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

The following is Blucora management's prepared remarks on a conference call Wednesday, May 9, 2018 at 8:30 a.m. ET to discuss first 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 first quarter 2018 Earnings Conference Call. By now, you should have 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 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.

With that, let me hand it over to John.

JOHN CLENDENING, PRESIDENT AND CHIEF EXECUTIVE OFFICER

Thanks Bill, and good morning everyone.

In addition to releasing our earnings results this morning, we also announced that our head of TaxAct, Sanjay Baskaran, has made the decision to step down as President of TaxAct and leave the company for personal reasons, effective last Friday, May 4. I know this was a difficult decision for him. We are grateful for all of Sanjay's contributions and we are pleased that he has agreed to remain with us on a transition basis through August 1. During his time with us, Sanjay has made many valuable contributions including playing a key role in the very strong tax season results we announced today, so we thank him for that and all he has contributed.

On an interim basis, I will assume Sanjay's responsibilities for TaxAct, supported by the strong team we have at both TaxAct and Blucora. We have intiated a search for a replacement and will make an announcement as soon as we have something finalized.

So now to earnings. I'm pleased to report that Blucora had a very strong start to the year, posting double-digit growth rates and exceeding the high-end of our guidance range on all metrics. Compared to last year's first quarter, Blucora revenue grew by 13%, adjusted EBITDA by 14% and non-GAAP EPS by 15%.

Strong cash flow generation allowed us to further strengthen our balance sheet. During the quarter we reduced debt by another $40 million and improved our net leverage ratio to 2.1x. This compares to 3.3x in the year earlier period and 6.3x at the end of 2015.

Big picture, we are on track with our plans to drive growth in our businesses.

Wealth Management

Moving to the business unit level, starting first with wealth management. HD Vest continued its strong business momentum with double-digit growth across its key metrics. Revenue grew by 11% year-over-year to $92 million. With continued investment in the business this year including costs associated with the clearing firm conversion, segment income grew 10% year-over-year to $13.1 million. Total assets under administration, or AUA, increased 10% year-over-year to $44.4 billion. And fee-based advisory assets under management, or AUM, were up 15% year-over-year to $12.7 billion. These levels for both AUA and AUM levels are new records for the company.

Net inflows into AUA in Q1 were about $625 million, which I believe is the highest single-quarter inflow level on record. This was driven in-part by a number of recent advisor recruits coming on board, including the first funds from the large advisor we announced last quarter. Net inflows into AUM were about $320 million, and AUM as a percent of AUA increased to 28.7%, up about 130 basis points from the year ago quarter also hitting a high-water mark.

A few updates I'll call out here for HD Vest:

- The clearing conversion remains on track for late September. We continue to expect to breakeven on the conversion for 2018 and perhaps see a slight net benefit, followed by a $6-$8 million benefit in 2019 and an $8-$10 million benefit in 2020.
- Our advisor success and productivity efforts continue to show progress. Advisors recruited under the new assessment process are showing exam pass rates 20 points higher than our historical average – which is a strong leading indicator. In addition, these advisors are hitting initial benchmarks in rolling gross (commissions) in about 120 days vs. our prior 800 days, which is a remarkable early statistic. While it is still a relatively new process and the dollar volumes are still small, it is a good indication that we are bringing the right new recruits on board and better enabling them to engage their clients on wealth management.
- Another update in terms of recruits – we have received about 700 advisor leads to-date from the relationship we announced late last year with Drake, a maker of tax software for the professional market. A few have already become HD Vest advisors, and with tax season now in the rear-view mirror, we would expect to increase activity in this regard.
- Lastly, we continue to make changes to drive improved advisor support. One example result during the quarter was in driving our average speed to answer advisor calls to its lowest point on record for February and March. These months represent a 50% improvement versus the comparable period last year. This is just another example of the types of opportunities in front of us to further improve an already strong business.

So, in summary, the first quarter was another strong quarter for HD Vest in terms of results as well as positioning for future success. And, speaking of the future, there is a great deal of potential ahead of us, in each of the three key drivers of value creation: organic growth, conversion to fee-based AUM and increased income from sweep.

Tax Preparation

Turning to tax preparation – and for this discussion I will be talking about the full tax-season which is through Tax Day +1, or through April 19, as well as our full first half 2018 expectation for TaxAct. TaxAct delivered good progress on our multi-year strategy to reposition the business with a focus on growing monetized units. Monetized units generally include online and desktop software units for which we are paid for either or both of the software or ancillary service, as well as partnership units. As you may recall, for the three prior tax seasons we've seen a decline in monetized units. I've described it in prior calls as being on the left-hand side of the letter "U," with our hope being to get to the "flat" part of the "U" over time as a precursor to growth in monetized units. In our last call I noted that we saw a path to get to flat this season, and I'm pleased that we could get there and a little beyond by growing monetized filers modestly.

The net effect, along with pricing and product actions, is that we expect to grow first half TaxAct revenue by approximately 15% vs. the comparable period last year, which would put us well above the high-end of both our original and revised outlook ranges for revenue. We continue to make strategic and technology infrastructure investment in the business and even with some incremental investment, expect first half segment income will come in at the 56% range, putting us slightly above our revised outlook on segment margin.

So, let's get in to a bit of the detail. While the season got off to a slow start with the IRS opening a week later than last year, along with some confusion around the impact of tax reform and as of early February total IRS filings were down 10%. The DDIY market saw a nice recovery from there and ultimately ended the season up about 3% in unit volume.

This season we continued our focus on higher value customers and driving monetized units for superior lifetime value. As we would expect when aiming for higher value customers and de-emphasizing 'free,' our total DDIY e-files declined year-over-year while our average revenue per user increased. Through April 19 our total U.S. consumer E-files were 3.772 million representing total market share of about 7.1%, a reduction of 130 basis points from last season, again due to a drop-off in unpaid filers, while increasing monetized filers.

Our efforts in driving higher value centered on the four areas of opportunity I've discussed in the past:

- Targeting high potential DDIY segments
- Transparent pricing
- Leveraging enhanced capabilities
- Diversifying revenue by gaining additional distribution and extending our relationship with filers

High-Potential Segments.

We worked hard to improve our competitive positioning for this tax season focused on enhancing the value proposition, particularly around our core focus segments within the gig-economy and disaffected Turbo Tax and H&R Block filers. We launched the $100,000 accuracy guarantee, personalized deduction maximizer, significantly enhanced our mobile capability and streamlined our import capabilities, in addition to launching a new Freelancer SKU for this season, which showed promise for growth in future years.

Transparent and marketable pricing.
While we continue to increase our federal pricing, we have maintained a strong advantage versus the volumetric leader of about 50%. In addition, we continue to present our pricing very clearly, from the very start of the experience so filers know what our prices are. During this season we introduced a new basic SKU, which targets the segment of the population that files 1040A that are willing to pay for a low-cost product to get a great experience, and all that comes with our products, while being clear about what they will pay. This product was very popular and exceeded our expectations.

It's important to point out that the market increased prices faster than last year and with second peak pricing weeks earlier than they have traditionally. These factors enabled us to move more aggressively on price than we had anticipated. So mix and additional pricing helped drive the incremental revenue relative to guidance.

Enhanced Capabilities.
This year we enhanced our capabilities through investments in our people as well as introducing machine learning and augmented intelligence at key parts of the filer experience. In addition, we significantly enhanced our customer support capabilities and efficiency – and migrated successfully to a new cloud platform, which makes us more secure, efficient and scalable. These enhancements will serve us well for years into the future.

Revenue Diversification through strategic partnerships and products.
Strategic partnerships enable us to diversify our revenue in two ways 1) by creating new sources of customer acquisition and 2) extending customer relationships to new products and offers while we serve them more holistically across their financial lives.

We announced over 10 new partner agreements for this season. In terms of the first point, new sources of customers, new agreements included Fidelity Investments, NetSpend and KeyBank. I'll use KeyBank as an example of new customer-centric propositions we are building – where KeyBank customers receive our premium filing solution free of charge to them, and at their election, can receive more accurate and relevant financial wellness recommendations from KeyBank. This type of partnership was new for us, and each partnership came online at a different point in the season, but in total they generated good learnings/insights. We hope to have even deeper product integration in the future to provide incremental volume opportunity, even greater partner value and enhanced customer experience.

As it pertains to the second item, extending customer relationships through new products and offers. This year we launched the BluPrint™ financial assessment, which turns insights from a tax return into actionable recommendations designed to improve the filers' financial situation. With the tax filer's consent, we use dozens of data points within the 1040 to offer financial insights and suggestions, which will help them save on their taxes, lessen their debt burdens and improve their future financial health. We believe we can help the average U.S. filer save thousands of dollars with the insights and solutions we provide. In fact, the average savings identified for consumers this season was approximately $2,700. Think about that - for the cost of filing their taxes finding savings of that magnitude. For the average filer, that would be a doubling of their tax return – that is differentiated from others in the marketplace that either offer no additional benefit or perhaps not much more than a credit score.

How do we enable those type of savings? By making it easy for customers to go from analysis to action, this year we offered access to product partners to help consumers generate more interest on their hard-earned money through a high-yield deposit account, get a better deal on consumer debt or manage risk through adding life insurance at a competitive rate. This was our debut season, early days with these partnerships, and they generated good learnings.

One other point I would add here on BluPrint is that our customer request rate to perform the customized analysis was well above expectations. We hope this represents the beginning of significant shift in how our TaxAct customers work with us. Historically they have come to have their taxes done and that's it. This year that has changed as a large majority of customers have agreed and shown that they want more solutions provided by TaxAct to help them with their financial lives throughout the year. Looking ahead, through partners and customer engagement we hope to shift to a more year-round engagement. We now have more than 2 million customers that have indicated an interest, and that we can seek to serve outside of tax season.

To finish up on TaxAct, a few other positive developments I'd call out for the season include:

1. Our retention rates, both overall and for paid filers, improved vs. last season;
2. From an efficiency standpoint, our customer call duration declined almost 10% vs. last year saving us several thousand employee hours; and
3. Professional e-files increased by 3% year-over-year.

Stepping back on tax preparation, given the season is only a few weeks behind us, we continue to build on our assessment of last year and will very quickly turn our attention to actions to generate continued progress next season, the first year under tax reform.

Summary

In closing, I'm very pleased with our strong first quarter with double-digit revenue and earnings growth, significant cash flow allowing us to continue to strengthen the balance sheet. And with HD Vest showing double-digit growth in revenue, segment income, AUA and AUM. TaxAct showed significant progress with improved retention, improved products and a return to growth in monetized units.

Simply put, we continue to do what we said we would do, and I'm pleased with our progress.

Finally, I wanted to add a big 'thank you' to our employees for all their work on behalf of our customers, clients and advisors. The team has been doing incredible work, and I am very proud to represent them.

With that I'm pleased to turn the call over for the first time to our, relatively, new CFO, Davinder Athwal who joined us in February. We are very excited to have him as part of the team and he is already making a strong positive impact. So welcome again, Davinder, the call is yours.

DAVINDER ATHWAL, CHIEF FINANCIAL OFFICER

Thanks John.

And before I begin my remarks, I'd like to say I'm excited to be here, and look forward to driving continued financial performance as we execute our strategy.

As a follow-up to John's comments I'd like to provide some additional detail on first quarter performance… a balance sheet update… as well as an outlook for each of the second quarter and full fiscal-year.

Beginning with consolidated results for the first quarter, and year-on-year growth:

- Revenue was $206 million, or up 13%;
- Adjusted EBITDA was $66.3 million, up 14%;
- Non-GAAP net income was $58.2 million, or $1.20 per diluted share, representing improvement of 23% and 15% respectively;
- GAAP net income was $45.3 million, or $0.93 per diluted share, representing improvement of 48% and 39% respectively; and
- Lastly, operating free cash flow for the quarter was $56.7 million, up 10%.

Turning now to segment performance, and beginning with **Wealth Management:**

HD Vest first quarter revenue was $92.1 million and segment income was $13.1 million, both above the high-end of our guidance range, driven by better than expected transactional revenue due in large part to higher annuity and mutual fund sales.

We are pleased with our AUA net flows of $625 million and fee-based AUM net flows of $319 million, each of which speak to the excellent work our advisors are doing with clients as well as the long-term potential of the business. I will note that as we approach the clearing firm conversion transition date we would expect to see a slowing in net flows, followed by a stronger fourth quarter.

The clearing transition is on schedule and non-recurring expenses incurred in the first quarter were approximately $200 thousand and we expect to incur another $1.2 million of non-recurring expenses in the second and third quarters of this year.

Our outlook for Wealth Management in the second quarter is for revenue of $88.6 to $91.6 million and segment income of $10.4 to $11.9 million.

Moving on to **Tax Preparation:**

TaxAct first quarter revenue was $113.9 million and segment income $58.8 million, both of which are above the high-end of our guidance range driven largely by pricing and packaging actions that we were able to accelerate given the competitive landscape.

As John mentioned, we expect first half revenue growth to be approximately 15% vs last year. These results are driven by an approximate 38% increase in DDIY consumer average revenue per user.

John has shared our growth and margin expectation for the first half of 2018 which translates into a second quarter outlook for TaxAct of revenue between $63.2 to $64.0 million and segment income of $40.3 to $41.5 million.

Finishing up on **first quarter performance:**

Unallocated corporate expenses came in at $5.5 million, a bit better than expected and included approximately $600 thousand of non-recurring transition-related costs. We expect second quarter unallocated corporate expenses to come in around $5.6 million. Approximately $200 to $300 thousand of expense that we expected in the first quarter has shifted to the second quarter.

Moving on to the balance sheet, we ended the quarter with cash and cash equivalents of $77.1 million and our net debt was $227.9 million, which reflects a $40 million pay-down during the quarter enabled by the continued strong cash-flow generation that characterizes our business. This reduction is consistent with our stated expectation of paying down $80 to $100 million of debt in the first half of 2018. Our focus on leverage reduction is reflected in our recent debt rating upgrade by S&P to 'BB' with a stable outlook, from 'BB-.'

With that let's turn to **consolidated outlook for the second quarter and full year.**

For the second quarter, we expect consolidated revenue of $151.8 to $155.6 million, Adjusted EBITDA of $45.0 to $48.0 million, non-GAAP net income of $39.8 to $42.9 million, or $0.82 to $0.88 per diluted share, and GAAP net income attributable to Blucora of $27.0 to $28.9 million, or $0.55 to $0.59 per diluted share.

For the full year, we expect consolidated revenue of $545.8 to $559.8 million, Adjusted EBITDA of $110.5 to $118.3 million, non-GAAP net income of $86.3 to $94.2 million, or $1.76 to $1.93 per diluted share, and GAAP net income attributable to Blucora of $38.7 to $45.0 million, or $0.79 to $0.92 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 4 to 8% for GAAP net income attributable to Blucora, and finally,
- 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 make our business so strong and 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.