Blucora, Inc. (BCOR)

Q2 2022 Earnings Script

Dee Littrell, Investor Relations

Thank you and welcome, everyone, to Blucora's second quarter 2022 Earnings Conference Call. On Monday afternoon, following market close, we posted the earnings release and supplemental information on the investor relations section of our website at Blucora.com. I am 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 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, 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, CHIEF EXECUTIVE OFFICER

Opening

Good morning, I'm pleased to share our second quarter 2022 results with you today.

Last quarter we achieved strong operating metrics across the board in alignment with our commitments from Investor Day last year, and our results this quarter continued that trend.

While the equity markets have remained volatile throughout Q2 and asset flows have been trending negative in the broader market, I'm happy to report that we have seen positive asset flows into our business, and our second-quarter results have come in aligned with our plan for the year. This reinforces my confidence that we are effectively executing on our strategy, and that we will continue to drive sustainable, long-term growth across both segments.

In particular, our performance in wealth in the second quarter was bolstered by continued positive net flows and high newly recruited assets as we attracted some of the best and brightest in the industry as well as strong production retention rates as we continued to deliver for our existing financial professionals. In tax software, we executed to our expectations to deliver our full year guidance.

With our financial results on track for the year, despite a volatile macro picture, we are confident in our ability to deliver even stronger results next year driven by continued strong operating performance as well as favorable interest rate impacts. We expect our positive trajectory to deliver valuable free cash flow in the coming years as we continue to deliver differentiated value and services to our customers and clients. It's an exciting time for our business.

I'd like to briefly highlight this quarter's performance for each business and then I'll turn it over to Marc for a deeper dive into segment financials. Let's begin with tax software.

Tax

With the 2021 tax season now behind us, I'd like to reflect on a few of the achievements this season that will set the foundation as we prepare for next year.

Most notably, we increased our consumer market share by 20 basis points from 4.75% to 4.94% and delivered meaningful revenue growth across our consumer, SMB, and professional offerings. One of the things we were most proud of this season: delivering expert help and exceptional customer service, answering over 90% of customer calls in a timely manner to support their tax filing needs. In the first full tax season of offering free expert help, almost 10% of our customers signed-up for the service, generating considerably higher conversion rates than we've historically seen. We anticipate this metric to climb as we communicate more broadly about the service next season. Our mission to deliver a full featured value offering that serves as the best alternative to Turbo Tax, not just in price but overall experience, is well underway.

Looking ahead to next season, we expect to continue to expand the number of partners we work with as well as the ways that we work with them. Our partnership efforts are focused on three critical areas:

- Increasing the number of data providers to make it easier for our customers to import their financial information,
- Driving new customer acquisition by having respected brands introduce TaxAct to their customers, and
- Bringing incremental products and services to our customers.

I want to also call out a recent sports partnership highlight: we renewed our TaxAct Texas Bowl title sponsorship as part of a multi-event, multi-year college football agreement with ESPN. We will be a featured sponsor throughout 2022 and 2023 ESPN bowl games and across ESPN network programming. This is just one example of the approach we are taking to enhance our position as the 3rd most well-known brand in the DDIY tax preparation space.

Moving on to our wealth management business.

Wealth

First, I'd like to touch on our exceptional recruiting effort this year. Our 2021 fiscal year recruiting efforts achieved a record-breaking performance of just under $1B in recruited total client assets. I'm pleased to share that as of June 30th we had already surpassed this level with over $1B in newly recruited assets for 2022.

For the second quarter of 2022, we added 37 new financial professionals, driving approximately $514 million in recruited total client assets. This beat our internal forecast for the second consecutive quarter in a row, the details of which Marc will provide in a moment.

Financial Professionals are choosing Avantax for a number of reasons including the strong, collaborative tax focused community, high quality support, growth opportunities they don't get anywhere else, increasingly enhanced technology and digital products, and the direct access to senior leadership that we provide.

Lastly, we continue to make progress on the RIA acquisition front. One recent example: we acquired our first wealth management practice in Florida, where the leader, a veteran of Avantax Wealth Management, joins us as a Financial Planning Consultant with Avantax Planning Partners. His wealth management practice had approximately $157 million in total client assets as of May 31, 2022. The seller saw the opportunity to spend more time focused on the well-being of his customers and his presence on the APP team has already been felt.

I mentioned community a few minutes ago, and I want to stress how important the Avantax community is for our current financial professionals and as a recruiting tool for bringing in new members. We've been pleased that 2022 has allowed us to re-engage with our financial professionals in person and at local and national events. We recently concluded our Elevate Conference and our Avantax Elite Summit for our Avantax Planning Partners, affiliated accounting firms and our top Financial Professionals, and we're looking forward to holding more of these events throughout the year. While the cost of these events will add to our cost base relative to the last couple of pandemic-affected years, the engagement and chance to learn from each other is our special sauce and we're thrilled to bring them back.

Overall, we've seen minimal regrettable financial professional attrition year to date, resulting in our production retention rate remaining almost 100%. We have a good pipeline for continued recruiting success, despite market-driven headwinds. We've also started to see some benefits from rising interest rates in Q2, with Q3 and beyond appearing set to deliver meaningful revenue and segment margin to the business which should offset the negative impacts of equity market decreases this year and should deliver meaningful upside next year.

Blucora

I am proud of our Company's performance this quarter. We have a lot of reasons to be optimistic about our future performance across the company, not just due to the favorable interest rate environment but also because of the purposeful investments we chose to make leading into this environment that we believe will allow us to take full advantage of the opportunities that come from operating from a position of strength.

With that, I'll turn it over to Marc.

MARC MEHLMAN, CHIEF FINANCIAL OFFICER

Thank you, Chris, and good morning everyone.

It's great to be with you all again. As Chris mentioned, we continued to execute effectively and I'm pleased to report continued strong results for second quarter 2022, amidst what is a difficult backdrop for many across the economy. This morning I'll be providing some additional detail on our second quarter results and our outlook for the balance of the year, which in short, is in line with what we shared last quarter, despite the market being down 16% during the second quarter.

Starting with second quarter results:

1. Total revenue of $256.9 million, an increase of 1% versus prior year and
2. GAAP net income of $39.4 million or $0.81 per diluted share. Embedded within our GAAP net income figure is:
   - A $7 million gain associated with accruals for the HKFS earn-out which ultimately will be paid out at ~$23 million due to market conditions and the significant decline in advisory asset levels during the second quarter of 2022 relative to what we expected earlier this year. This concludes the payments associated with the HKFS transaction.
3. Adjusted EBITDA, which excludes these and certain other items, was $62.1 million which represents a 21% decline versus the prior year period due both to the timing of the tax season last year as well as the 16% decline in the equity market affecting wealth.
4. Non-GAAP net income was $48 million, or $0.99 per diluted share, down 24% for the same reasons as Adjusted EBITDA.

Tax Software

Turning now to the tax software segment, which had results that were in-line with our expectations for the quarter. TaxAct revenue was $94.2 million, and segment operating income was $53.9 million. Year to date, revenues for TaxAct were up 9.1% to $235.4 million versus prior year, reflecting our market share and ARPU gains, partially offset by a higher level of extensions in Q2, which we expect to come in later in the year. Our total e-files were up 2.4% year-to-date, despite a temporary, we believe, decline in the market for this past season. Consumer e-files were up 2.3% and Professional up 2.6% with both increasing primarily due to growth in market share from favorable customer retention and acquisition, both of which benefited from our investments in strategic marketing spend and customer care support.

Segment operating income for the quarter came in at $53.9 million relative to $63.4 million in the same period last year as some marketing dollars shifted from Q1 to Q2 this year compared to last. Year-to-date segment income came in at $111.9 million versus $114.3 million for the first six months of last year.

With the industry-wide expectation of a faster growing market last tax year, we pulled some spending forward into the first half to ensure that our support services would meet the benchmark we set for ourselves. As a result of the unanticipated market decline, we took measures to control one-time operating expenses in the second half. As a result, our plan is for second half expenses to come in meaningfully below those of last year, which gives us confidence to reaffirm the guidance we provided last quarter for segment operating income between $89 million and $91 million for the year.

Wealth Management

Moving to wealth management. Second quarter reported wealth management revenue was $162.7 million, down 2% sequentially as a result of the decline in markets and lower transaction-based commission revenues of 13%, which tends to occur during times of heightened market volatility.

On a year-over-year basis, total wealth management revenue was up $274 thousand from $162.4 million a year ago. We feel good about this solid performance, as the things we do control – retention, recruiting – more than offset the impact of factors outside of our control - including a 16% decline in the equity markets since the end of Q1 and so far very modest benefits from the interest rate rebound.

Wealth management segment operating income came in at $15.9 million, down 3% sequentially driven by costs associated with one of our larger conferences for the year. I'll address costs more broadly momentarily.

We saw net inflows in advisory assets of $581 million with total client assets having net inflows of $185 million, the second straight quarter of driving positive net flows for both advisory and total assets.

Newly recruited assets continued to be a bright spot for the business, as Chris previewed. In the second quarter we added another $514 million of total client assets bringing the year-to-date total to just over $1 billion which surpasses last year's full year total of ~$930 million, which had been a record for the business.

Total client assets decreased 13% year-over-year to $76.5 billion, reflecting broader market declines, partially offset by successful recruiting efforts. Fee-based advisory assets were down 7% year-over-year to $36.7 billion with advisory assets as a percentage of total client assets ending the quarter at 48%, an increase of 50bp versus last quarter and up ~310bp versus Q2 of 2021.

I'd like to spend a few minutes discussing operating margins, particularly with regard to the wealth business. I want to reiterate what we have said consistently over the last couple of years, which is that before 2020 the business had systematically underinvested across technology, product and support – and been paying for it. More importantly, cost cuts associated with aligning HD Vest and First Global had been too deep.

Our investments in technology, product and support have moved the needle on closing the gaps in our platform offerings. As we look at our business holistically, including the benefits of interest rates, we expect to see margins dramatically improve in the second half of this year to the mid to high teens for the wealth segment.

As I mentioned last quarter, we continue to feel very positive about the investments we've made and are comfortable with our current staffing levels, and so we expect year-over-year expense growth to start to decline in the second half of this year. Further, as Chris mentioned earlier, we have brought back our full slate of in-person conferences this year, which has contributed to our elevated expense levels relative to last year. We expect the impact of conferences on expense growth to moderate as conferences continue in the future.

Because of the investments we have been making, we believe Blucora's wealth business is in a stronger position today than at any time over the last several years, as demonstrated by:

- Improvements in advisor satisfaction as measured by our annual Voice Of The Advisor (VOTA) survey scores
- Record recruiting in the form of newly acquired assets
- Higher retention levels as measured by 99%+ production retention levels
- Net positive flows for 2 straight quarters for the first time since early 2019
- Meaningful shifts to advisory which is driving higher returns after financial professional payout along with higher sweep assets ahead of the rising interest rate environment, and lastly
- A steady pipeline of product releases addressing the most critical pain points of our financial professional base

These enhancements have led to consistently improving returns on assets after financial professional payout for the business, increasing from the mid 21bp level in Q1 of 2020 to the mid 23bp level this second quarter. The importance here is that we are generating more return for the business after accounting for financial professional payout at today's asset balances relative to what we generated when asset balances were at these similar levels during 2020.

The key here is: As asset levels continue to rise in the future, we believe we'll be in a position to create more value, translating into higher profits and margins.

Now to return to the second quarter financial results.

Blucora

At the Corporate level, unallocated corporate expenses came in at $7.7 million with most of the increase related to insurance costs associated with higher premiums for items like cyber.

Liquidity

Turning to the balance sheet, we ended the quarter with cash and cash equivalents of $171 million, and net debt of $389.1 million. Our Net Leverage Ratio at the end of the quarter was 3.1x. For the second quarter, we generated $38.3 million in cash from operating activities, and spent $4.5 million on share repurchases with the year-to-date amount of repurchases adding up to $35 million.

Subsequent to the end of the quarter, we paid down our term loan balance by $35 million, resulting in an updated principal amount of $525.4 million as of August 5th.

Our key priorities for cash remain investing in our business to fuel growth, both organically and via acquisitions of our independent financial professionals, and lastly continuing to return excess cash to shareholders while maintaining a strong balance sheet. Our long-term approach, and especially in this environment of heightened uncertainty, we will balance the benefits associated with repurchasing shares and continued paydown of debt with an eye toward cementing our net leverage ratio closer to 2 times before turning our attention toward more aggressive share repurchases.

Full Year Outlook

With that, let's turn to our refined FY 2022 outlook taking into account current market conditions:

For the full year, we continue to expect our tax software segment revenue of between $247.5 million to $251.0 million and segment income of $89.0 million to $91.0 million. For our wealth management segment, we now expect full year revenue of between $645.0 million to $665.0 million, down modestly from our prior outlook reflecting market declines, with segment income of $90.5 million to $94.5 million, which is in-line with the midpoint of our prior guidance, reflecting an uptick in more profitable sweep income. This translates to a consolidated full year outlook of revenue of between $892.5 million and $916.0 million, adjusted EBITDA of $149.0 million to $156.5 million, GAAP net income of $28.5 million to $43.5 million or $0.58 to $0.89 per diluted share and non-GAAP net income of $84.0 million to $93.5 million or $1.71 to $1.90 per diluted share. This outlook includes $30.5 million to $29.0 million in corporate unallocated expense.

Included in this outlook is sweep income of nearly $40 million for the year based on the current target range for the federal funds rate. Expectations for next year continue to be robust based on current fed rate expectations. I had shared last quarter that based on rate expectations, and of course market levels, we could see wealth management segment income approach $150 million. While market levels are down meaningfully from the end of Q1 and commissions revenues continue to show weakness, we estimate that an improved outlook for rates at 3.25% by year end would still have us delivering ~$120 million of segment income at an S&P level of 3,000, which is another 20% decline from the S&P close as of June 30th, and upwards of $150 million at market levels above 4,250.

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