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Raymond James Financial's (RJF) CEO Paul Reilly on Q4 2019 Results - Earnings Call Transcript

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FQ4: 10-23-19 Earnings Summary

SEC *10-K*

EPS of $2.0 beats by $0.09 | Revenue of $2.02B (6.53% Y/Y) beats by $35.7M

Earning Call Audio

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Raymond James Financial, Inc. (NYSE:RJF) Q4 2019 Earnings Conference Call October 24, 2019 8:15 AM ET

Company Participants

Kristie Waugh – Vice President, Investor Relations

Paul Reilly – Chairman and Chief Executive Officer

Jeff Julien – Chief Financial Officer

Paul Shoukry – Senior Vice President of Finance

Conference Call Participants

Devin Ryan – JMP Securities

Brian Wu – Citi

Craig Siegenthaler – Crédit Suisse

Steven Chubak – Wolfe Research

Chris Harris – Wells Fargo

Alex Blostein – Goldman Sachs

Jim Mitchell – Buckingham Research

Kristie Waugh

Good morning, and thank you all for joining us on the call today. We appreciate your time and interest in Raymond James Financial. With us today are Paul Reilly, Chairman and Chief Executive Officer; and Jeff Julien, Chief Financial Officer. Following their prepared remarks, the operator will open the line for questions.

Please note certain statements made during this call may constitute forward-looking statements. Forward-looking statements include, but are not limited to, information concerning future strategic objectives, business prospects, financial results, anticipated results of litigation and regulatory developments or general economic conditions.

In addition words such as believes, expects, could and would as well as any other statement that necessarily depends on future events are intended to identify forward-looking statements. Please note that there can be no assurance that actual results will not differ materially from those expressed in the forward-looking statements. We urge you to consider the risks described in our most recent Form 10-K and subsequent Forms 10-Q, which are available on our website.

During today's call, we may also use certain non-GAAP financial measures to provide information pertinent to our management's view of ongoing business performance. A reconciliation of these non-GAAP measures to the most comparable GAAP measures may be found in the schedule accompanying our press release.

With that, I would like to turn it over to Paul Reilly, Chairman and CEO of Raymond James Financial. Paul?

Paul Reilly

Great. Thanks, Kristie. Good morning, everyone. Today marks the 90th anniversary of Black Thursday beginning of the great depression. It's amazing if we look back and look at the development of the financial markets and the resiliency of the U.S. economy over that period of time.

Today, you're also going to be witnessing another momentous event and as the longest serving CFO in the financial in the S&P 500 is going to have its last official quarterly earnings call. So after I talk about our results for the fourth quarter and the fiscal year, I'll turn it over to our legendary CFO to provide more details on the financials, before I discuss the outlook and open it up for questions.

First, I'm going to remind you with the backdrop going in to this fiscal year. We came off a record year in 2018 and almost all measures under very, very strong. We entered the year thinking interest rates would be on their way up that gave us stress tests that rates going up into the future and we thought the markets could be challenging. They were in the first quarter as rates rose and it was a very soft, tough quarter.

Interest rates went up, which drove a lot of momentum than interest rates came down and the market went down, but the market went up. We had tariffs on. We had tariffs off. We had increased competition both in the recruiting market, transition assistance, and through that we really delivered another record year.

Overall, I'm pleased with our results in the fiscal fourth quarter and the fiscal year. Business metrics were strong and I'm encouraged by the solid performance in a number of key areas during the quarter, which included record quarterly net revenue of $2.02 billion. We crossed the $2 billion mark for the first time, which increased 70% over prior year's fiscal quarter and increased 5% over the preceding quarter.

Revenue growth, this quarter was driven largely by a higher Private Client Group assets and fee-based accounts, strong quarterly assessment banking revenues, and a solid performance for both our fixed income for capital markets business and tax credit fund business. We generated record quarterly earnings per diluted share of $1.86 or $2 on a non-GAAP adjusted basis for the $19 million goodwill impairment associated with our Canadian capital markets business.

Despite this impairment, which was due to challenging market environments in Canada, we remain fully committed to growing our capital markets business in Canada. Thanks to our strong financial advisor retention and recruiting results. We ended the fiscal year with records for client assets under administration of $838.3 billion, Private Client Group fee-based assets under administration of $409.1 billion, total Private Client Group financial advisors of 8,011 and net loans of Raymond James Bank, a $20.9 billion. All key fundamental drivers of our business.

Annualized return on total equity for the quarter was 16.2% or 17.3% on a non-GAAP basis, adjusted for the aforementioned goodwill impairment. And while it isn't a metric that we've historically use, starting in the first quarter of fiscal 2020, we'll begin reporting the return on tangible common equity ROTCE, whether we agree with the metric or not, even though we don't have preferred equity, but it seems that all other financial companies are now reporting that metric as well.

If you look at what we discussed at our Analyst and Investor Day in June, adjusted return on tangible equity on an annualized basis at that time was about 180 basis points higher than our adjusted return on equity, which should be in the range of what the impact would be this quarter as well.

During the fiscal year, we had record net revenue of $7.74 billion, increased 6% net income of $103 billion, increasing 21% and adjusted net income of $1.07 billion, increased 11% over fiscal 2018. Earnings per diluted share of $17.17 increased 25% and adjusted earnings per diluted share $7.40 increased 14% over fiscal 2018. Notably and really an accomplishment, all four of our core business generated net – record net revenues and three of the four generated record pretax income during the fiscal year. And if you adjust for the non-GAAP items during the year, the Capital Markets segments would have also generated an annual pretax income record, so really a strong performance all four of our core businesses.

The return on equity for the year with 16.2% or 16.7% on an adjusted basis, which is near the top of our range between 16% and 17%, and a really fantastic result given the tough start to the fiscal year and our very strong capital position. Speaking to capital, we were active in deploying capital this year repurchasing 9.83 million shares for $752 million at an average price of $76.50 per share. This represents just over 6.5% of the shares outstanding at the beginning in the year and combined with dividends we returned approximately $945 million to shareholders during the fiscal year. Even with these actions, our capital ratios remain healthy with total capital ratio of 25.8% in Tier 1 leverage ratio of 15.7% at the end of the year, giving us ample flexibility of the future.

Now let me briefly describe the segment results. In the Private Client Group, we generated record net revenue of $1.38 billion for the quarter and $5.36 billion for the fiscal year. We had another fantastic year of retaining and recruiting advisors. On a net basis, we added nearly 200 advisors during the fiscal year, which includes those advisers recruited, no, the ones lost due to retirements or regrettable or non-regrettable basis.

On a gross recruited basis, our Private Client Group domestic at its second best year just behind 2018 with advisors joining the fiscal year with nearly $300 million of trailing 12 production and $43.5 billion of assets under administration at the prior firms. This is an excellent result, especially given the slow start to the year and the increasing competitive environment.

While many firms increase their transition assistance and bet on cash balances at beginning of the year, we remain disciplined and still had an outstanding recruiting year. While higher short-term net interest rates and cash spreads were a tailwind during most of fiscal year, that benefit was partially offset by a decline in total clients domestic cash sweep balances during the fiscal year, as clients increased their allocations to other investments. As you know, the two rate cuts in our fourth quarter will likely be a significant headwind as they work through during fiscal 2020, which Jeff will explain more in detail.

Capital Markets finished the fiscal year with strong fourth quarter given investment banking results in a strong quarter for fixed income capital markets and the tax credit business, which offset the continued weakness in equity brokerage revenue. The segment finished the year with record net revenues of $1.8 billion, up 12% from fiscal 2018. The segments pretax income of $110 million was up 21% over fiscal 2018, despite a $19 million goodwill impairment in the fourth quarter and a $15 million loss associated with the sale related to our research sales and trading of European equities in the first quarter.

As I’ve said, we remained committed to the Canadian Capital Markets business and continue making long-term investments to expand [indiscernible] banking and sales and trading capabilities in Canada. Last year, we operated in a very small portion of the Canadian life sciences space and chose not to participate in the underwriting of Cannabis firm. Whereas the underwriting Cannabis space was very strong in the most significant part of the market last year, the subsequent market performance has been weak as the associated market index is down close to 40% over the last six months. Once again, we kept a long-term view and our decision making process.

And the Asset Management segment, we generated record net revenues and pretax income for both fourth quarter and fiscal year. Financial assets under management end of the fiscal year at $143.1 billion, an increase of 2% over September, 2018 and flat compared to June, 2019. Overall, the growth in financial assets under management continues to be largely driven by equity market appreciation and positive inflows associated with the increase utilization of fee-based accounts in the Private Client Group segment, which has more than offset than that outflows experienced by Carillon Tower Advisers given the extremely challenging market environment for actively managed products.

And last but certainly not least Raymond James Bank generated record net revenues and pretax income for the fiscal year. Record net loans of $20.9 billion, grew 7% over last year's September. And the growth of loans continues to be focused heavily on residential mortgages and security based loans, so the Private Client Group as well as C&I other sections. While the banks net interest margin for the fiscal year years 3.32% improved 10 basis points of the fiscal 2018 lower short-term interest rates including the two-rate cuts during the quarter, cause net interest margin declined during the quarter.

Most importantly, the credit quality of the loan portfolio remains solid and remained extremely diligent with any new loans we add to our balance sheet. So overall I believe a very strong quarter and fiscal year.

Now I'll turn it over to Jeff to provide some more color on the financial results and then I will provide some more comments on the outlook. Jeff?

Jeff Julien

Thanks, Paul. On the revenue side, most of the trends this quarter were fairly self explanatory or have been covered by Paul, so my comments on that side of the P&L will be somewhat limited. I will comment on asset management and related admin fees. However, there are up 5% sequentially, which happens to be directly in line with the consensus model, so not unusual there. The only reason I really bring it up is it happens to correlate directly with the increase in the prior quarter in fee-based assets of 5%. And it's nice just to see something work like it should sometimes. And that's our biggest revenue item by far.

So the 3% growth in fee-based assets in the most recent quarter should be an indicator of this line item for the December quarter here as you are aware of large percentage of these accounts are billed in advance and have already been billed. The investment banking line was a slight beat relative to the consensus model as both M&A and fixed income investment banking contributed to the quarter and you can see that in detail on Page 12 of the release, which is the investment banking P&L for the quarter.

Further on that same page, you'll see other revenues, which were well ahead of expectations in our current revenue format, that is where the tax credit fund revenues fall and they – as they did last year had a very, very strong September quarter. So you can see that also in a detail on Page 12.

Turning to a couple of the expense items, let's talk about compensation for a second. We had a higher absolute number than consensus as you would expect because of the – some of the higher compensable revenues, notably investment banking and tax credit fund world. But the comp ratio for the quarter of 65.2% was actually better than expectations and well under our 66.5% target.

Looking forward in the very short–term like at least about a quarter, we're really not going to change that target in the near-term. You have to remember that as revenues from client cash sweep balances declined a higher proportion of our revenues are going to be compensable in nature, which is kind of put some pressure on the margin.

In addition, successful recruiting, which we've had two years in a row of near record levels, it's going to create a drag on the short-term through amortization of hiring dollars. At the end of the day, the 2020 budgeting process is still being tweaked a little bit. We're looking very hard at some of the controllable expense items, given the potential headwinds here, but we anticipate being in a position to give a little better guidance on some of these items next quarter.

On the non-comp expenses, although there was a large sequential increase of 13%, that includes the $19 million goodwill impairment charge, which hitting the other expense line item. There was a small spike in occupancy and equipment. So it’s a number of factors in there. There’s some recurring rental increases. We’re actually incurring some double rent on our significant office space in Memphis, which we are relocating from downtown Memphis out to East Memphis. And on a portion of that new space, we’re paying rent as we’re still in the old space as well.

So there’s a double rent. That will haunt us for the next couple quarters as well. There are some additional equipment amortization that kicked in. That will not go away. But one of the lumpy items that won’t necessarily recur has to do with what we call PC refresh. We do -- we have a policy here of refreshing, widely changing out to the newest, latest and greatest models, our laptops and desktops on a three-year rotational basis. And we try to spread that somewhat ratably over the course of the year – over the course of three years really. So it doesn’t have lumpiness to it. But in this particular quarter, it did. And those are just expense given the relatively low cost of individual PCs.

I do want to talk about the bank loan loss provision as well. Even though, it came in near consensus, it was certainly a turnaround from last quarter’s credit. And actually, it may appear high relative to the $200 million of net loan growth, as you can see, shown on Page 17 of the release. But that was really caused by some downgrades during the quarter. We did get the semiannual SNC exam results at the end of September. That led to three downgrades of some credits we had fairly sizable hold positions in, and that also was -- what primarily caused the $88 million jump in criticized loans, that you can also see on the same page. No pattern to it or anything else, different industry, different types of credits.

And I don’t really think indicative of any upcoming credit issues. It’s just our policy to accept the lower ratings by the SNC. And if we have something low rated, say substandard or special mention and they come in with a pass, we leave it at our ratings.

So the SNC exam can only mean bad news to us in terms of the charge, so we stuck with that policy and which caused a couple of million dollars of additional credit charges this quarter.

Some other items I'd like to talk about. You may have noticed we don't have a non-controlling interest line anymore. We have collapsed that into other expenses to simplify the disclosure and presentation for what's become a really immaterial line item for us. If and when there is reason to that it becomes material again in the future, that line item may reappear, but for the foreseeable future. That will just be a collapse into the other expenses.

Now let me talk about net interest for a moment. At the firm level, net interest held up pretty well following the fed rate cut in July. First, I'll talk about RJ Bank's NIM, that actually fell 7 basis points sequentially from 3.37% to 3.30% and Page 18 gives you all the detail you could want on how that happened, but the bottom line is it was a primarily a result of the rate cut in July where, which caused some spread compression.

And you can see RJ Bank's earning assets fell 19 basis points in yield while the cost of funds fell only 13 basis points. So that's an indicative of the spread compression that we saw there. However, the loan growth for the quarter did allow them to have an increase in net interest earnings quarter-over-quarter.

So going forward, first of all, I guess I should point out that the July rate cut by the fed, about two-thirds of that was reflected in this quarter. And of that, with respect to client sweep balances, we had a deposit beta of about 55%. We passed through 13 of the 25. The September rate cut, very little of it was actually reflected in the September quarter, of course. And we passed through 60%, 15 basis points to clients.

The other change that we made before that first fed rate cut, where we switched in May from aggregate asset balances to aggregate cash balances, also was a 7 basis point weighted average impact to clients. So when you add all those things together, over the last six months, there has been basically a 70% beta on these first two rate cuts. If there are additional rate cuts next week and possibly in December as the forward curve would suggest, it's certainly likely -- highly likely the deposit beta will be significantly lower than it was on these first couple of cuts, which will have a more dramatic impact on our results going forward.

One wildcard I should have pointed out on the bank's net interest margin, the reason it's not as easy to correlate to fed movements is that a lot -- most of their earning assets, their loan portfolio is based on LIBOR, which doesn't always move in lockstep with fed funds. Generally, it's been a leading indicator. So it's been going down ahead of the fed rate cuts. And when the fed indicates that it's finished or skips a cut or whatever, then maybe we'll see LIBOR rebound and we may actually see NIM react much differently than you would think with no fed movement.

So it's a little bit difficult to pinpoint the NIM, but for guidance purposes, I guess that we've done some work. And the bank also has some fixed rate assets in its portfolio that are impacted by rate cuts that aren't necessarily pre-payable. So when you – the work we've done with, say, for each of the next couple of rate cuts, it looks like the NIM at the bank could be impacted negatively by somewhere between 8 and 10 basis points. It's about as close as we can get given the LIBOR dynamic and some of the other things I've mentioned.

With respect to client cash sweep balances, they've somewhat stabilized here at the $37 billion to $38 billion range. The simple math here would say that every basis point of spread change will impact us by about $3.8 million annually or just under $1 million per quarter. Most of that is reflected in accounting service fee revenues as opposed to interest earnings as we've talked about in the past.

That's about as close that we can get. What we do with the next couple of rate cuts from a holding company basis, obviously will depend on the competitive landscape. We have tried to stay at or near the top of each client strata with our peer groups. And I say groups because there's regional firms, national firms, custodial firms, et cetera. There are number of different competitive groups that we look at. So it's going to be largely dependent on what the competitive landscape is.

On Page 7 of the release, I think it's – we really do need to look at the annual results, which is obviously a compendium of all the quarterly explanations we've given you over the year. But for the year, 6% increase in a net revenues, comp ratio of 65.7%, which we are happy to see below our target. Non-comp expense growth of 9%, but remember, that includes the non-GAAP adjusted items on our schedules in the press release to – and it also includes some what we'll call accounting gross-ups and the expense side, because the revenue recognition adoption in early in the year, that were previously netted out of some of the revenues, obviously impacted both sides to some extent.

I would refer you to Page 5, to look at the annual non-GAAP results, if you really wanted to see what we'll call a good apples-to-apples type comparison of operating results, where you can see pre-tax up 7% for the year on a non-GAAP basis. And a non-GAAP net income up 11%. The reason that's higher than the pre-tax, we had a full year of the lower tax rate this year. Last year, we had a – the last quarter a phase in of the tax rate cut. So that's probably more indicative of our tax rate going forward.

And then diluted EPS, you can see up even a higher percentage at 14, obviously reflecting the share buybacks that we had during the year. So that's a wonderful page to look at, and then all in all, a great quarter to, and a great year.

So I'll turn it back to Paul.

Paul Reilly

Great. Thanks, Jeff. And thanks for being such a valuable partner for so many years. Tom and I and Jeff isn't really going anywhere, he gets as the CFO role, but we'll have his services at least for another year and as he helps us through the transition. So as Jeff has explained, we are in the middle of our budgeting process and looking at expenses, and I do want to just point out the magnitude. Jeff talked about our non-comp expenses up 9%. But if you look at the two non-GAAP items that we talked about and the impact of the accounting change that grossed up expenses. That accounted for $65 million of the $110 million increase, so over half of the increase was really accounting related.

So I think that people kind of maybe have missed that in the market. They talk about our expense growth, if you do the math. I think it's significantly less than actual dollar spent. And going forward, we still are focused as a growth company and we still with recruiting. We historically have done very well in down markets of recruiting if that comes, we continue to recruit for long-term growth and there's just more expense associated with that. But we're certainly looking at the non-controllable expenses.

We do have some visibility entering this next quarter, even though, with interest rates proposed cuts, certainly will – it makes it difficult right now to figure out, where we're going to be for the year. But the private client group assets and fee based accounts as Jeff talked about, increased 3% for the quarter and that should reflect in the asset management related administrative fees for the first quarter of 2020 as those assets are primarily pulled in advance.

Speaking of those billings, while client cash balances shown signs of stabilization over the past three months, our balance just decline in October, and that's really given to we bill, only bill, they come out to client's accounts in cash generally. So that was that impact. So what we see is even more impactful is 25 point that a rate basis cut at the end of our fiscal fourth quarter, as Jeff talked about isn't really fully reflected yet, because it was at the end of the quarter and that will impact 2020.

On a positive note, our financial advisor recruiting activity remains very active across our affiliation options, not a numeric metric, but I can't remember seeing so many $5 million to $10 million teams in the pipeline. And again, I think it shows the strengthening of our platform and even with our discipline transition assistance approach. Our M&A pipeline is robust. I know the market forecast has been down, but we have several large key deals that we hope will close and I think bode well for M&A at least how we can see it today, you never know in that market.

And the outlook for fixed income business is still very positive. We expect continued rate volatility in 2020. Raymond James Banks enters the quarter with fiscal year with record loan balances and solid credit metrics. And while I think about the only negative financial implications of lower interest rates, many of you do, there are some positives. I do think that the spread difference between cash sweeps and money markets has caused a lot of money to go out of cash and the money market instruments appropriately.

And as that spread comes in and goes to more historical levels, the premium for FDIC sweep balances should close enough, but I think total 12 for cash balances. Although, we may give it up at rate or return to more normal states long-term, and more rational pricing, I think this is going to be a long-term positive for the market. And hopefully also more rational pricing in the market on transitional systems and other packages, but there always seems to be some – but somewhat in the market being extremely aggressive.

A lot of you have asked about e-broker cutting their commission to zero. As you all know, we do not have a direct channel, so there's no impact there. And on the advisory side of our business, we think this move actually really reflects the RIA custody segment catching up with the full service segment. That's the vast majority of our fee based accounts today do not have transaction fees.

As for our growing and importantly significant but smaller RIA custody business, we did announce that we will follow the e-brokers, but that impacts us pretty small to the overall firm around $6 million to $7 million of annual transaction fees to the firms.

With that being said, all these actions always remind us there will be price pressure in our business just as there is in all industries, which means we'll have to continue to make investments in resources to help our advisors at value and strength to their client relationships and investments to make us more efficient on the cost side, which is exactly what we've been focused on.

Before I open for question, I want to thank the associates and advisors for contributing to another great year. We're kind of overhead here. They really generate the revenue and the great client relationships we have. We're a people business and our success simply would not be possible without our client focused advisors and associates that support them every day.

With that Calandra, I'm going to turn it over to you and open up the line for questions.

Question-and-Answer Session

Operator

[Operator Instructions] And your first question, sir, comes from the line of Devin Ryan of JMP Securities.

Devin Ryan

Great. Good morning, everyone.

Paul Reilly

Hey Devin.

Devin Ryan

Maybe start where you left off, Paul, just on the kind of competitive dynamic and some the pricing changes we've recently seen here. I guess first, maybe I just missed it at the end of year, but did you actually quantify the impact of the pricing change that you're making on the RIA side? I guess that's number one. Number two, what other areas are you seeing within kind of the financial advice part of the business, if you will, that that potentially could come under pressure. Are you seeing any areas of pressure? We've recently seen UBS cut fees on SMAs. I'm curious if there's any other areas as we're kind of constantly in this kind of competitive environment where your pricing seems to come under pressure, I'm not sure if there's anything else you would point to.

Paul Reilly

Yes, it is obviously not clear enough, but it was $7 million to $8 million the RIA revenue impact to the firm on those transaction for equities and ETFs. So $7 million to $8 million firm wide is the impact. Yes, we always see competitive pressure. Devin, whether it's been moving to ETFs, the industry moving mutual funds to ETFs whether it's pressure on advisory fees. UBS' announcement wasn't clear, a few years ago they unbundled between what the advisor charged in the firm. I don't know if it's a re-bundling, so we're going to have to see more, but there is always people that are pushing that dynamic and we've been going through that for years, it's not new been going through that for years, it's not new.

I can say the advisor fees have held very, very steady. And it's pushed us to be more efficient. And I think that's the advantage of scale as we've gotten larger that we can deal with some of that, but certainly if that continues long-term and Reg BI will be out in June and we'll see the impacts of that. But I think over the longer-term, if that dynamic continues, people have to remember there is three people that are impacted by changes the client, the advisor and us. And it has to be fair with the client. They're the advisor and then we have to be in business to operate and I think you always have to look at that dynamic.

So right now we feel pretty good. Industry dynamics change, we're going to have to change with them. So I don't think that's a new dynamic. It's just a interesting during these periods of time. It will also be interesting as firms who have been dependent on a transaction fees, but especially we're most of the rent earnings or more than all their earnings are interest, but dependent that reaction. So we've certainly benefited from them, but I think we're a little more diversified in that. So we watch, we think through them, but I don't see any short-term call to action, but we're watching closely.

Devin Ryan

Okay, great color. Thanks, Paul. And just to follow-up on kind of the recruiting strength in the quarter, obviously good to see and heard the commentary around I guess the backlogs. I mean with this pent up demand that just kind of came through in the quarter or was there something else that changed where maybe there's a reacceleration of trying to dig into that a little bit more. And then also you guys have been opening a lot of new offices with some of this expansion and that's led to at least some of the expense growth. And so I'm also just curious at what point you maybe see that slowing and ultimately I think that would be good for operating margin potential, just trying to think about that piece as well.

Paul Reilly

Yes. So I think in the shorter-term you've got two dynamics, as we grow in open offices that is cost. And leases renew, especially in the big markets right now, may be cyclically at a peak, maybe they continue, but with those renew, that adds cost pressure to it. As we grow in major markets and need more space, that certainly has moved against us, but that comes and goes in the cycle.

So I don't see any relief in that part of the cycle. Again, we believe that the franchise value of recruiting great advisors is key to what we do. So that part I don't see kind of a lot of relief to. We just have to be more efficient at the back office side and that's what we're managing. And a lot of our expense growth, again, if you look at half the expense growth over half was accounting related, I'll call it, between our investments in technology beefing up our compliance supervision and service. I mean I think the expense growth is pretty reasonable given the growth we've had. So we'll continue to monitor that.

Devin Ryan

Got it. In terms of just the recruiting kind of the pretty material acceleration, any other color you could provide there if something else that's happening?

Paul Reilly

Yes. I think that, last year you saw that the recruiting was kind of flattish from the first quarter, which I think if you go back historically, a lot of people stayed for their bonuses and things through the year-end. And we just got used for a couple of years. We just people came anyway, right. So I think that that after you're in and go through bonuses, you generally, it's a more logical time for people to move and the pipeline has been strong. And I'll tell you a lot of people we thought would even join in the fourth quarter just for transitions, timing for their businesses, which is what they should do what's best for their business, moved into the next quarter. So we've – I can't tell you. What we said in the beginning was that we thought that it would accelerate and we'd have near record, which I think we delivered.

And I would say the backlog isn't any different whatsoever. It's very, very strong. So I can't cited to anything, I get to push, pull business people don't leave for fun. They are leaving something to join something. And we just have to be that great platform that people want to come to. And if they're unsatisfied where they are, we know we've been the recipient of that.

Devin Ryan

Got it. Great, thank you very much.

Paul Reilly

Thank you.

Operator

And your next question comes from the line of Bill Katz of Citi.

Brian Wu

Hi, good morning. This is Brian Wu on for Bill Katz. Thank you for taking the question. Can you give a sense of the client cash mix between purchase money market funds versus holding cash since you guys discontinued the money market sweep option? And how has that trended particularly in this declining rate backdrop?

Paul Reilly

So we haven't reported on with some money market is certainly a lot of the cash movement, but we reported sweeps is cash, cash, pure cash in our system. But a lot of the movement out has been in the money markets and positional money market.

Brian Wu

Got it. And then it looks like client cash after declining quarter as ticked up in September. You mentioned it stabilize and any update you can provide on client cash trends in October?

Jeff Julien

Only as Paul reported that, we have the fee billings come out at the beginning of each quarter, which causes a hiccup in the down direction and then it generally rebuilds over the course of the quarter to be in a position to accommodate those at fee billing in the next quarter. So that was the same dynamic that we reported last quarter that we saw in July that we obviously we saw it again for the billings in October. And so it's down now versus where it was at the end of the year, because of those billings, which are a little over $800 million now for us as a firm.

So it's down now because of that. And we – it'll generally, if it follows history, it'll build back up over the course of the quarter through recruiting and through repositioning in those accounts to be in a position to accommodate the billing next quarter.

Paul Reilly

Our feeling is that, that we're into a stabilized kind of platform and those money market rates, which tend to come down a little slower, because they buy a securities, it takes away while for them to mature and then invest in the new rates, which are lower rates, as those rates continue to come down, we think that pressure is going to leave as that spread narrows.

Brian Wu

Got it. Thank you for taking my question.

Paul Reilly

Okay.

Operator

Your next question comes from the line of Craig Siegenthaler of Crédit Suisse.

Craig Siegenthaler

Thanks. Good morning, everyone.

Paul Reilly

Craig.

Jeff Julien

Hi Craig

Hi Craig.

Craig Siegenthaler

And Jeff, just wanted to congratulate you again for the 30 plus years and wish you the best for the next step.

Jeff Julien

Thank you, sir.

Craig Siegenthaler

So I had a follow-up to the first set of questions on recruiting. Have you seen any changes in the composition of the incoming advisers in terms of where they're coming from and their sizes of book of business? And I'm especially looking on a near-term basis where we saw this reacceleration.

Paul Reilly

Yes. Again, I think the reacceleration has been steady through the pipeline is just when they hit. But the – I would say that the average advisor continues to be higher. We're seeing much larger teams through the pipeline. So it doesn't mean they'll all join us, but the pipeline is very, very strong in the size, very, very big. We just announced the big team that joined us the last quarter. It's almost $6 million.

And so we are – we have a number of those teams in the pipeline in $5 million to $10 million range. So hopefully there we'll be able to recruit them and still there's very, very good advisors that are in $0.5 million and they're very profitable and very good with their clients. But so we are looking to recruit across the platform, but we are getting much bigger teams, I think in general right now anyway.

Craig Siegenthaler

Thanks, Paul. And just as my fault here with the RJF stock now well above the average levels of where you've purchased over the last year. I just wanted to see if we get an update on your appetite for buybacks, but also M&A in the future. And can you remind us roughly how much excess capital you currently hold?

Paul Reilly

Well, the excess capital is always a subjective question, but I do think first that, we were going to hold true to our – we've committed to purchase dilution on a regular basis and opportunistically buy in the market. I don't think that's changed. You would see we kind of raised our threshold given the tax act and our excess liquidity. So we were probably more aggressive than we've done historically.

So I – but I think the guidance we've given and still we will buy dilution and then be aggressive when we think there's an opportunity. And on the M&A front, I can tell you. All I can tell you is, we've been very active. It's a very interesting cycle right now. There's a lot more firms talking about maybe doing something, but they seem to be looking at this last year's environment as if it's going to continue for the next 10 years.

And so if you discount interest rates, if you discount, what you think market may be involve ability and all that. The pricing has led to a number of places where those things didn't transact to anybody, not just us. And so we're going to stay very active, very connected and be very discipline. So we are very active in the M&A side. But again, we're not going to do something just to be bigger. It has to make us better, so it has to be strategic. It has to fit our culture. And then we have to be able to have a good return for shareholders.

So with all of that, I'd say it's been a frustrating years. We've had some very good opportunities that didn't transact anywhere, because the pricing to us. I think the market agreed at least so far that the pricing just wasn't realistic. So but we'll stay active and I think that's the advantage. If there is a downturn and certainly downward interest rates will put pressure, it's been a great tailwind for the whole industry. That's tightening. So it may give us more opportunities, but we're still on it. But I can't tell you again with this type of market when we can do something, but we're very active.

Craig Siegenthaler

Thanks, Paul.

Operator

And your next question comes from the line of Steven Chubak of Wolfe Research.

Steven Chubak

Hey, good morning.

Paul Reilly

Hey Steve.

Steven Chubak

So Jeff, congrats. Enjoy the well-deserved R&R. Paul, I wanted to start off with a question on the industry pricing changes. Appreciate a lot of the commentary you gave and addressing some of the pricing developments on the SMA side at UBS. I was hoping you can quantify your direct exposure that third-party and internal SMAs and how you think this change may impact the fees on this particular product?

Paul Reilly

Again, we have significant assets in our advisory accounts. So it's a both internal management and third-party sub advisors. So again, I think UBS' announcement isn't very clear, whether they're just re-bundling, whether advisers are sharing on that or what's going on. So it's hard for me to comment on that.

If you look overtime, there's always been pressure on those advisory accounts and the fees that we in third-party managers charge. And it's been very competitive. So it would impact us if we lowered these. But we've continually since I've been here, I don't know how many times we've lowered fees in those accounts to be more competitive. And the good news of our scale has grown significantly. So it's been a pressure, but with size has been still a growth area for us.

So again, UBS announcement for us, I have no idea. Again, the impact is how is that change going to be passed to the advisor and client, and that wasn't announced at all. And if it's a re-bundling, it could have no impact. If it's charged the advisor, it has different impact. If they're going to eat it all and the advisor, client and shared as a more significant impact. But I have no idea what that is right now. So I wish I could be more clear, I just don't know. But we are looking at it. And it's just a couple day old announcement.

Steven Chubak

Recognizing we're still waiting additional color on that context is certainly quite helpful. I had a question on some of the developments ahead of the upcoming election. There's been lots of focus on election rich for financials and given some of Warren's momentum. What her agenda can mean for the group recognizing that the legislative hurdles for the DOL could potentially be much lower. I was hoping you could just give some perspective on whether you think it's reasonable for to be repurposed, especially given the implementation of Reg BI and how you're thinking about that potential threat or have you made sufficient changes already to your business model, you're already pretty well prepared.

Paul Reilly

So I'd say there is multiple answers. So first, the DOL will come back. I mean there is a – we've been told that the Department of Labor is looking for an October type of announcement. If you remember, Reg BI specifically talked about the DOL and our belief is that the – I have no idea, but our belief is the SEC and the DOL had long talks to make sure that what the SEC proposing with it and for the DOL proposal. And some of BI already signals some of the stuff that you'd have to do with DOL type of account.

So I don't think, and again we may see something in October for proposal and formal regulation in December. I don't think the DOL portion will be big. I think that Reg BI in a lot of ways is harder than the DOL, because the DOLs – here's what you have to do, here's what you can't do. And it was kind of easy to programs for it. Now I think it was bad for advisors and flexibility. Best interest standard says, hey, make sure you're putting clients first, you disclose everything. And so as you do that, you got a little harder from a judgment standpoint, but I actually think the standards more align. It just gives flexibility to say, yes, you can do this, just make sure it's in the best interest of your client.

And so, certainly, I think all firms will be better positioned if a DOL type of administration came back, we'd all be closer. Because a lot of those elements would have been already kind of programmed in, especially on disclosure, which is hard to argue against best interest, hard to argue with and documenting why you made decisions hard to argue with. The DOL, we're just going tolot of more stop, where it would have been hard to do, much harder to do commission accounts and other things.

So I think the industry would be better off. I think the challenge right now, it's been a little quiet lately as proposed state rules that we take to have a series of state legislations that differed, which is certainly add complexity to the business. Many think in our industry that it's surpassing the states authority to do those kinds of rules.

So my guess is that would go to court too. So the industry certainly who is ever President whether they like financial services companies [indiscernible] could have an impact on regulation. Many of the people in the regulatory seats terms do go for a few years after the next elections. So there'll be pressure, but it'll be harder to do it by appointment. It'll have to go through regulation and my guess is we'll have a divided Congress no matter what.

So who knows, right? But we'll react to it. I can't predict. I certainly think certain candidates, if they're look like they have an opportunity to be the next president would be a lot more disruptive than other ones. But I can't do anything about that. I only have one vote.

Steven Chubak

Fair enough. Although it is a vote in Florida. I could make sure, it gets counted. Just one more for me, Jeff, just to clean up question on the NII geography. Certainly good momentum this quarter. Looks like the beat was in the corporate other catchall segment. I was hoping you can discuss what contributed to some of the strength there. Just trying to gauge the sustainability of that NII momentum.

Jeff Julien

Yes. That kind of jumped off the page with us too. And I'm going to let our Treasurer, who we've asked to look into that, address that since you're going need to get used to hearing his voice in the future anyway. I'll let Paul Shoukry talk to that one.

Paul Shoukry

I think Steve is already sick in my voice. Some of the geography, Steve, is really attributable to rounding when you're dealing with such small numbers from quarter-to-quarter. So the other segment is showed that it was up $9 million sequentially through interest income. More than half of that was attributable to rounding, believe it or not, just when you're dealing with such small numbers. But the remaining portion was due to higher cash balances sequentially. They were up, the parent company around $300 million on average quarter-to-quarter. And we really didn't see the negative impact of the interest rates just given the timing of the cuts. So that will be reflected on those balances next quarter.

Steven Chubak

Very helpful, Paul, and Paul, thanks very much for taking my questions.

Operator

And your next question comes from the line of Chris Harris of Wells Fargo.

Chris Harris

Thanks guys. So we've seen pay rates on deposits come down quite a bit across the industry in it, your firm as well and you've already highlighted that. Is there a point though, where you might decide, hey, you know what, we need to be a little bit more generous with these pay rates if we want to grow cash balances a little bit more. Or is that not really under consideration at this point?

Paul Reilly

I think we look this way that we think that, obviously, we like funding by cash balances. And again to the extent, that spreads come in, the negative is spreads came in. The positive is that the delta between cash sweep, FBIC insured and the premium that you may give up in the money market will narrow. And we think that will naturally caused people to stay in the FBIC assured. So we think that may grow.

But being led as a firm, the number one thing, you always look at liquidity. We will look into raising higher rates, if we needed liquidity, third party funding in the bank. We're testing – we tested our CD program and it worked just fine and we're going to test other measures just to make sure the liquidity is there. But that's all at a much higher rate. So that would compress NIM, if we needed it. Right now, we don't. But you don't – everyone assume you don't.

So one of the things we'd like as having been more conservative in how we funded the bank, that the cash drop has not impacted our operations. Again at point, it would. And just need to make sure that we have that access to third party funds, but it would be at a higher cost. So we are looking at it, I would call it more as a contingency. You may see us raise some money, just to test that. But right now, it isn't a big driver of our cash program in our minds, certainly, not in the short-term.

Chris Harris

Okay, got it. I did want to ask you one question on your margins. And if the last Investor Day, I think you guys talk big picture. Hey, probably be an environment, where margins are generally flattish, revenues growing in line with expenses or expenses – excuse me, growing in line with revenues. If we – if the fed cuts again in the December quarter and we have kind of like a formal equity market for your fiscal year 2020. Do you think that outlook is still achievable?

Paul Reilly

I think as we look, Chris, honestly, the more interest rate cuts, certainly that's top line and frankly for the bottom line. We don't pay anything on that, right? So that's going to compress margins and even if revenue grows, it will be compensable revenue. We're paying 65% or 66%, whatever the number is this quarter, next quarter on that. So that the comp ratio will go up, as you go from non-compensable to compensable and margins will come down, because you can't make up a non-comp expenses, you can't make up that difference. The only way you do that is by changing your grid. And that's a major effort difference. The only way you do that is by changing your grid. And that's a major effort, which we have to do, we'll do, if that's the right thing of balance for the business. But it's not a short term fix. So interest rate cuts is going to impact anyone, who's interest rate sensitive.

Chris Harris

Got you. Okay, thank you.

Operator

And your next question comes from the line of Alex Blostein of Goldman Sachs.

Alex Blostein

Hey. Hi, guys. Good morning. Just one question around expenses, I think Paul, to your point around non-comp growth this year being really impacted by couple of accounting changes and charges. If you backed us out, I guess, you guys would have been in the closer to mid single digit growth in non-comp expenses for fiscal 2019. And understand that you guys are still early in the kind of budgeting process, but assuming it's similar level of – kind of investment continues. Is that a more reasonable way to think about non-comp expense growth in June 2020? Thanks.

Paul Reilly

I would say, yes, it is something we're going to manage. And I do think, we're not an e-broker. I mean, we will have recruiting expenses. We will have – you add raises, which you looked at the marketplaces, those 3% this year to our – you multiply that across our system. You have technology investment, which certainly isn't going down, you've got some embedded growth. I mean, even when you manage all those other expenses, if you're recruiting now, the good way is to make us all look good is to stop recruiting. And a lot of those expenses will go away. But I don't want to hand over the business some day to a successor who has a business that's not viable and growing. So we're going to continue to grow and that will drive expenses.

It's probably last two years. It's probably been 50 basis points. It shouldn't just in a comp ratio just from amortization. So, and the more we recruit, that number will grow over time. And so – and we plan to continue to recruit. We had a number in 2009, we had our record recruiting year until last year. And this year we beat it. But in downturns, we recruit now, it may not look good on the numbers on the downturn, but it certainly looked good, when I came out of it and drove really a decade of I think great performance. So, yes, it's not going to go away. We're going to manage it as well as we can, but it's not going away.

Jeff Julien

And there to point out, there are a couple of expenses that are really somewhat out of our control, such as now legal reserves can depends what happens with that and regulatory issues and bank loan loss provision being another one. It's subject to whatever happens in those particular areas. Those are very difficult to budget, although, they've been within a range, they're very difficult to pinpoint anytime over a year or such. Those can go either direction from this year to next.

Paul Reilly

And I'll just say that the CEO there in our control, but there are long-term cyclical impacts. So we make good loans and get good people. We allow a lot less of those. But I think we're in good shape.

Operator

And your last question comes from the line of Jim Mitchell.

Jim Mitchell

Maybe we could just talk a little bit about fee-based asset flows, if I – not that you disclose them but we can take the stab back in our market impact. If I look at flows this year or 2019, they seem to be down probably about, still solid but down very strong a year ago. Maybe cut the half in terms of the annualized growth. How much – I'm just trying to unpack that, how much of that has been the slow down and recruiting at the beginning of the year versus a tough equity market versus a slowdown and sort of migration from brokerage to fee based. I mean, I know there's a lot of moving parts there, but maybe you can help us think about the taste of flows. How that trajectory has been and where it could go with accelerating recruiting.

Jeff Julien

Yes. I'll just make a couple of comments on that, Jim. First of all, I think that last year was an abnormal year before they killed the DOL rule. There was a, as you know, as huge movement over to fee-based. And for us that happened for the first nine months of last year in a pretty big way. That has definitely slowed down to some extent. But having said that, we're still recruiting advisors that use our fee-based platforms to a large extent. And we still do see migration from our existing advisors to fee-based just at a slower rate. So that's why you see the growth of fee-based assets outstripping the growth of the market. S&P up one and fee-based assets up three, this most recent quarter, because we continue to see both those dynamics still at play.

Jim Mitchell

Okay. So but you would think last year was a lot of it or a good chunk of it was driven by just sort of that migration.

Jeff Julien

Now, last year and the year before, probably we're both heavily DOL driven.

Jim Mitchell

And we think about the new recruits, it looks like it was more in the employee channel versus the independent contractor channel. Where I guess geographically is that coming from and does that help the margin a little bit, because it's in the employee channel instead of the more fixed margin independent contractor.

Paul Reilly

So the employee channel had a very good last few quarters, where the independent, who's been really leading recruiting the last couple of years, had a little bit of slowdown, but not much. So I would call it, it's – I think it's episodic. Both channels are recruiting very, very well. And so I think economically we've had a big bull run, so independence look really good.

And if you get a little tougher market environment, the employee channel looks a lot safer. So some advisors just like, they want to work with clients and they don't want to worry about turning on the lights and paying bills and others want to have, feel like they own their business every day. So, although, we tell all the advisors they do.

So I don't think, I wouldn't call it one versus the other. I think they're both robust and their pipelines. And I couldn't explain why the independent has been a little higher and the employees pick up. I do think some of that's big teens, geographically it's all over doing better in the Northeast, pushing harder in the West. We're gaining ground, but we've got a lot of markets in the west. So we think we still have a big opportunity in California as long as we have electricity though around the offices.

So we are – and then people ask, have large market share in Michigan yet as a strong recruiting market, even though we have great presence. So it feels good all over. But I think we're starting, if you've seen growth, which has impacted expenses. So I'm just seeing a lot more growth from the big cities, where there's still a lot of opportunities. So, I wish I could give you more of a definitive answer that's the color, but I'd say it's too short to say that people switched to an employee of a cycle.

Jim Mitchell

Okay. I guess generator cost in California will have to go up for the Raymond James.

Paul Reilly

Yes.

Jim Mitchell

All right. Thanks for the color. And Jeff, good luck the retirement, hope your golf game improves.

Jeff Julien

Thanks, Jim.

Paul Reilly

Jeff, little quite the off the hook for another year, he's saying we still have a little more time that maybe a little more freedom, but we'll have his services both at the bank and as an advisor and helping Paul through that transition. So want to thank you all for the call. I do think that a lot of people, the recruiting numbers are big numbers, but you look at $300 million in assets and I made production the trailing 12, those $40 plus billion in assets. It's like a Morgan Keegan. I'm in, sorry, Alex Brown acquisition just on organic recruiting.

So we believe that's a great way of growth. We get to pick advisor by advisor and I still think it's the biggest testament to the underlying platform is that, and the fact that they're generally joining us for less checks and sometimes significantly less checks and then get at other places.

So we'll continue to push. I think the fundamentals are great from advisor and platform standpoint, but the fundamentals are very difficult from an interest rate standpoint and the markets will be the markets, especially coming to an election here. So appreciate you joining the call and we'll talk to you soon.