LPL Financial Holdings Inc.
Form 10-Q
October 31, 2012

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, 2012
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, 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 x	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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 26, 2012 was 108,544,407.

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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”, the “firm” 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, projected costs, plans, liquidity and ability and plans to repurchase shares and pay future dividends, as well as any other statements 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 31, 2012. The words “anticipates,” “believes,” “expects,” “may,” “plans,” “predicts,” “will” and sim 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; 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 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 success in integrating the operations of acquired businesses; 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 2011 Annual Report on Form 10-K. For example, the Company may be unable to successfully integrate the systems and operations related to our acquisitions of Concord Wealth Management, Fortigent Holdings Company, Inc. and Veritat Advisors Inc. and realize the expected synergies from these transactions. 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 those statements as representing the Company's views as of any date subsequent to the date of this quarterly report.

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Income
(Unaudited)
(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
REVENUES:				
Commissions	$442,129	$438,294	$1,353,025	$1,350,053
Advisory fees	267,334	267,878	786,507	776,254
Asset-based fees	100,024	89,691	300,049	270,018
Transaction and other fees	84,730	78,476	238,196	220,980
Interest income, net of interest expense	4,629	5,036	14,139	15,288
Other	8,382	3,482	24,928	18,129
Total net revenues	907,228	882,857	2,716,844	2,650,722
EXPENSES:				
Commissions and advisory fees	620,165	614,068	1,858,139	1,833,433
Compensation and benefits	91,309	77,337	273,355	242,889
Promotional	31,844	28,660	74,797	62,985
Depreciation and amortization	18,423	19,222	53,010	55,794
Professional services	15,672	10,656	46,992	33,309
Occupancy and equipment	13,914	13,637	42,418	41,556
Brokerage, clearing and exchange	9,938	9,818	29,007	28,868
Communications and data processing	10,249	9,235	28,945	26,823
Regulatory fees and expenses	6,979	6,441	21,416	19,385
Restructuring charges	1,211	7,684	4,962	13,035
Other	20,460	7,434	36,573	20,617
Total operating expenses	840,164	804,192	2,469,614	2,378,694
Non-operating interest expense	12,826	16,603	42,297	52,929
Loss on extinguishment of debt	—	—	16,524	—
Total expenses	852,990	820,795	2,528,435	2,431,623
INCOME BEFORE PROVISION FOR INCOME TAXES	54,238	62,062	188,409	219,099
PROVISION FOR INCOME TAXES	19,939	25,634	73,429	88,165
NET INCOME	$34,299	$36,428	$114,980	$130,934
EARNINGS PER SHARE (Note 12):				
Basic	$0.31	$0.33	$1.05	$1.19
Diluted	$0.31	$0.32	$1.02	$1.15

See notes to unaudited condensed consolidated financial statements.

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LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income
(Unaudited)
(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
NET INCOME	$34,299	$36,428	$114,980	$130,934
Other comprehensive income, net of tax:				
Unrealized gain on interest rate swaps, net of tax expense of $0 and $304 for the three months ended September 30, 2012 and 2011, and $527 and $2,004 for the nine months ended September 30, 2012 and 2011, respectively	—	464	850	3,209
Total other comprehensive income, net of tax	—	464	850	3,209
TOTAL COMPREHENSIVE INCOME	$34,299	$36,892	$115,830	$134,143

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)

	September 30, 2012	December 31, 2011
ASSETS		
Cash and cash equivalents	$445,971	$720,772
Cash and securities segregated under federal and other regulations	393,583	382,905
Receivables from:		
Clients, net of allowance of $791 at September 30, 2012 and $716 at December 31, 2011	326,873	301,292
Product sponsors, broker-dealers and clearing organizations	135,442	143,493
Others, net of allowance of $6,918 at September 30, 2012 and $8,833 at December 31, 2011	210,926	187,408
Securities owned:		
Trading — at fair value	7,158	6,290
Held-to-maturity	7,676	11,167
Securities borrowed	10,039	7,890
Income taxes receivable	1,517	—
Fixed assets, net of accumulated depreciation and amortization of $326,547 at September 30, 2012 and $305,143 at December 31, 2011	121,718	91,317
Debt issuance costs, net of accumulated amortization of $3,782 at September 30, 2012 and $19,197 at December 31, 2011	22,375	18,620
Goodwill	1,372,987	1,334,086
Intangible assets, net of accumulated amortization of $227,890 at September 30, 2012 and $198,139 at December 31, 2011	513,319	537,670
Other assets	106,993	73,416
Total assets	$3,676,577	$3,816,326
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Drafts payable	$166,011	$187,575
Payables to clients	406,022	456,719
Payables to broker-dealers and clearing organizations	37,799	34,755
Accrued commissions and advisory fees payable	107,724	109,715
Accounts payable and accrued liabilities	200,592	161,776
Income taxes payable	—	906
Unearned revenue	56,872	59,537
Securities sold, but not yet purchased — at fair value	60,097	161
Senior secured credit facilities	1,328,550	1,332,668
Deferred income taxes — net	119,626	127,766
Total liabilities	2,483,293	2,471,578
STOCKHOLDERS' EQUITY:		
Common stock, $.001 par value; 600,000,000 shares authorized; 115,431,259 shares issued at September 30, 2012 and 110,531,939 shares issued at December 31, 2011	115	110
Additional paid-in capital	1,216,756	1,137,723
Treasury stock, at cost — 6,228,440 shares at September 30, 2012 and 2,617,629 shares at December 31, 2011	(199,570)	(89,037)
Accumulated other comprehensive loss	—	(850)

Retained earnings	175,983	296,802
Total stockholders’ equity	1,193,284	1,344,748
Total liabilities and stockholders’ equity	$3,676,577	$3,816,326

See notes to unaudited condensed consolidated financial statements.

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Stockholders' Equity
(Unaudited)
(Amounts in thousands)

	Common Stock		Additional Paid-In Capital	Treasury Stock		Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders' Equity
	Shares	Amount		Shares	Amount			
BALANCE — December 31, 2010	108,715	$109	$1,051,722	—	$—	$(4,496)	$126,420	$1,173,755
Net income and other comprehensive income, net of tax expense						3,209	130,934	134,143
Treasury stock purchases				2,618	(89,037)			(89,037)
Stock option exercises and other	1,652	1	8,746					8,747
Share-based compensation			12,530					12,530
Excess tax benefits from share-based compensation			57,277					57,277
BALANCE — September 30, 2011	110,367	$110	$1,130,275	2,618	$(89,037)	$(1,287)	$257,354	$1,297,415
BALANCE — December 31, 2011	110,532	$110	$1,137,723	2,618	$(89,037)	$(850)	$296,802	$1,344,748
Net income and other comprehensive income, net of tax expense						850	114,980	115,830
Issuance of common stock to settle restricted stock units (Note 11)	2,823	3	(3)					—
Treasury stock purchases (Note 11)				3,610	(110,533)			(110,533)
Cash dividends on common stock							(235,799)	(235,799)
Stock option exercises and other	2,054	2	12,832					12,834
Share-based compensation	22		16,451					16,451
Excess tax benefits from share-based compensation			49,753					49,753
BALANCE — September 30, 2012	115,431	$115	$1,216,756	6,228	$(199,570)	$—	$175,983	$1,193,284

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)
(Dollars in thousands)

	Nine Months Ended September 30,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$114,980	$130,934
Adjustments to reconcile net income to net cash provided by operating activities:		
Noncash items:		
Depreciation and amortization	53,010	55,794
Amortization of debt issuance costs	3,470	3,818
Share-based compensation	16,451	12,530
Excess tax benefits related to share-based compensation	(49,753)	(57,277)
Provision for bad debts	1,221	1,111
Deferred income tax provision	(12,297)	(5,953)
Impairment of intangible assets	—	2,643
Loss on extinguishment of debt	16,524	—
Change in estimated fair value of contingent consideration obligations	9,882	933
Loan forgiveness	1,126	1,146
Other	665	2,267
Changes in operating assets and liabilities:		
Cash and securities segregated under federal and other regulations	(10,678)	105,789
Receivables from clients	(25,656)	(11,301)
Receivables from product sponsors, broker-dealers and clearing organizations	8,051	37,872
Receivables from others	(22,242)	(20,908)
Securities owned	(633)	1,234
Securities borrowed	(2,149)	(2,056)
Other assets	(37,575)	(1,150)
Drafts payable	(21,564)	(45,195)
Payables to clients	(50,697)	(4,547)
Payables to broker-dealers and clearing organizations	3,044	10,954
Accrued commissions and advisory fees payable	(1,991)	(21,092)
Accounts payable and accrued liabilities	3,637	(25,196)
Income taxes receivable/payable	47,330	193,230
Unearned revenue	(2,665)	2,831
Securities sold, but not yet purchased	59,936	(4,665)
Net cash provided by operating activities	$101,427	$363,746

LPL FINANCIAL HOLDINGS INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows - (Continued)
(Unaudited)
(Dollars in thousands)

	Nine Months Ended September 30,	
	2012	2011
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	$(32,534)	$(24,339)
Purchase of securities classified as held-to-maturity	(2,914)	(4,634)
Proceeds from maturity of securities classified as held-to-maturity	6,350	4,000
Deposits of restricted cash	(67)	(3,040)
Release of restricted cash	6,800	18,923
Acquisitions (Note 3)	(43,684)	(37,184)
Purchases of minority interest investments	(1,575)	—
Net cash used in investing activities	(67,624)	(46,274)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of senior secured credit facilities	(1,354,118)	(50,478)
Proceeds from senior secured credit facilities	1,330,681	—
Payment of debt issuance costs	(4,431)	—
Repurchase of common stock	(107,524)	(89,037)
Dividends on common stock	(235,799)	—
Excess tax benefits related to share-based compensation	49,753	57,277
Proceeds from stock options and warrants exercised	12,834	8,747
Net cash used in financing activities	(308,604)	(73,491)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(274,801)	243,981
CASH AND CASH EQUIVALENTS — Beginning of period	720,772	419,208
CASH AND CASH EQUIVALENTS — End of period	$445,971	$663,189
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid	$42,288	$52,981
Income taxes paid	$36,971	$44,379
NONCASH DISCLOSURES:		
Capital expenditures purchased through short-term credit	$5,065	$3,444
Fixed assets acquired under build-to-suit lease	$5,599	$—
Unrealized gain on interest rate swaps, net of tax expense	$850	$3,209
Discount on proceeds from senior secured credit facilities recorded as debt issuance costs	$19,319	$—
Pending settlement of treasury stock purchases	$3,009	$—

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"), formerly known as LPL Investment Holdings Inc., 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, the Company provides access to diversified financial products and services enabling its advisors to offer independent financial advice and brokerage services, using integrated technology, to retail investors (their "clients").

2. Summary of Significant Accounting Policies

Basis of Presentation — Quarterly Reporting — 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. Certain reclassifications were made to previously reported amounts in the unaudited condensed consolidated financial statements and notes thereto to make them consistent with the current period presentation.
The unaudited condensed consolidated financial statements do not include all information and notes necessary for a complete presentation of financial position, results of income, comprehensive income 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, 2011, contained in the Company's Annual Report on Form 10-K as filed with the SEC. The Company has evaluated subsequent events up to and including the date these unaudited condensed consolidated financial statements were issued.

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.

Comprehensive Income — In accordance with Accounting Standards Update No. 2011-05, Comprehensive Income — Presentation of Comprehensive Income, adopted in the first quarter of 2012, the Company presents its unaudited condensed consolidated statements of comprehensive income separately and immediately following its unaudited condensed consolidated statements of income. The Company's comprehensive income is composed of net income and the effective portion of the unrealized gains on financial derivatives in cash flow hedge relationships, net of related tax effects.

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. On an on-going basis, the Company evaluates estimates, including those related to revenue and related expense recognition, asset impairment, valuation of accounts receivable, valuation of financial derivatives, contingent consideration obligations, contingencies and litigation, valuation and recognition of share-based payments, dividends and income taxes. These accounting policies are stated in the notes to the audited consolidated financial statements for the year ended December 31, 2011, contained in the Annual Report on Form 10-K as filed with the SEC. 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 under different assumptions or conditions and the differences may be material to the unaudited condensed consolidated financial statements.

Reportable Segment — The Company's internal reporting is organized into three service channels; Independent Advisor Services, Institution Services and Custom Clearing Services, which are designed to enhance the services provided to its advisors and financial institutions. These service channels qualify as individual operating segments, but are aggregated and viewed as one single reportable segment due to their similar economic

characteristics, products and services, production and distribution process, regulatory environment and quantitative thresholds.

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 5 for additional detail regarding the Company’s fair value measurements. As of September 30, 2012, the carrying amount and fair value of the Company’s indebtedness was approximately $1,328.6 million and $1,319.3 million, respectively. As of December 31, 2011, the carrying amount and fair value was approximately $1,332.7 million and $1,328.2 million, respectively.

Contingent Consideration — The Company may be required to pay future consideration to the former shareholders of acquired companies, depending upon the terms of the applicable purchase agreement, that is contingent upon the achievement of certain financial and operating targets. The fair value of the contingent consideration is determined using financial forecasts, which estimate the probability and timing of the financial targets being reached, and discounting the associated cash payments to their present value using a risk-adjusted rate of return. The estimated fair value of the contingent consideration on the acquisition date is included in the purchase price of the acquired company. At each reporting date, or whenever there are significant changes in underlying key assumptions, a review of these assumptions is performed and the contingent consideration liability is updated to its estimated fair value. If there are no significant changes in the assumptions, the quarterly determination of the fair value of contingent consideration reflects the implied interest for the passage of time. Changes in the estimated fair value of the contingent consideration obligation may result from changes in the terms of the contingent payments, changes in discount periods and rates and changes in probability assumptions with respect to the timing and likelihood of achieving the certain financial targets. Actual progress toward achieving the financial targets for the remaining measurement periods may be different than the Company's expectations of future performance. The change in the estimated fair value of contingent consideration has been classified as other expenses in the unaudited condensed consolidated statements of income.

Recently Issued Accounting Pronouncements — Recent accounting pronouncements or changes in accounting pronouncements during the nine months ended September 30, 2012, as compared to the recent accounting pronouncements described in the Company's 2011 Annual Report on Form 10-K, that are of significance, or potential significance, to the Company are discussed below.

In July 2012, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2012-02, Intangibles—Goodwill and Other (Topic 350)—Testing Indefinite-Lived Intangible Assets for Impairment ("ASU 2012-02"), which updated guidance on the periodic testing of indefinite-lived intangible assets, other than goodwill, for impairment. This guidance will allow companies to make a qualitative assessment about the likelihood that an indefinite-lived intangible asset, other than goodwill, is impaired in order to determine whether it is necessary to perform a quantitative impairment test. ASU 2012-02 will be effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The Company does not plan to early adopt ASU 2012-02; therefore, the ASU 2012-02 is effective for the Company beginning with the first quarter of fiscal year 2013. The Company does not anticipate the adoption of ASU 2012-02 to have a material impact on its results of operations, financial condition or cash flows.

3. Acquisitions

The Company completed several acquisitions in 2011 and 2012, including National Retirement Partners, Inc. ("NRP"), Concord Capital Partners ("Concord"), Fortigent Holdings Company, Inc. and Veritat Advisors, Inc. The pro forma results of operations and the results of operations for acquisitions since the acquisition dates have not been separately disclosed because the effects were not sufficiently significant to the consolidated financial statements, individually or in the aggregate. See Note 3 in the 2011 Annual Report on Form 10-K for further discussion of the NRP and Concord acquisitions.

Each of the purchase prices for NRP and Concord included initial cash payments, as well as future contingent consideration payments. In accordance with the acquisition agreements, the former owners have the right to receive certain future payments contingent upon achieving certain financial and operating targets. These contingent

consideration obligations are measured at fair value on a quarterly basis based on progress towards the defined milestones (see Note 5).

Fortigent Holdings Company, Inc.

On April 23, 2012, the Company acquired all of the outstanding common stock of Fortigent Holdings Company, Inc. and its wholly owned subsidiaries Fortigent, LLC, Fortigent Reporting Company, LLC and Fortigent Strategies Company, LLC (together, "Fortigent"). Fortigent is a leading provider of solutions and consulting services to registered investment advisors, banks and trust companies servicing high net worth clients. This strategic acquisition further enhances the Company's capabilities and offers an extension of the Company's existing services for wealth management advisors.

The Company paid $38.8 million at the closing of the transaction, net of cash acquired. As of September 30, 2012, $9.9 million remained in an escrow account to be paid to former shareholders of Fortigent in accordance with the terms of the stock purchase agreement. Such amount has been classified by the Company as restricted cash and is included in other assets on the unaudited condensed consolidated statements of financial condition. Goodwill resulting from this business combination is largely attributable to the existing workforce of Fortigent and synergies expected to arise after the Company's acquisition of Fortigent. The Company cumulatively incurred transaction costs associated with its acquisition of Fortigent totaling $1.2 million; $0.7 million of which were recorded during the nine months ended September 30, 2012 and are included in other expenses in the unaudited condensed consolidated statements of income.

Veritat Advisors, Inc.

On July 10, 2012, the Company acquired all of the outstanding common stock of Veritat Advisors, Inc. ("Veritat"). Veritat is a registered investment advisory firm that developed and utilizes a proprietary online financial planning platform designed to support advisors who serve the mass market. This strategic acquisition enhances the technological capabilities of the Company and increases the flexibility of its service offering, in light of its recently announced initiative to serve the mass market.

The Company paid $4.9 million at the closing of the transaction, net of cash acquired. Goodwill resulting from this acquisition is primarily attributable to synergies expected to arise after the Company's acquisition of Veritat. The Company incurred transaction costs associated with its acquisition of Veritat totaling $0.1 million during the nine months ended September 30, 2012 that are included in other expenses in the unaudited condensed consolidated statements of income.

The Company may be required to pay future consideration to the former Veritat shareholders that is contingent upon the achievement of certain financial targets and retention of key employees. The maximum aggregate amount of contingent payments is $20.9 million to be paid over the following measurement dates: December 31, 2013, June 30, 2015, June 30, 2017 and December 31, 2017 (together the "Measurement Dates"), if the financial targets are fully achieved and key employees retained.

The Company estimated the future payment of contingent consideration and fair value of the contingent consideration at the close of the transaction. A discounted cash flow methodology was used to determine the contingent consideration based on financial forecasts determined by management that include assumptions about growth in assets under management, earnings, employee retention and discount rates. The majority of the contingent consideration is based on a sliding scale of the financial targets. The financial targets are sensitive to advisor recruitment, market fluctuations and the ability of advisors to grow their business. The Company will evaluate the actual progress toward achieving the financial targets at least quarterly and adjust the estimated fair value of the contingent consideration based on the probability of achievement, with any changes in fair value recognized in earnings. As of September 30, 2012, the Company has estimated the amount of future payment of contingent consideration to be $12.5 million. Using a discounted cash flow methodology, the Company determined the fair value of the contingent consideration to be $8.4 million, which has been recorded within accounts payable and accrued liabilities on the unaudited condensed

consolidated statements of financial condition. The Company will recognize the accretion of the contingent consideration in earnings each quarter as it approaches the Measurement Dates until all such dates have passed and payments made.

Including the estimated fair value of contingent consideration of $8.4 million, the total consideration for the

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acquisition was approximately $13.3 million.
The Company is in the process of finalizing the purchase price allocations for Fortigent and Veritat; therefore, the provisional measures of goodwill, intangibles and fixed assets are subject to change.
Set forth below is a reconciliation of assets acquired and liabilities assumed during the nine months ended September 30, 2012 (in thousands):

	Fortigent	Veritat	Total
Goodwill	$28,067	$10,834	$38,901
Accounts receivable	3,548	—	3,548
Other assets	2,310	—	2,310
Intangibles	5,400	—	5,400
Fixed assets(1)	6,275	4,180	10,455
Accounts payable and accrued liabilities	(4,803)	(67)	(4,870)
Deferred income taxes — net	(2,031)	(1,599)	(3,630)
Net assets acquired	$38,766	$13,348	$52,114

(1) Fixed assets acquired from Fortigent and Veritat relate primarily to internally developed software, which are being amortized over 5 years.

Set forth below is supplemental cash flow information for the nine months ended September 30, 2012 (in thousands):

	Fortigent	Veritat	Total
Cash payments, net of cash acquired	$28,866	$4,918	$33,784
Cash paid to escrow	9,900	—	9,900
Contingent consideration	—	8,430	8,430
Total purchase price	$38,766	$13,348	$52,114

The Company preliminarily allocated the estimated purchase price of Fortigent for intangibles to specific amortizable intangible asset categories as follows (dollars in thousands):

	Weighted Average Amortization Period (in years)	Amount Assigned
Client relationships	9.4	$4,200
Trade names	10.0	1,200
Total intangible assets acquired from Fortigent		$5,400

4. Restructuring

Consolidation of UVEST Financial Services Group, Inc.
On March 14, 2011, the Company committed to a corporate restructuring plan to consolidate the operations of UVEST Financial Services Group, Inc. ("UVEST") with LPL Financial LLC ("LPL Financial"). The restructuring plan was effected to enhance the Company’s service offering, while also generating efficiencies. In connection with the consolidation, certain registered representatives associated with UVEST moved to LPL Financial through a transfer of their licenses. The Company completed the transfers in December 2011. Following the transfer of registered representatives and client accounts to LPL Financial, all registered representatives and client accounts are associated with LPL Financial and all of the Company’s securities business is done through a single broker-dealer. UVEST has withdrawn its registration with the Financial Industry Regulatory Authority ("FINRA") effective

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July 16, 2012 and is no longer subject to net capital filing requirements.
The Company estimates total expenditures associated with the initiative to be approximately $31.1 million over the course of the restructuring plan. These expenditures are comprised of advisor retention and related benefits, contract penalties, technology costs, non-cash charges for the impairment of intangible assets resulting from advisor attrition and other expenses principally relating to the conversion and transfer of registered representatives and client accounts from UVEST to LPL Financial.
The following table summarizes the balance of accrued expenses and the changes in the accrued amounts as of and for the nine months ended September 30, 2012 (in thousands):

	Accrued Balance at December 31, 2011	Costs Incurred	Payments	Non-cash	Accrued Balance at September 30, 2012	Cumulative Costs Incurred to Date	Total Expected Restructuring Costs(1)
Conversion and transfer costs	$1,076	$3,307	$(4,383)	$—	$—	$12,485	$14,160
Contract penalties	8,832	—	(8,270)	—	562	8,642	8,642
Advisor retention and related benefits	250	908	(196)	(712)	250	1,697	5,513
Asset impairments	—	—	—	—	—	2,776	2,776
Total	$10,158	$4,215	$(12,849)	$(712)	$812	$25,600	$31,091

(1) At September 30, 2012, total expected restructuring costs exclude approximately $11.0 million of internally developed software related to the corporate restructuring initiative that is expected to be capitalized with a useful life ranging from three to five years, and with expense being recorded as depreciation and amortization within the unaudited condensed consolidated statements of income. As of September 30, 2012, approximately $14.1 million has been spent on development activities of which approximately $10.7 million has been capitalized, with the remainder included in costs incurred.

5. 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 fair value measurement classifications during the nine months ended September 30, 2012.

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 September 30, 2012, 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 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. treasuries, mutual funds, certificates of deposit, traded equity securities and debt securities.

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 September 30, 2012, the Company did not adjust prices received from the independent third-party pricing services.

Other Assets — The Company’s other assets include deferred compensation plan assets that are invested in money market funds and mutual funds which are actively traded and valued based on quoted market prices in active markets.
Contingent Consideration Liabilities — The contingent consideration liabilities, which are included in accounts payable and accrued liabilities in the unaudited condensed consolidated statements of financial condition, result from the Company's acquisitions of NRP, Concord and Veritat.
Interest Rate Swap — The Company’s interest rate swap, which matured on June 30, 2012, was not traded on a market exchange; therefore, the fair value was determined using models which included assumptions about the London Interbank Offered Rate (“LIBOR”) yield curve at interim reporting dates as well as counterparty credit risk and the Company’s own non-performance risk. Accordingly, the Company has classified the interest rate swap as a Level 2 measurement within the fair value hierarchy. At December 31, 2011, the interest rate swap is included in accounts payable and accrued liabilities in the unaudited condensed consolidated statements of financial condition.

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The following table summarizes the Company’s financial assets and financial liabilities measured at fair value on a recurring basis at September 30, 2012 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value Measurements
At September 30, 2012:				
Assets				
Cash equivalents	$264,064	$—	$—	$264,064
Securities owned — trading:				
Money market funds	307	—	—	307
Mutual funds	5,722	—	—	5,722
Equity securities	59	—	—	59
Debt securities	—	170	—	170
U.S. treasury obligations	900	—	—	900
Total securities owned — trading	6,988	170	—	7,158
Other assets	28,005	—	—	28,005
Total assets at fair value	$299,057	$170	$—	$299,227
Liabilities				
Securities sold, but not yet purchased:				
Mutual funds	$59,711	$—	$—	$59,711
Equity securities	67	—	—	67
Debt securities	—	72	—	72
Certificates of deposit	—	247	—	247
Total securities sold, but not yet purchased	59,778	319	—	60,097
Contingent consideration obligations	—	—	34,416	34,416
Total liabilities at fair value	$59,778	$319	$34,416	$94,513

Changes in Level 3 Recurring Fair Value Measurements

The contingent consideration obligations result from the Company's 2011 acquisitions of NRP and Concord, and 2012 acquisition of Veritat, and represent future amounts that the Company may be required to pay upon the achievement of certain financial and operating targets. The contingent consideration obligations are recorded at their estimated fair value with any changes in fair value recognized in earnings. Fair value measurements are based on significant inputs unobservable in the market and thus represent Level 3 measurements.

The contingent consideration obligation related to the acquisition of NRP is based on the achievement of certain revenue-based targets for the year ended December 31, 2013 (the "Measurement Period"), in aggregate for those advisors who joined LPL Financial from NRP and for advisors joining LPL Financial subsequent to the NRP acquisition for whom retirement plans comprise a significant part of their business. As a result of greater than expected recruitment of new advisors who serve retirement plans, which is expected to continue throughout the Measurement Period, the Company revised its revenue estimates during the third quarter of 2012 and made certain changes in the probability assumptions with respect to the likelihood of achieving the revenue targets. The revisions, combined with implied interest, resulted in a $15.3 million increase in the fair value of the contingent consideration obligation related to NRP during the nine months ended September 30, 2012 and are recorded in other expenses in the unaudited condensed consolidated statements of income.

The contingent consideration obligation related to the acquisition of Concord is based on the achievement of targeted levels of gross margin from both the acquired Concord business and from revenue synergies arising from cross-selling opportunities between Concord and the Company for the twelve month period ending June 30, 2014. Gross margin is calculated as net revenues less commissions and advisory fees and brokerage, clearing and exchange expense and accordingly, the Company considers it to be a non-GAAP measure. The Company revised

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the amount and timing of gross margin estimates and made certain changes in the probability assumptions with respect to the likelihood of achieving these estimates as a result of delays in the timing of the expected realization of revenue synergies between Concord and the Company. The revision, offset by implied interest, resulted in a $5.4 million decrease in the fair value of the contingent consideration obligation related to Concord during the nine months ended September 30, 2012 and is recorded in other expenses in the unaudited condensed consolidated statements of income. Set forth below is a reconciliation of the contingent consideration for the nine months ended September 30, 2012 (in thousands):

Fair value at December 31, 2011	$16,104
Issuance of contingent consideration	8,430
Change in estimated fair value of contingent consideration obligations	9,882
Fair value at September 30, 2012	$34,416

The following table summarizes the Company’s financial assets and financial liabilities measured at fair value on a recurring basis at December 31, 2011 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value Measurements
At December 31, 2011:				
Assets				
Cash equivalents	$575,243	$—	$—	$575,243
Securities owned — trading:				
Money market funds	262	—	—	262
Mutual funds	4,966	—	—	4,966
Equity securities	47	—	—	47
Debt securities	—	115	—	115
Certificates of deposit	900	—	—	900
Total securities owned — trading	6,175	115	—	6,290
Other assets	21,400	—	—	21,400
Total assets at fair value	$602,818	$115	$—	$602,933
Liabilities				
Securities sold, but not yet purchased:				
Equity securities	$134	$—	$—	$134
Debt securities	—	2	—	2
Certificates of deposit	—	25	—	25
Total securities sold, but not yet purchased	134	27	—	161
Contingent consideration obligations	—	—	16,104	16,104
Interest rate swap	—	1,377	—	1,377
Total liabilities at fair value	$134	$1,404	$16,104	$17,642

6. Held-to-Maturity Securities

The Company holds certain investments in securities including 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 Company discloses the fair value of its securities held-to-maturity using quoted prices in active markets, which is a Level 1 fair value measurement.

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

	Amortized Cost	Gross Unrealized Gains	Fair Value
At September 30, 2012:			
U.S. government notes	$7,676	$7	$7,683
At December 31, 2011:			
U.S. government notes	$11,167	$27	$11,194

At September 30, 2012, the securities held-to-maturity were scheduled to mature within one year.

7. Goodwill and Intangible Assets

A summary of the activity in goodwill is presented below (in thousands):

Balance at December 31, 2011	$1,334,086	
Acquisition of Fortigent (Note 3)	28,067	(1)
Acquisition of Veritat (Note 3)	10,834	(1)
Balance at September 30, 2012	$1,372,987	

(1) This is a provisional amount and is subject to change (see Note 3).

The components of intangible assets as of September 30, 2012 and December 31, 2011 are as follows (dollars in thousands):

	Weighted Average Life Remaining (in years)	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
At September 30, 2012:				
Definite-lived intangible assets:				
Advisor and financial institution relationships	13.0	$450,164	$(151,365)	$298,799
Product sponsor relationships	13.3	230,916	(73,100)	157,816
Client relationships	11.4	19,110	(3,375)	15,735
Trade names	9.6	1,200	(50)	1,150
Total definite-lived intangible assets		$701,390	$(227,890)	$473,500
Indefinite-lived intangible assets:				
Trademark and trade name				39,819
Total intangible assets				$513,319
At December 31, 2011:				
Definite-lived intangible assets:				
Advisor and financial institution relationships	13.7	$450,164	$(132,503)	$317,661
Product sponsor relationships	14.0	230,916	(63,710)	167,206
Client relationships	12.9	14,910	(1,926)	12,984
Total definite-lived intangible assets		$695,990	$(198,139)	$497,851

Indefinite-lived intangible assets:	
Trademark and trade name	39,819
Total intangible assets	$537,670

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Total amortization expense of intangible assets was $10.0 million and $9.9 million for the three months ended September 30, 2012 and 2011, respectively, and $29.8 million and $29.1 million for the nine months ended September 30, 2012 and 2011, respectively. Amortization expense for each of the fiscal years ended December 31, 2012 through 2016 and thereafter is estimated as follows (in thousands):

2012 - remainder	$9,791
2013	39,006
2014	38,680
2015	37,775
2016	37,619
Thereafter	310,629
Total	$473,500

8. 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. 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.

The effective tax rates were 36.8% and 41.3% for the three months ended September 30, 2012 and 2011, respectively, and 39.0% and 40.2% for the nine months ended September 30, 2012 and 2011, respectively. For the three and nine months ended September 30, 2012, the Company's effective tax rate was impacted by two matters related to its stock acquisition of Concord that together lowered the rate by approximately 3.0% for the three months ended September 30, 2012: a change in the fair value of contingent consideration that is not recognizable for tax purposes and the recognition of a deferred tax asset and related income tax benefit from pre-acquisition net operating losses that were recorded during the quarter.

9. Indebtedness

Senior Secured Credit Facilities — On March 29, 2012, the Company entered into a Credit Agreement (the “Credit Agreement”) with its wholly owned subsidiary, LPL Holdings, Inc., the other Credit Parties signatory thereto, the Several Lenders signatory thereto, and Bank of America, N.A. as Administrative Agent, Collateral Agent, Letter of Credit Issuer, and Swingline Lender. The Credit Agreement refinanced and replaced the Company’s Third Amended and Restated Credit Agreement, dated as of May 24, 2010 (the "Original Credit Agreement").

Pursuant to the Credit Agreement, the Company established a Term Loan A of $735.0 million maturing on March 29, 2017 (the "Term Loan A"), a Term Loan B of $615.0 million maturing on March 29, 2019 (the "Term Loan B") and a revolving credit facility with borrowing capacity of $250.0 million maturing on March 29, 2017 (the "Revolving Credit Facility"). In connection with the Credit Agreement, the Company incurred $23.7 million in costs that are capitalized as debt issuance costs in the unaudited condensed consolidated statements of financial condition.

The Revolving Credit Facility was undrawn at September 30, 2012 and at closing. As of September 30, 2012, the Revolving Credit Facility was being used to support the issuance of $31.3 million of irrevocable letters of credit for the construction of the Company's future San Diego office building, the Company's subsidiary The Private Trust Company N.A. ("PTC") and other items.

Quarterly repayments of the principal for Term Loan A will total 5.0% per year for years one and two, and 10.0% per year for years three, four, and five, with the remaining principal due upon maturity. Quarterly repayments of the

principal for Term Loan B will total 1.0% per year with the remaining principal due upon maturity. Any outstanding principal under the Revolving Credit Facility will be due upon maturity.

Borrowings under the Credit Agreement bear interest at a base rate equal to either one, two, three, six, nine or twelve-month LIBOR (the "Eurodollar Rate") plus the applicable margin, or an alternative base rate (“ABR”) plus

the applicable margin. 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% and (d) solely in the case of Term Loan B, 2.00%. The Company may voluntarily repay outstanding loans under its Credit Agreement at any time without premium or penalty, other than customary breakage costs with respect to LIBOR loans and with the exception of certain repricing transactions in respect of the Term Loan B consummated before March 29, 2013, which will be subject to a premium of 1.0% of the principal amount of Term Loan B subject to such repricing transaction.

The Credit Agreement subjects the Company to certain financial and non-financial covenants. As of September 30, 2012, the Company was in compliance with such covenants.

The applicable margin for borrowings with respect to the (a) Term Loan A is currently 1.50% for base rate borrowings and 2.50% for LIBOR borrowings; and (b) Term Loan B is currently 2.00% for base rate borrowings and 3.00% for LIBOR borrowings. The LIBOR rate with respect to the Term Loan B shall in no event be less than 1.00%. The applicable margin for borrowings under the Revolving Credit Facility is currently 1.50% for base rate borrowings and 2.50% for LIBOR borrowings with a commitment fee of 0.50%.

On March 29, 2012, the Company used proceeds from borrowings under the Credit Agreement to repay all outstanding principal borrowings under the Original Credit Agreement. Accordingly, in the first quarter of 2012, the Company accelerated the recognition of $16.5 million of debt issuance costs related to borrowings under the Original Credit Agreement, which has been recorded as loss on extinguishment of debt within the unaudited condensed consolidated statements of income. Prior to the repayment, the Original Credit Agreement consisted of three term loan tranches: a $302.5 million term loan facility with a maturity of June 18, 2013 (the "2013 Term Loans"), a $476.9 million term loan facility with a maturity of June 25, 2015 (the "2015 Term Loans") and a $553.2 million term loan facility with a maturity of June 28, 2017 (the "2017 Term Loans"). The Original Credit Agreement also subjected the Company to certain financial and non-financial covenants. As of December 31, 2011 the Company was in compliance with all such covenants.

The Original Credit Agreement included a revolving credit facility of $163.5 million, which had a maturity date of June 28, 2013, with a commitment fee of 0.75%. Borrowings were priced at LIBOR + 3.50%. Such facility had no outstanding balance at December 31, 2011 and has been replaced by the Revolving Credit Facility.

The applicable margin for borrowings under the Original Credit Agreement with respect to the (a) 2013 Term Loans was 0.75% for base rate borrowings and 1.75% for LIBOR borrowings, (b) 2015 Term Loans was 1.75% for base rate borrowings and 2.75% for LIBOR borrowings, and (c) 2017 Term Loans was 2.75% for base rate borrowings and 3.75% for LIBOR borrowings. The LIBOR Rate with respect to the 2015 Term Loans and the 2017 Term Loans had a floor of 1.50%.

Bank Loans Payable — The Company maintains three uncommitted lines of credit. Two of the lines have an unspecified limit, and are primarily dependent on the Company’s ability to provide sufficient collateral. The other line has a $150.0 million limit and allows for both collateralized and uncollateralized borrowings. Certain lines were utilized in 2012 and 2011; however, there were no balances outstanding at September 30, 2012 or December 31, 2011.

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The Company’s outstanding borrowings were as follows (dollars in thousands):

		September 30, 2012			December 31, 2011		
	Maturity	Balance	Interest Rate		Balance	Interest Rate	
Senior secured term loans:							
Hedged with an interest rate swap(1)	6/28/2013	$—			$65,000	2.33	%(4)
Unhedged:							
2013 Term Loans	6/28/2013	—			237,489	2.05	%(5)
2015 Term Loans	6/25/2015	—			476,935	4.25	%(6)
2017 Term Loans	6/28/2017	—			553,244	5.25	%(7)
Term Loan A	3/29/2017	716,625	2.72	%(2)	—		
Term Loan B	3/29/2019	611,925	4.00	%(3)	—		
Total borrowings		1,328,550			1,332,668		
Less current borrowings (maturities within 12 months)		42,900			13,971		
Long-term borrowings — net of current portion		$1,285,650			$1,318,697		

(1) The Company had an interest rate swap with a notional balance of $65.0 million that matured on June 30, 2012.

(2) As of September 30, 2012, the variable interest rate for Term Loan A is based on the one-month LIBOR of 0.22%, plus the applicable interest rate margin of 2.50%.

(3) As of September 30, 2012, the variable interest rate for Term Loan B is based on the greater of the one-month LIBOR of 0.22% or 1.00%, plus the applicable interest rate margin of 3.00%.

(4) As of December 31, 2011, the variable interest rate for the hedged portion of the 2013 Term Loans is based on the three-month LIBOR of 0.58%, plus the applicable interest rate margin of 1.75%.

(5) As of December 31, 2011, the variable interest rate for the unhedged portion of the 2013 Term Loans is based on the one-month LIBOR of 0.30%, plus the applicable interest rate margin of 1.75%.

(6) As of December 31, 2011, the variable interest rate for the unhedged portion of the 2015 Term Loans is based on the greater of the one-month LIBOR of 0.30% or 1.50%, plus the applicable interest rate margin of 2.75%.

(7) As of December 31, 2011, the variable interest rate for the unhedged portion of the 2017 Term Loans is based on the greater of the one-month LIBOR of 0.30% or 1.50%, plus the applicable interest rate margin of 3.75%.

The combined average balance outstanding in the uncommitted line of credit facilities was approximately eleven thousand dollars and $0.4 million for the three months ended September 30, 2012 and 2011, respectively, and $0.1 million for the nine months ended September 30, 2012 and 2011, respectively. The weighted-average interest rate was 4.50% and 1.00% for the three months ended September 30, 2012 and 2011, respectively, and 1.63% and 1.00% for the nine months ended September 30, 2012 and 2011, respectively.

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The minimum calendar year payments and maturities of the senior secured borrowings as of September 30, 2012 are as follows (in thousands):

2012 — remainder	$10,725
2013	42,900
2014	70,463
2015	79,650
2016	79,650
Thereafter	1,045,162
Total	$1,328,550

10. Commitments and Contingencies

Leases — The Company leases certain 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.

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.

Future minimum payments under leases, lease commitments and other noncancellable contractual obligations with remaining terms greater than one year as of September 30, 2012, are as follows (in thousands):

2012 - remainder	$6,893
2013	27,339
2014	28,497
2015	27,461
2016	27,319
Thereafter	264,726
Total(1)	$382,235

(1) Minimum payments have not been reduced by minimum sublease rental income of $5.2 million due in the future under noncancellable subleases.

Included in the schedule of future minimum payments above is a fifteen-year lease commitment that was executed in December 2011 for the Company's future San Diego office building with a lease commencement date of May 1, 2014. Future minimum payments for this lease commitment are $9.6 million, $14.8 million, $15.4 million and $236.8 million for the years 2014, 2015, 2016 and thereafter, respectively.

Total rental expense for all operating leases was approximately $5.0 million and $4.2 million for the three months ended September 30, 2012 and 2011, respectively, and $14.1 million and $12.9 million for the nine months ended September 30, 2012 and 2011, respectively.

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.

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Notes to Condensed Consolidated Financial Statements (Unaudited)

Loan Commitments — From time to time, LPL Financial makes loans to its advisors which may be forgivable, primarily to newly signed advisors to assist in the transition process. Due to timing differences, LPL Financial may make commitments to issue such loans prior to actually funding them. These commitments are generally contingent upon certain events occurring, including but not limited to the advisor joining LPL Financial. LPL Financial had no significant unfunded commitments at September 30, 2012.

Litigation — The Company has been named as a defendant in various legal actions, substantially all of which are arbitrations. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases in which claimants seek substantial or indeterminate damages, the Company cannot predict with certainty what the eventual loss or range of loss related to such matters will be. The Company recognizes a legal liability when it believes it is probable a liability has occurred and the amount can be reasonably estimated. If some amount within a range of loss appears at the time to be a better estimate than any other amount within the range, the Company accrues that amount. When no amount within the range is a better estimate than any other amount, however, the Company accrues the minimum amount in the range.

The Company records legal reserves and related insurance recoveries for significant or unusual cases on a gross basis.

The Company is subject to and maintains insurance coverage for claims and lawsuits in the ordinary course of business, such as customer complaints or disclosures about risks with securities purchased, as well as various arbitrations and other litigation matters. With respect to these matters, the estimated losses on the majority of pending matters are less than the applicable deductibles of the insurance policies, and matters with estimated losses in excess of the applicable deductibles are not, in the aggregate, material.

Defense costs are expensed as incurred and classified as professional services within the unaudited condensed consolidated statements of income. When there is indemnification or insurance, the Company may engage in defense or settlement and subsequently seek reimbursement for such matters. In connection with various acquisitions, and pursuant to the purchase and sale agreements, the Company has received third-party indemnification for certain legal proceedings and claims. Some of these matters have been defended and paid directly by the indemnifying party.

The Company believes, based on the information available at this time, after consultation with counsel, consideration of insurance, if any, and indemnifications provided by the third-party indemnitors, that the outcomes of any legal proceedings will not have a material adverse impact on the unaudited condensed consolidated statements of income, comprehensive income, financial condition or cash flows.

Regulatory — On July 20, 2012, the Internal Revenue Service (the “IRS”) issued a Notice of Proposed Adjustment (the “Notice”) asserting that the Company is subject to a penalty with respect to an alleged untimely deposit of withholding taxes related to the exercise of certain non-qualified stock options in connection with the Company's initial public offering in 2010. The Company has been engaged in discussions with the IRS regarding the Notice. As a result of these discussions, the Company believes the outcome will not be material to its unaudited condensed consolidated statements of income, comprehensive income, financial condition or cash flows. The Company has recorded an estimate of the probable loss within other expense in the unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2012 and within accounts payable and accrued liabilities in the unaudited condensed consolidated statement of financial condition as of September 30, 2012.

Other Commitments — As of September 30, 2012, LPL Financial had received collateral primarily in connection with client margin loans with a market value of approximately $353.4 million, which it can sell or re-pledge. Of this amount, approximately $42.3 million has been pledged or sold as of September 30, 2012; $23.1 million was pledged with client-owned securities to the Options Clearing Corporation ("OCC") as collateral to secure client obligations related to options positions, and $19.2 million was loaned to the National Securities Clearing Corporation ("NSCC") through participation in its Stock Borrow Program. Additionally, approximately $140.5 million are 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 $170.6 million has not been re-pledged or sold, and as of

September 30, 2012 there are no restrictions that materially limit the Company's ability to re-pledge or sell the remaining $311.1 million of client collateral.

As of December 31, 2011, LPL Financial had received collateral primarily in connection with client margin loans with a market value of approximately $350.2 million, which it can sell or repledge. Of this amount, approximately $32.7 million has been pledged or sold as of December 31, 2011; $18.4 million was pledged with client-owned securities to the OCC as collateral to secure client obligations related to options positions, and $14.3 million was loaned to the NSCC through participation in its Stock Borrow Program. Additionally, approximately $145.0 million are 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 $172.5 million had not been re-pledged or sold, and as of December 31, 2011 there are no restrictions that materially limited the Company's ability to re-pledge or sell the remaining $317.5 million of client collateral.

Trading securities on the unaudited condensed consolidated statements of financial condition includes $0.9 million pledged to clearing organizations at September 30, 2012 and December 31, 2011, respectively.

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

11. Stockholders' Equity

Share-Based Compensation

The Company's stock incentive plan provides for granting stock options to certain employees, officers and advisors, warrants to certain financial institutions and restricted stock to non-employee directors. Beginning in the third quarter of 2012, certain employees participate in the 2012 Employee Stock Purchase Plan. 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 cliff vest after a two-year period.

The Company recognizes share-based compensation expense for stock options awarded to employees and officers, and restricted stock awarded to non-employee 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 $4.3 million and $3.8 million during the three months ended September 30, 2012 and 2011, respectively, and $12.8 million and $10.9 million during the nine months ended September 30, 2012 and 2011, respectively, which is included in compensation and benefits on the unaudited condensed consolidated statements of income. As of September 30, 2012, total unrecognized compensation cost related to non-vested share-based compensation arrangements granted was $42.2 million, which is expected to be recognized over a weighted-average period of 3.44 years.

The Company recognizes share-based compensation expense for stock options and warrants awarded to its advisors and financial institutions based on the fair value of the awards at each interim reporting period. The Company recognized share-based compensation of $2.9 million and $1.4 million during the nine months ended September 30, 2012 and 2011, respectively, related to the vesting of stock options and warrants awarded to its advisors and financial

institutions, which is classified within commissions and advisory fee expense on the unaudited condensed consolidated statements of income. As of September 30, 2012, total unrecognized compensation cost related to non-vested share-based compensation arrangements granted was $10.0 million for advisors and financial institutions, which is expected to be recognized over a weighted-average period of 3.15 years.

On May 8, 2012, the Company awarded 22,092 shares of common stock in conjunction with the acquisition of Fortigent, at a price of $33.95 per share, which resulted in share-based compensation expense of $0.8 million during the nine months ended September 30, 2012.

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

2008 Nonqualified Deferred Compensation Plan

On November 19, 2008, the Company established an unfunded, unsecured deferred compensation plan to permit employees and former employees who held non-qualified stock options issued under the 2005 Stock Option Plan for Incentive Stock Options and 2005 Stock Option Plan for Non-qualified Stock Options that were to expire in 2009 and 2010, to receive stock units under the 2008 Nonqualified Deferred Compensation Plan ("Deferred Compensation Plan"). On February 22, 2012, the Company distributed 1,673,556 shares, net of shares withheld to satisfy withholding tax requirements, pursuant to the terms of the Deferred Compensation Plan. Distributions to participants were made in the form of whole shares of common stock equal to the number of stock units allocated to the participant's account, with fractional shares paid out in cash. Participants authorized the Company to withhold shares from their distribution of common stock to satisfy their withholding tax obligations. Accordingly on February 22, 2012, the Company repurchased 1,149,896 shares and paid $37.5 million of cash consideration related to tax withholdings. The repurchase of shares was executed under the share repurchase program approved by the Board of Directors on August 16, 2011.

Dividends

On March 30, 2012, the Company's Board of Directors approved a special dividend of $2.00 per share to common stockholders. The dividend of $222.6 million was paid on May 25, 2012 to stockholders of record as of May 15, 2012. On July 30, 2012, the Board of Directors declared a cash dividend of $0.12 per share on the Company's outstanding common stock. The dividend of $13.2 million was paid on August 30, 2012 to stockholders of record as of August 15, 2012.

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 September 30, 2012 and 2011, the Company had the following activity under its approved share repurchase plans (in millions, except share and per share data):

			2012			2011		
Approval Date	Authorized Repurchase Amount	Amount Remaining at September 30, 2012	Shares Purchased	Weighted Average Price Paid Per Share	Total Cost	Shares Purchased	Weighted Average Price Paid Per Share	Total Cost
May 25, 2011	$80.0	$—	—	$—	$—	13,869	$34.47	$0.5
August 16, 2011	$70.0	$—	186,190	$27.56	$5.1	319,906	$28.11	$9.0
May 25, 2012	$75.0	$25.5	1,719,739	$28.79	$49.5	—	$—	$—
September 27, 2012	$150.0	$150.0	—	$—	$—	—	$—	$—
		$175.5	1,905,929	$28.67	$54.6	333,775	$28.37	$9.5

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

For the nine months ended September 30, 2012 and 2011, the Company had the following activity under its approved share repurchase plans (in millions, except share and per share data):

			2012			2011		
Approval Date	Authorized Repurchase Amount	Amount Remaining at September 30, 2012	Shares Purchased	Weighted Average Price Paid Per Share	Total Cost	Shares Purchased	Weighted Average Price Paid Per Share	Total Cost
May 25, 2011	$80.0	$—	—	$—	$—	2,297,723	$34.84	$80.0
August 16, 2011	$70.0	$—	1,891,072	$32.27	$61.0	319,906	$28.11	$9.0
May 25, 2012	$75.0	$25.5	1,719,739	$28.79	$49.5	—	$—	$—
September 27, 2012	$150.0	$150.0	—	$—	$—	—	$—	$—
		$175.5	3,610,811	$30.61	$110.5	2,617,629	$34.01	$89.0

12. Earnings Per Share

Prior to February 22, 2012, the Company was required to calculate earnings per share using the two-class method by allocating a portion of its earnings to employees who held stock units containing non-forfeitable rights to dividends or dividend equivalents under its Deferred Compensation Plan. Basic earnings per share was computed by dividing income less earnings attributable to employees that held stock units under the Deferred Compensation Plan by the basic weighted average number of shares outstanding. Diluted earnings per share was computed in a manner similar to basic earnings per share, except the weighted average number of shares outstanding was increased to include the dilutive effect of outstanding stock options, warrants and other stock-based awards. After the distribution of shares on February 22, 2012 pursuant to the Deferred Compensation Plan, the two-class method was no longer applicable.

A reconciliation of the income used to compute basic and diluted earnings per share for the three and nine months ended September 30, 2012 and 2011 is as follows (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Basic earnings per share:				
Net income, as reported	$34,299	$36,428	$114,980	$130,934
Allocation of undistributed earnings to stock units	—	(465)	—	(1,676)
Net income, for computing basic earnings per share	$34,299	$35,963	$114,980	$129,258
Diluted earnings per share:				
Net income, as reported	$34,299	$36,428	$114,980	$130,934
Allocation of undistributed earnings to stock units	—	(451)	—	(1,618)
Net income, for computing diluted earnings per share	$34,299	$35,977	$114,980	$129,316

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

A reconciliation of the weighted average number of shares outstanding used to compute basic and diluted earnings per share for the three and nine months ended September 30, 2012 and 2011 is as follows (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Basic weighted average number of shares outstanding	110,213	107,835	109,997	108,559
Dilutive common share equivalents	1,664	3,338	2,439	3,924
Diluted weighted average number of shares outstanding(1)	111,877	111,173	112,436	112,483

(1) Included within the weighted average share count for the three and nine months ended September 30, 2012, are approximately 850,000 shares resulting from the distribution pursuant to the Deferred Compensation Plan (see Note 11) that were not included in the weighted average share count for the three and nine months ended September 30, 2011.

Basic and diluted earnings per share for the three and nine months ended September 30, 2012 and 2011 are as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Basic earnings per share	$0.31	$0.33	$1.05	$1.19
Diluted earnings per share	$0.31	$0.32	$1.02	$1.15

The computation of diluted earnings per share excluded stock options and warrants to purchase 4,307,637 shares and 3,953,455 shares for the three months ended September 30, 2012 and 2011, respectively, and 4,120,953 shares and 3,930,723 shares for the nine months ended September 30, 2012 and 2011, respectively, because the effect would have been anti-dilutive.

13. Related Party Transactions

One of the Company’s significant stockholders owns a minority interest in Artisan Partners Limited Partnership (“Artisan”), which pays fees in exchange for product distribution and record-keeping services. During the nine months ended September 30, 2012 and 2011, the Company earned $2.6 million and $2.2 million, respectively, in fees from Artisan. Additionally, as of September 30, 2012 and December 31, 2011, Artisan owed the Company $0.8 million and $0.7 million, respectively, which is included in receivables from product sponsors, broker-dealers and clearing organizations on the unaudited condensed consolidated statements of financial condition.

American Beacon Advisor, Inc. (“American Beacon”), a company majority-owned by one of the Company’s significant stockholders, pays fees in exchange for product distribution and record-keeping services. During the nine months ended September 30, 2012, the Company earned $0.3 million in fees from American Beacon.

One of the Company’s significant stockholders owns a minority interest in XOJET, Inc. (“XOJET”), which provides chartered aircraft services. The Company paid $0.5 million and $1.3 million to XOJET during the nine months ended September 30, 2012 and 2011, respectively.

Aplifi, Inc. ("Aplifi"), a privately held technology company in which the Company holds an equity interest, provides software licensing for annuity order entry and compliance. The Company paid $0.5 million and $1.1 million to Aplifi for such services during the nine months ended September 30, 2012 and 2011, respectively.

An immediate family member of one of the Company's executive officers is an executive officer of CresaPartners LLC ("CresaPartners"). CresaPartners provides the Company and its subsidiaries real estate advisory, transaction and project management services. The Company paid $0.6 million and $0.4 million to CresaPartners during the nine months ended September 30, 2012 and 2011, respectively.

One of the Company's stockholders, TPG Capital ("TPG") provided the Company with procurement-related services. During the nine months ended September 30, 2012, the Company paid $0.2 million to TPG.

Certain entities affiliated with SunGard Data Systems Inc. ("SunGard"), a company minority-owned by one of the Company's significant stockholders, provide data center recovery services. The Company paid $0.2 million to SunGard during the nine months ended September 30, 2012.

14. Net Capital and Regulatory Requirements

The Company operates in a highly regulated industry. Applicable laws and regulations restrict permissible activities and investments. These policies 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 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 $128.7 million with a minimum net capital requirement of $7.0 million and net capital in excess of the minimum requirement of $121.7 million as of September 30, 2012.

PTC is also 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 a direct material effect on the Company’s unaudited condensed consolidated financial statements.

As of September 30, 2012 and December 31, 2011, LPL Financial and PTC have met all capital adequacy requirements to which they are subject.

UVEST was an introducing broker-dealer until it withdrew its registration with FINRA effective July 16, 2012 in connection with the Company's 2011 initiative to consolidate UVEST with LPL Financial. UVEST is no longer subject to net capital filing requirements.

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 advisor's 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 on both a long and short basis 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 October 29, 2012, the Board of Directors declared a cash dividend of $0.12 per share on the Company's outstanding common stock to be paid on November 30, 2012 to all stockholders of record on November 15, 2012.

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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 13,100 independent financial advisors and financial advisors at approximately 685 financial institutions (our "advisors") across the country, enabling them to provide their retail investors (their "clients") with objective, conflict-free financial advice. We also support approximately 4,500 financial advisors who are affiliated and licensed with insurance companies with customized clearing, advisory platforms and technology solutions.

In addition, through our subsidiary companies, we support a diverse client base. Fortigent Holdings Company, Inc. is 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. manages trusts and family assets for high net worth clients in all 50 states. Our newest subsidiary, NestWise LLC, supports the recruitment and development of new-to-the-industry financial advisors dedicated to serving the mass market under the fee-based, independent model.

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 was 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 approximately 2,900 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 use of our technology, custody, clearing, trust and reporting platforms. We also generate asset-based fees through the distribution of financial products for a broad range of product manufacturers. Under our self-clearing platform, we custody the majority of client assets invested in these financial products, which includes providing 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 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 value of the asset balances and current interest rates. These asset balances, specifically related to advisory fee revenues and asset-based revenues, have approximately a 60% correlation to market fluctuations. Accordingly, 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 based on

transaction volumes or other activity-based fees, which are more difficult to predict, particularly in declining or volatile markets.

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, a characterization of revenue and a statistical measure:

	Sources of Revenue	Primary Drivers	For the Nine Months Ended September 30, 2012 Total (millions)	% of Total Net Revenue	% Recurring
Advisor-driven revenue with ~85%-90% payout ratio	Commissions	- Transactions - Brokerage asset levels	$1,353	50%	39%
	Advisory Fees	- Advisory asset levels	$787	29%	99%
Attachment revenue retained by us	Asset-Based Fees - Cash Sweep Fees - Sponsorship Fees - Record Keeping	- Cash balances - Interest rates - Number of accounts - Client asset levels	$300	11%	100%
	Transaction and Other Fees - Transactions - Client (Investor) Accounts - Advisor Seat and Technology	- Client activity - Number of clients - Number of advisors - Number of accounts - Premium technology subscribers	$238	9%	63%
	Interest and Other Revenue	- Margin accounts - Alternative investment transactions	$39	1%	44%
	Total Net Revenue		$2,717	100%	65%
	Total Recurring Revenue		$1,760	65%	

- Commissions and Advisory Fees. Commissions and advisory fees both represent advisor-generated revenue, generally 85-90% of which is paid to advisors.

Commissions. Transaction-based commission revenues primarily represent gross commissions generated by our advisors, primarily from commissions earned on the sale of various financial products such as variable and fixed annuities, mutual funds, alternative investments, general securities, fixed income, insurance and group annuities. 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 also earn trailing commission revenues (a commission that is paid over time, such as 12(b)-1 fees) 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 Fees. Advisory fee revenues represent fees charged on our corporate RIA platform 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 the 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 the calendar quarter. Generally, the advisory fees collected on our corporate RIA platform range from 0.5% to 3.0% of the underlying assets.

In addition, we support independent RIAs who conduct their advisory business through separate entities by establishing their own RIA pursuant to the Investment Advisers Act of 1940, rather than using our corporate

registered RIA. The assets held under these investment advisory accounts

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custodied with LPL Financial LLC ("LPL Financial") are included in our advisory and brokerage assets, net new advisory assets and advisory assets under custody metrics. The fee-based production generated by the Independent RIA is earned by the advisor, and accordingly not included in our advisory fee revenue. However, there are administrative fees charged to Independent RIAs including custody and clearing and trading fees, 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%.

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 Fees. Asset-based fees 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 and networking fees represent fees paid to us in exchange for administrative and record-keeping services that we provide to clients of our advisors. Omnibus fees, paid to us by mutual fund manufacturers, are generally correlated to assets served while networking fees, paid to us by mutual fund and annuity product manufacturers, are correlated to the number of positions we administer.

- Transaction and Other Fees. Revenues earned from transaction and other 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 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 monthly administrative fees to our advisors. We charge 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. During the reporting periods that these conferences are held we anticipate higher transaction and other fees resulting from the collection of revenues from sponsors and advisors, in comparison to other periods.

- Other Revenue. Other revenue includes marketing re-allowance fees from certain financial product manufacturers, mark-to-market gains or losses on assets held by us for the advisors' non-qualified deferred compensation plan, fees from our retirement partner program, as well as 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 commissions and advisory fees earned on each client's account (collectively, commissions and advisory fees earned are referred to as gross dealer concessions, or "GDC"); bonuses earned by advisors based on the levels of commissions and advisory fees they produce; the recognition of share-based compensation expense from stock options and warrants granted to advisors and financial institutions based on the fair value of the awards at each interim 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 interim 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 commissions and advisory revenues.

We characterize production payout, which includes 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 GDC sensitive because they are variable and highly correlated to the level of our commissions and advisory revenues in a particular reporting period. Non-GDC sensitive payout is correlated to market movement in addition to the value of our stock. Non-GDC sensitive payout

includes share-based compensation expense from stock options and warrants granted to advisors and financial institutions based on the fair value of the awards at each interim reporting period, and mark-to-market gains or losses on amounts designated by advisors as deferred commissions in a non-qualified deferred compensation plan.

The following table is presented as an illustration of how the aforementioned production expenses impact our payout ratio for the nine months ended September 30, 2012:

Base payout rate	84.20	%
Production based bonuses	2.44	%
GDC sensitive payout	86.64	%
Non-GDC sensitive payout	0.21	%
Total Payout Ratio	86.85	%

See "Results of Operations" for the three and nine months ended September 30, 2012 and comparative 2011 periods' analyses of production payout ratio.

- 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, travel and entertainment, professional services and other expenses. We host certain advisor conferences that serve as training, sales and marketing events. During the reporting periods that these conferences are held, we anticipate higher general and administrative expenses in comparison to other periods.

- Depreciation and Amortization Expense. Depreciation and amortization expense represents the benefits received for using long-lived assets. Those assets represent significant 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 represent expenses incurred as a result of our 2011 consolidation of UVEST Financial Services Group, Inc. ("UVEST") and 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 key metrics as of and for the three and nine months ended September 30, 2012 and 2011 are as follows:

	As of September 30,		
	2012	2011	% Change
Business Metrics (unaudited)			
Advisors(1)	13,170	12,799	2.9 %
Advisory and brokerage assets (in billions)(2)	$371.4	$316.4	17.4 %
Advisory assets under custody (in billions)(3)(4)	$118.6	$96.3	23.2 %
Net new advisory assets (in billions)(5)	$8.2	$9.8	(16.3)%
Insured cash account balances (in billions)(4)	$14.2	$14.2	— %
Money market account balances (in billions)(4)	$7.4	$8.9	(16.9)%

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Financial Metrics (unaudited)				
Revenue growth from prior period	2.8 %	16.2 %	2.5 %	15.6 %
Recurring revenue as a % of net revenue(6)	66.5 %	63.1 %	65.2 %	61.9 %
Net income (in millions)	$34.3	$36.4	$115.0	$130.9
Earnings per share (diluted)	$0.31	$0.32	$1.02	$1.15
Non-GAAP Measures:				
Gross margin (in millions)(7)	$277.1	$259.0	$829.7	$788.4
Gross margin as a % of net revenue(7)	30.5 %	29.3 %	30.5 %	29.7 %
Adjusted EBITDA (in millions)	$108.0	$111.6	$344.5	$358.9
Adjusted EBITDA as a % of net revenue	11.9 %	12.6 %	12.7 %	13.5 %
Adjusted EBITDA as a % of gross margin(7)	39.0 %	43.1 %	41.5 %	45.5 %
Adjusted Earnings (in millions)	$53.0	$51.6	$171.2	$169.7
Adjusted Earnings per share (diluted)	$0.47	$0.46	$1.52	$1.51

(1) Advisors are defined as those independent financial advisors and financial advisors at financial institutions who are licensed to do business with the Company's broker-dealer subsidiaries. We consolidated the operations of UVEST with LPL Financial which resulted, as expected, in the attrition of 124 advisors during the trailing twelve months ended September 30, 2012. Excluding attrition from the integration of the UVEST platform, we added 495 net new advisors during the twelve months ended September 30, 2012.

(2) Advisory and brokerage 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. Such totals do not include the market value of other client assets as of September 30, 2012, comprised of $41.6 billion held in retirement plans supported by advisors licensed with LPL Financial, $11.1 billion of trust assets supported by Concord Capital Partners ("Concord"), and $58.7 billion of assets supported by Fortigent Holdings Company, Inc. Data regarding certain of these assets was not available at September 30, 2011, and therefore is not meaningful for comparison. In addition, retirement plan assets represent assets that are custodied with 26 third-party providers of retirement plan administrative services who provide reporting feeds. We estimate the total assets in retirement plans served to be between $65.0 billion and $80.0 billion. If we receive reporting feeds in the

future from providers for whom we do not currently receive feeds, we intend to include and identify such additional assets in this metric.

(3) In reporting our financial and operating results for the three and nine months ended September 30, 2012 and 2011, we have renamed this business metric as advisory assets under custody (formerly known as advisory assets under management). Advisory assets under custody are comprised of advisory assets

under management in our corporate RIA platform, and Independent RIA assets in advisory accounts custodied by us. See "Results of Operations" for a tabular presentation of advisory assets under custody.

(4) Advisory assets under custody, insured cash account balances and money market account balances are components of advisory and brokerage assets.

(5) Represents net new advisory assets consisting of funds from new accounts and additional funds deposited into existing advisory accounts that are custodied in our fee-based advisory platforms. Net new advisory assets for the three months ended September 30, 2012 and 2011 were $2.9 billion and $3.0 billion, respectively.

(6) Recurring revenue, a characterization of net revenue and a statistical measure, is derived from sources such as advisory fees, asset-based fees, trailing commission fees, fees related to our cash sweep programs, interest earned on margin accounts and technology and service fees, and is not meant as a substitute for net revenues.

(7) Gross margin is calculated as net revenues less production expenses. Production expenses consist of the following expense categories from our unaudited condensed consolidated statements of income: (i) commissions and advisory fees and (ii) brokerage, clearing and exchange. All other expense categories, including depreciation and amortization, are considered general and administrative in nature. Because our gross margin amounts do not include any depreciation and amortization expense, we consider our gross margin amounts to be non-GAAP measures that may not be comparable to those of others in our industry.

Adjusted EBITDA

Adjusted EBITDA is defined as EBITDA (net income plus interest expense, income tax expense, depreciation and amortization), further adjusted to exclude certain non-cash charges and other adjustments set forth below. We present Adjusted EBITDA because we consider it an important measure of our performance. Adjusted EBITDA is a useful financial metric in assessing our operating performance from period to period by excluding certain items that we believe are not representative of our core business, such as certain material non-cash items and other adjustments.

We believe that Adjusted EBITDA, viewed in addition to, and not in lieu of, our reported GAAP results, provides useful information to investors regarding our performance and overall results of operations for the following reasons:

- because non-cash equity grants made to employees, officers and non-employee directors at a certain price and point in time do not necessarily reflect how our business is performing at any particular time, share-based compensation expense is not a key measure of our operating performance and

- because costs associated with acquisitions and the resulting integrations, debt refinancing, restructuring and conversions and equity issuance and related offering costs can vary from period to period and transaction to transaction, expenses associated with these activities are not considered a key measure of our operating performance.

We use Adjusted EBITDA:

- as a measure of operating performance;

- for planning purposes, including the preparation of budgets and forecasts;

- to allocate resources to enhance the financial performance of our business;

- to evaluate the effectiveness of our business strategies;

- in communications with our board of directors concerning our financial performance and

- as a factor in determining employee and executive bonuses.

Adjusted EBITDA is a non-GAAP measure and does not purport to be an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Adjusted

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EBITDA is not a measure of net income, operating income or any other performance measure derived in accordance with GAAP.

Adjusted EBITDA has limitations as an analytical tool and should not be considered in isolation or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are:

- Adjusted EBITDA does not reflect all cash expenditures, future requirements for capital expenditures or contractual commitments;

- Adjusted EBITDA does not reflect changes in, or cash requirements for, working capital needs;

- Adjusted EBITDA does not reflect the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our debt and

- Adjusted EBITDA can differ significantly from company to company depending on long-term strategic decisions regarding capital structure, the tax jurisdictions in which companies operate and capital investments, limiting its usefulness as a comparative measure.

Adjusted EBITDA should not be considered as a measure of discretionary cash available to us to invest in our business. We compensate for these limitations by relying primarily on the GAAP results and using Adjusted EBITDA as supplemental information.

Set forth below is a reconciliation from our net income to Adjusted EBITDA, a non-GAAP measure, for the three and nine months ended September 30, 2012 and 2011 (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
	(unaudited)			
Net income	$34,299	$36,428	$114,980	$130,934
Interest expense	12,826	16,603	42,297	52,929
Income tax expense	19,939	25,634	73,429	88,165
Amortization of purchased intangible assets and software(1)	9,971	9,909	29,751	29,132
Depreciation and amortization of all other fixed assets	8,452	9,313	23,259	26,662
EBITDA	85,487	97,887	283,716	327,822
EBITDA Adjustments:				
Employee share-based compensation expense(2)	4,439	3,833	13,775	11,120
Acquisition and integration related expenses(3)	10,528	1,241	17,442	4,205
Restructuring and conversion costs(4)	1,217	8,086	5,391	13,520
Debt extinguishment costs(5)	—	—	16,652	—
Equity issuance and related offering costs(6)	4,040	421	4,486	2,062
Other(7)	2,289	128	3,072	195
Total EBITDA Adjustments	22,513	13,709	60,818	31,102
Adjusted EBITDA	$108,000	$111,596	$344,534	$358,924

(1) Represents amortization of intangible assets and software as a result of our purchase accounting adjustments from our merger transaction in 2005 and our various acquisitions.

(2) Represents share-based compensation expense based on the grant date fair value under the Black Scholes valuation model for: i) stock options awarded to employees and officers; ii) restricted stock awarded to non-employee

directors; and iii) beginning in the third quarter of 2012, shares awarded to employees under the 2012 Employee Stock Purchase Plan ("ESPP").

(3) Represents acquisition and integration costs resulting from various acquisitions, including changes in the estimated fair value of future payments, or contingent consideration, required to be made to former shareholders of certain acquired entities. During the three and nine months ended September 30, 2012,

approximately $9.2 million and $9.9 million, respectively, was recognized as a charge against earnings due to a net increase in the estimated fair value of contingent consideration.

(4) Represents organizational restructuring charges and conversion and other related costs incurred resulting from the 2011 consolidation of UVEST and the 2009 consolidation of the Affiliated Entities. As of September 30, 2012, approximately 86% and 98%, respectively, of costs related to these two initiatives have been recognized. The remaining costs largely consist of the amortization of transition payments that have been made in connection with these two conversions for the retention of advisors and financial institutions that are expected to be recognized into earnings by December 2014.

(5) Represents expenses incurred resulting from the early extinguishment and repayment of amounts outstanding under the prior senior secured credit facilities, including the write-off of $16.5 million of unamortized debt issuance costs that have no future economic benefit, as well as various other charges incurred in connection with the repayment under the prior senior secured credit facilities and the establishment of the new senior secured credit facilities.

(6) Represents equity issuance and offering costs incurred in the three and nine months ended September 30, 2012 and 2011, related to the closing of a secondary offering in the second quarter of 2012, and the closing of a secondary offering in the second quarter of 2011. In addition, results for the three and nine months ended September 30, 2012, include a $3.9 million charge for the late deposit of withholding taxes related to the exercise of certain non-qualified stock options in connection with our 2010 initial public offering. See Note 10 - Commitments and Contingencies, within the unaudited condensed consolidated financial statements for additional information.

(7) Represents certain excise and other taxes. In addition, results for the three and nine months ended September 30, 2012 include approximately $2.3 million for consulting services aimed at enhancing our performance in support of our advisors while operating at a lower cost.

Adjusted Earnings and Adjusted Earnings per share

Adjusted Earnings represents net income before: (a) share-based compensation expense, (b) amortization of intangible assets and software, a component of depreciation and amortization resulting from our merger transaction in 2005 and our various acquisitions, (c) acquisition and integration related expenses, (d) restructuring and conversion costs, (e) debt extinguishment costs, (f) equity issuance and related offering costs and (g) other. Reconciling items are tax effected using the income tax rates in effect for the applicable period, adjusted for any potentially non-deductible amounts.

Adjusted Earnings per share represents Adjusted Earnings divided by weighted average outstanding shares on a fully diluted basis.

We prepared Adjusted Earnings and Adjusted Earnings per share to eliminate the effects of items that we do not consider indicative of our core operating performance.

We believe that Adjusted Earnings and Adjusted Earnings per share, viewed in addition to, and not in lieu of, our reported GAAP results provide useful information to investors regarding our performance and overall results of operations for the following reasons:

- because non-cash equity grants made to employees, officers and non-employee directors at a certain price and point in time do not necessarily reflect how our business is performing, share-based compensation expense is not a key measure of our operating performance;

- because costs associated with acquisitions and related integrations, debt refinancing, restructuring and conversions, and equity issuance and related offering costs can vary from period to period and transaction to transaction, expenses associated with these activities are not considered a key measure of our operating performance and

- because amortization expenses can vary substantially from company to company and from period to period depending upon each company's financing and accounting methods, the fair value and average expected life of acquired intangible assets and the method by which assets were acquired, the amortization of intangible assets obtained in acquisitions are not considered a key measure in comparing our operating performance.

Since 2010, we have used Adjusted Earnings for internal management reporting and evaluation purposes. We also believe Adjusted Earnings and Adjusted Earnings per share are useful to investors in evaluating our operating performance because securities analysts use them as supplemental measures to evaluate the overall performance of companies, and our investor and analyst presentations include Adjusted Earnings and Adjusted Earnings per share. Adjusted Earnings and Adjusted Earnings per share are not measures of our financial performance under GAAP and should not be considered as an alternative to net income or earnings per share or any other performance measure derived in accordance with GAAP, or as an alternative to cash flows from operating activities as a measure of our profitability or liquidity.

We understand that, although Adjusted Earnings and Adjusted Earnings per share are frequently used by securities analysts and others in their evaluation of companies, they have limitations as analytical tools, and you should not consider Adjusted Earnings and Adjusted Earnings per share in isolation, or as substitutes for an analysis of our results as reported under GAAP. In particular you should consider:

- Adjusted Earnings and Adjusted Earnings per share do not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;

- Adjusted Earnings and Adjusted Earnings per share do not reflect changes in, or cash requirements for, our working capital needs and

- Other companies in our industry may calculate Adjusted Earnings and Adjusted Earnings per share differently than we do, limiting their usefulness as comparative measures.

Management compensates for the inherent limitations associated with using Adjusted Earnings and Adjusted Earnings per share through disclosure of such limitations, presentation of our financial statements in accordance with GAAP and reconciliation of Adjusted Earnings to the most directly comparable GAAP measure, net income.

The following table sets forth a reconciliation of net income to non-GAAP measures Adjusted Earnings and Adjusted Earnings per share for the three and nine months ended September 30, 2012 and 2011 (in thousands, except per share data):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
	(unaudited)			
Net income	$34,299	$36,428	$114,980	$130,934
After-Tax:				
EBITDA Adjustments(1)				
Employee share-based compensation expense(2)	3,357	2,933	10,330	8,511
Acquisition and integration related expenses(3)	4,307	765	9,014	2,594
Restructuring and conversion costs	751	4,989	3,326	8,342
Debt extinguishment costs	—	—	10,274	—
Equity issuance and related offering costs(4)	3,986	260	4,262	1,272
Other	1,412	79	1,895	120
Total EBITDA Adjustments	13,813	9,026	39,101	20,839
Amortization of purchased intangible assets and software(1)	6,152	6,113	18,356	17,974
Acquisition related benefit for a net operating loss carry-forward(5)	(1,265)			