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

The following is Blucora management's prepared remarks on a conference call Thursday, May 4, 2017 at 8:30 a.m. ET to discuss first 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 First 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. Before I get us rolling, I'd like to warmly welcome Bill Michalek, who has recently joined the IR team at Blucora. We are delighted to have him. He has big shoes to fill as Stacy Ybarra, who has been with Blucora since 2005, has elected to not make the move to Irving, and so this is her last earnings call. I know you join me in thanking Stacy for her fine work over the years.

I'm pleased to report that Blucora had a very strong start to the year, exceeding the high-end of our range on all guidance metrics - revenue, adjusted EBITDA and non-GAAP EPS. Compared to last year's first quarter, these metrics were up 10, 8 and 11 percent, respectively.

Our tax preparation software business, TaxAct, drove strong financial performance and continues to benefit from the strategic shift, which we began last year, to focusing on profitable share vs. simply total unit share. And we are well on our way to our 19th consecutive year of revenue growth in this business, a remarkable run. Our wealth management business, HD Vest, saw renewed momentum and continued to benefit from a strong equity market. And we continue to execute on our stated goals and improve our positioning as we complete our multi-stage strategic transformation. I will provide a few more insights on our operational highlights for the quarter, and then turn it over to Eric to review the financial results in more detail.

Tax Preparation

Starting with tax preparation. It was an eventful tax season, which began with the slow start, included the implementation of the PATH Act, and saw increased competition, especially for 'free' filers, and ultimately a flat DIY market. Despite these challenges, TaxAct turned in strong financial results for the tax season. Based on our results, we expect to grow first half 2017 revenue by approximately 15 percent and segment income by approximately 14 percent versus the prior year comparable period and ahead of our expectations. This performance is aligned with our focus on higher value customers and driven by a higher average revenue per user. It also demonstrates that under our new strategy we can generate strong financial performance with revenue growth and strong cash flow even in a tough market environment.

Stepping back, it is important to emphasize we are in the early stages of a multi-year pivot to profitable customers and ultimately paid unit growth. This year we focused on simplifying our product and packaging coupled with a transparent marketing message that de-emphasizes 'free' and instead emphasizes our starkly superior value. We are focused on acquiring savvy customers who value a great experience at a fair price and who don't want to be lured by promises of free filing, only to be forced into an upsell and charged for things they didn't expect to have to pay for, or to be bombarded with emails pitching low-value products they don't need or want. With other significant players – and new entrants – all shouting 'free,' we see an opportunity to differentiate TaxAct as the brand that stands for exceptional value and is known as the most trustworthy. We believe that with transparency, we are in the best position to grow customer loyalty over time, and this combined with a focus on paying customers will translate into increased lifetime value.

As we would expect when aiming for higher value customers and de-emphasizing 'free,' our total DDIY e-files declined while our average revenue per user increased. Let's take a moment to dissect the decline in units. Despite an offsetting higher revenue from paid units we saw a decline in total units driven by a reduction of new filers. We also experienced declines in paid units, which was primarily a result of steps we took to simplify our pricing and packaging. For example, we eliminated our Basic SKU which was priced at $9.99 for a Federal return at the start of tax season 2015, and included features that we offer in our free SKU this year. The decision to eliminate it was driven by our emphasis on transparency and a better user experience to increase customer loyalty – in short the right call for our customers and for us long-term. Other factors contributing to the paid unit decline include:

- a trade-off of paid units in exchange for higher ARPU
- decreased marketing efficiency as we spent more heavily in January before the market developed, and
- experimentation with channel mix and messaging.

We are encouraged by a number of developments during the quarter that we believe reinforce the merits of our strategy pivot:

1. Completion rate improved by 140 basis points. We believe this illustrates that customers value transparency and the product and customer experience improvements we have implemented such as expanded coverage for W-2 import. Adoption rate for this feature went from less than 1 percent of our customers in TY15 to approximately 20 percent this year.
2. Overall retention increased to 70 percent and paid unit retention increased by approximately 400 basis points. Specifically, we are encouraged by year 2 retention improvements showing that last year's pricing and packaging change drove higher-value new customers.
3. Upsell rate decreased as we saw more users start in the right product at the outset. We attribute this to messaging transparency that is resonating and providing a better user experience, which we believe builds customer loyalty and ultimately, higher lifetime value.
4. Paid mix improved when normalizing for pricing and packaging changes and the impact of prior year promotions.
5. And lastly, attach rates for both bank and audit ancillary services significantly increased.

We are convinced that our new strategy has put us on the right track in the consumer business. We believe that continued pricing power, supported by a substantial pricing umbrella created by the volumetric leader, will enable TaxAct to grow revenue and segment income.

Closing on TaxAct first half 2017 performance, we increased the number of professionals using our preparers edition and increased professional e-files.

Wealth Management

Now turning to wealth management. HD Vest performed well in the first quarter, with revenue up 7 percent and segment income up 9 percent compared to last year. Assets under management in fee-based AUM grew 16% year-over-year to more than $11 billion, and now represent more than 27 percent of total assets under administration, a new record for the firm. Net inflows in AUM for the first three months of the year were approximately $300 million compared with net outflows of about $140 million during the same period last year. The strong first quarter performance comes on the heels of approximately $130 million and $150 million in net inflows during the third and fourth quarters of 2016, respectively.

Our total assets under administration also set a new record, growing 11% year-over-year and surpassing the $40 billion mark. In addition to gains from market performance, we are seeing momentum in net fee-based advisory flows and AUA tied to VestVision® plans. VestVision is our investment and retirement planning tool that enables advisors to create client-personalized, goals-based plans and track individual goals in varying market conditions. Strong growth in VestVision plan creation in recent months, and related inflows, helped lead to a more than 40% increase in AUA tied to VestVision plans in first quarter vs. a year ago.

Big picture, HD Vest has two notable competitive advantages compared to other marketplace participants. First, our financial advisors are primarily certified tax professionals, who are thus ideally positioned to focus on tax smart investing. Other firms, even very successful ones, simply ignore taxes. But we all know taxes matter a great deal, so firms ignore them at the peril of their clients. In fact, Americans spend more on taxes than on food, clothing and housing combined. And a significant amount of potential tax savings go unclaimed each year, so this is a big deal. Second, we "grow our own" advisors, cultivating and empowering them to grow their tax practices through wealth management. This, in turn, creates loyalty to the HD Vest brand, and creates a model with far-superior economics versus other players.

Bob Oros joined the firm in February and is already looking at several ways to further capitalize on these structural advantages. One initiative is focused on advisor recruitment effectiveness and efficiency. A core part of this initiative involves the rollout of new predictive models that identify which tax professionals are most likely to be successful as a wealth management advisor. Second, we are exploring ways in which we can optimally align our focus and support of the overall advisor base in the most effective way. We will look to sharpen our focus on advisors that create the most value and have the most potential going forward. As a part of this, we expect to deploy more HD Vest resources to help high-potential mid-tier advisors be even more successful. We are looking at metrics such as assets per advisor and support per advisor ratios, more so than simply total numbers of advisors. We will talk more about this in coming quarters.

I'll wrap up on Wealth Management with a brief comment on the DOL fiduciary rule. We continue to work with our advisors to prepare for the new rule. At this point, more than 80% of our AUA sits with advisors who are already licensed to give fiduciary advice as a fee-based advisor under the Investment Advisers Act. We have continued to encourage advisors to move to fee-based accounts when that is appropriate for clients and we've seen good momentum thus far with increased fee-based flows. As you know, the fiduciary rule is currently under review. As a result of this review, unless there is a further delay, the implementation date has been moved so that it will begin to be phased in beginning in June rather than April. And, while the final outcome of the rule remains unclear, our teams continue to work on the assumption that the rule's transition period will begin on June 9. And we are well-positioned for full implementation of the rule on January 1.

Synergies

Let's now discuss synergies. Stepping back, it is fair to say that we have just begun our efforts to capitalize on the combination of our two great businesses. As we have noted previously, our go-forward strategy will focus on four main areas:

1. Extending financial solutions to TaxAct DDIY tax filers,
2. Converting TaxAct professional users into HD Vest Advisors,
3. Creating integrated tax pro software solutions, and
4. Generating operational synergies.

A quick update on each. First, this tax season we launched BluVest, an integrated platform that offers TaxAct customers the option to obtain affordable and objective investment advice through an automated or "robo" type offering. The service provides our customers with a current year tax benefit by investing in individual retirement accounts during the tax return filing process, and funds their investments directly with their tax refund. We are thrilled to offer such a unique service to our customers – no other tax return software provider or automated investment advisor offers a comparable integrated solution. Although we did not expect BluVest to materially impact our financial results this year, we did a lot of testing and gained valuable insights that we will incorporate into version 2.0 of this service for next tax season.

Second, through our marketing efforts to TaxAct pros, we have generated hundreds of qualified leads, and we are now seeing these leads turn into licensed HD Vest advisors. Though small in absolute numbers, we like what we see so far and are redoubling our efforts in this upcoming off-season.

Third, providing integrated solutions for tax pros is a longer-term goal, and we have begun to take small steps in that direction. This year's professional edition integrated HD Vest's 1040 Analyst®, allowing TaxAct Pros, with their client's permission, to seamlessly utilize their tax data from the Form 1040 to provide a customized report highlighting tax smart investment opportunities. As both a wealth management and tax software company, we are in a unique position to deliver integrated, comprehensive solutions to tax professionals. We believe there is significant value to be unlocked if we are successful.

Fourth, we are already achieving benefits from our new 'One Blucora' operating model. By bringing our teams together we have created stronger connections and collaboration across the business units. And our shared services approach enables us to operate the business more efficiently as well.

Strategic Transformation

Turning now to our strategic transformation. We have been open and clear with you about our plans to transform the business, and have continued to update you on our strong progress. We have now simplified and streamlined our business around Tax Act and HD Vest and deployed a new operating model. As a result, we are now able to turn much more of our focus to growing our businesses organically. Last quarter, we provided a summary of our significant accomplishments in 2016, and our progress has continued at a rapid pace so far in 2017.

During the quarter:

- We named Sanjay Baskaran, who joined us from Amazon, to lead TaxAct and named Bob Oros, a former Fidelity executive, to lead HD Vest. The fusion of new and strong leadership with deeply experienced teams has already begun to bear fruit in each of our businesses.
- We continued our aggressive de-levering efforts, paying down $38.0 million in debt during the quarter.
- We appointed two new independent directors with long and successful track records in financial services, adding significant strength to our board.
- We continued to fill the remaining positions in our new headquarters location and are about 80% complete.
- We also agreed to a sublease agreement for our Bellevue office, which will enable us to come in at the lower-end of our cash restructuring cost guidance.

In addition:

- In April, we announced that we plan to enter into a new credit facility that simplifies our capital structure, adds tenor and is expected to reduce our annual interest expense. We expect to close this facility in May.
- Our Board of Directors has also nominated another independent director for election at our annual meeting of stockholders and I believe she will also be a great addition to our Board.

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

In closing, we have two strong businesses that are well positioned in attractive markets and with strong growth potential. The businesses share a tax theme and together provide a unique and distinctive information advantage that enables us to serve customers better than other far larger and better resourced companies. Both businesses generated compelling financial performance in the quarter. Our work to capture synergies between the businesses is just beginning, and, we believe, remains a significant opportunity. And lastly, our progress in paying down debt and in reducing our interest rate, combined with strong adjusted EBITDA performance and our significant NOL, is enabling us to drive strong non-GAAP EPS performance.

Our transformation continues and we continue to execute on our stated objectives. And, overall, as I pass my one-year anniversary with Blucora, I am even more optimistic about our future than I was when I joined. And we have only just begun.

Finally, I wanted to add a big 'thank you' to our employees for all of 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'll turn it over to Eric…

ERIC EMANS, CHIEF FINANCIAL OFFICER

Thanks John.

Lots to cover today including first quarter results, tax season expectations, and outlook for the second quarter and full year. Additionally, we will provide some detail on our debt refinancing and update our estimates on our restructuring expenses.

Let's begin with a summary of our first quarter results and year-on-year growth, which finished ahead our expectations.

- Consolidated revenue of $182.4 million, up 10 percent
- Adjusted EBITDA of $58.2 million, up 8 percent
- Non-GAAP net income of $47.4 million, up 21%, or $1.04 per diluted share which is up 11 percent, and

- GAAP net income attributable to Blucora of $30.6 million, up 35%, or $0.67 per diluted share which is up 24 percent. GAAP net income attributable to Blucora included a benefit of $7.4 million or $0.16 cents per diluted share primarily related to the reversal of the valuation allowance. This reflects the impact of the beginning of the year adoption of the new stock based compensation rule, ASU 2016-09, which now requires the release of valuation allowance on equity NOLs to flow thru tax expense versus APIC which was the prior practice.

Turning to the balance sheet, we have cash, cash equivalents and short-term investments of $74.8 million. During the quarter, we paid down debt of $38.0 million and we exited the quarter with net debt of $323.3 million for a net leverage ratio of 3.3 times. We expect to make an additional debt pay down of at least $25 million in the second quarter and expect to achieve our stated goal of 3.0 times net leverage by June 30th. As John mentioned, we expect to complete a refinancing of our debt in the second quarter. It has been our explicit goal to refinance our existing term loan and redeem our convertible notes upon the completion of tax season and in doing so we will optimize the refinancing costs while taking advantage of a favorable credit market. I'm happy to report that we expect to close a $425 million credit facility comprised of $375 million of term loan and $50 million of revolver in May. The new term loan will have a maturity of seven-years and be priced at LIBOR plus 375 basis points with a LIBOR floor of 1 percent which will drive cash interest savings of approximately $3.4 million annually. This result exceeded our expectations and speaks to our strong execution since the HD Vest acquisition.

Shifting to segment performance, beginning with Tax Prep.

TaxAct revenue for the first quarter was $99.7 million up 13 percent versus prior year and segment income was $53.1 million up 12% year-on-year. Both revenue and segment income exceeded the high-end of our guidance expectations.

Let me provide a bit more color on our tax results in the context of our tax season expectations which include second quarter. For the first half of 2017, we expect revenue growth of approximately 15 percent and segment income growth of approximately of 14 percent. These results are driven by an approximate 35% increase in DDIY consumer average revenue per user, primarily from software revenue. We expect these ARPU gains will translate into approximately 16 percent growth in consumer revenue for the first half of 2017 and bemore than sufficient to offset our DDIY consumer e-file decline of 14% for this tax season as compared to the last year's tax season. Additionally, we expect growth in our professional software revenue for the first half of 2017 of approximately 5 percent driven by a 4 percent increase in units sold to preparers who drove a 5 percent increase in e-files this year.

First half 2017 TaxAct segment income is expected to grow approximately 14 percent as operating expenses are expected to increase approximately 18 percent. Higher operating expenses reflect increased marketing, in part driven by early season inefficiency, increased in-season customer service costs and increased personnel and professional service costs focused on growth initiatives beginning in the second quarter and are expected to continue into the second half of the year. Let me touch on these initiatives in the context of TaxAct outlook.

Starting with the second quarter, we expect TaxAct revenue of $52.5 to $53.0 million and segment income of $34.5 to $35.0 million. For the full year, we expect revenue growth of 13.5 to 14.5 percent and segment margin of 45.0 to 45.5 percent. On the revenue side, we expect revenue to be flat in the second half of 2017. This reflects the impact of no longer charging for data archive service, or DAS. DAS revenue is recognized ratably over a three-year period and will phase out over the next two years.

The full year segment margin step down from 2016 reflects the impact of planned investments and while we will not be giving a lot of detail on these investments, I am confident that these investments will further improve customer experience and service, enable new revenue opportunities, provide flexibility in our go-to-market strategies and will benefit not just TaxAct for tax year 2017 and beyond but Blucora as a whole. In order to provide a bit of context – one of these initiatives involves taking TaxAct to the cloud for next season and while we will take on some transition costs this year the long-term benefits are clear, and include increased innovation, added speed and agility, enhanced information security and processing scale that will better support TaxAct's seasonality. The other initiatives are squarely focused on driving revenue growth.

Transitioning to our Wealth Management segment.

HD Vest first quarter revenue was $82.7 million up 7 percent versus prior year and segment income was $11.9 million, up 9 percent. Revenue came in just above the high-end of our guidance range on the strength of transactional revenue which was up 9 percent versus first quarter 2016, driven in large part by our mutual fund and insurance sales. Both fee based advisory revenue and trailers were up 6 percent. Other revenue was up 7 percent year on year driven by sweep product revenue which has benefited two federal fund rate increases over the past twelve months. I do want to point out that our clearing firm contract does contain an interest rate cap and given where interest rates sit today we will only partially benefit from the next raise and then be capped. We will be seeking to renegotiate the cap with our clearing partner.

Fee-based AUM net flows were again a highlight for the quarter as we brought in net inflows of $298 million. While these flows provide minimal benefit within the quarter they will benefit us in the second quarter and beyond. As John called out, this marks the third quarter of net fee-based inflows representing an increase of fee-based AUM of approximately $580 million over the past nine months. Additionally, a strong equity market produced an approximate $400 million increase in our fee-based AUM in the first quarter, enabling us to crest the $11 billion mark. Fee-based AUM is up 16 percent year on year and 7 percent sequentially. Touching quickly on total AUA, which includes fee-based AUM, we exceeded $40 billion for the first quarter, up 11 percent year on year and up 5 percent sequentially.

HD Vest segment income came in at the high-end of our guidance range. The 9 percent growth can be attributed to revenue growth coupled with operating expense leverage.

Turning to outlook, we expect second quarter HD Vest revenue of $82.5 to $85.5 million and segment income of $11.0 to $12.5 million. For the full year, we expect revenue to grow approximately 6 to 9 percent with a segment margin of 13.8 to 14.7 percent. In determining our second 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 increased operating expenses as opposed to significant revenue impact in 2017. Specifically, we have included $2.0 to $2.3 million in additional expense of which $1.7 to $1.9 million are implementation costs and therefore non-recurring. We expect a portion of these costs will impact the second quarter pending clarity from the DOL expected in early June.
- Incremental operating expense as Bob comes up to speed and identifies investment needs, and
- Market volatility, including impact to net flows, and a range of interest rate outcomes.

Let's finish up with unallocated corporate operating expenses and an update to our restructuring estimates.

First quarter unallocated operating expenses came in at $6.8 million and better than our guidance. Of the $6.8 million, $2.9 million related to non-recurring transition costs associated with our headquarters move, which do not qualify for restructuring expense treatment, as well as costs associated with the HD Vest leadership transition. For the second quarter, we expect unallocated operating expenses of $6.1 to $5.5 million of which approximately $2.2 million is non-recurring.

During our third quarter 2016 call we provided a restructuring expense range of $7.5 to $11.3 million of which we expected $5.6 to $8.7 million to be cash charges. Given our current line of sight we expect total restructuring expense of approximately $7.0 million of which approximately $6.0 million will be cash charges – we are very pleased with this result, especially on the cash side. The primary driver of lower cash, which John noted, was the securing of a sublease for our Bellevue, Washington office that commences in June for the remainder of the lease term and provided approximately $2.3 million of cash savings versus the high-end of the range.

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

For the second quarter we expect revenue between $135.0 to $138.5 million, Adjusted EBITDA between $39.4 to $42.0 million, non-GAAP net income of $28.5 to $31.5 million or $0.63 to $0.69 per diluted share and a GAAP net loss attributable to Blucora of $4.0 million to $200 thousand or a $0.09 cent loss per share to breakeven.

Before I share full year outlook, it is worth noting that although I have provided color on our full year expectations for each segment, including segment margin – we are focused on segment revenue growth and consolidated adjusted EBITDA. Thus, we expect as we proceed through the year, we will continue refine our investments into each segment, along with corporate operating expense, optimizing for adjusted EBITDA.

For the full year we expect revenue between $493.0 to $506.0 million, Adjusted EBITDA between $96.0 to $103.3 million, non-GAAP net income of $59.0 to $66.8 million or $1.28 to $1.45 per diluted share and a GAAP net loss attributable to Blucora of $3.4 million or a $0.08 cent loss per share to net income attributable to Blucora of $2.9 million or a $0.06 cents per diluted share.

As a reminder, second quarter and full year 2017 guidance includes the aforementioned increase in operating expense related to DOL.

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 debt extinguishment costs associated with the expected refinancing or our existing term loan and convertible notes which are estimated to be approximately $16.0 million in the second quarter,
2. Second, it includes the impact of restructuring expense,
3. Third, 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 20% - but again will likely vary as estimates are adjusted throughout the year. With that being said, we expect to pay between $3.5 to $4.0 million in cash taxes this year, and
4. 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.

Before I turn the call over to the operator, I would like to add that we are exiting first quarter with good momentum to deliver top-line and bottom-line growth across the firm. As a team, we are focused on execution, including strategic investments that will allow us to deliver growth for years to come.

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. We were pleased to report such a strong start to the year and look forward to continuing to update you on our progress.