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Blucora, Inc. Third Quarter 2021
Earnings Conference Call

DEE LITTRELL, INVESTOR RELATIONS

Thank you and welcome, everyone, to Blucora's third quarter 2021 Earnings Conference Call. Earlier this morning, we posted the earnings release and supplemental information on the investor relations section of our website at Blucora.com. I'm joined today by Chris Walters, Chief Executive Officer, and Marc Mehlman, 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 that 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 and 10-Q and other reports, for more information on some of these specific risks and uncertainties. We assume no obligation to update our forward-looking statements, except as required by law.

We will discuss both GAAP and non-GAAP financial measures today. Our earnings release and supplemental financial information are available on blucora.com and include full reconciliations of each non-GAAP financial measure discussed to the nearest applicable GAAP measure.

With that, let me hand the call over to Chris.

CHRIS WALTERS, PRESIDENT AND CHIEF EXECUTIVE OFFICER

Thank you Dee, and good morning everyone.

Opening

I am happy to report that Blucora's third quarter financial results have been strong across the board. The execution of our sustainable growth strategy is going well with TaxAct now running ahead of schedule. Our team's focus on continually improving the experiences for our financial professionals and customers is central to our progress.

I'll now share the highlights of the third quarter as well as share our preliminary outlook for 2022:

Starting with Tax Software

With the majority of revenue for the year realized, we're raising our guidance for full-year on revenue to \$225.5M to \$226.5M. Now that 3rd peak of the Tax Year 2020 season is complete, we are focused on preparing to deliver on our best season yet for TaxAct.

I am delighted to share that we are expecting to grow unit share for the first time in many years and generate revenue growth in 2022 of 14% to 18%, which exceeds the expected top-line cumulative annual growth rate of

7% to 9% that we communicated at Investor Day for the period of 2021 to 2024. In addition, we expect 2022 segment operating income between $98 and $106 million, which would be the highest in TaxAct's history.

When we shared our long-term guidance during Investor Day, we were just completing the Tax Year 2020 season and had not yet had the opportunity to fully analyze the data from the season or the full range of opportunities to deliver performance improvement for the business. Each tax year, we run a number of tests to assess the potential of product enhancements, marketing tactics, commercial approaches and partnerships. We also conduct extensive consumer research during and after the season to better understand opportunities and challenges. The results of these tests and research increased our expectations for the performance of the business for 2022 and beyond.

We are focused on a few areas to drive positive momentum for the business.

- First, brand recognition. We expect our continued marketing optimization in terms of timing of deploying spend as well as media channels and partners utilized to continue to drive improvements in brand recognition.
- Second, we continue to work to address the highest priority areas of friction in the consumer experience. Fortunately, our recent tests, research, and resulting data provide us with confidence about the business impact of the enhancements, including improvements in start and conversion rates.
- Third, we have spoken about the importance of commercial partnerships. We benefit meaningfully from associating ourselves with respected brands that our current and potential customers trust. We grew our commercial partnerships 10X this year and therefore we are in the first year of working with most of our commercial partners. With a full season with these partners under our belts, we now have a clear understanding of what worked and what didn't. We plan to focus our efforts with existing partners on scaling strategies that worked. One of the opportunities that we are most excited about is potentially expanding an existing partnership in a way that we believe could be significant enough to have a notable impact on our long-term growth trajectory. In addition, we're optimistic that we can bring on multiple new partners.

The actions we are taking have long-term benefits that we expect to positively impact the retention and growth of our customer base. I am pleased with the results of Tax Year 2020 and the many learnings that our team has translated into action plans for Tax Year 2021. I look forward to sharing our progress next quarter.

Avantax

Moving on to Wealth Management:

I am encouraged by our continued progress in our Wealth Management business. The actions we are taking align with the playbook we applied to the Tax business, we're just earlier in the game. Our key product and technology initiatives focused on our Financial Professional and end client experiences continue at pace. The enhanced service and support we are providing is also paying dividends. In addition, our efforts to drive growth in advisory relationships continue to have a positive impact.

Our pipeline of independent financial professionals interested in joining our employee-based RIA, which we refer to as Avantax Planning Partners, continues to grow. In mid-October we closed another great acquisition, Warner Finance, which further positions our employee-based model for success in the northeast region. This brings the acquired assets from our independent channel to our employee-based model to roughly $1.6 billion, which comprised nearly 30% of our employee-based model managed assets as of September 30, 2021. The ability to offer our financial professionals a variety of affiliation models and a seamless transition to this alternative model is proving to be an attractive option for both our Financial Professionals and Avantax.

We still have work to do on the technology experience for our Financial Professionals and their clients. We are on track to launch our new compensation system in the first half of 2022 as well as delivering on the end client experience enhancements that we shared during Investor Day. The actions we have taken are delivering strong business results, and we remain confident in our ability to drive positive net flows by the end of 2022 with a continued shift toward advisory assets.

And now a few highlights for the quarter:

- The business set a record through Q3 for the greatest percentage of AUM of total client assets, at 45.9%.
- Our Financial Professional Quarterly Production retention in Q3 was at 97.9%.
- The opportunity that we are providing for our independent Financial Professionals to be acquired into the employee-based RIA model, either for succession purposes or growth opportunities continues to accelerate with roughly $6B in assets in our pipeline.
- Recruiting of transfer Financial Professionals from other firms is at record levels. We're attracting Financial Professionals who are seeking the combination of our tax focus, scale and more personalized engagement model. Our pipeline is strong, and we expect to continue growing our recruiting assets in 2022 versus 2021.
- Our advisory and commission revenue per financial professional continues to improve, up 38% versus Q3 2020.

Blucora

Before handing it off to Marc, I'll reiterate how pleased I am with the significant progress we've made. Our team is focused on driving long-term sustainable growth by delivering delightful experiences for our financial professionals and customers. The investments we have made in TaxAct customer experiences and reimagining what our marketing and partnership teams could achieve, have resulted in our meaningfully enhanced guidance for the Tax Software segment for calendar year 2022 as compared to our performance for 2021 and the expected 2021 to 2024 CAGR that we shared at Investor Day.

This formula is also being applied to our Wealth Management business, where we are seeing similar early results as we saw with our Tax Software business: improved client feedback, enhanced product and technology capabilities and marketing and business development functions delivering greater value to our financial professionals. We expect to see these efforts translate to improved KPIs and financial performance in the coming quarters of 2022 and beyond.

With that I'll turn it over to Marc to review our Q3 financial performance, Full Year 2021 outlook and preliminary Tax Software segment outlook for calendar year 2022.

MARC MEHLMAN, CHIEF FINANCIAL OFFICER

Thank you Chris, and good morning everyone.

It's great to be with you all again. I'd like to provide some additional detail on our third quarter results and our outlook for full year as well as a preliminary view of our Tax Year 2021 season.

Starting with third quarter results, which due to Tax Year 2019 extending into the third quarter of 2020 resulted in disjointed year-over-year comparisons:

1. Total revenue of $174.2 million, a decrease of 1% versus the third quarter of the prior year but above the high-end of our guidance range. Total revenue was driven primarily by the Wealth Management business.
2. GAAP net income of negative $27.8M or negative $0.57 per diluted share which are both better than the guidance range previously provided. Embedded within our GAAP net income figure is:
    - A $1.7M true-up associated with the HKFS 2022 earn-out, which we still believe will be paid out in full at $30 million.

Adjusted EBITDA, which was better than the guidance range previously provided, and which excludes these and certain other factors, was negative $0.8 million versus $27M in the third quarter of 2020.

Non-GAAP net income was negative $12.8 million, or negative $0.26 per diluted share, and was also better than the guidance range previously provided.

Tax Software

Turning now to the Tax Software segment.

Tax Software segment revenue for the third quarter was $5.0 million, at the low end of our guidance range driven by the backlog at the IRS leading to a lower funded rate for those leveraging our refund transfer offering. We expect this to be a timing issue and related amounts to be realized in the fourth quarter. When combined with our performance during the third quarter, this leads us to raise full year revenue guidance for 2021, which I will discuss momentarily.

Segment operating income was negative $13.9 million, better than the guidance range provided as we continue to operate the business prudently from an expense standpoint.

Wealth Management

Moving on to wealth management. Third quarter reported wealth management segment revenue was $169.1 million, higher than the high end of our previously released guidance of $162.5M and up 4% sequentially. Transaction-based commission revenues were up quarter-over-quarter by 6%, coming in at $22.4M.

On a year-over-year basis, total wealth management revenue was up 24%.

Wealth management segment operating income came in at $19.6 million for the third quarter, above the high-end of our guidance of $18M, driven by lower than expected operating costs and a strong top-line revenue performance driven by transactional revenue and the timing of revenue recognized in the third quarter that we expected to come in Q4.

Over the last nine months, we have also seen an increase in our payout ratio to financial professionals, which when combined with the investments we are making into the business, has resulted in near-term margin compression. The increase in payout to financial professionals has been driven by a number of factors including:

- Improved market performance, which has shifted a number of financial professionals into higher payout levels;
- The exit of lower-producing Financial Professionals over the last 12 to 18 months, which were concentrated at lower payout levels; and
- An alignment of our payout grid between 1st Global and HD Vest, which created aligned incentives toward higher ROA assets, where appropriate, but resulted in higher payouts

As mentioned, we have also invested in the business in the areas of product management, software engineering, support and sales and marketing and believe we have a more appropriate level of staffing to support our growth initiatives going forward, which we expect to result in margin expansion in the future.

Total client assets came in at $86.6 billion, which included approximately $5.4 billion from the addition of Avantax Planning Partners. Fee-based advisory assets were up 23% year-over-year to $39.8 billion with advisory assets as a percentage of total client assets ending the quarter at a new high of 45.9%.

We saw net inflows in advisory assets of $621 million with total client assets having net outflows of $433 million, which relates in part to our change in focus toward higher ROA on platform assets and lower ROA off platform DTF assets.

At the Corporate level, unallocated corporate expenses came in at $6.5 million, below the guidance range as we continue to monitor our corporate costs in support of our businesses. During the quarter, we had about $2.2 million in acquisition and integration costs related to HKFS and 1st Global, with the majority related to the HKFS payment true-up.

Liquidity

We ended the quarter with cash and cash equivalents of $184.9 million, and net debt of $376.9 million. Our reported net leverage ratio at the end of the quarter was 2.6x, compared to 1.9x and 3.5x at the end of Q2 2021 and Q1 2021 respectively. Through the nine months ending September 30th, we have generated $74.4M in cash from operating activities, which is more than double what we generated during the same time period in 2020.

Our key priorities for cash include investing in our business to fuel growth and returning cash to shareholders. Our capital investments are aimed at:

- Solving critical customer pain points in the workflows of our customers
- Ensuring continued positive momentum in net new assets and favorable Financial Professionals sentiment, all while delivering on the most critical current needs of our Financial Professionals
- Providing capital for RIA acquisitions.

2021 Full Year and Preliminary 2021 Tax Season Outlook

With that, let's turn to our FY 2021 and preliminary Tax Season outlook:

For the full-year, we expect our tax software segment revenue to be between $225.5 million and $226.5 million and a segment income of $80.5 million to $81.5 million. The increase in revenue is driven by our performance in third quarter and the expectation that we will earn additional revenue in Q4 once IRS delays abate. We expect to invest this upside in investments leading into the first quarter of 2022 that relate to our improved outlook for next tax season. For our wealth management segment, we expect full-year revenue of between $645.0 million and $650.0 million and segment income of between $81.0 million and $83.0 million. This represents a full year improvement for wealth management segment income, at the mid-point of the range of $700,000, as compared to the guidance released at Investor Day, and which includes investments we are planning to make in Q4 for the business.

On a consolidated basis for the full year, we expect total Blucora revenue of between $870.5 million and $876.5 million, adjusted EBITDA of between $135.5 million and $139.0 million, GAAP net loss of $4.5 million to $0.0 million or a loss of $0.09 to $0.00 per diluted share and non-GAAP income attributable to Blucora of $82.0 million to $86.0 million or gain of $1.65 to $1.73 per diluted share. This outlook includes full-year unallocated corporate expenses of $26.0 million to $25.5 million.

Finally, at this time of year it has been customary to provide a preliminary outlook for the upcoming tax season. As Chris mentioned earlier, we are excited to share that our efforts to drive improved sustainable growth in TaxAct is ahead of schedule. This was a valuable off-season for the business, where we were able to further test and iterate on our product and marketing approaches, which - through deep analysis and testing - has resulted in a more favorable view for the season than we could share in June when the season was just coming to its delayed close.

Our view for the season is predicated on driving the following key metrics:

- Start Rate – We believe that the focus on our consistent messaging from last season, the learnings from our media partner testing during the off-season and key product enhancements will drive a meaningful improvement in our start rate for new users.
- Conversion – The continued improvement in NPS scores from last season, as along with targeted enhancements to the consumer workflow, have been factored in and are supported by our off-season testing.
- Unique Visits – We expect unique visits to be positively impacted by three things: continued marketing optimization, enhancing partnerships that brought us success last season, and new partnerships - all of which we are excited about.

The result is a preliminary view of revenue growth of between 14% and 18% to the mid-point of 2021 full-year guidance and for segment operating income of between $98 and $106 million.

Delivering results within this guidance range would have us either approaching or falling within the guidance ranges offered for 2024 during Investor Day last June.

This concludes our prepared remarks; we will now turn the call over to the operator for Q&A. Operator?

CHRIS WALTERS, PRESIDENT AND CHIEF EXECUTIVE OFFICER

Thank you all for joining us today and for your interest in Blucora. Speak with you next quarter.