



Blucora, Inc. Second Quarter 2017 Earnings Conference Call Management's Prepared Remarks

The following is Blucora management's prepared remarks on a conference call Thursday, July 27, 2017 at 8:30 a.m. ET to discuss second quarter 2017 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 2017 Earnings Conference Call. By now, you should've had the opportunity to review a copy of our earnings release, supplemental information and prepared remarks. If you have not reviewed these documents, all three are available on the investor relations section of our website at Blucora.com.

I'm joined today by John Clendening, Chief Executive Officer and Eric Emans, Chief Financial Officer. In a moment, we'll hear brief remarks from both of them, followed by Q&A.

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.

With that, let me hand it over to John.

JOHN CLENDENING, PRESIDENT AND CHIEF EXECUTIVE OFFICER

Thanks Bill, and good morning everyone. We continued our positive momentum in the second quarter, strengthening Blucora and improving our positioning across both businesses. Total Blucora revenue grew 16% year-over-year with adjusted EBITDA growing faster at 20%, and Non-GAAP EPS improving by 27% - strong results against any peer group.

About 18 months ago, following the acquisition of HD Vest, we laid out a goal to achieve a 3x net leverage ratio, down from 6.3x at the time. I am pleased to report that we have already exceeded that goal, ending the second quarter at 2.7x. During the quarter we reduced debt by about \$35 million, in addition to simplifying our capital structure with a new lower-cost credit facility replacing our old facility and convertible notes. This new structure is expected to reduce cash interest expense by about \$3.4 million per year. We also added two new independent directors in Georganne Proctor, the former Chief

Financial Officer of TIAA-CREF, and Steven Aldrich, Chief Product Officer at GoDaddy, Inc., further strengthening our Board.

Wealth Management

At the business unit level, turning first to wealth management. HD Vest continued the momentum of the last few quarters with revenue up 12% year-over-year and segment income up 25% year-over-year. Following the stock market volatility and post-acquisition transition of the year-ago quarter, HD Vest has continued to improve on important growth metrics:

- Assets under administration, or AUA, increased 11% year-over-year to \$41.4B – setting a new record.
- Fee-based assets under management, or AUM, were up 18% year-over-year to \$11.6B – also a new record.
- Net inflows into AUM were \$222 million in Q2 and AUM as a percent of AUA increased to 28%, up 150 basis points from the year ago quarter and also hitting a high-water mark.

While the business has strong momentum, we believe it also has significant opportunity. As you know, Bob Oros joined the company in February to lead the HD Vest business and has brought fresh new leadership and ideas into an already strong and structurally advantaged business. The team and advisors are responding well to Bob's leadership. We have talked about many of the strengths of the business, which center upon dual advantages:

- First, HD Vest was the prime mover in creating a new type of advisor: tax professionals who also expertly advise their clients on investing. Today, we believe HD Vest is by far and away the leader in this space. So, rather than ignoring the tax situation of clients as most other firms do, our advisors embrace taxes and focus on leveraging that information into tax-smart investing approaches. This is important because it means when we are at our best, our advisors can give better advice than anyone out there.
- Second, a grow-our-own advisor approach, which we believe, creates a strong cultural advantage along with a lower risk profile than what I call the "rent-a-broker" approach that typifies much of the brokerage world.

When you put those together, they turn into real and measurable advantages, including superior retained revenue and segment margin. While we have a strong business and unique strengths, what makes us most excited is the real opportunities we see to further strengthen this business. While I won't go in to the full strategy today, there are a couple of initial areas that I'll briefly touch on. You can expect more details toward the end of the year as we complete our strategic planning process.

First is platform optimization. Our client base values tax-smart investing. We will focus our technology investments on solutions that are truly differentiated and proprietary and leverage our expertise in that area. One way to accomplish that is to leverage third-party technologies in areas that are not differentiated, and in many cases, are just as good or better than our current solution. For example, we will begin deploying a new third party portfolio modeling product in August, which we expect will offer our advisors additional investment options as well as better portfolio management and reporting tools.

This optimization also includes transitioning to a new clearing partner, the importance of which cannot be over-stated – it’s a big deal that we expect will be a win for end-clients, advisors, and the company. As noted in our press release, we have selected Fidelity Clearing and Custody Solutions as our new clearing provider, with that relationship going into effect sometime in mid-2018. First and foremost, the new platform will enable us to better serve advisors, and in turn, end-clients. We’ll capitalize on new capabilities, like highly-integrated business processing, data aggregation and a world-class client portal.

We expect to begin to capture economic benefits immediately upon conversion, with the long-term benefits being significant. The primary benefit drivers are:

- First, better capture of interest income in a rising rate cycle, without the restrictive cap that exists in our current contract. Once we’re on the new platform, each 25 basis point increase will translate into a roughly \$2.5-\$3 million expected annual revenue benefit.
- Second, an opportunity to bring direct-to-fund assets fully on our platform over time. This makes it more convenient for the client from both a reporting and trading perspective, and provides the potential for better economics for us. There are currently more than \$14 billion of assets that fall in to this DTF category.

Big picture, while the conversion is a year-long process and has inherent risks, we expect the new clearing arrangement to be accretive to the tune of \$60-100 million over 10 years, which can drop to the bottom line or enable acceleration in growth. Regardless, clearly this is a significant impact on a business that’s currently at a \$50 million annual run-rate in segment income.

The second area is driving growth through optimizing advisor success. Our company is unique – our advisors are like family. We have mentors, chapters and support groups. Our engaged advisors are very involved, very successful and do wonderful things for clients. The better we can be at predicting which new advisors will be similarly successful, the better the company and our clients will be. We discussed last quarter our plan to use predictive models in advisor recruitment in order to identify which tax pros are most likely to be successful as an HD Vest wealth management advisor. We rolled this out in earnest in June and have our first prospects in the pipeline using this methodology.

At the other end of the spectrum there are those advisors that never really took off for one reason or another. While a growing advisor count is nice to talk about, the truth is that just stacking headcount doesn’t mean anything, and when you have the wrong mix you can spread resources thin, add incremental cost and risk, and distract from focusing on the advisors who are fully engaged and who have the most performance and potential.

Last quarter we talked about how we are shifting to looking at production per advisor as a more meaningful metric, rather than total number of advisors. Our strategies and implications are becoming more clear. For example, this means we will be more selective in who we recruit. We will allocate more resources toward advisors that are in the best position to grow, some of whom are in the group we call the “moveable middle.” And, we’ll look to reduce advisors that are not engaged and who account for virtually no clients and assets.

While total advisor counts will come down as a result, we expect to see production per advisor grow and we believe we will also see greater asset accumulation and growth in AUM through greater focus. To be clear, we don't see this resulting in an adverse impact to our financial performance, in fact we see the opposite. We will talk more about our overall strategy here later in the year, including how we expect see total advisor counts trending. I'll stop there, but hopefully that gives you a flavor for the types of opportunities that are available. We are working through our strategic planning process and will continue to keep you updated on our plans and progress.

A couple final thoughts related to HD Vest. We held our annual CONNECT conference for advisors and had record attendance with more than 1,500 advisors, industry experts and partners. Advisors came away with high energy, fresh perspective and ideas. The event is another example of how we aim to provide advisors with the most up-to-date industry insights and to share best practices. On DOL - we saw no adverse impacts to the business of any note following the initial June 9 change and remain on-track for a full implementation on January 1, if the Fiduciary Rule goes into effect in its current form.

In summary, we continued to demonstrate progress in the quarter, and improve our positioning for future quarters, to grow our assets, continue to increase the proportion that are fee-based, and better participate in the economics that go with client cash.

Tax Preparation

Turning to tax preparation. TaxAct completed a strong tax season and first half of the year, with revenue and segment income both up 16% versus last year. We were also pleased with our customer retention levels at 70%, up roughly 400 basis points, as well as an increase in our professional users. This year we continued our shift toward higher value customers and a higher average revenue per user. During the off-season we have been working hard to refine our plans, improve our competitive positioning for next season, and to provide a truly enhanced customer experience.

For those who follow this part of the business, you know that competitive intensity is very high and ratcheted up a bit further last year in the DDIY segment with new entrants and competitive offers, including offers positioned as "free," and increased marketing spend. We continue to believe a focus on long-term value and higher-value customers is the right strategy. And some of the lines of our strategy for tax-year 17 and beyond are emerging. We are clearly seeing the benefits of Sanjay's thought leadership as we are deep in our strategic planning process. We'll share more later in the year, but some of the themes are around:

- Focusing on the most attractive segments of the filer population, based on new custom research and offer testing.
- Providing more long-term value for our clients/customers with improved products, and an enhanced customer experience.
- Improving marketing effectiveness, based on learnings from last tax year.
- Enabling speed, efficiency and growth through investing in our technology and infrastructure, including transitioning to the cloud, upgrading our operations and support technology, and

growing investments in data-driven technologies, tools and platforms to personalize and optimize, to name a few.

We also see opportunity to diversify our sources of acquisition and revenue through broader distribution of our offerings.

In closing, we had another strong quarter of continued execution across both businesses. We posted mid-teens revenue growth with strong operating leverage. Our businesses are well-positioned and getting stronger, and I remain very optimistic about the opportunities we have ahead.

With that I'll turn it over to Eric.

ERIC EMANS, CHIEF FINANCIAL OFFICER

Thanks John.

Let's dive in starting with our second quarter results including year-on-year growth.

- Consolidated revenue of \$139.2 million, up 16%
- Adjusted EBITDA of \$42.5 million, up 20%
- Non-GAAP net income of \$32.9 million, up 41%, or \$0.70 per diluted share which is up 27%, and
- GAAP net income attributable to Blucora of \$3.3 million, up 123%, or \$0.07 per diluted share which is up 121% and includes the write-off of debt issuance costs of \$16.3 million or \$0.35 per diluted share. The write-off was triggered by the refinancing of our TaxAct-HD Vest 2015 credit facility and convertible notes into a single Term B credit facility in the second quarter. It is also worth noting that second quarter 2016 included a loss on discontinued operations of \$20.0 million, which is also impacting the year-on-year trend.

Turning to the balance sheet, we have cash and cash equivalents of \$78.3 million. During the quarter we reduced our debt by \$35 million and we exited the quarter with net debt of \$284.9 million – this brings our net leverage ratio down to 2.7 times. Let me echo John's comments, we are pleased to have surpassed our stated goal of 3.0 times net leverage and while this will allow us to look beyond delevering in our capital allocation strategy, you should expect we will continue to highly prioritize debt pay down for the foreseeable future. Lastly, just a quick reminder that we closed our \$425 million credit facility in the second quarter – this new facility cleans up our capital structure, provides us greater flexibility and allows us to achieve significant interest expense savings.

Shifting to segment performance, beginning with Wealth Management. HD Vest second quarter revenue was \$85.3 million up 12% versus prior year and segment income was \$12.4 million, up 25%. Both revenue and segment income finished at the high-end of our guidance range. Revenue for the quarter was driven by an 11% year-on-year increase in advisor driven revenue and a 20% increase in other revenue. Fee-based revenue was the highlight for the quarter and was up 14% versus prior year and up 7% sequentially. As a reminder, fee-based revenue represents fees earned from fee-based AUM for investment advisory and management services provided by our advisors, typically as a fiduciary, to their end-clients. Other revenue was driven by sweep revenue which was up 89% versus prior year and up 8% sequentially as well as an increase in rep fees. As a reminder, with the latest fed fund rate

increase we have essentially topped out on our sweep revenue rate upside under our current clearing arrangement. As John mentioned, we will be transitioning our clearing relationship to Fidelity Clearing and Custody Solutions in mid-2018 and under this arrangement we expect further market upside from sweep.

Momentum around fee-based AUM net flows continued as we added \$222 million in the second quarter, which will benefit us in the third quarter and beyond. This brings our net inflows to over \$800 million over the last twelve months. This is in stark contrast to the \$60 million of net inflows for the comparable twelve-month period ended June 30th 2016 – needless to say, we have been on a nice run since third quarter 2016. Additionally, we again had a market tailwind which added approximately \$240 million increase in fee-based AUM, net of fees, for the quarter. We ended the quarter with fee based AUM of \$11.6 billion, up 18% year-on-year and up 4% sequentially. Touching quickly on second quarter total AUA, which includes fee-based AUM, we exceeded \$41 billion, up 11% year on year and up 2% sequentially. HD Vest segment income growth of 25% year-on-year can be attributed to revenue growth and operating leverage.

Turning to HD Vest outlook for the third quarter and the rest of the year. We expect third quarter HD Vest revenue of \$85.6 to \$88.0 million and segment income \$11.2 to \$13.2 million. For the full year, we expect revenue of \$339.6 to 345.9 million and segment income of \$46.7 to 51.5 million. In determining our third quarter and full year ranges, we considered several factors including but not limited to the following:

- A broad range for transactional revenue due to its inherent variability.
- Impact of DOL, which we believe will drive an increase in operating expenses in the second half of the year. With that being said we have revised our estimates down to a range of \$1.4 million to \$200 thousand of cost. We expect these costs, which are primarily implementation in nature, will be back-end loaded and the wide range is meant to capture the possibility that there will be a further delay in implementation.
- Impact of clearing firm transition which was not included in our prior outlook. We expect to incur transition expenses in the range of \$1.1 million to \$800 thousand in the second half of 2017, which again are more back-end loaded.
- Incremental operating expense related to additional investments identified during our planning process, and
- Market volatility, including impact to net flows and cash sweep balances.

Transitioning to our Tax Prep segment. TaxAct revenue for the second quarter was \$53.9 million up 22% versus prior year, and segment income was \$36.5 million up 23% year-on-year. Both revenue and segment income exceeded the high-end of our guidance expectations in part driven by revenue out performance but also due to a shifting of costs into the second half of the year as our investments ramp. For tax season, 2017 first half revenue and segment income were up approximately 16% marking another good year of growth for TaxAct.

We have shifted our focus to our strategic planning process and are looking to build upon what we learned from this tax season. As I mentioned last call we have begun making investments that will

further improve customer experience and service, enable new revenue opportunities and provide flexibility in our go-to-market strategies. These investments are ramping up and will impact TaxAct segment losses in the back half of the year. For the year we are expecting revenue for TaxAct of \$160.4 to \$160.6 million and segment income of \$71.4 to \$73.2 million or a segment margin of approximately 45%. We look forward to sharing more of our strategy and 2018 expectations over the next couple of calls.

Let's finish up with unallocated corporate operating expenses. Second quarter unallocated operating expenses came in at \$6.5 million, a bit heavier than we expected and largely driven by search fees and non-recurring personnel costs that were unrelated to the headquarters move. Of the \$6.5 million, \$1.9 million related to non-recurring transition costs associated with our headquarters move, which do not qualify for restructuring expense treatment. For the third quarter, we expect unallocated operating expenses of \$5.5 to \$4.6 million of which approximately \$1.0 million is non-recurring transition costs associated with our headquarters move.

With that let's turn to consolidated outlook for the third quarter and an update for the full year. For the third quarter we expect revenue between \$88.8 to \$91.3 million, Adjusted EBITDA between a loss of \$2.9 million to a positive of \$900 thousand, non-GAAP net loss of \$10.9 to \$6.3 million or \$0.24 to \$0.14 cent loss per share and a GAAP net loss attributable to Blucora of \$18.7 to \$14.8 million or a \$0.42 to \$0.33 cent loss per share.

For the full year we expect revenue between \$500.0 to \$506.5 million, Adjusted EBITDA between \$94.1 to \$102.3 million, non-GAAP net income of \$58.7 to \$67.8 million or \$1.25 to \$1.45 per diluted share and a GAAP net loss attributable to Blucora of \$3.8 million or a \$0.09 cent loss per share to net income attributable to Blucora of \$4.6 million or a \$0.10 cents per diluted share.

As a reminder, third quarter and full year 2017 guidance includes the aforementioned increase in operating expense related to the clearing firm transition.

Lastly, there are a few things to be aware for our GAAP net income and loss attributable to Blucora guidance:

1. First, it includes the impact of restructuring expense,
2. Second, GAAP net income or loss attributable to Blucora will be greatly impacted by variability in our tax rate which can be volatile, especially on an intra-period basis, as we expect full year book income before taxes to be just north of breakeven. Given current estimates, our effective tax rate for the year is approximately 15% - but again will likely vary as estimates are adjusted throughout the year.
3. Finally, our GAAP net income or loss attributable to Blucora guidance excludes any impact to tax expense for discrete items and variable stock based compensation granted to non-employee advisors.

In closing, I just wanted reiterate what we shared last quarter in regards to segment outlook and how we are managing the business. In short, while I have provided color on our full year expectations for each segment, including segment income – we are focused on segment revenue

growth and consolidated adjusted EBITDA. Thus, we expect as we proceed through the remainder of the year, we will continue to refine our investments into each segment, along with corporate operating expense, optimizing for adjusted EBITDA.

With that, I will turn the call over to the operator and we will take your questions.

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 make our business so enjoyable and are at the heart of our success. We were pleased to report another strong quarter and look forward to continuing to update you on our progress.