Blucora, Inc. Conference Call on Acquisition of 1st Global

BILL MICHALEK, VICE PRESIDENT INVESTOR RELATIONS

Thank you and welcome, everyone, to Blucora's Conference Call. On the call today are John Clendening, Chief Executive Officer and Davinder Athwal, our Chief Financial Officer. Please note that we have posted a press release and supplementary presentation in the investor relations section of our website at Blucora.com.

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, 8-K 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. For a reconciliation of these measures, please refer to our website, where our press release, supplementary presentation and other SEC filings provide these reconciliations.

With that, let me hand it over to John.

JOHN CLENDENING, PRESIDENT AND CHIEF EXECUTIVE OFFICER

Thanks Bill, and thank you, everyone, for joining our call today. We're excited to discuss our announcements today, most significantly our agreement to acquire 1st Global and the strategic and financial benefits we expect, as well as our new share repurchase authorization.

I'd like to begin my remarks with a brief reminder of our strategy, which includes **A**ccelerating growth, **B**uilding tax-smart leadership, **C**reating one Blucora and **D**elivering results. In our most recent earnings release and conference call, we discussed our 2018 performance and how we advanced these strategic goals as we strengthened our platform, invested for future growth, generated outstanding financial results and laid the groundwork to capture the significant opportunities we see ahead.

A few of the highlights we discussed for 2018 included:

- Growing total revenue by 10%,
- Growing adjusted EBITDA by almost double that rate at 19%,
- Growing non-GAAP earnings by an even stronger 30% and approaching $2 per share,
- Generating nearly $100 million in free cash flow,
- Strengthening the balance sheet by paying down $80 million in debt and reducing our net leverage ratio to 1.5 times from 2.8 times,
- Achieving record net flows at HD Vest, including almost $1 billion into advisory,
- Transitioning to a new clearing platform and technologies, which we believe will benefit advisors and clients while enabling us to capture more than $120 million in additional benefit over the 10-year term,
- Achieving our 21st consecutive year of revenue growth at TaxAct, growing 16% and meeting our goal of stabilizing monetized units,
- And last but not least, bringing great new talent in to the organization up to and including the management team and Board of Directors.

The strong results in 2018 build on our track record of execution and demonstrated success. Over the past 5 years we have now grown revenue by 8%, Adjusted EBITDA by 12% and Non-GAAP EPS by 28%. We have generated hundreds of millions in free cash flow and strengthened our balance sheet, reducing net leverage to 1.5x from a high of 6.3x.

While we have delivered great results, much of my first nearly three years has been about repositioning the company for future growth and building the platform. Now it is time to take the next step.

We have shared in the past that our capital allocation priorities would focus on debt reduction until we reached the 1.5-2x net leverage level at which point we'd consider a variety of capital allocation strategies, including stock buyback and inorganic growth opportunities, should they present themselves. While I believe we have quite significant runway to grow though execution of organic opportunities, we identified an inorganic opportunity that we could not pass up, the acquisition of 1st Global.

1st Global is very similar to HD Vest in that it is also a tax-focused wealth management firm, and it is the #2 player in this market segment based on revenue, to HD Vest's #1 position. 1st Global has about 850 advisors and roughly $18 billion in total client assets, a full 50% of which is in advisory, which compares to about 30% for HD Vest. This acquisition aligns well with our strategy of accelerating growth, building tax-smart leadership and delivering results. 1st Global is a good business both in terms of quality and scale. Big picture, this acquisition is right in our wheelhouse and has important attributes that make it both strategically and financially attractive. I would point you to four main takeaways:

1. This is a classic **consolidating acquisition** that adds **significant scale** to our wealth management business with a nationwide community of tax-focused financial advisors that combined is nearly 4,500 advisors strong and entrusted with overseeing approximately $60 billion in total client assets, with nearly $22 billion, or 36%, in fee-based advisory assets and creates greater capacity to invest in supporting our advisors. **Scale drives both substantial revenue and cost synergies**. It's also very positive that 1st Global is also located in the Dallas metropolitan area, and utilizes, similar key service partners, including Fidelity, eMoney and Envestnet. Combined, we believe that the fact that this is a consolidating, scale-building acquisition with geographic and vendor overlap, lowers the relative risk of the transaction and should make integration, cost savings and synergies easier to achieve. In fact, the majority of external scale synergies are already contracted, further mitigating risk.
2. The businesses are also **complementary** in that 1st Global has a focus and strong position in large, multi-partner accounting firms, with HD Vest leading in, and primarily focused on, individual advisors. This accelerates our push into the institutional and multi-partner accounting firm market, which is underpenetrated.
3. The combined business will feature **strengthened capabilities** in several important areas, including growth drivers like recruiting, on-boarding, and advisor development; as well as proprietary research, in-house portfolio management and proprietary technology.
4. This **expands our established tax-aware investing footprint** by creating by far **the largest and most capable tax-focused wealth manager**. We share a common vision, believing that clients are only truly well-served when advisors are focused on minimizing taxes and maximizing after-tax returns. The combined advisor community will have access to the tools we are now in the process of developing that enable the systematic capture of tax alpha, through creation of a holistic Tax-Smart Investing software suite.

The acquisition is structured as a stock purchase with a price of $180 million, which represents an attractive multiple of approximately 7.5x run-rate synergized pro forma 2019 EBITDA. Overall, we estimate the transaction can generate $23mm - $24mm of run-rate EBITDA accretion by the end of 2019, with meaningful accretion to earnings per share.

It's important to punctuate that we have high confidence on achieving the key synergies that underpin this transaction, for two reasons: 1) many of the synergies are contractual in nature and are essentially in the bank 2) the bulk of the remainder are fully in our control as they relate to cost reduction.

I'm very excited about this transaction and the strategic and financial benefits that we expect it will bring to Blucora. 1st Global has an impressive advisor base, team and business model, and a culture very similar to our own. Our entire leadership team is looking forward to their employees, advisors and clients joining us as we continue to grow. We plan to be very visible and engaged with 1st Global's employees and advisors during the integration to ensure a smooth transition for everyone, while not taking our eye off managing and growing our business. We'll be sure to update you on our progress on this front as we move forward.

Now I'll turn it over to Davinder for some additional detail about the transaction as well as our share repurchase program and out updated outlook.

DAVINDER ATHWAL, CHIEF FINANCIAL OFFICER
Thank you, John and good morning everyone.

First let me say that I share John's excitement about this transaction. This is a great opportunity for us to accelerate our growth as well as profitability from significant revenue and cost synergies; and, as mentioned, it is expected to be accretive to both EPS and free cash flow, enhancing shareholder value. To start with, I'll provide an overview of First Global's business and their revenue mix and then we'll talk more about the specifics of the transaction.

As John mentioned, First Global is the number two tax-focused wealth management firm, and specializes in embedding advisors into multi-partner tax and accounting firms. This complements our core approach that has focused on turning individual tax pros into wealth managers. They offer a variety of advisory programs and their asset mix consists of a diversified portfolio of advisory solutions. As for their client asset mix, about 50% is in brokerage accounts and about 50% is in advisory accounts, which approaches industry best practice levels. From a revenue perspective, for 2018 they generated total revenue of $174 million, 65% of their revenue was from fee-based advisory, which compares to 44% for HD Vest over the same period. Trailers were 15% and transaction revenue was 10%. The remaining 10% came primarily from fees, sweep revenue and mutual fund revenue share. Their recurring revenue rate was about 88%, compared to 81% for HD Vest over the same period, driven by their very high proportion of advisory assets. In terms of client cash, their client cash balances as a percent of total client assets are slightly higher than HD Vest.

We expect to capture significant cost and revenue synergies from this transaction. Nearly 80% of cost synergies are expected to come from operational overlap. We also expect external cost and revenue synergies from key partners and vendors, most of which is already contracted. In merging the two clearing agreements for example, we will benefit from the increased scale of the combined entity. We are also making decisions that will appeal to advisors, including as we rationalize and ensure a compelling payout grid, that along with the other benefits, will make this the place where advisors want to build a long-term successful franchise. Additionally, we expect substantial cost synergies to be driven by operational redundancies, back-office system and contract consolidation, and technology savings.

Given our long-standing focus on shareholder value creation, we have put an increased emphasis on the quality of our planning and execution of this transaction and resulting integration. We anticipate reaching our run-rate cost synergies within 18 months, post-close, and therefore expect calendar year 2021 to be the first full year of integrated operations. However, we expect to harmonize with respect to Fidelity, eMoney and Envestnet within 12 months of closing. As we noted on our recent earnings call, we have a solid line of sight to stabilizing our conversions to each of these in the coming months, and are pleased to see that many advisors have already fully adapted to each platform.

Looking at near- and long-term opportunities, we expect several. In the near-term this transaction gives us greater scale and new opportunities to leverage efficiencies, capabilities and technology to better serve our combined advisor base. We will also be able to better to reinvest in our business – in line with our strategic growth plan – and take advantage of the "best of breed" across both platforms to enable advisors to provide even more value-add to their clients. Longer-term, we expect that our advisors will be able to use their capabilities to increase the share of client assets in advisory accounts where appropriate, potentially also including bringing more directly held assets onto our platform. Both of these opportunities can create additional value as advisors and clients take advantage of the breadth of our combined capabilities.

The transaction was signed yesterday, with a purchase price of $180 million, which will be funded through cash on hand and a $125 million add-on to our Term Loan B due 2024. The transaction values 1st Global at about 7.5x synergized 2019 EBITDA, or 13.4x excluding synergies. This would take our net leverage ratio to 2.7x, based on Pro Forma 2018 EBITDA. As a result of this acquisition, we anticipate that our cash flow will increase by approximately $11mm excluding synergies, and we plan to use that cash flow to de-lever, similar to what you saw following the HD Vest acquisition at the end of 2015. The resulting increase in profitability of the combined company will also increase the likelihood that we fully utilize our NOL balance over the next few years.

On the matter of advisor retention, we plan to include 1st Global advisors in our equity incentive plans which reward top producing and fast growing advisors. This not only demonstrates Blucora's commitment to our combined advisor base, but to our future growth in this area. We're also putting in place a simplified on-boarding and conversion process designed to make the advisor's transition as seamless as possible, with a negative consent process and no repapering required. Both firms use the same clearing provider, Fidelity, making the transition even easier.

As I mentioned, we expect the transaction to generate $23mm - $24mm of run-rate EBITDA accretion by the end of 2019 and drive high-single-digit, and growing, EPS accretion by 2020.

We anticipate integration costs to be approximately $28 million, which is primarily composed of on-boarding costs for 1st Global employees, advisors and clients; business system, compliance and other technology and infrastructure costs; consulting, severance and other administrative matters. The impact to the P&L is estimated to be approximately $10 million in 2019, $18 million in 2020, with no additional costs beyond 2020. Any rolling integration costs beyond 2020 have been included in our run-rate synergized EBITDA. Finally, we expect the transaction to close in the second quarter of 2019, subject to regulatory approval and customary closing conditions.

In addition to the acquisition, we also had a few other announcements or updates today.

First, is that our Board of Directors has authorized the repurchase of up to $100 million of our common stock. This new repurchase program furthers our capital allocation strategy and provides us with a complementary tool to deliver value to our shareholders. While we remain focused on debt reduction and investments that catalyze future period growth, this authorization provides additional flexibility and an alternative for cash redeployment through opportunistic buybacks. The authorization is effective immediately and does not have a specified expiration date.

We also updated our outlook for first quarter. On a consolidated basis, for the first quarter of 2019, the Company currently expects revenues to be between $224.0 million and $229.0 million, GAAP net income to be between $57.5 million and $60.0 million, or $1.14 to $1.20 per diluted share, Adjusted EBITDA to be between $78.5 million and $82.0 million, and Non-GAAP income to be between $71.0 million and $74.5 million, or $1.41 to $1.49 per diluted share. The better than expected outlook is primarily the result of higher tax preparation revenue, driven by pricing as well as timing of volume between the first and second quarters. This outlook includes unallocated corporate operating expense of $8.0-$8.5 million, which includes transaction related expenses of approximately $1 million.

For the first quarter TaxAct, we expect that $135.0 to $137.0 million or approximately 69 percent of the first half 2019 revenue to come in the first quarter and segment income of $76.5 to $78.0 million. Our first quarter outlook for HD Vest remains unchanged at revenue between $89.0 and $92.0 million and segment income of $10.5 to $12.0 million.

Finally, we updated our tax preparation outlook for the first half of 2019. We now expect first half revenue to grow by 8%-11% vs. the comparable period last year, up from our previous expectation of 7.5%-10%. We expect an associated segment margin of 56.9-58.1%, which is also up from our previous outlook of 56.7% to 57.7%.

With that, I'll turn it over to the operator for any questions.