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NEWS RELEASE

WHAT TO MAKE OF LPL NEARING A SUCCESSFUL – BUT SCALED BACK – IPO

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Originally Published By Brooke Southall, RIABiz

*Brooke's Note: I kept hearing from industry observers that LPL Financial's public offering bid was looking long-in-the-tooth as the months dragged by with no action. But when I checked [over recent weeks] with a key investment banking source, **Dan Seivert**, he assured me that the whole idea is to file and then wait — sometimes for six months or more — for an opportune moment. Reading anything into the passing months was over-analyzing. Yesterday he told me he saw several factors that may pave the way for LPL to turn public including: the Dow Jones industrial index at a two-year high, GM's pending IPO energizing investors, a Federal stimulus of \$600 billion and business-minded Republicans winning seats in Congress.*

LPL Investment Holdings has set pricing on its long-awaited public offering, but the amount raised, \$445 million, would be about a quarter less than its SEC filings suggested it would strive to raise back in June.

The Boston-based independent broker-dealer will – if all goes well – sell 17,176,195 shares at \$28.50 per share. The range is \$30 at the high end and the \$27 on the low end.

The lower-than-expected pricing is a hard-won understanding between the company, its investment bankers and investors around the country who have assented to purchase shares from day one.

Big differential

The \$155 differential between the \$600 million that LPL stated it was seeking in its S-1 filing on June 4 will mostly affect investors in the company who are selling their shares to cash out and may reduce the amount that the company can pay down its \$1.4 billion of debt.

Still, a successful IPO at the price LPL is seeking will be a boon to the giant IBD and the industry, said one consultant.

"This has a huge positive psychological impact... this is the number one IBD — by a factor of 100%-plus — going public," says Charles "Chip" Roame, managing principal of Tiburon [Calif.] Strategic Advisors.

"The \$445 versus \$600 million is likely not the biggest issue... I think that the point is to make a partial public offering, frankly a minority one, create a public capital value and allow the firm to use additional stock to make acquisitions. All [effectively gets] accomplished at \$445 as well as \$600."

Indeed, getting a foot in the door as a publicly traded company has value because it likely means an overnight bump in value of about 30%, which creates a great currency of the stock for making acquisitions — but there's also a downside, according to **Dan Seivert**, CEO of **ECHELON Partners** of Manhattan Beach, Calif.

Blown wide open

The company will likely pay about \$2 million in regulatory-related and other costs to maintain that status. It also means — and LPL has famously valued its ruggedly private status — a shift in orientation. “Your company is blown wide open so your competition can have a field day reengineering your best practices,” he says.

In its Wednesday filing LPL explained that it will not receive any of the proceeds from the sale of common stock by selling stockholders. But if the underwriters exercise their option to purchase additional shares in full at \$28.50. LPL estimates its net proceeds will be \$35.4 million.

“We expect to use all of the net proceeds from this offering received by us to repay a portion of the term loans under our senior secured credit facilities,” the filing says.

It's notable, too, that the proceeds are beneficial to Mark Casady, chairman and CEO, Esther Stearns, the firm's president and chief operating officer for one and William Dwyer, the firm's president of national sales and marketing who stand to gain \$58 million, \$35 million and \$8.25 million from the offering. Goldman Sachs, an underwriter, owns shares and stands to gain \$58 million from a portion of its stake in the company. [Calculations made by InvestmentNews.]

Hundreds of LPL financial advisors own smaller stakes.

Plethora of secondary underwriters

An investment banking source who asked not to be named says there were signs early on that LPL shares were not being snapped up like hotcakes – starting with the large number of secondary underwriters that Goldman Sachs,

Morgan Stanley, Merrill Lynch and JPMorgan sought to cast a wider net. The observer says that LPL was not able to find big anchor investors among institutions.

The lead underwriters ended up joining forces with Sanford Bernstein, William Blair, CitiGroup Global, Keefe Bruyette Woods, Lazard Capital Markets, Macquarie Capital, Sandler O'Neill and UBS Securities.

If fewer investors rise initially to the LPL bait, it may have as much to do with how unique LPL is in the market as to how good its prospects are as an investment, according to Roame. He said that at times, he has difficulty explaining LPL even to some of the brighter minds on Wall Street because they're accustomed to evaluating banks and wirehouses.

“The IBD market is difficult to understand. Even a smart portfolio manager at a big mutual fund or pension fund still sees financial services as primarily banks – [which represent] about 60% of all financial services market cap — to a lesser extent the public insurance companies, and a small handful of investment banks/wirehouses. Most investment management firms are private with the exception of a T. Rowe Price or Franklin Templeton or a few others. And almost all independent broker/dealers are private. IBDs are a different breed; that's why they have to fight so hard in FINRA, SIFMA, and other places to explain/defend their model.”

From an M&A and capital-raising standpoint, “The big knock on IBDs has been that they're a low-margin business.”

Debt factor

LPL explained its reasons for going public back in its S-1 filing. Chief among them: debt.

The company accumulated much of its debt when it bought out its previous owner, Todd Robinson in 2005 in a deal valued at \$2.5 billion that included \$1.3 billion of debt.

“Our indebtedness could adversely affect our financial health... [it could]require us to dedicate a substantial portion of our cash flow from operation to payments on our indebtedness and may limit our flexibility in planning for changes in our business and the industry in which we operate,” says its S-1 filing.

Seivert says that debt levels are only significant when looked at in comparison to cash flow.

What matters is not the debt but the debt coverage but how many times cash flow exceeds the debt requirement. If current cash flow is 15 times the debt servicing requirement then the debt amount is very low risk, he says.

“If the debt were a real issue, the private equity firms [that own much of LPL] would restructure the debt prior to the offering,” Seivert says.

Bring out the Hellman’s

The two private equity firms — Hellman & Friedman LLC and TPG Group — each have 36.3% stakes in the company right now, according to the SEC filing. After the IPO, they will continue to own more than 31% each. What LPL has working in its favor is its ability to grow, Roame says.

“I think they will continue to outgrow other similar players... If [hypothetically] LPL adds 2,000 reps on 12,000 rep base, one says 15% growth. I say, they added the fourth or fifth biggest IBD,— distancing themselves forever from their 'peers' who are falling far behind already.”

ABOUT ECHELON PARTNERS

ECHELON Partners (ECHELON) was formed in 2001 to offer investment banking and consulting to a subset of the financial services industry known as “investment product developers and distributors” (IPDADs). Since that time, ECHELON’s professionals have helped hundreds of senior executives envision, initiate, and execute a multitude of complex business strategies and transactions. ECHELON’s business is making companies more valuable through delivering advice and orchestrating transactions. Accordingly, ECHELON measures its success in the enterprise value it creates for its clients. Companies that strive to outperform their peers choose to work with ECHELON because we are as passionate about their results as they are.

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