Blucora, Inc. (BCOR)
Q3 2022 Earnings Call Script

Dee Littrell, Investor Relations

Thank you and welcome everyone to Blucora's third quarter 2022 Earnings Conference Call. This morning 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 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, CHIEF EXECUTIVE OFFICER

Announcement highlights

Good morning. Before we share our third-quarter results, Marc and I will discuss the announcement we made earlier this morning.

Yesterday, we signed an agreement to sell our software business, TaxAct, to an affiliate of Cinven for $720 million in cash. We expect to close the transaction by the end of the year.

While the decision to sell TaxAct may come as a bit of a surprise for some of you, the Board has been consistent in its position to remain open to opportunities to create or unlock value for shareholders.

We commenced the process to explore such a transaction, and Cinven's offer validates the extraordinary work our TaxAct team has done to grow the business by enhancing our products and customer care approach as well as the significant strides made acquiring customers via increasing the sophistication of our marketing efforts and scaling partnerships. A few of the team's numerous accomplishments over the last few years include increasing NPS scores, providing exemplary customer care with free access to tax experts and having TaxAct products rated as the best in market by multiple third-party reviewers including Business Insider.

We believe the sale to Cinven, a highly respected Private Equity firm with deep experience in the tax space, is the right next step for TaxAct to continue to scale. Through our discussions, we recognized that we are completely aligned with Cinven on the importance of meeting customers' needs including delivering exceptional software combined with best-in-class customer care for the upcoming tax year and in the future.

Cinven has indicated that it intends to operate TaxAct independently during the transition period, expected to be 6-9 months post-closing, on a business-as-usual basis and prepare for the upcoming tax season to ensure our customers are not impacted by the transaction.

Following the closing, we will rebrand Blucora to Avantax and focus solely on executing our long-term, sustainable growth strategy for our tax-focused wealth business, which has delivered impressive results over the last couple of years. This means aligning the company's operations and enabling strategic investment in high-return initiatives to best support the needs of our Financial Professionals and CPA firms and their clients.

Additionally, the transaction should allow us to return significant capital to shareholders.

Looking ahead, we see many opportunities for our wealth business. As a pure-play wealth management company, we will be laser focused on further differentiating ourselves as the partner of choice for tax focused financial professionals, tax professionals and CPAs.

Now, I'll turn it over to Marc to discuss some of the other details regarding both capital return and the long-term growth algorithm for Avantax.

Marc Mehlman, CHIEF FINANCIAL OFFICER

Thank you, Chris. As Chris shared, the sale of the TaxAct business is compelling for a number of reasons:

1. We will create a differentiated pure-play tax focused wealth management company by monetizing TaxAct at a meaningful valuation following a successful turnaround by the management team
2. The proceeds of the transaction, totaling expected after-tax net cash proceeds of ~$620 mm, will be used to paydown existing debt. With a go forward Net Debt / EBITDA target of 2x to 3x, we will be in position to return significant capital to shareholders, which is expected to be in the range of ~$400 mm to ~$450 mm post close.
3. Moving forward, Avantax will have the focus, and cost structure, to invest for growth and deliver strong Adjusted EBITDA margins, which following the transition services period, we would expect to be in the 16-18% range, assuming a more streamlined corporate structure.

This transaction will position each of our businesses to operate from a position of strength, after both turned in peak performances this year across the most critical KPIs.

To focus on Avantax given it will be the go-forward company, through the first nine months of this year, it has delivered record breaking results across the following metrics:

1. $1.3 billion in newly recruited assets on a year-to-date basis, is ~$329 million more than our record performance in all of 2021.
2. $380 million in Q3 positive net flows, our highest result since Q1 2018
3. ~$810 million in YTD positive net flows, the highest since at least 2015 when we acquired HD Vest
4. A 99%+ average quarterly production retention rate year to date, considered best in class in the industry.
5. Advisory assets representing 48.8% of overall assets with 10 straight quarters of upward movement.

With this strong foundation in place, we project Avantax to grow revenue annually in the 8.5 to 11% range over the medium term with an assumption of the market growing at 4% and additional growth drivers of newly recruited assets, net growth on existing assets and lastly high value mix shifts toward Advisory and our RIA business rounding out our growth algorithm.

As stated earlier, our profitability expectations of 16-18% Adjusted EBITDA margins for the go forward company, are grounded in a streamlined corporate structure, the current interest rate environment and our ability to focus our attention on growing Avantax in an efficient and scalable manner. The TSA period is likely to last between 6-9 months, after which we would expect the new margin profile to begin to take hold.

With that, let me now turn it back to Chris to discuss our third quarter results.

CHRIS WALTERS, CHIEF EXECUTIVE OFFICER

Thanks, Marc. Now, I'll highlight our third quarter results, beginning with our tax software segment.

Tax

As we have mentioned before, our plan to drive TaxAct to profitable, sustainable long-term growth has been built on a base of unit growth fueled by new customer acquisition and customer retention; enabling market share gains combined with higher ARPU through delivering more value to customers.

Now that we are past the October tax extension window, and with the overall positive third peak performance, we have better visibility across the entirety of the tax season. The DIY market has performed in-line with expectations for the 2nd half of the year, we have maintained our market share gains and our forecast for the balance of the year has us coming in slightly higher on revenue and stable at the mid-point of our segment income guidance.

With TY 21 now largely behind us, the TaxAct team will shift their efforts to fully prepare for the upcoming tax season. This season, the team will focus on a few key areas:

- Investing in tools and technologies to further improve the efficiency of our industry-leading customer care and tax expert teams
- Enhancing our products including an improved mobile offering for consumers and enhanced data import capabilities and forms coverage for Tax Pros
- Continuing to scale our partnership efforts and refine our marketing approach to acquire new customers

Overall, we had a strong season despite the headwind of market declines. We met or exceeded most operating metrics. We accelerated top-line growth, gained market share ahead of schedule, increased ARPU by utilizing bundling of various products and enhanced our value proposition by providing free access to experts.

I am confident that TaxAct will carry this momentum into next season and continue to deliver the best full-featured value software and exceptional customer care in the market.

Now, turning to our Wealth Management business.

Wealth

As has been the case over the past several quarters, underperformance in the equity markets negatively impacted advisor-driven revenue as assets associated with equities have declined with the market. However, this was partially offset by an increase in cash sweep revenue driven by the portion of assets held in cash and increased interest rates. In addition, we saw lower payouts for Financial Professionals due to decreased market levels. Beyond these financial metrics, we have continued to reach new heights across a range of our most important key indicators.

First, our Net Positive Flows. For the 3rd straight quarter, we have seen net positive asset flows. In Q3 we had $380M in net new assets, the highest since Q1 2018. Our year-to-date net flows have now topped $810M.

Second, recruiting. We also continued to successfully recruit Financial Professionals away from larger firms with over $200M in newly recruited assets this quarter and have a great pipeline for the remainder of the year.

Third, firm acquisitions and succession plans. This quarter we closed 4 acquisitions in our RIA business, totaling 20 acquisitions since we began the program.

Fourth, on Financial Professionals attrition we had fewer departures than anticipated, and this combined with recruited Financial Professionals, allowed us to virtually stay flat quarter over quarter. Of the financial professionals who departed during the quarter, about 81% were non-producing Financial Professionals with less than $50K in rolling gross production.

Finally, our Production Retention Rate. We maintained our consistently high production retention rate coming in at 98.6% for the quarter.

Now, I'll turn it over to Marc and we'll be happy to answer any questions after the prepared remarks.

Marc Mehlman, CHIEF FINANCIAL OFFICER

Thank you, Chris. I will provide some additional detail on our third quarter results and our outlook for the remainder of the year.

Starting with third quarter results:

1. Total revenue of $171.7 million, a decrease of 1% versus the third quarter of the prior year. Total revenue was driven primarily by the Wealth Management business.
2. GAAP net loss of $21.8M or a loss of $0.46 per diluted share which are 21% and 20% better than prior year respectively

Adjusted EBITDA, which excludes certain other factors, was $7.7 million, meaningfully better than the prior year 3rd quarter figure loss of $0.8M.

Non-GAAP net loss of $9.8 million, or a loss of $0.20 per diluted share, both 23% better than prior year.

Tax Software

Turning now to the Tax Software segment.

Tax Software segment revenue for the third quarter was $6.7 million, a $1.6M improvement versus prior year, driven by greater extensions volume versus prior year. We expect this trend to continue into the fourth quarter resulting in a slight improvement at the mid-point for TaxAct full-year revenue.

Segment operating loss was $12.5 million, better than the prior year by $1.3M, driven primarily by the improved revenue performance.

Wealth Management

Moving on to wealth management. Third quarter reported wealth management segment revenue was $165 million, up 1% sequentially despite a meaningfully lower asset base on which we billed for Advisory Assets, offset by the impact of the rising interest rate environment. Transaction-based commission revenues were flat quarter-over-quarter, coming in at $17.9M.

On a year-over-year basis, total third quarter wealth management revenue was down 2%.

Wealth management segment operating income came in at $27.6 million for the third quarter, up 74% sequentially, driven by the rising interest rate environment and up 41% versus the third quarter of the prior year.

Segment operating expenses were down $9.4 million sequentially and $12.2 million year over year. Changes in operating expenses included declines in cost of revenue, which is highly variable and dependent on changes in advisory and commission revenue, of $8.2 million and $15.1 million, respectively. On a year over year basis, our other operating expenses increased at a lower rate than compared to the first and second quarters of the year, as the investments made in the second half of 2021 began to normalize.

We saw net inflows in advisory assets of $514 million with total client assets having net inflows of $380 million, the third straight quarter of driving positive net flows for both advisory and total assets. Our year-to-date net flows of $810M is the highest value since at least 2015.

Newly recruited assets continued to be another bright spot for the business. In the third quarter we added another $214 million of total client assets bringing the year-to-date total to $1.3 billion.

Total client assets decreased 16% year-over-year to $72.6 billion, reflecting broader market declines, partially offset by successful recruiting efforts. Fee-based advisory assets were down 11% year-over-year to $35.4 billion with advisory assets as a percentage of total client assets ending the quarter at 48.8%, an increase of 80bp versus last quarter and up ~290bp versus Q3 2021.

Liquidity

We ended the quarter with cash and cash equivalents of $91.1 million, and net debt of $434.3 million. Our reported net leverage ratio at the end of the quarter was 3.3x. In the quarter we paid down $35 million in our term loan balance as well as paid the final installment of the earn-out related to the HKFS acquisition in the amount of $23 million.

2022 Full Year Outlook

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

For the full year, we expect our tax software segment revenue of between $249 million to $250 million and segment income of $89 million to $91 million. For our wealth management segment, we now expect full year revenue of between $660 million to $665 million, with segment income of $93 million to $95 million, reflecting an uptick in more profitable sweep income. This translates to a consolidated full year outlook of revenue of between $909 million and $915 million, adjusted EBITDA of $152 million to $156.5 million, GAAP net income attributable to Blucora of $36 million to $41 million or $0.73 to $0.83 per diluted share and non-GAAP net income of $86 million to $90.5 million or $1.75 to $1.84 per diluted share. This outlook includes $30.0 million to $29.5 million in corporate unallocated expense.

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 $120-$150 million in 2023. While market levels are down somewhat from end of Q2 and commission revenues continue to show weakness, we estimate that an improved outlook for rates at 4%+ by year end would now have us delivering ~$135 million of segment income at an S&P level of 3,000, which is another 16% decline from the S&P close as of September 30th, and upwards of $170 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?

CHRIS WALTERS, CHIEF EXECUTIVE OFFICER

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