BLUCORA

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

BILL MICHALEK, VICE PRESIDENT INVESTOR RELATIONS

Thank you and welcome, everyone, to Blucora's third 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.

With that, let me hand it over to John.

JOHN CLENDENING, PRESIDENT AND CHIEF EXECUTIVE OFFICER

Thanks Bill, and good morning everyone.

I'm pleased to report that our third quarter results came in at or above the high-end of our target ranges on all metrics.

- Third quarter revenue improved by 6% year-over-year to $95.4 million,
- Adjusted EBITDA was $1.4 million, which was down slightly year-over-year, as expected due to timing, as we reinvested some of the stronger than expected first half profits in the third quarter
- Non-GAAP net loss of $4.4 million, or $0.09 loss per share, represents a 25% improvement on a per-share basis, year-over-year, and
- GAAP net loss was $14 million, a 17% improvement y/y, or $0.37 per diluted share

Wealth Management

Moving to the business unit level, starting first with wealth management. The big story in this segment for Q3 was clearly the critical clearing conversion project. As you'll recall, we announced last year that we'd be transitioning to Fidelity Clearing and Custody Solutions as our new clearing platform and with it, would receive a number of significant benefits including better capture of interest income on client cash or 'cash sweep' in a rising rate cycle; increased revenue share economics including an opportunity to bring back on platform assets currently held direct-to-fund or 'DTF;' and technology savings along with superior capabilities such as eMoney and operational improvements.

The magnitude of the benefits is significant and rightfully dominated the team's focus the past several months, with work accelerating in the third quarter, focused on ensuring readiness, the right change management, training internal teams, training advisors, and so much more. It was our primary focus and we had to get it right. I'm delighted to share that the conversion of assets occurred successfully on September 23rd. That's great news, and I commend the strong leaders at HD Vest and their teams that drove this outcome, along with our terrific advisor community and our partners at Fidelity. We are now focused on helping employees, advisors and end-clients get accustomed to the new technologies, policies and processes and are seeing rapid progress.

We now look forward to fully capitalizing on the many added benefits that the new platform provides, including the new technology and resources that are now available to our advisor base, such as eMoney, and Envestnet. As a reminder, eMoney is cutting edge planning and collaboration technology. This platform will make it easier for advisors to create and update holistic financial plans. It aggregates household information in real-time, and enables advisors to visually demonstrate projected benefits and potential impacts under multiple scenarios to their clients through an interactive portal. Improving the ability for advisors to provide a clear vision of a client's financial picture helps to strengthen relationships and retention, and often drives additional client asset consolidation along with interest in for-fee advisory services, potentially increasing total advisory assets.

Envestnet is a market-leading wealth management platform that simplifies the process for advisors to create, maintain and report on client portfolios, including key technology for unified managed accounts, or UMAs. Our UMA solution, VestStrategist™ provides high net worth investors with an investment solution that offers low fees, direct ownership of underlying securities, and tax loss harvesting while leveraging premier third-party investment managers such as Putnam and Legg Mason.

At the other end of the spectrum, we have rolled out VestAccess™ a low-fee, low account minimum introductory solution that leverages automated investing and "robo" technology. VestAccess™ is also a strategic tool as it gives advisors a compelling investment solution for small clients with significant future promise as well as the children of larger clients. We have accounts opened in each of these solutions, and over time they may serve to further accelerate the shift of funds from brokerage into advisory.

As we've told you in previous quarters, we expect the new clearing arrangement will generate more than $120 million in incremental segment income over the 10-year contract duration, and this will allow us to provide end-customers higher interest income over time, while splitting the bulk of the benefit between growth initiatives and enhancing bottom-line earnings.

Our targets for the net benefit from the clearing conversion over the next few years remain unchanged. For 2018 we expect a small net benefit of $1 million. For 2019, assuming one additional rate increase in the target range by mid-year to 2.25% to 2.50%, we expect a benefit of between $10-$12 million, and for 2020, assuming no additional rate changes, we expect an incremental $2 million, or $12-$14 million total vs. our pre-conversion run-rate. As we've shared in the past, you should think of these numbers on a gross basis, in other words before modest increases in client yields and potential investments for growth.

Despite the distractions of this project, HD Vest grew revenue for the quarter by 6% year-over-year to $92 million. With the continued investment in the clearing project, segment income also grew 4% to $13 million. As we discussed on our last call, we deliberately metered advisor transfers from other firms ahead of the conversion to avoid a dual migration. Despite this, net flows in to advisory were quite strong at about $200 million. In total, we are pleased that Advisory assets were up 13% year-over-year to $13.5 billion, and now represent 29.1% of total client assets, an increase of 100 basis points, year-over-year. Total client assets increased 9% year-over-year to $46.4 billion. The levels for both advisory assets and total client assets represent new records for the company.

Given the metering of advisor transfers ahead of conversion, we had previously indicated that we might see strong inflows in Q4 and possibly overflow into Q1 of 2019. We still believe that to be the case and expect that 2018 will be a record year for advisory net flows, possibly approaching, or even exceeding, the $1 billion mark for the first time.

Lastly on HD Vest, we have mentioned on recent calls that we had expanded our available market to now serve larger accounting firms with multiple partners and multiple offices. To provide an example success story, one of the new firms on our platform that we mentioned on our February call is now in the process of adding their first 5 accounts with an average account size of $1.6 million, which is more than 10x our average account size. While we don't expect average accounts of that size across all of the firms added, it's a nice example that supports our strategy and this organic growth opportunity.

Tax Preparation

Moving now to Tax Preparation. As we look forward to the start of another tax season, we continue to execute our plans and ensure that we are best positioned to build on our success from earlier this year. We continue to invest in technology, infrastructure, partnerships and people to provide the upgrades, improvements and value that will delight our customers this season as well as the technology improvements that will benefit us and our customers for years to come.

With regard to technology improvements, we embarked last year on a multi-year process to modernize and upgrade our capabilities, initially focused on moving to the cloud via AWS, an enhancement that we've completed, as well as introducing machine learning and augmented intelligence at key parts of the tax filing experience. We are now turning to additional technology upgrades, which we are carefully pacing. These investments when completed, in addition to making us more modern and efficient, will enable increasingly rapid product development and roll-out in future years. On the front-end, we believe customers will have an enhanced experience for the tax-year 2018 season, finding our product easier, more intuitive and faster to use from start to e-file completion.

We'll also see the next evolution of our strategic partnerships. As we have said in the past, these 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 as we try to help them improve their financial lives. We expect our offerings for next season will include deeper and broader relationships with select key partners from this year. We will include an expanded partnership platform with new partners and more ways for us to maximize value to our customers. We may also announce an additional distribution partner or two.

Overall, we feel that we are in great shape at this point ahead of the 2018 tax season and are making the right moves for the short- and long-term, for our customers and our company. As we have shared, we believe the tax preparation industry as a whole, continues to focus consumers on the inherently reactive approach of maximizing the refund. We prefer to focus on enabling consumers to minimize taxes, increase cash flows and enable better long term after-tax outcomes, so people can do more in their lives. We are uniquely positioned to accomplish this and I'm excited about what the future holds for our customers.

Davinder will talk more about our outlook for tax season in a moment.

Team Update & Closing

In addition to releasing our earnings results this morning, we also announced a few key updates to the team.

- First, I'm excited to announce that we have appointed Curtis Campbell as the new President of TaxAct. Curtis has an incredible background and skills developed through leadership positions with Capital One, Intuit, Amazon Web Services and Dell. Most recently, Curtis led the consumer auto division at Capital One and prior to that was in a variety of executive roles at Intuit, including product innovation and strategy. Curtis has a remarkable track record of driving growth through innovation, and I believe he is exactly the right fit for this business at the right time and I know he'll do great things. He starts officially next week.
- Second, adding to the excitement, we also announced today that Mike Hogan has joined us as our President of Tax-Smart Innovation. This is a new position responsible for driving our cross-platform vision and strategy for innovation, including how we best capitalize on the significant tax-smart opportunities we see ahead around enabling our advisors to more systematically and easily capture tax alpha for end clients, and growing our BluPrint platform. We've described these types of opportunities in the past as creating Tax-as-a Platform and Mike's hire is a tangible sign of our optimism of what can be accomplished with the right focus. Mike was most

recently at GameStop where he drove the transformation from brick and mortar retailer to diversified retail business including digital gaming and creation of technology brands and a loyalty program. His previous roles included heading international marketing at Frito Lay and Chief Marketing Officer at Dean Foods.

- With the additions of Curtis and Mike, along with our new CHRO, Tran Taylor, announced earlier this month, we have rounded out the team at the executive level in terms of leadership capability and domain expertise.
- The third update, which I am sad to announce, is that Bob Oros, the CEO of HD Vest, will be transitioning out of the business for personal reasons with a goal to be closer to his extended family. Bob will stay with us full-time through November 15, then will turn his immediate focus to attending to a close family member who has recently learned of significant health challenges. We thank Bob for his work here, but understand his need to put his family first and be closer to home. He's agreed to remain on as a consultant until March 1, 2019.
- We initiated the search for a new head of HD Vest, and in the meantime will appoint Todd Mackay to serve as interim CEO of HD Vest. The transition is planned for November 15, pending the associated regulatory certifications and filings. Todd is a great talent and has been a valuable leader for us. He joined Blucora in 2015 after advising the company for more than a year, initially responsible for Corporate Development and M&A, including the efforts that brought HD Vest into the Blucora family. Most recently, Todd has been the EVP and General Manager of TaxAct, leading the business in preparation for the 2018 tax season as well as positioning it for future growth. We are very pleased with what Todd has done while leading TaxAct, and are equally excited about his interim role leading HD Vest. Todd has an accomplished background leading growth-oriented financial and fintech businesses. Notably, during his long tenure with E*TRADE, he held executive positions including EVP of Strategy and Corporate Development, Corporate Treasurer and EVP in charge of E*TRADE's Asian broker dealer business. Additionally, Todd has served on the board of directors of both private and public broker dealers. The business unit is in great hands with Todd as we continue to build on our success and business momentum.

In closing, we continue to execute well across both businesses and I'm pleased that we were able to beat our financial targets for the quarter. HD Vest continued to post strong results with 6% revenue growth and strong asset flows despite headwinds from the conversion during the quarter. The conversion was a success and will yield significant benefits for years to come. Our TaxAct business is on-track for the upcoming tax season and ready to build on this year's success. And with three new members of our leadership team, we are attracting the right talent and are excited about the opportunities we see ahead.

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

DAVINDER ATHWAL, CHIEF FINANCIAL OFFICER

Thanks John –

I'll jump right in and cover third quarter results, update our outlook for full year 2018 and provide some some color, on our current revenue and segment margin expectations for the upcoming tax season.

As John mentioned, all financial metrics came in, either at or above the high-end of our target ranges. Comparing third-quarter results with the same-quarter last year:

- Revenue was up 6% to $95.4 million,
- Adjusted EBITDA was down slightly, but no more than anticipated, to $1.4 million as we reinvested some of the stronger-than-expected first half profits in the third quarter
- Non-GAAP loss per share, improved by 25% to $0.09 on a non-GAAP net loss of $4.4 million,
- And finally GAAP-net-loss attributable to Blucora improved by 17% to $14.0 million, or $0.37 on a per share basis.

The calculation of GAAP net loss per share for the quarter includes a charge of approximately $3.5 million or 8 cents per share related to an increase in the redemption value of a non-controlling interest in HD Vest.

This interest is held by certain members of the former management team and totals approximately 4.5 percent. It is redeemable beginning in the first quarter of 2019 following publication of this year's 10-K at a price that is the higher of its carrying value or a value calculated in accordance with contractual terms. During the third quarter, the calculated redemption value of the non-controlling interest became higher than its' carrying value for the first time and as a result, was recorded at the higher value with a corresponding charge to additional paid-in capital. Under GAAP accounting rules that govern the calculation of EPS this write-up in value is treated like a preferred dividend and reduces net income attributable to Blucora that is used for the numerator in the calculation of EPS.

Moving to the balance sheet… we ended the quarter with cash and cash of equivalents of $88.3 million, and net debt of $176.7 million… our net leverage ratio was 1.5 times, which is down from 2.6 times in the year-ago period. and flat vs. the prior quarter as we typically skew our debt paydown to the first half of each year. As a reminder, our capital-allocation focus continues to be organic investments and debt pay down so absent any compelling and strategic opportunity that presents itself we'd expect further de-levering in 2019.

Wealth Management

I'll turn next our segment performance beginning with Wealth Management. HD Vest third quarter revenue was $91.9 million up 6 percent when compared to prior year, and toward the high-end of our guidance range. Segment income was $12.9 million, net of clearing-related costs, up 4 percent vs. the year ago period and above the high-end of our guidance range.

Third quarter revenue growth was highlighted by fee-based revenue, which was up 10 percent year-on-year driven by strong net flows and a favorable market tailwind in the first half of the year. Transaction revenue was up 9 percent versus prior year and primarily driven by variable and fixed annuities. Advisor-driven revenue PER advisor for the third quarter was up 28 percent year-on-year and up 3 percent sequentially, as we continue to show good revenue growth while shedding under-performing advisors. We are now at the tail-end of the pruning process and expect we could reduce advisor count by another 200 or so over the next few months, before getting back to seeing annualized growth in advisors focusing on quality over total counts. Closing out on revenue retained revenue was down 4 percent primarily driven by the adoption of ASC 606 at the start of the year which causes certain fees charged to advisors to be recognized net of related costs rather than on a gross basis,

We added approximately $200 million in advisory net flows during the quarter, which brings our year-to-date net flows to about $610 million. We continue to be pleased with our advisory net flows with this being an area of focus for us as we continue to convert existing brokerage assets to fee-based advisory assets where appropriate for clients while also driving new fee-based assets. We ended the quarter with fee-based Advisory Assets of approximately
$13.5 billion which is up 13 percent year-on-year. Fee based Advisory Assets as a percentage of Total Client Assets is 29.1%. Total Client Assets at quarter-end were $46.3 billion, up 9% versus prior year.

Turning to the HD Vest full-year outlook we expect revenue of between $372 to $375 million and segment income of between $53.5 to $55.0 million. In determining our 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…and
- Market volatility and interest rates including their impacts on net flows and cash sweep balances.

Tax Preparation
Moving on to the Tax Prep segment TaxAct revenue for the third quarter was $3.5 million up 4 percent versus prior year. Segment loss was $6.9 million and up 11 percent versus prior year as we used the incremental segment income relative to plan in the first half to increase our investment in the business in the second half of this year, as discussed last quarter.

For the full year we expect revenue of $187 to $187.5 million and segment income of $83.0 to $84.5 million or a segment margin of approximately 44 to 45 percent as we shift certain expenses from the third quarter to the fourth.

Looking forward to next tax season or the first half of 2019, we expect revenue growth at TaxAct of 7.5 to 10.0 percent versus the comparable prior-year period… and a segment margin in the range of 56.7 to 57.7 percent. This outlook is consistent with the target growth we outlined at this time last year and weighs the potential headwind of tax reform with our belief that we can offset any headwind through pricing and packaging adjustments.

Consolidated
Finishing up on the third quarter performance. unallocated corporate operating expense was $4.6 million flat year-over-year, on an absolute basis or up 12% y/y, excluding approximately $500 thousand of transition-related costs in the year-ago quarter. For the full year we expect unallocated operating expenses of $20.5 million.

With that let's turn to the consolidated outlook for the full year. We expect revenue between $559 to $562.5 million, adjusted EBITDA between $116 to $119 million, non-GAAP, net income of $90.5 to $94.0 million or $1.83 to $1.91 per diluted share, and GAAP net income, attributable to Blucora, of $44.5 to $48.0 million or $0.70 to $0.82 cents per diluted share. Our guidance for GAAP, net income per share, includes a 15 cent charge related to the estimated redemption value of the non-controlling interest in HD Vest.

For those of you who are new to the Blucora story our past practice relative to guidance has been to provide quarterly guidance on each conference call with the addition of a first-half outlook for the tax prep segment only, on our October call and then a full-year consolidated outlook on our April call.

One more note for modeling purposes… as John has mentioned for the past few quarters a portion of the incremental benefit from the new clearing arrangement will be shared with end-clients in the form of higher yield paid on their cash balances with the bulk of the benefit being split between new growth initiatives, and simply dropping to the bottom line to enhance current earnings. As we look to 2019and considering the confluence of organic growth opportunities we see in the business along with not only the clearing benefit, but also the tailwind of pricing opportunities we currently enjoy in the tax prep business we intend to 'flex' our investment in the business in 2019 to a higher level. We will provide more granular detail as we get in to next year, but I'd think about it in general in the following way: Depending on the actual number of rate increases, the Fed hands down between now and the end of 2019 we would look to reinvest somewhere between a third and a half of the incremental sweep benefit net of higher client-yield back into the business in the form of new growth initiatives with the remainder falling to the bottom line.

In closing we are looking to finish out the year, strong and carry that momentum into 2019… utilizing strong cash flows to further de-lever and strengthen the balance sheet and executing our strategies, which we believe will lead to near-term success while enabling long-term growth.

With that, I'd now like to 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 another strong quarter, continuing our momentum of the last several years. We are looking forward to next tax season and are ready to provide even more value to customers through improved products and stronger partner offerings. And with our clearing conversion behind us, we are positioned

capture even more financial and productivity benefits than we had access to previously. Overall, we are positioning both businesses to capture the significant organic growth opportunities we see ahead, and we look forward to continuing to update you on our progress. Thank you everyone.