)	(180,740)
Cash, cash equivalents and restricted cash — beginning of period	1,625,655	1,558,608
Cash, cash equivalents and restricted cash — end of period	$1,393,428	$1,377,868

Cash requirements and liquidity needs are primarily funded through our cash flow from operations and our capacity for additional borrowing.

Net cash provided by operating activities includes changes in operating assets and liabilities, including balances related to the settlement and funding of client transactions, receivables from product sponsors, and accrued commission and advisory expenses due to our advisors. Operating assets and liabilities that arise from the settlement and funding of transactions by our advisors' clients are the principal cause of changes to our net cash from operating activities and can fluctuate significantly from day-to-day and period-to-period depending on overall trends and clients' behaviors.

The increase in cash flows provided by operating activities for the nine months ended September 30, 2018 compared to the same period in 2017 was primarily attributable to an increase in draft payable, payables to broker-dealers and clearing organizations, accrued commission and advisory expenses payable and income tax payable due to the timing of payments made, and a decrease in securities borrowed. These were partially offset by a decrease in payables to clients due to the timing of payments, and an increase in receivables from clients and advisor loans.

The decrease in cash flows used in investing activities for the nine months ended September 30, 2018 compared to the same period in 2017 was due to the NPH Acquisition in 2017.

The increase in cash flows used in financing activities for the nine months ended September 30, 2018 compared to the same period in 2017 was primarily attributable to an increase in repurchases of our common stock, partially offset by a decrease in payment of debt issuance costs. Financing activities provided cash for the same period in 2017 due to proceeds received from senior secured term loans and senior notes.

We believe that based on current levels of operations and anticipated growth, cash flow from operations, together with other available sources of funds, which include three uncommitted lines of credit available and the revolving credit facility established through our senior secured credit agreement (the "Credit Agreement"), will be adequate to satisfy our working capital needs, the payment of all of our obligations, and the funding of anticipated capital expenditures for the foreseeable future. In addition, we have certain capital adequacy requirements related to our registered broker-dealer subsidiary and bank trust subsidiary and have met all such requirements and expect to continue to do so for the foreseeable future. We regularly evaluate our existing indebtedness, including refinancing thereof, based on a number of factors, including our capital requirements, future prospects, contractual restrictions, the availability of refinancing

on attractive terms, and general market conditions.

Share Repurchases

We engage in share repurchase programs, which are approved by our board of directors ("Board of Directors"), pursuant to which we may repurchase our issued and outstanding shares of common stock from time to

time. Purchases may be effected in open market or privately negotiated transactions, including transactions with our affiliates, with the timing of purchases and the amount of stock purchased generally determined at our discretion within the constraints of our Credit Agreement, the indenture governing our Notes, and general liquidity needs. See Note 10. *Stockholders' Equity*, within the notes to unaudited condensed consolidated financial statements for additional information regarding our share repurchases.

During the nine months ended September 30, 2018, we repurchased a total of 4,608,020 shares of our common stock at a weighted-average price of $65.12 per share for a total cost of $300.1 million. As of September 30, 2018, the Company was authorized to purchase up to an additional $200.0 million of shares pursuant to the share repurchase programs approved by the Board of Directors.

Dividends

The payment, timing, and amount of any dividends are subject to approval by the Board of Directors as well as certain limits under our Credit Agreement and the indenture governing our Notes. See Note 10. *Stockholders' Equity*, within the notes to the unaudited condensed consolidated financial statements for additional information regarding our dividends.

Operating Capital Requirements

Our primary requirement for working capital relates to funds we loan to our advisors' clients for trading conducted on margin and funds that we are required to maintain for regulatory capital and reserves based on the requirements of our regulators and clearing organizations, which also consider client balances and trading activities. We have several sources of funds that enable us to meet increases in working capital requirements that relate to increases in client margin activities and balances. These sources include cash and cash equivalents on hand, cash segregated under federal and other regulations, and proceeds from re-pledging or selling client securities in margin accounts. When an advisor's client purchases securities on margin or uses securities as collateral to borrow from us on margin, we are permitted, pursuant to the applicable securities industry regulations, to repledge, loan, or sell securities, up to 140% of the client's margin loan balance, that collateralize those margin accounts. As of September 30, 2018, we had approximately $293.5 million of client margin loans, collateralized with securities having a fair value of approximately $410.9 million that we can re-pledge, loan, or sell. Of these securities, approximately $56.5 million were client-owned securities pledged to the Options Clearing Corporation as collateral to secure client obligations related to options positions. As of September 30, 2018, there were no restrictions that materially limited our ability to re-pledge, loan, or sell the remaining $354.3 million of client collateral.

Our other working capital needs are primarily related to advisor loans and timing associated with receivables and payables, which we have satisfied in the past from internally generated cash flows. Notwithstanding the self-funding nature of our operations, we may sometimes be required to fund timing differences arising from the delayed receipt of client funds associated with the settlement of client transactions in securities markets. These timing differences are funded either with internally generated cash flow or, if needed, with funds drawn on our uncommitted lines of credit at LPL Financial, or under our revolving credit facility.

Our registered broker-dealer, LPL Financial, is subject to the SEC's Uniform Net Capital Rule, which requires the maintenance of minimum net capital. LPL Financial computes net capital requirements under the alternative method, which requires firms to maintain minimum net capital, as defined, equal to the greater of $250,000 or 2.0% of aggregate debit balances arising from client transactions. At September 30, 2018, LPL Financial had net capital of $166.1 million with a minimum net capital requirement of $8.5 million. LPL Financial's ability to pay dividends greater than 10% of its excess net capital during any 35 day rolling period requires approval from the Financial Industry Regulatory Authority ("FINRA"). In addition, payment of dividends is restricted if LPL Financial's net capital would be less than 5% of aggregate customer debit balances.

LPL Financial also acts as an introducing broker for commodities and futures. Accordingly, its trading activities are subject to the National Futures Association's ("NFA") financial requirements and it is required to maintain net capital that is in excess of or equal to the greatest of NFA's minimum financial requirements. The NFA was designated by the Commodity Futures Trading Commission as LPL Financial's

primary regulator for such activities. Currently, the highest NFA requirement is the minimum net capital calculated and required pursuant to the SEC’s Net Capital Rule.
Our subsidiary, The Private Trust Company, N.A. (“PTC”), is also subject to various regulatory capital requirements. Failure to meet the respective 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 on PTC’s operations.

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Debt and Related Covenants

See Note 8*. Debt,* within the notes to the unaudited condensed consolidated financial statements for further detail regarding the Credit Agreement.

The Credit Agreement and the indenture governing the Notes contain a number of covenants that, among other things, restrict, subject to certain exceptions, our ability to:

- incur additional indebtedness or issue disqualified stock or preferred stock;
- declare dividends, or other distributions to shareholders;
- repurchase equity interests;
- redeem indebtedness that is subordinated in right of payment to certain debt instruments;
- make investments or acquisitions;
- create liens;
- sell assets;
- guarantee indebtedness;
- engage in certain transactions with affiliates;
- enter into agreements that restrict dividends or other payments from subsidiaries; and
- consolidate, merge or transfer all or substantially all of our assets.

Credit Agreement EBITDA, a non-GAAP financial measure, is defined in, and calculated by management in accordance with, the Credit Agreement as "Consolidated EBITDA", which is Consolidated Net Income (as defined in the Credit Agreement) plus interest expense, tax expense, depreciation and amortization, and further adjusted to exclude certain non-cash charges and other adjustments (including unusual or non-recurring charges and gains), and to include future expected cost savings, operating expense reductions or other synergies from certain transactions, including the NPH Acquisition. We present Credit Agreement EBITDA because we believe that it can be a useful financial metric in understanding our debt capacity and covenant compliance. However, Credit Agreement EBITDA is not a measure of our financial performance under GAAP and should not be considered as an alternative to net income or any other performance measure derived in accordance with GAAP, or as an alternative to cash flows from operating activities as a measure of profitability or liquidity. In addition, our Credit Agreement-defined EBITDA can differ significantly from adjusted EBITDA calculated by other companies, depending on long-term strategic decisions regarding capital structure, the tax jurisdictions in which companies operate, capital investments, and types of adjustments made by such companies.

Set forth below is a reconciliation from our net income to Credit Agreement EBITDA for the trailing twelve months ended September 30, 2018 (in thousands):

Net income	$383,259
Non-operating interest expense	122,161
Provision for income taxes	126,825
Depreciation and amortization	85,897
Amortization of intangible assets	54,577
EBITDA	772,719
Credit Agreement Adjustments:	
Employee share-based compensation expense(1)	22,274
Advisor share-based compensation expense(2)	7,886
NPH run-rate EBITDA accretion(3)	92,000
Realized NPH EBITDA Offset(4)	(50,500)
NPH onboarding costs	70,132
Other(5)	17,294
Credit Agreement EBITDA(6)	$931,805

(1) Represents share-based compensation for equity awards granted to employees, officers, and directors. Such awards are measured based on the grant-date fair value and recognized over the requisite service

period of the individual awards, which generally equals the vesting period.

(2) Represents share-based compensation for equity awards granted to advisors and to financial institutions based on the fair value of the awards at each reporting period.

(3) Represents estimated potential future cost savings, operating expense reductions or other synergies included in Credit Agreement EBITDA in accordance with the Credit Agreement relating to the acquisition of NPH. Such amounts do not represent actual performance and there can be no assurance that any such cost savings, operating expense reductions or other synergies will be realized.

(4) Represents the portion of Credit Agreement EBITDA that management estimates to be attributable to the NPH Acquisition, which is added back to offset NPH run-rate EBITDA accretion, in accordance with the Credit Agreement.

(5) Represents items that are adjustable in accordance with the Credit Agreement to calculate Credit Agreement EBITDA, including employee severance costs, employee signing costs, employee retention or completion bonuses, and other non-recurring costs.

(6) In calculating Credit Agreement EBITDA for a twelve month period at the end of each quarter, management may make adjustments to prior quarters.

Our Credit Agreement and the indenture governing the Notes prohibit us from paying dividends and distributions or repurchasing our capital stock except for limited purposes or in limited amounts. In addition, our revolving credit facility requires compliance with a maximum Consolidated Total Debt to Consolidated EBITDA Ratio ("Leverage Test", as defined in the Credit Agreement) and a minimum Consolidated EBITDA to Consolidated Interest Expense Ratio ("Interest Coverage", as defined in the Credit Agreement), tested as of the last day of each fiscal quarter. The breach of this covenant is subject to certain equity cure rights. As of September 30, 2018, we were in compliance with both of our financial covenants. The maximum permitted ratios under our financial covenants and actual ratios were as follows:

Financial Ratio	Covenant Requirement	Actual Ratio
Leverage Test (Maximum)	5.00	2.24
Interest Coverage (Minimum)	3.00	8.09

Off-Balance Sheet Arrangements

We enter into various off-balance-sheet arrangements in the ordinary course of business, primarily to meet the needs of our advisors' clients. These arrangements include Company commitments to extend credit. For information on these arrangements, see Note 9. *Commitments and Contingencies* and Note 16. *Financial Instruments with Off-Balance-Sheet Credit Risk and Concentrations of Credit Risk,* within the notes to the unaudited condensed consolidated financial statements.

Contractual Obligations

During the nine months ended September 30, 2018, there have been no material changes in our contractual obligations, other than in the ordinary course of business, from those disclosed in our 2017 Annual Report on Form 10-K. See Note 8. *Debt* and Note 9. *Commitments and Contingencies,* within the notes to the unaudited condensed consolidated financial statements, as well as the Contractual Obligations section within Part II, "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in our2017 Annual Report on Form 10-K, for further detail on operating lease obligations and obligations under noncancelable service contracts.

Fair Value of Financial Instruments

We use fair value measurements to record certain financial assets and liabilities at fair value and to determine fair value disclosures. See Note 5*. Fair Value Measurements,* within the notes to the unaudited condensed consolidated financial statements for a detailed discussion regarding our fair value measurements.