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Blucora, Inc. Second Quarter 2018 Earnings Conference Call
Management's Prepared Remarks

The following is Blucora management's prepared remarks on a conference call Wednesday, August 1, 2018 at 8:30 a.m. ET to discuss second quarter 2018 financial results. This webcast can be accessed within the Investor Relations section of the Blucora corporate website at www.blucora.com.

BILL MICHALEK, VICE PRESIDENT INVESTOR RELATIONS

Thank you and welcome, everyone, to Blucora's second quarter 2018 Earnings Conference Call. By now, you should have had the opportunity to review a copy of our earnings release and supplemental information. If you have not reviewed these documents, they are available on the investor relations section of our website at Blucora.com. In addition, this quarter we will be referencing a set of slides that are also available on the website and will be on displayed in the webcast viewer. I'm joined today by John Clendening, Chief Executive Officer and Davinder Athwal, our Chief Financial Officer.

Before we begin, let me remind everyone that today's discussion contains forward-looking statements based on the environment as we currently see it and speak only as of the current date. As such, they include risks and uncertainties, and actual results and events could differ materially from our current expectations. Please refer to our press release and our other SEC filings, including our Forms 10-K, 10-Q and other reports, for more information on the specific risk factors. We assume no obligation to update our forward-looking statements.

We will discuss both GAAP and non-GAAP financial measures today, and the earnings release available on blucora.com includes the full GAAP and non-GAAP reconciliations.

Finally, I'd like to call your attention to a change in our naming convention as it relates to assets at HD Vest. In the interest of clarity, and to make the categories more intuitive, the term "Total Client Assets" has replaced the previous term of Total Assets Under Administration, or AUA. The term Advisory Assets, has replaced the previous term Assets Under Management, or AUM. We have also introduced a new category, Brokerage Assets, which represents the difference between Total Client Assets and Advisory Assets, or in other words, all non-advisory assets. For those of you looking at the webcast slides, the table on page 3 summarizes the changes.

With that, let me hand it over to John.

JOHN CLENDENING, PRESIDENT AND CHIEF EXECUTIVE OFFICER

Thanks Bill, and good morning everyone.

Blucora has continued to demonstrate strong momentum in the second quarter, posting double-digit growth rates and exceeding the high-end of our guidance range on all metrics. Compared to last year's second quarter, Blucora grew revenue by 13%, adjusted EBITDA by 24% and non-GAAP EPS by 39%.

Strong cash flow generation allowed us to further strengthen our balance sheet and pay down another $40 million in debt. Our net leverage ratio exiting the quarter was a very comfortable 1.5x, which is down from 2.1x last quarter and 2.7x in the year-ago period.

Overall, we continue to execute to plan and are very pleased with the results.

Wealth Management

Moving to the business unit level, starting first with wealth management. HD Vest continued to demonstrate momentum, growing revenue by 8% year-over-year to $92 million. With continued investment in the clearing conversion project, segment income also grew 4% to $13 million. As Bill mentioned, we have updated our nomenclature for our asset categories. Advisory assets, previously referred to as AUM, were up 12% year-over-year to $12.9 billion. Total client assets, previously referred to as AUA, increased 9% year-over-year and crossed the $45 billion mark. The levels for both advisory assets and total client assets represent new records for the company.

Net inflows into advisory assets were about $90 million in the second quarter, and advisory assets as a percentage of total client assets were 28.8%, representing an increase of about 90 basis points, year-over-year, also hitting a record level. As advisory assets continue to grow faster than the total, it is one component, along with trailing commissions and sweep revenue, that further reduces our dependence on transactions and increases our recurring revenue rate. Our recurring revenue rate reached 82% in the second quarter, up 100 basis points year-over-year.

A few additional updates I'll add here for HD Vest:

- First, you may recall that in our Q4 call we announced that, in our effort to expand our available market to serve accounting firms with multiple partners and offices, we had added our first two firms. In the second quarter we added two more firms to the platform, with another 7 firms now in the licensing stage. The 9 new firms have about $23 million in cumulative accounting revenue with total estimated client assets, using an industry rule of thumb, of about $2.3 billion that the advisors can look to serve once all are fully licensed.
- Second, we recently completed the second phase of our advisor reductions. As you'll recall, the first phase of reductions was tied to those that had de minimis assets and a debit balance with us. The second phase included a mandate that advisors achieve a minimum level of client assets within certain intervals – specifically $1 million by May. While we do have one more interval, requiring $2.5 million by January 2019, we expect that the bulk of the reductions are now behind us. We could still see another 300 or so reduction by year-end, then would expect to return to a normalized environment in 2019.
- Third, during the quarter we announced our relationship with eMoney, which will provide our advisors with cutting edge planning and collaboration technology. The platform, which we will pilot this month and launch concurrent with the clearing conversion, will make it easier for advisors to create and update holistic financial plans, aggregating household information in real-time, and enable them to visually demonstrate projected benefits with clients through an interactive portal. Any time you can improve the ability for advisors to provide a clear vision of a client's financial picture, it helps to strengthen relationships and retention, and often drives additional client asset consolidation along with interest in for-fee advisory services, increasing total advisory assets.
- Fourth, we will soon be launching two new advisory solutions for clients including VestStrategist™, a centrally managed solution for high net worth investors that boasts low-fees, direct ownership of underlying securities, and tax loss harvesting, while leveraging third-party investment managers such as Putnam and Legg Mason as well as VestAccess™, a low-fee, low account minimum managed solution that leverages automated investing, or "robo" technology. We believe these will be attractive new offerings for clients at both ends of the asset spectrum, and may serve to further accelerate the shift of funds from brokerage into advisory solutions. Both solutions launch concurrent with the clearing conversion.
- Finally, as we get closer to the clearing conversion date in late September, I'd like to provide a bit more detail on what to expect.
    - To avoid a dual migration and duplicative paperwork, in June we began to slow advisor and client transfers ahead of the conversion. As a result, we expect to see slower net inflows in Q3, followed by a stronger Q4 and possibly even overflow into Q1 of 2019.
    - Now that we have had two interest-rate increases this year and have incremental guidance from the Fed on expectations for the remainder of this year and next, it seems like a good time to update our expectations for total clearing related revenue benefits. As you'll recall, we have indicated that there are

three primary ways in which we expect to benefit from the clearing conversion in terms of either increased revenue or decreased cost, including 1) better capture of interest income on client cash or 'cash sweep' in a rising rate cycle 2) increased revenue share economics including an opportunity to bring back on platform assets currently held direct-to-fund or 'DTF' and 3) technology savings. As it relates to cash sweep, we indicated that each 25 basis point increase in the Fed Funds rate would equate to $2-$3 million in incremental segment income benefit that could either drop to the bottom line or enable acceleration in growth. Of course as the Fed Funds rate increases, we would expect also that client yields would move up but at a far slower pace, in part to optimize balance retention. Big picture, we would expect the majority of the benefit of rising rates would result in increased segment income in-year, with the bulk of the remainder focused on targeted investments to drive organic growth in the ensuing few years.

- Looking at all of the components in aggregate, for the fourth quarter of 2018, assuming the Fed increases the target range to 2.00% – 2.25% in September, we now expect a small net benefit of approximately $1 million, which compares to our previous expectation of breakeven. For 2019, assuming one additional increase in the target range to 2.25% to 2.50% by mid-2019, we now expect a benefit of between $10-$12 million, which compares to our previous expectation of $6-$8 million. And for 2020, assuming no additional change in Fed Funds rate, we now expect a benefit of between $12-$14 million, which compares to our previous expectation of $8-$10 million. The significant difference versus our previous expectation is primarily due to higher interest rate expectations as well as updated assumptions into the revenue share opportunity. We realize that the composite view of the Fed Funds rate is far more aggressive, with 2 or 3 more increases by the end of 2019. As we get through the transition, we expect to further update our assumptions and provide more detail.
- As you can see, even annualizing the low-end of our 2020 benefit assumption, we would already be at a total incremental value over the 10-year contract of about $120 million dollars in segment income. That's about $20 million above the top-end of the estimated range we had provided just a year ago, and equates to more than two full additional years of segment income at our current run-rate, over that 10-year period.
- I'd also point out that the incremental revenue sources from this agreement, cash sweep and mutual fund revenue share, will serve to further benefit our recurring revenue rate that I referenced earlier.
- Given the importance of this conversion, and sheer number of touchpoints across the business, we are dedicating an increasing number of resources across the organization to ensure a successful completion and mitigate any disruption to advisors in Q4.

So, overall, another strong quarter at HD Vest with great opportunity ahead.

Tax Preparation

Turning to tax preparation. TaxAct completed a very strong tax season and first half of the year, with first half revenue up 17% year-over-year, coming in a bit higher than our upwardly revised guidance from May of 15% growth, and almost double our original expectation going in to tax season. This marks the 20th consecutive year of revenue growth for TaxAct. First half segment margin came in at 57.3%, which was also above our previous expectation of 56.0%.

We were pleased with our progress this season which included a number of highlights, including:

- Returning to growth in monetized filers;
- Improving the customer experience with enhanced support and functionality including a greatly enhanced mobile experience;
- Improving paid customer retention;
- Launching our BluPrint™ financial assessment to analyze tax returns and offer suggestions to improve customers' financial health – for which we received more than 2 million requests and identified average savings of $2700;
- Increasing professional e-files by 3%; and

- Launching more than 10 new partnerships to improve customer acquisition and extend customer relationships with new products and offers to serve them more holistically across their financial lives.

Now with tax-year 2017 behind us, we are working hard to refine our plans to build on the success of this year and further improve our competitive positioning for next season. We'll share more detail on that later in the year, but a few areas of focus are around:

- Providing more long-term value for our clients/customers with improved products, and an enhanced customer experience; in tax year 2018 our customers will find our product easier to use from start to e-file completion
- Incorporating our learnings on pricing, packaging and messaging;
- Deepening and broadening our partner relationships; and
- Expanding third-party offers through BluPrint, and within the tax interview, to give customers more products, more value and more ways to improve their financial lives.

Closing

In closing, we had another strong quarter of continued execution across both businesses. We posted double-digit revenue growth with strong operating leverage, strong cash flow and a strengthened balance sheet. HD Vest saw record levels of advisory assets and total client assets and our TaxAct business finished the first half with high-teens revenue growth and strong segment margin. And subsequent to the end of the quarter, we announced that we added two new independent directors to our Board, including Carol Hayles, the former CFO at CIT Group and John MacIlwaine, the CTO at the Braintree subsidiary of PayPal. Overall, we continue to improve our business positioning and capabilities, and I remain very optimistic about the opportunities we have ahead.

With that I'll turn the call over to Davinder.

DAVINDER ATHWAL, CHIEF FINANCIAL OFFICER

Thanks John, and Good Morning everyone.

I'll review our second-quarter financial performance, our third-quarter outlook and provide an update to our full-year guidance. I'll also provide detail on our net leverage position at quarter-end.

Comparing Blucora's current-quarter results with the same-quarter last year:

- Our revenue was \$157.8 million, up 13%
- Adjusted EBITDA was \$52.8 million, up 24%
- Non-GAAP EPS was \$0.97, up 39% on Non-GAAP net income of \$47.7 million, which is up 45%
- GAAP-net-income, attributable to Blucora was \$34.9 million, or \$0.71 per share, representing improvements of 957% and 914%, respectively

Looking at segment performance:

Wealth Management revenue for the quarter was \$92 million and segment income was \$13.0 million, both above the high-end of our guidance range.

Revenue for the quarter was 8% higher than prior year, primarily due to fee-based advisory revenue, which was up 12% versus prior year on higher advisory asset balances. As a reminder, advisory revenue represents fees earned in advisory accounts where HD Vest is the registered investment advisor. Commission revenue was up 6% year-over-year, primarily on higher trailing commissions reflecting higher asset values. Other revenue was up 3% year-over-year, primarily driven by higher cash sweep as well as increased mutual fund revenue share.

Net flows into advisory assets were $89 million during the quarter, bringing our year-to-date net flows to $408 million. Market appreciation during the quarter, added approximately $140 million to Advisory Asset balances, net of fees. We are pleased with our net-flows performance, as this is an area of focus for us as we continue to convert brokerage assets to advisory assets, as well as drive growth in new advisory assets. We ended the quarter with advisory assets of approximately $13 billion, which is up 12% year-on-year and up 2% sequentially. Advisory assets as a percentage of total client assets was 28.8%.

Total client assets for the quarter were $45 billion, up 9% versus prior year and 1% sequentially. As I previewed last quarter and as John mentioned in his remarks, we began to slow advisor transfers in June ahead of the clearing conversion. The result of this slowing combined with the departures of a large advisor, and an unusually large end-client in Q2, caused net flows into total client assets to be slightly negative during the quarter, to the tune of about $45 million. However, we expect to see a corresponding pickup in net flows in Q4.

The clearing transition is on schedule for late September. Non-recurring clearing-related expenses incurred in the second quarter were approximately $800 thousand and we expect to incur another $700 thousand in third quarter and about $300 thousand in the fourth quarter. Although as John mentioned, we expect to see a benefit in the fourth quarter that will more than offset these expenses and result in a full year net benefit of approximately $1 million.

Turning next to our Wealth Management outlook for the third quarter and full-year 2018. We expect third quarter revenue of $89.5 to $92.5 million and segment income of $10.0 to $11.5 million. For the full year, we expect revenue of $369.0 to $377.0 million and segment income of $53.0 to $55.5 million.

Moving on to **Tax Preparation:**
TaxAct revenue for the second quarter was $65.8 million, up 22% versus prior year, and segment income was $44.1 million, up 21% year-on-year. Both revenue and segment income exceeded the high-end of our guidance expectations in part driven by a better than expected collection-rate on our refund transfer product as well as higher product sales. First half revenue was up approximately 17% with segment income up 15%, marking another good year of growth for TaxAct.

As John mentioned, we are working hard to build on what we learned from this tax season and further improve our competitive positioning for next tax season. As part of this, we plan to use the incremental segment income relative to plan, to increase our investment in the business in the second half of this year. For the full-year we are expecting revenue for TaxAct of $184.5 to $186.0 million and segment income of $82.5 to $84.0 million or a segment margin of approximately 45%. We look forward to sharing more of our strategy and 2019 expectations over the next couple of calls.

Finishing up on **second quarter performance:**
Unallocated corporate operating expenses were $4.2 million, a bit lighter than we expected due to the timing of certain items between quarters. For the third quarter, we expect unallocated operating expenses of $5.0 to $5.5 million.

Moving on to liquidity, we ended the quarter with cash and cash equivalents of $89.8 million and our net debt was $175.2 million, which reflects another $40 million pay-down during the quarter. This brings our total debt reduction year-to-date to $80 million, in-line with our stated goal and demonstrating the strong cash flow generation of our businesses.

With that let's turn to the **consolidated outlook for the third quarter and an update for the full year.** For the third quarter we expect revenue between $92.0 to $95.5 million, an Adjusted EBITDA loss of between $2.0 to 5.0 million, a non-GAAP net loss of $8.0 to 11.0 million, or $.17 to 0.23 cents per share and a GAAP-net-loss attributable to Blucora of $18.5 to $22.5 million, or $0.39 to 0.47 cents per share.

For the full year, we expect consolidated revenue of $553.5 to 563.0 million, Adjusted EBITDA of $114.5 to 119.5 million, non-GAAP net income of $89.0 to 94.5 million, or $1.80 to $1.92 per diluted share, and GAAP-net-income attributable to Blucora of $42.5 to $46.0 million, or $0.86 to 0.93 per diluted share.

As a reminder, our outlook includes the following assumptions:

- A broad range for transactional revenue due to its variability;
- Impact of clearing firm transition related expenses;
- Market volatility, including the impact to net flows and cash sweep balances;
- An effective tax rate of 2 to 6% for GAAP-net-income, attributable to Blucora; and
- Our guidance for GAAP-net-income or loss attributable to Blucora excludes any impact to tax expense for discrete items and variable stock-based compensation granted to non-employee advisors.

Consistent with our previous messaging, we will continue to run the business to optimize for adjusted EBITDA… as such we will refine our investments into each segment, along with corporate operating expense for second half of the year.

This concludes our prepared remarks; we will now turn the call over to the operator for Q&A. Operator?

JOHN CLENDENING, PRESIDENT AND CHIEF EXECUTIVE OFFICER

Thank you all for joining us today. In closing, I'd like to also thank our employees, advisors and customers that are at the heart of our success and make our business so enjoyable. We were pleased to report another strong quarter and look forward to speaking with you next quarter.