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TD Ameritrade Holding Corp. (AMTD)

Q4 2018 Earnings Call

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Richard Henry Repetto
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Michael Carrier
Analyst, Bank of America Merrill Lynch

Christopher Harris
Analyst, Wells Fargo Securities LLC

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the TD Ameritrade Holding Corporation's September Quarter Earnings Results Conference Call. This call is being recorded. With us today from the company is President and Chief Executive Officer, Tim Hockey; and Chief Financial Officer, Steve Boyle.

An audio file containing Mr. Hockey's and Mr. Boyle's comments on the quarter and fiscal 2018 can be found on the company's corporate website, amtd.com, under Investor Relations. This call is intended to address related questions from investors and analysts. Questions from reporters can be directed to the company's media relations team, or you can follow their Twitter handle, @TDAmeritradePR, which we'll be live tweeting this morning's call.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Devin Ryan from JMP Securities. Please go ahead.

Devin Ryan
Analyst, JMP Securities LLC

Q

Great. Good morning, guys.

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Good morning.

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Good morning.

Devin Ryan
Analyst, JMP Securities LLC

Q

I guess first question here. I'm getting this question after last evening. Just trying to think about the operating leverage potential here in a scenario where maybe the revenue backdrop is quite a bit better. You guys gave kind of a low end of the revenue range, but to the extent revenues maybe come in with the interest rate curve that's currently out there and DARTs aren't down as much as the kind of low-end forecast, how should we think about operating leverage potential as we think about next year?

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. Thanks, Devin. That's a really good question. We've gotten a lot of questions on our new guidance. Maybe I'll just give a little bit of context on what we were trying to accomplish and then I'll answer your question.

So, our hope is that you all are going to be creating your own revenue ranges in the future as you look forward, and you'll use your interest rate scenarios and your trade scenarios to come up with some of the major inputs here. That's one of the reasons why we gave all the additional detail on the maturities on the DDAs that you'll be able to have a more precise model on some of that stuff.

The reason we gave the low end of the range was really just to frame up the way that we thought about expenses. So, we want to be positive operating leverage over a cycle. We think that with all the tailwinds that we have with interest rates, we ought to be at least 200 basis points positive operating leverage coming into this year. So, that's sort of set our expense range. Our expenses tend not to be as volatile as our revenues. So, we're not able to flex them quite as much.

So, just to give you, for instance, to your point, if you used the forward curve that would pick up about $100 million off of our base. If you use last year's trade that would pick up about $200 million off of our base. If you use the midpoint of our expense range that would get you to about 6% positive operating leverage. So, we really view the 2% as a minimum that we're going to manage to and we would expect if we continue very strong numbers like we've seen so far this quarter that the actual positive operating leverage would be strong.

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

I can just add a little bit more, Devin. From my point of view, over the cycle, as Steve said, given the volatility in our revenue number, we just want to make sure that the team is investing when times are good. So, the opportunity when we have revenue tailwinds and good strong market fundamentals, high trading levels and you've seen our activity so far this quarter, we're not flat to last year, we're up 20% in terms of trading levels.

So, when you see that type of revenue, you want to be able to reinvest back into your business for further growth. On the other hand, there is just a sheer capacity level that the company can absorb in terms of growth rate of expenses. You just don't create net new subject matter experts to build your next new capability. And so, you need to have an absolute limit in that growth rate even with revenues that run away from you. So, let's hope you have a great high revenue year starting off to be in great shape, but we wanted to give you the low end of our revenue and then how we run the place over the long-term.

Devin Ryan
Analyst, JMP Securities LLC

Q

Got it. Very helpful. Thank you. And then, just my follow-up is on the competitive environment and the conversation around the outlook for commission pricing. I think that's clearly been one factor weighing on in the space. And so, as we think about the model today, and clearly you're rolling out a lot of new capabilities and products to differentiate Ameritrade. But how are you thinking about M&A either to gain more scale than you currently have and maybe economic benefit or even M&A or other actions that would accelerate the focus away from trading or from commissions?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Well, you know our standard answer. We're constantly observing the marketplace and we'll take advantage of opportunities that still a need for us, and that can be a scale need or it could be a capability need or it could be a diversification need. So, we continue to look. We don't have any specific areas we're saying, hey, we need to target that right now and we're quite comfortable with our position in the competitive environment. And as you say, we're reinvesting those excess revenues, if you will, back to build out the capabilities for our future.

Devin Ryan
Analyst, JMP Securities LLC

Q

Okay, great. Thank you.

Operator: Your next question comes from the line of Rich Repetto from Sandler O'Neill. Please go ahead.

Richard Henry Repetto
Analyst, Sandler O'Neill & Partners LP

Q

Yeah. Good morning, Tim. Good morning, Steve. And, I guess, my first question will be on the BDA balances, and I guess this is more for Steve. But you ended the year – the end period was $112.5 billion lower than the average. So, I guess the question is, do you expect to grow BDA balances next year? And I guess a little bit deeper is, do you think that we've reached a floor level of cash as a percentage of client assets? And when you see the next rate hike, you won't see an outflow of cash or how are you thinking about overall BDA balance growth?

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. Great question, Rich. Thanks. So, I think there's really two big trends happening in the whole industry. So, one is, we've seen very strong client engagement. We've seen very strong buying over the last several quarters. And so, it feels like our clients are pretty fully invested here. We've also seen a pretty significant increase in rates over the last couple years. And we are seeing a bit of clients who have excess cash in their accounts. We don't need it for their day-to-day operating who are now moving to get better yields on those funds.

I think both of those cycles were reasonably far into the cycle. So, we think that should have a lessoning impact over time. And we do expect to see strong growth as we move into the future and accounts, which is going to mitigate that impact. So, to your point, I don't think we would expect to see significant declines or even meaningful declines in our BDA balances, but these are the things that I know you and everybody is watching pretty closely.

Richard Henry Repetto
Analyst, Sandler O'Neill & Partners LP

Q

Got it. Okay.

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

The only thing I will mention, Rich, is just, we have a natural offset in our earnings that as our cash balances, we see the strong buying activity. Our cash balances tend to go down, but we tend to see very strong offsetting increases in margin balances that are pretty positive spread. And so, that's obviously helped our NII quite a bit. And if we saw the opposite, if we saw engagement deteriorate or [indiscernible] (00:08:14), we expect our cash would pop back up.

Richard Henry Repetto
Analyst, Sandler O'Neill & Partners LP

Q

Yeah. Understood. Okay. And then my follow-up question, and I wasn't going to ask this, but, Tim, you did make some comments on M&A. So, it's a theoretical question. Do you think you are able to truly able ascertain what someone will pay for an asset without soliciting a bid or without a formal competitive process?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Great question, Rich. And I won't comment on a hypothetical. So, why don't I give you a mulligan now? And you can ask another one.

Richard Henry Repetto
Analyst, Sandler O'Neill & Partners LP

Q

Fair enough. I guess, the question would be, on interest rate sensitivity, you got $70 million to $95 million of upside from the next rate hike. I guess, Steve, could you just give us a little feel on the breakup between margin lending? I know you're not going to say exactly, but is there a portion, a chunk of that? What percentage of a chunk of that sensitivity goes to increase – taken on a price increase for margin lending?

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. So, I think we have pretty simplified assumptions in there, Rich. So, that's assuming no change in BDA balances and no really mix shift in margin. And I would assume the 15% to 25% betas and we fully bake in the margin change as well.

Richard Henry Repetto
Analyst, Sandler O'Neill & Partners LP

Q

Okay. That's helpful. Thank you very much.

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. 15% to 20% on the beta. Sorry about that.

Operator: Your next question comes from the line of Mike Carrier from Bank of America Merrill Lynch. Please go ahead.

Michael Carrier
Analyst, Bank of America Merrill Lynch

Q

Hi. Good morning. Thanks, guys. The first one, just on the low end of the revenue base in the $5.75 billion. So, Steve, I think you gave some of the assumptions in terms of the rate outlook. The DARTs down 10% in the commission pressure. Because you didn't give like the margin balances or the BDA, obviously you don't want to predict that in this environment. But I just wanted to get some context in like different environments. How we should be expecting whether the cash balances, the margin, even the fee revenues to shift around?

I guess, more importantly, has anything changed like structurally given whether it's the mix of business, some of the products that are offered that would maybe not have like the offsetting factors be as relevant as in the past, meaning, what you just said in the last question in terms of margin up, cash down or cash up, margin down?

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. So, I think we expect the business to behave relatively similarly to what it has in the past. We're growing our institutional business a little bit faster than our retail business so that drives a little bit of a consistent mix shift.

But beyond that, to the extent we stay in a strong environment like we've been in, I think you'll continue to see some modest pressure on the BDA that I mentioned before that'll be offset by growth in accounts, good margin balances. So that should continue to see strong NII growth. And depending on the scenario that you're modeling, you could see those things move in opposite directions. But we wouldn't expect the fundamental mechanics of the business to be any different next year.

Michael Carrier
Analyst, Bank of America Merrill Lynch

Q

Okay. Thanks. And then just as a follow up. Given that the level of competition has picked up, I just wanted to maybe focus on some of the things that – some of the tools that you guys have to maybe offset any potential moves in the future. So, the one would be maybe the pace of buybacks. You mentioned up to 40%, but like how opportunistic will that be versus very consistent?

And then, I guess, on some of the investments in technology, AI, automation, just where are some of the, maybe the significant, like, potential opportunities over time for Ameritrade to either become more efficient or redirect those resources elsewhere?

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Okay. Great. So, why don't Tim start on the expenses and then I'll come back?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Sure. Yeah. Just in terms of a spend on technology side, I absolutely feel like we're at a bit of interesting time in our industry in that the investments you can make in making your business more efficient have the corollary effect of making your client experience even better. And so, there are significant emerging technologies everybody likes to talk about them; AI, machine-learning, bots, voice recognition, many of which we've launched, more that we're launching imminently that actually can help deliver better job of a client experience, and at the same time take cost out. So, I think, it's quite a significant opportunity for us in the near term, which is one of the reasons why we want the opportunity to reinvest back and more and more as our revenue growth is strong, but still keeping inside that operating leverage framework.

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. And I guess, just to add on that, we are targeting to be – if you adjust for our business mix, best-in-class, expense on client assets over time. And so, that's a goal that we're shooting towards. We're investing to that right now.

On your buyback question, we've got a number of questions on the level of the buybacks. And I think it make sense. We have a very strong with our capital-light model, our Q4 return on tangible equity was 85%. So, we generate a lot of free cash flow. So, the 70% assumes that we'll have the opportunity to build up our capital levels a little bit. And I think to extent that we stay in a very benign environment and we don't have other uses for that capital, and we don't see that the explosive kind of margin growth that we've seen, but I think we'll have the opportunity to potentially up that guidance in the future.

Michael Carrier
Analyst, Bank of America Merrill Lynch

Q

Okay. Thanks a lot.

Operator: Your next question comes from the line of Chris Harris from Wells Fargo. Please go ahead.

Christopher Harris
Analyst, Wells Fargo Securities LLC

Q

Thanks. Hey, guys. So, my understanding is, the operating expense guide for next year is on a GAAP basis. And so, it appears that on a non-GAAP basis, you guys are forecasting kind of flattish here because you did about $2.87 billion in non-GAAP operating expense in fiscal 2018. So, number one, I guess the first question is, does that sound correct? And then secondly, if it is, shouldn't we be assuming a lot more operating leverage than 200 basis points on a non-GAAP basis?

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. So, Chris, to your basic question, it is a GAAP number. And our expectation is that the amortization and intangibles for the next year will be about $125 million. So, you can get to the non-GAAP number pretty easily. And then, I think we actually have a role forward in the fact sheet. But essentially, I think maybe you're – what we do when we talk about positive operating leverage as we go back to sort of a core number for last year which takes out the realized synergies. And so, I think if you adjust for that, you'll see that there's modest expense growth next year.

Christopher Harris
Analyst, Wells Fargo Securities LLC

Q

I see. Got it. Thank you.

Operator: Your next question comes from the line of Bill Katz from Citigroup. Please go ahead.

William Katz
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thank you very much for taking the question this morning. So, just going back to some of the inputs to the revenue assumptions for this year. You mentioned some of the trade-off between margin balances and cash balances, and it seems very clear. How do you think about the beta on margin balances? It's been surprised though the ability to sort of pass that through given your client base. I wonder if you can provide some details on that.

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. Sure, Bill. Thanks. So, we have been able to raise our margin rate pretty consistently here with each move, and so that's been a positive. I think the competitors have been pretty rationale on margin rates. And the only thing that we saw this quarter is, we tend to see more growth in our very high balance accounts, which either are at high tiers or negotiated. So, sometimes, the yield doesn't go up the whole 25 basis points, but we are seeing on the rack rate customers who use margin more occasionally that there hasn't been a lot of price pressure there. So, I think you'll continue to see similar trends in the future.

William Katz
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thank you.

Operator: Your next question comes from the line of Christian Bolu from Bernstein. Please go ahead.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

Good morning, Steve. Good morning, Tim.

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Good morning.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

I guess, just on the RIA business, Tim, how do you think about the value of that business? If I think about the three monetization engines, whether it's trading commissions, client cash, our revenue share for mutual funds, all seem to be some sort of structural decline. So, are there other opportunities to better monetize those assets given the vast majority of your growth comes from that channel?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Well, Christian, I could say if you look at pretty much any revenue stream certainly in wealth management and arguably in business today and it's under pressure again because of the disruptive technologies that are in place, the new entrants, et cetera. So, when it comes to the RIA business in particular, actually, we're quite bullish on that business. It is a no question macro secular trend that has been for many years, fastest growing wealth channel, et cetera. Yes, the revenue levels per dollar of asset are relatively low, but it certainly scaled up nicely. We are at scale. And we have a very nice positive operating leverage and we'll continue to grow. But to your point, we'll continue to see where there are opportunities for monetization of those assets. But right, now we're quite comfortable with our growth rate and where we're going.

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. And we have been able to do some things over time that we've talked about. So, we've reinvigorated our ETF Market Center. We've added the Model Market Center. So, there's opportunities I think to get paid for distribution in our scale as well as some of the traditional methods.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. And then just real quick follow-up for me on, I guess, Tim, you're very focused on new technologies. I think I've asked this before, but on cryptocurrencies, I guess, Fidelity is now looking to enter the space with a trading and custodial product. So, maybe your updated thoughts on kind of where you guys stand on that?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. We've just announced about a month or so ago a small investment in ErisX, a new exchange in crypto. Our general view is, it is very much a watching brief for everybody. There's clearly a lot of retail and institutional, in fact global interest in it, but at the same time what we've seen over the last year or so has been a lot of shadier entrants into this space as well. So, one of the things we like about our ErisX partnership is, it's to start to try to address client's interest in this space, but in a highly regulated manner or so that we can do it appropriately for our clients.

Having said that, that's the crypto space. And, of course, like everybody else, I think we are continuing to experiment all sorts of opportunities for blockchain technology itself and the two often go hand in hand. The ErisX exchange should have products likely to rollout later into next year as it gets built out.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Thank you very much.

Operator: Your next question comes from the line of Chris Shutler from William Blair. Please go ahead.

Chris Charles Shutler
Analyst, William Blair & Co. LLC

Q

Hey, guys. Good morning. So, cash, I think, is about 11% of client assets today. Can you give us a sense of where the retail percentage sits and where the institutional percentage sits? And then, given that we've been in this low rate environment now for quite some time, how do you really properly gauge where that cash allocation particularly in the institutional side could bottom?

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. So, we don't give out those specific numbers, but we are seeing that there's been more pressure on the institutional side on the total and on the client per client. We're seeing a lot of growth there that's offsetting that. So, that's a great thing. I think in terms of the bottom, I think when you look at the two businesses a little bit differently, I think on the institutional side, there's a certain amount of operational cash that needs to be in those accounts. And so, we think that that's sort of the measure of the bottom and it's hard to get a precise number because we're sort of testing new lows here, but I think that's the concept that we're thinking about.

And on the retail side, it's really how much cash to clients need on hand to transact the securities transactions that they want to do. And so, we think that's going to be a measure of the new bottom and those clients tend to be a little bit less sensitive in terms of the absolute amount of cash they keep in their account. So, we think that'll continue to stay higher than the institutional side.

So, we do think, as I said before, we're pretty far into these cycles, but we're continuing to monitor that. We don't have an absolute prediction of where it's going to end up.

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

But just to put a color on it, we've been here – we've had a basically a 10-year bull run, 10 years ago that clash level at the enterprise was 21%. So, 10 points down as a percentage over the last 10 years as the market has increased. So, that sort of gives you the range.

Chris Charles Shutler
Analyst, William Blair & Co. LLC

Q

All right. Thanks, guys. And then, with Fidelity rolling out that zero-expense ratio mutual funds, just want to get your thoughts on the effectiveness of that type of thing as a marketing strategy and is that something you would consider?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Well, price is always one way to advertise. We've been very clear. We think we are going to have a great value proposition for clients based on the client experience, and we're quite comfortable with our own value proposition, because price is just one component of it. But zero anything is an interesting marketing proposal. But as it's been said by others, there is always a cost of doing business and it's usually somewhere inside in the business model.

Chris Charles Shutler
Analyst, William Blair & Co. LLC

Q

Yeah. Okay. Thank you.

Operator: Your next question comes from the line of Michael Cyprys from Morgan Stanley. Please go ahead.

Michael J. Cyprys
Analyst, Morgan Stanley & Co. LLC

Q

Hey, good morning. Thanks for taking the question. Just on the – related to the BDA and the securities portfolio. In a rising rate environment, prepaid piece is low and duration extends on MBS. Just curious to what extent that's a risk in the securities portfolio that you have today and with the fixed rate ladder? And just, how do you think about broadly managing that sort of extension duration risk?

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. We don't have any prepayment risk at all on our balance sheet. So, our securities are not mortgage-backed, they're treasuries and the BDA doesn't have any prepayment risk either.

Michael J. Cyprys
Analyst, Morgan Stanley & Co. LLC

Q

Got it. Great. Thanks for clarifying. And then just lending products, just given the strong growth and margin balances, how are you thinking about opportunities set for broadening out the lending suite a little bit more, maybe pledged asset lines, et cetera? How are you thinking about the growth opportunity there and as it relates to other types of loan lending products, relative to your current offerings?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

We have it on the institutional side and we've got it on a, call on an exception basis on the retail side, but looking to roll out a security-backed product fairly soon.

Michael J. Cyprys
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you.

Operator: Your next question comes from the line of Kyle Voigt from KBW. Please go ahead.

Kyle Voigt
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hi. Thanks for taking my question. Just a follow up regarding the larger increase in the money market fund balances in the last quarter. It seems that you've taken a view that you'll let the investment cash kind of seek those higher yielding instruments and keep betas relatively low in the remaining transactional cash. I guess, how do you weigh that versus maybe segmenting the clients more and increasing overall betas?

And then, as my follow-up to that, I guess the strategy here on betas and client segmentation and your view on the [ph] field picking (00:25:37) cash or investing cash. Is that different than your thinking before the tightening cycle began? Thanks.

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. Thanks, Kyle. So, good question. We view our cash balances as mostly operating cash and we realize that there'll be some clients that will opt to move into purchase money funds and that's okay. It's good for the client. I think it allows us, as you said, to keep relatively low pricing on that operational cash. We don't have any need to fund our balance sheet like a bank. So, all we're really looking to do is optimize, spread income and we feel very comfortable that our current strategy is doing that well. We think if we try to raise our betas even in a segment that approaches you discuss to keep all those balances that we'd be having a lower spread income.

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. And I'd say, we did a lot of work to try and really understand the betas of our particular tiers client cash and their sensitivity. And so, as a result, we just frankly just think we're a little smarter this time around in terms of really maximizing the opportunity for beta variances across those tiers.

Kyle Voigt
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you.

Operator: Your next question comes from the line of Brian Bedell from Deutsche Bank. Please go ahead.

Brian Bedell
Analyst, Deutsche Bank Securities, Inc.

Q

Great. Thanks. Good morning, folks. Maybe just to clear up on the expense side that was the first question I got yesterday from a lot of investors. Just on the base that you're calculating the operating leverage from obviously the $2.9 billion to $3 billion is a GAAP number. So, the midpoint of that operating expense guidance left the $125 million, intangible amortization is $2.825 billion. The base that you're saying in footnote three of $2.8 billion, we should be taking the $125 million out of that as well, which would get you a base expense growth of 6% for the year based on the midpoint. Just wanted to verify if the $2.8 billion was correct on the base.

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. So, yeah, remember last quarter, we went through and we created sort of a new GAAP operating base level of $2.8 billion and that's what we used to calculate the jump off.

Brian Bedell
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. It's $2.675 billion, ex the $125 million amortization.

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. That's right.

Brian Bedell
Analyst, Deutsche Bank Securities, Inc.

Q

Right. So, 6%. Okay. And then, so just from the operating leverage potential, we could see a situation where you usually have double-digit revenue growth. If it ends up being in the mid-teens level because we get, let's say, very strong trading activity and a favorable rate curve. I guess, what is the view of spending going beyond the $3 billion GAAP expenses? Are you sort of committed to staying in that zone and generating more operating leverage, or would you look at that as an opportunity to invest more in growth strategies including advertising?

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. So, as I said earlier, if we continue to get a, call it, out of the ballpark year that is shaping up to be so far in terms of the initial few weeks of trends, there is an absolute cap in our own minds that's more driven on the organizational capacity to effectively spend. There are only so many initiatives you can spin up. There's only so many expert people to work on them. And so, as much as you'd like to flex out on your expense growth to invest back as appropriate, it would be inappropriate for us to try to grow that fast just for initiative. So, yes, we will flex out at around, call it, 7% growth rate on that number we're talking about earlier. It feels like that's probably the operational capacity.

On the other hand, I could see that if that market went crazy and our marketing opportunity was such that, as we said in the past, it'd be an opportunity to deploy some dollars to get further growth without sort of baking in a run rate of expenses, then that is something that we might want to do. So, just want to be a little bit flexible and then we think that would be a good growth trade-off, but that's sort of how we think about expense growth.

Brian Bedell
Analyst, Deutsche Bank Securities, Inc.

Q

Great. That's great color. Thank you.

Operator: Your next question comes from the line of Brennan Hawken from UBS. Please go ahead.

Brennan Hawken
Analyst, UBS Securities LLC

Q

Good morning, guys. Thanks for taking the questions. First, I'd just like to start, it seems like investors are really, really concerned about both commission competition and cyclical risks, but those seem to have a component of an embedded hedge. And curious whether or not you could share your views on this. In your experience, how much pricing and commission pressure tends to be cyclical, and how much do you see those pressures easing when we see markets roll and the cycle ease back a bit?

....

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Well, there's a few things we've assumed. As you've seen, we've got sort of an ongoing 2% to 3% pressure on our commission rate. We see the same step function flurry of activity that you get every 5, 7, 10 years in our particular space of the industry. But a lot of that is partly driven by the rising value of cash deposits and a rising rate environment. And that eases the pain that one would feel if you were rushing down.

I'd say, we've long said reducing price from a competitive point of view is really an opportunity to gain market share. So, you have to assess when you have these changes, especially the step function changes whether market share actually changes. We're very comfortable with our growth rate. We had literally 46% growth year-over-year in our high-value funded accounts, new to the firm last year.

So, even with our higher price point on commission rates, we're still very attractive in the marketplace. And these are absolutely low levels of trading commission rates historically. So, it doesn't seem to be too much of an impediment for the activity. So, if we saw revenue from cash, for example, start to abate because interest rates started to go down again, if we had a recession, I think you would find the industrial system slowdown in terms of competitiveness on other forms of revenue. It is a competitive market.

....

Brennan Hawken
Analyst, UBS Securities LLC

Q

It makes a lot of sense. Thanks. And then, just one quick one here. When you see volatility pick up as we've seen in October, how quickly do you notice your customer base adjust to cash levels and maybe a corresponding change in margin balances? Have we seen that in October in the quarter to-date or does it take a more extended period of volatility to actually see that start to play through them?

....

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. So, we see a few things. Typically, our clients are buy on the dip. They're opportunistic, and we see strong buying. We tend to see it a blip in margin balances. We actually saw a new record margin balance in October here. We also see as volatility comes up that we see our option customers reengage. It gives them an opportunity to take advantages of some opportunities that they see in the market. So, we think those are both very positive.

....

Brennan Hawken
Analyst, UBS Securities LLC

Q

Okay. So, I guess, with that activity you see cash levels – is there any change in cash levels as well or...?

....

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. So, I guess as we were coming into October, we saw our cash start to come back up and then as we saw the volatility increase, we saw cash come back down to around where we ended the period but margin balances went up.

Brennan Hawken
Analyst, UBS Securities LLC

Q

Got it. Thanks a lot.

Operator: Your next question comes from the line of Dan Fannon from Jefferies. Please go ahead.

Daniel Thomas Fannon
Analyst, Jefferies LLC

Q

Thanks. Good morning. Can you discuss the Scottrade revenue opportunity? It does seem as if the first year came in better than expected. And I guess, can you talk about what's left and where you still see opportunity to cross-sell and penetrate that customer is more?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. So, as I said last quarter, it's really in our mind only been a couple of quarters because from the revenue synergies point of view it really starts after our February conversion. We're quite comfortable with our expense synergies we achieved in 2018 and 2019, a little bit more than we forecasted, say, over 60%.

And on the revenue side, as I've articulated, it's basically 11 categories of ways that we think we will get revenue synergies than we've mapped them out for the next five years in terms of what are our expectations were. After first quarter and still now after the second quarter post the integration weekend itself, we're running somewhere between the two and three year mark of the weighted average of all of those 11 categories. So, we're very comfortable at the rate of, call it, the Scottrade client comfort with our offering. As we said in my prepared remarks, I think our mobile trade levels were up almost 100% from where they were, derivatives trading by that client base up 50% from where they were. So, fairly significant lift in activity. And so, we continue to be very pleased with how it's gone.

Daniel Thomas Fannon
Analyst, Jefferies LLC

Q

Great. And then, one of your 2018 strategic themes was kind of diversifying revenue. I guess, can you talk about, in a couple years or longer term, what your ideal revenue mix is, and kind of how you get there from here in terms of new products or you haven't really talked about M&A, but I guess organically, how you think you can get or what that mix looks like?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. Well, we're comfortable with our progress. We're up 20-plus in our, call it, third revenue stream. On the other hand, our other revenue streams are growing even faster, which makes it difficult to change your mix. So, we have launched a few products which help with that. Obviously, our personalized portfolio we just launched a few months ago was off to a great start. And we've got our ETF Market Center and others that help to mix it. But in terms of a long-term goal, we don't really have an established ratio percentage, but as you say there might be opportunities to take advantage of the growth opportunities to balance this out either organically or through M&A.

Daniel Thomas Fannon
Analyst, Jefferies LLC

Q

Great. Thank you.

Operator: Your next question comes from the line of Chris Allen from Compass Group. Please go ahead.

Chris Allen
Analyst, Compass Point Research & Trading, LLC

Q

Morning, guys. I think most of the base has been covered. I guess one question, just on the rate per trade outlook you gave, it sounds like it's a look back in the prior period's ongoing compression there. There's a factor in increased adoption of Scottrade customers utilizing derivatives, which I would think would have a beneficial impact on rate per trade moving forward.

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. As you said, Chris, it's really just to look back at the last four years if you exclude the one big price move that's sort of the 2% to 3%. But to your point, we are seeing various things that impact the overall commission per trade. One positive item has been the lift in derivatives from Scottrade customers, which is, as you point out, the option trades in particular are higher average commission. And so, that's one of the net positives. But if we grow our futures business, that's one of the lowest commission per trade items that we have. So, there's a lot of items that play into the mix over time. We're comfortable that looking back at history is probably the right way to think about it.

Chris Allen
Analyst, Compass Point Research & Trading, LLC

Q

Got it. And just a quick follow-up on that. You noted Scottrade customers' derivative adaption of 50% year-over-year. I'm just wondering how did that customer base compare as to kind of the legacy customer base at present. Trying to think about the opportunity set moving forward from there.

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. As we said before, the Scottrade client base was, call it, looked like a lot like the TD Ameritrade client base, but it was less active. They had less educational tool. They had less platforms and capability. So, our revenue synergy premise was similar to what we had seen in other acquisitions, notably thinkorswim. And so, when we introduced a series of additional capabilities and tools to that Scottrade client or to, in that example, the TD Ameritrade client, we saw an adoption of the new tools fairly dramatically and rapidly, and that's precisely what we're seeing with the Scottrade client level.

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. And I think – I don't know if you're looking for a number, but I think when we bought Scottrade, their numbers were sort of in the low teens in terms of derivatives. And so, we've seen a nice uptick, but from a relatively low base. And what we're seeing now is that their mobile trades and their derivative trades are starting to approach the legacy TD Ameritrade levels.

Chris Allen
Analyst, Compass Point Research & Trading, LLC

Q

Good. Thanks, guys.

Operator: Your next question comes from the line of Patrick O'Shaughnessy from Raymond James. Please go ahead.

Patrick J. O'Shaughnessy
Analyst, Raymond James & Associates, Inc.

Q

Hey. Good morning. By my math your retail channel net new asset growth rate dipped to below 3% in fiscal 2018, which to be fair is partially a function of Scottrade attrition which you expected and then the higher denominator of retail client assets. But how optimistic are you that you can drive that retail asset growth rate back up to the 4% to 5% level where it's historically stood?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. Thanks. Great question. You're absolutely right. What we expected was, the attrition that we would see this year as a result of, I'd say, two factors, not just the Scottrade clients being converted to the TD Ameritrade platform and then deciding whether they wish to stay or not. That was the spike we saw in the second quarter and to some degree is abating now.

The second factor is that there is not a small amount of distraction from our business and our channels notably in retail as the integration itself was being done. So, the good news is that last quarter I think we reported our retail institutional M&A split of 85/15. And then now it's back more to about 80/20. And we're continuing to see great momentum build. And certainly, in light of this particular quarter, it's getting better. So, we expect our retail growth rate to continue to accelerate as we bed down all of our new extended branches and deliver more and more capabilities to our client.

Patrick J. O'Shaughnessy
Analyst, Raymond James & Associates, Inc.

Q

Thanks. And then for my follow up, I'm not sure how much you're going to be able to say on this. But in September, the District Court granted class-action status to lawsuit regarding your order routing practices. What's the process from here for that lawsuit and how confident are you that TD Ameritrade's order routing practices will be shown to be consistent with your best execution requirements?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. We're very comfortable with our position. The ticket lawsuit you're talking about we've appealed. Interesting to note that we've had two supporting briefs filed by both SIFMA and the Chamber of Commerce, because of the strength of our argument. I, obviously, can't comment more on that, but we completely believe that we focus on best execution for our clients and that our disclosures are very strong and that payment for order flow is a legitimate form of revenue offsetting the costs and giving us one good solid offer that delivers a great opportunity for retail client.

Patrick J. O'Shaughnessy
Analyst, Raymond James & Associates, Inc.

Q

Great. Thank you.

Operator: Your next question comes from the line of Craig Siegenthaler from Credit Suisse. Please go ahead.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks, guys. Good morning.

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Good morning.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

In the institutional channel, how is transition assistance expenses trended in fiscal 2018 versus last year?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

I'm sorry. Can you say that again, Craig? Don't think we got that.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Yeah. So, in the institutional RA channel, how is transition assistance expense trended in fiscal 2018 versus the prior year?

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

Yeah. I think, Craig, we don't track that number in detail at the corporate level anyway, but I do think what we're seeing is, we're seeing very good engagement with breakaway brokers, the percentage of ins that we're seeing from breakaway brokers is up significantly this year. And we think that that's a good use of our expenses. So, it's not a big part of our total expense base, but we are seeing that that's a big area of emphasis for us. And we're also seeing that as we're getting significant ACATS in, there're some costs related to that that we're incurring. But again, well worth it for those clients that are going to be here for the long-term.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

And then just as my follow-up on the BDA, we saw your comments that fixed income was the biggest substitute but you have the rough mix of where clients were moving their money when they pull out of cash last quarter between like money market funds, stocks, equity funds, ETFs, fixed income, et cetera?

Stephen J. Boyle
Chief Financial Officer & Executive Vice President, TD Ameritrade Holding Corp.

A

No. It's hard to get at, Craig, because what we're seeing is that there's a modest amount of fixed income in substitution. There's a lot of buys and sells out there, right? So, as our clients – as their equity balances are going up and they're reallocating into fixed income that comes in as a fixed income purchase, et cetera, et cetera. So, it's really hard to sort through exactly where we're going, but we can see, by virtue of the way our clients act that on the institutional side, they're more likely to move into a purchase money market fund. On the retail side, they're more likely to purchase CDs on our platform.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

Operator: Your next question comes from the line of Mac Sykes from Gabelli. Please go ahead.

Macrae Sykes
Analyst, Gabelli & Company

Q

Well, good morning, everyone. Can you provide some more perspectives on the competitive dynamics with some of the "free trading platforms", which seem to rely on enhanced payment for order flow for their economics? I mean, how should we think about that competitive segment versus some of your more major competitors?

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

A

Yeah. Look, it is a competitive environment. We're constantly watching who is in our space. The free trading model is certainly not new. In fact, in our history at TD Ameritrade, we had a product that was called free trade long ago, and it relied on some of the same components. As I said, there was no such thing as a truly free model. There is revenue mixed into all business models. It's just portrayed differently perhaps to the end client. We like our model. It is a fantastic client offering at one all-inclusive, if you will, price.

But to your main point, have we seen much of an impact? Well, arguably not. As I said, our new accounts are up almost 50% year-over-year. And we have a great opportunity to continue to grow and invest with our current revenue stream and price point. So, we're quite comfortable with where we are.

Macrae Sykes
Analyst, Gabelli & Company

Q

Great. Thank you.

Operator: There are no further questions at this time. I turn the call back over to Mr. Hockey.

Timothy D. Hockey
Director, President & Chief Executive Officer, TD Ameritrade Holding Corp.

Great. Well, thanks, everybody. I hope you liked our new disclosure. We think less is more, and it really gets to the main points that you need to have an understanding of our outlook. We're quite excited about 2018. It was a really transitional fantastic year for us. It sets us off on a new course and a new base, and we're looking forward to continuing the first few weeks of fantastic energy and growth here in 2019. So, we'll see you next quarter.

Operator: This concludes today's conference call. You may now disconnect.