Blucora, Inc. Fourth Quarter and Year End 2021

Earnings Conference Call

Dee Littrell, INVESTOR RELATIONS

Thank you and welcome, everyone, to Blucora's fourth quarter and full year 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 SEC filings, including our most recent Form 10-K and Form 10-Q, 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 the investor relations section of our website at 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

Today I am pleased to share our fourth quarter and full year 2021 results.

Overall, in 2021, we made significant progress executing our sustainable growth strategy for the Company and are pleased to be ahead of our long-term growth goals. We generated strong financial results while investing for future growth, deepening our relationships with customers and financial professionals, strengthening our platforms, and laying the groundwork to build on the significant opportunities we see ahead. Our financial results exceeded expectations including delivering revenue growth of 17% and Adjusted EBITDA growth of 46% for the full-year 2021.

We believe that executing on our growth strategy is key to realizing the full value of Blucora's differentiated tax-focused businesses. As we have said, this strategy is not operating in isolation, nor without a timeframe. We have laid out clear goals and KPIs for our business over the next several years and consistently judge our progress against a wide range of value-creating alternatives to the Company's business structure and capital allocation.

Our approach across both businesses has been to continue to focus on our three key drivers of sustainable growth:

- First, **customer acquisition** – which is finding unique ways to bring new customers and financial professionals to our business, including innovative marketing and partnerships.
- Second, **customer retention** – building valuable long-term relationships with our financial professionals and customers, by providing best in class experiences with great products and services.
- And finally, **realizing cross-over benefits between our two businesses** – which is operating high quality and efficient shared functions, extending our TaxAct technology and marketing capabilities to benefit Avantax, as well as introducing wealth management opportunities to TaxAct Pros and customers.

With support from our Board of Directors, our leadership, and most importantly, our teams, we made significant progress in each of these areas.

Now I'd like to provide an update on our businesses, beginning with our Tax Software business.

Tax Software

TaxAct had a very solid year in 2021, reaching a critical inflection point on the path toward unit share gains and ARPU growth, which as we have said are key to unlocking the value of this business and driving profitable growth:

- In particular, for the first time since 2014, TaxAct was flat on consumer units at 3.2 million after having declining unit volume for a number of years. This is a critical step on our stated expectation of growing units and building share through embracing our value position.
- As a result, we had a strong finish to the year, exceeding our mid-point guidance of $226 million in revenue.
- Just as crucially, our customer satisfaction scores continued to improve with net promoter scores (NPS) up an additional 1.5 points on top of the prior season's historical high, thanks to our continued investments in product and user experience.
- We tested and iterated on product enhancements to deliver the most value to taxpayers this tax season, with a focus on improving product flow and customer data entry.

These results give us solid confidence about our outlook for 2022. When we released our Q3 2021 results in November, we gave our preliminary outlook for 2022 segment revenue to be up between 14% and 18% from fiscal year 2021, and for our 2022 segment operating income of between $98 million and $106 million, representing 26% growth relative to the mid-point of our fiscal 2021 guidance for the business.

Today, we are reaffirming this strong 2022 guidance for our Tax Software business.

The team and I are confident and excited about the year ahead.

Heading into the 2021 tax season, we are bullish about the potential benefits to be realized from our product enhancements, marketing improvements, and partnership investments.

Although it is early in the tax season, I would like to share some initial observations. Over the last several years, we have seen a shift of filers starting and completing their returns later in the season. This shift has accelerated in Tax Year 2021 as the number of reported e-files by the IRS, roughly two weeks into the season, is approaching 50% below what has been seen in past seasons.

This relatively low number of filers makes it difficult to comment definitively on certain elements of the season. That said, we are already seeing a number of areas for which we previously forecasted improvements performing at or above expectations.

This season, we are focused on several areas to support our customer acquisition and retention.

To support **customer acquisition**, we've focused on partnerships and marketing initiatives.

- Taking our learnings from prior seasons, we continued to invest in **partnerships** to build brand recognition and drive traffic. For the 2021 tax season, we have refined our approach with existing partners and added several new partners.
- On the **marketing** side, this season we are using improved data and analytics to provide enhanced insights into customer behavior as the season progresses. As we saw last year, we expect this will enable us to more efficiently deploy our marketing spend.
- Our investment in these enhanced capabilities facilitate our ability to rapidly test and optimize our marketing efforts during the season.

To support **customer retention**, we are focused on product enhancements and customer assistance.

- We've invested in strategic **product enhancements** to simplify our user experience and increase start rates. I'll share a couple of great examples: During 3rd peak testing, we learned that improvements in how we **import prior year data** could increase user completion rate. We also made improvements to **W-2 and 1099** form import tools and have already seen a significant increase in users leveraging them.

- We remain committed to making the user experience as smooth as possible for our customers. Beyond improving our product, we have also focused on incremental ways to assist our customers. We've made two notable enhancements on this front:
    - We launched **Xpert Assist,** which provides filers of all types access to a team of CPAs and tax experts at no additional cost. Xpert Assist can guide customers through complex tax situations and is a powerful component of our value positioning because easy access to expert help is typically an incremental charge for users of competitors' paid products.
    - We also increased our **customer care** investment to be able to provide direct, human assistance to a significantly greater percentage of customers than prior seasons.

Avantax

Now onto the Wealth Management segment, where we have continued to see the value in our hybrid, independent broker-dealer/in-house RIA approach to wealth management. The combination of Avantax Wealth Management and Avantax Planning Partners enables us to offer multiple affiliation models which presents unique opportunities for us to better service our financial professionals and CPA firms.

Heading into last year, we were focused on several initiatives.

In customer acquisition, the focus was on:

- Recruiting new firms, and
- Scaling our employee-based RIA model.

On the **customer retention** front, we were focused on continuing our progress with several initiatives, which also benefit customer acquisition. These include:

- Improving the overall experience for financial professionals and their clients, and
- Enhancing our technology and service capabilities to provide additional, customized resources to our financial professionals to help them grow their practices over time.

I'd like to highlight how we made progress on each of these areas last quarter

On the **customer acquisition** and recruiting front, it was a great quarter. We welcomed 49 new financial professionals, adding $330 million in total client assets.

To improve **customer retention**, I am pleased to share that we are making meaningful progress in meeting the needs of our financial professional community.

- Our fall 2021 financial professional satisfaction survey results improved by 20 percentage points since spring 2021, and 33 percentage points since fall 2020.

- These results were driven by enhancements in our financial professional customer service and technology. On the **tech front**, we've also made several improvements.
  - We launched the first version of a new client portal to a pilot group of financial professionals and will continue to expand this portal's availability to all firms throughout 2022. This exciting new feature will directly enhance the experience that end-clients have when working with their financial professionals and will be the foundation of how end-clients and financial professionals collaborate.
  - We also launched new account opening and off-platform asset transition tools to help increase financial professional efficiencies by saving time and decreasing overall processing times.
  - Finally, we expanded our **consultation services** to boost firm efficiency by using sophisticated data and analytics to provide proactive advice to financial professionals on how to become more operationally efficient as they grow, thus boosting their profitability potential.

We believe our increased investments across the Wealth Management segment will continue to provide a more enhanced, cohesive suite of services and opportunities to support our financial and tax professionals and help them grow their businesses.

In addition, in 2021 we acquired eight RIA firms to scale this portion of our business. This initiative is a compelling capital allocation opportunity in addition to supporting our customer acquisition and retention efforts as well as enhancing cross business synergies. Together, these acquisitions have added approximately $1.9 billion in asset under management to our employee-based model, which as a reminder is meaningfully more profitable than the independent broker dealer model. The model for each of these deals has us approaching a margin profile double that of our wealth business today. As this continues to present a compelling opportunity to the business, we will allocate capital in-line with our communicated capital allocation priorities of maintaining a strong balance sheet, driving organic growth and returning capital to shareholders. We plan to increase the number of RIA acquisitions during 2022.

In addition to our focus on executing to improve the fundamental value drivers of our business, we are set up to benefit greatly from the macro environmental factors that we believe likely lie ahead. Market volatility can influence fees as the value of the assets under management impacts our revenue. In a market in which asset values are under pressure, our fees will be lower; conversely, as asset values increase, so too will our fees. That said, the profit-sharing model in place with our financial professionals mutes the impact of market volatility, but the effects of an increasing rate environment flowing through to the bottom line is much more significant.

As everyone on this call no doubt appreciates, the near-zero interest rate environment over the past two years has been unprecedented. This has severely impacted cash sweep revenue, which is a critical input for all wealth management businesses.

As we have repeatedly said, a return to a historically normalized interest rate environment represented a significant opportunity for additional revenue, which will positively impact Blucora's earnings.

As the interest rate environment normalizes back to conventional, pre-Covid rates, sweep revenue will once again be a source of high margin income to the business. As an example, upon reaching a fed funds rate of 125 to 150 basis points, Avantax will generate incremental annual segment Operating Income of between $40 and $50 million, assuming today's level of assets, among other factors. This is a key component of our earnings power.

Due to the timing of rate increases and the non-linear nature of upside associated with the first 4 rate hikes, we won't see all the positivity hit our P&L in 2022, but based on what the forward interest rate curve implies, we will return to normalized levels in 2023.

Now, let's talk about Blucora overall.

Blucora

As I complete my second year as Blucora's CEO, I want to reiterate how encouraged I am by the Company's progress and how optimistic I am about our growth outlook. We are making solid headway returning TaxAct and Avantax to sustainable, profitable growth which is essential to unlocking Blucora's value.

We have focused on empowering our teams, supporting our financial professionals, and exceeding the expectations of our customers. I'm pleased to see the satisfaction improvement we have made with each group – and this bolsters our confidence in the future. As the macro environment begins to revert to pre-pandemic norms, headwinds of the past two years are becoming tailwinds and expected to boost our earnings and shareholder value substantially.

I believe the steps we have taken to reposition our business - coupled with the continued execution of our differentiated strategy - have the potential to create tremendous value for our team, our financial professionals, our customers, and ultimately, our shareholders.

I look forward to continuing our progress throughout this year.

With that, I'll turn it over to Marc to outline our Q4 and full year 2021 financial performance.

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 fourth quarter and full-year results as well as our outlook for the quarter ahead.

Starting with fourth quarter results, as Chris mentioned, we are thrilled to have executed well across the board, exceeding the mid-point or high-end of our guidance across most metrics. 2021 was a strong year for the business, one which saw our TaxAct business return to meaningful revenue and profit growth and considerably higher margins versus the prior year. Further, our Wealth Management business, saw a shift of over 400bp toward higher ROA advisory assets as a percentage of total assets, and an expansion of almost $2 billion of assets to our RIA model.

Our plan to create sustainable growth frameworks while shifting our business toward higher valuation models is on track and expected to accelerate.

Now, on to fourth quarter financial results:

1. Total revenue was $178.3 million, an increase of 15% versus the fourth quarter of the prior year and above the high-end of our guidance. Total revenue was driven primarily by the Wealth Management business.
2. GAAP net loss was $23.7 million, or a $0.49 loss per diluted share, both of which outperformed the high-end of our guidance. As a reminder, the fourth quarter is a seasonally small quarter for our tax business, and we typically generate a consolidated net loss for the period. Embedded within our GAAP net income figure is:
    - A $2.9 million increase in the fair value of the HKFS Contingent Consideration earn-out, which we still believe will be paid out in full at $30 million, as well as a $12.1 million tax benefit, primarily associated with a reduction in our valuation allowance.

Adjusted EBITDA, which outperformed the mid-point of our guidance, was negative $3.8 million versus a positive $2.2 million in the fourth quarter of 2020.

Non-GAAP net loss was $14.1 million, or a loss of $0.29 per diluted share, which outperformed the high-end of our guidance.

Tax Software

Turning now to the Tax Software segment.

Tax Software segment revenue for the fourth quarter was $6.1 million, which outperformed the high-end of our guidance as the backlog at the IRS was significantly reduced, helping to drive over-performance. For the year, the Tax Software segment delivered $227 million of revenue, representing 8.7% growth versus the prior year. Consumer e-files were 3.2 million for tax year 20, which as Chris mentioned, is flat to tax year 2019, the first time we have maintained or grown our e-file volume in at least 6 years. This is a testament to our team and the strategy they are executing. This is a big moment for the business and is another signal of our turnaround toward healthy, unit-driven growth.

Segment operating income was negative $18.6 million, which outperformed the high-end of our guidance. We continued to operate the business prudently from an expense standpoint, maintaining the financial flexibility to invest in a number of marketing opportunities ahead of tax year 2022, such as the ESPN Bowl series, which exceeded our expectations for brand awareness.

Wealth Management

Moving to the Wealth Management segment. We continued our strong momentum during the fourth quarter. Wealth Management segment revenue was $172.2 million, above the high-end of our guidance and up 2% sequentially. Transaction-based commission revenues were $24.2 million, an increase of 8% sequentially. Year-over-year transaction-based commission revenues increased 22% for the quarter and 20% for full year 2021.

On a year-over-year basis, total Wealth Management revenue was up 15% for the quarter and 21% for the full-year.

Wealth Management segment operating income was $21.9 million for the fourth quarter, above the mid-point of our guidance, driven by favorable revenue performance, offset by incremental headcount and investments in technology to enhance the experience of our financial professionals and their customers.

Our pay-out rate decreased slightly versus Q3, coming in at 75.6% versus 76.1% in the 3rd quarter of 2021. We will see fluctuations in payout rate depending on the concentration of transaction-based revenues, the make-up of net flows and lastly the type of assets for which we have quarter to quarter movement.

We ended the year with total client assets of $89.1 billion. Fee-based advisory assets were up 18.5% year-over-year to $42.2 billion with advisory assets as a percentage of total client assets ending the quarter at a new high of 47.3%, 440 basis points higher than the end of 2020.

We saw net inflows in advisory assets during the fourth quarter of $780 million with total client assets having net outflows of $562 million, which relates in part to our change in focus toward higher ROA on platform assets and lower ROA off platform DTF assets, where it makes sense for our customers.

I would now like to turn your attention to slide 6 in the earnings presentation. Over the last 24 months a key strategic imperative has been to shift our business development focus to attract more established financial professionals with higher expected long-term retention.

This has been a success. We have driven our newly recruited assets for full-year 2021 to $929 million versus $363 million in 2020 and an average of $407 million for the years 2017 through 2019. Our expectation for 2022 is for meaningful growth over 2021.

This focus on fewer but more productive financial professionals has greatly increased recruitment of assets; and so, while we will continue to share financial professional counts and discuss the drivers of movement, our strategic focus will continue to primarily be on assets and our drive toward positive net new assets in 2022.

Corporate

At the Corporate level, unallocated corporate expenses during the quarter came in at $7.1 million, as we continue to manage our corporate costs prudently. During the quarter, we had about $3.9 million in acquisition and integration costs related to HKFS and 1st Global, with the vast majority of it related to the increase in fair value of HKFS Contingent Consideration that I have previously mentioned.

Liquidity

Turning to the balance sheet, we ended the quarter with cash and cash equivalents of $134.8 million, and net debt of $426.5 million. Our Net Leverage Ratio at the end of the quarter was 3.1x. For the full-year 2021, we generated $36.8 million in cash from operating activities, which includes a $16.9 million one-time settlement with the SEC that dates back to the 1st Global acquisition.

Our key priorities for cash remain investing in our business to fuel growth and returning cash to shareholders. As it relates to returning cash to shareholders, we commenced share repurchases in the first quarter of 2022 under our expanded $100 million share repurchase authorization announced in December. Through February 15th, we have purchased roughly 500,000 shares or about 1% of outstanding shares for a total cash outlay of about $8.5 million.

2022 First Quarter Outlook

With that, let's turn to our First Quarter 2022 outlook:

As is customary, we will provide second quarter guidance and full year guidance during Q1 earnings in early May. For first quarter in our tax software business, we expect revenue between $150.0 million and $175.0 million and segment operating income of $57.0 million to

$77.0 million. As Chris mentioned earlier, the tax season is off to a significantly slower than usual start, which makes it a bit difficult to pinpoint which e-files will come through at the end of March versus the first two weeks of April. We therefore have a wide guidance range to take this phasing uncertainty into account. This has no impact on our view of the full season.

For our wealth management business, we expect first quarter revenue, of $164.5 million to $171.5 million and segment operating income of $19.5 million to $22.0 million.

On a consolidated basis, we expect first quarter revenue between $314.5 million and $346.5 million, adjusted EBITDA between $69.0 million and $92 million, GAAP net income of $38.0 million to $62.0 million or $0.75 to $1.23 per diluted share and non-GAAP income attributable to Blucora of $52.5 million to $76.5 million or $1.04 to $1.52 per diluted share. This includes unallocated corporate operating expense of $7.0 million - $7.5 million.

Q&A

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.