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# Blucora Q2 2016 Management's Prepared Remarks

The following is Blucora management's prepared remarks on a conference call Thursday, July 28, 2016 at 5:30 a.m. PT / 8:30 a.m. ET to discuss Blucora's second quarter 2016 financial results. This webcast can be accessed within the Investor Relations section of the Blucora corporate website at www.blucora.com.

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**FORWARD LOOKING STATEMENT - STACY YBARRA, VICE PRESIDENT INVESTOR RELATIONS**

Good morning, and welcome to Blucora's investor conference call to discuss second quarter 2016 earnings.

Before we begin, I'd like to remind you that during the course of this call, Blucrora representatives will make forward-looking statements, including but not limited to statements regarding Blucora's expectations about its products and services, outlook for the future of our business and growth initiatives, and anticipated financial performance for 2016.

Other statements that refer to our beliefs, plans, expectations or intentions - which may be made in response to questions - are also forward-looking statements for purposes of the safe harbor provided by the Private Securities Litigation Reform Act. Because these statements pertain to future events, they are subject to various risks and uncertainties, and actual results could differ materially from our current expectations and beliefs. Factors that could cause or contribute to such differences include, but are not limited to, the risks and other factors discussed in Blucora's most recent Quarterly Report on Form 10-Q on file with the Securities and Exchange Commission. Blucora assumes no obligation to update any forward-looking statement, which speak only as of the date the statement is made.

In addition, during this call, our management will discuss GAAP and non-GAAP financial measures. In the press release, which has been posted on our website and filed with the SEC on Form 8-K, we present GAAP and non-GAAP results along with reconciliation tables, and the reasons for our presentation of non-GAAP information.

We have also provided supplemental financial information to our results in the investor relations section of our corporate website at www.blucora.com and filed with the SEC on Form 8-K. Now, I'll turn the call over to John Clendening. Following his comments, Eric Emans will review second quarter results and full year outlook. Then we'll open up the call to your questions.

**JOHN CLENDENING, PRESIDENT AND CHIEF EXECUTIVE OFFICER**

Thank you, Stacy. Good morning everyone, and thank you for joining our call today.

I would like to begin by simply expressing my appreciation to the entire Blucora team, our customers and our shareowners, for their support as I lead Blucora through our transformation to a strong and growing technology-enabled financial solutions company. After a little over 100 days as CEO, I am pleased to provide an update on the exciting and positive changes going on at our Company and my views on how we will create long term value.

When I first joined Blucora in April of this year, I knew the company had significant potential. Over the last few months, I have had the opportunity to watch our business evolve and to see the hard work of our teams begin to affect positive change across our operations. I have been consistently impressed with the efforts of our people, who are fully focused on delivering great value to our customers, clients and advisors. It's exciting to be a part of a company that is so committed to doing everything possible to assist those that depend upon us in the markets we serve.

As we transform Blucora our commitment to our shareholders is to deliver reliable financial performance that generates attractive returns. The full team is focused on this commitment. In these updates, you can expect me to share a balanced perspective on the company, both in terms of what's working well along with challenges we need to overcome to meet that commitment.

Last quarter, I shared our near term focus on the four Ds - Divest, De-lever, Deliver and Drive. Each D represents an element of our action plan to reconfigure our capabilities and create a more streamlined, effective and efficient business model that delivers near term performance while positioning the firm to capture long term growth opportunities. Today, I'll report on the progress we have made on these elements.

As I discussed during our first quarter earnings call, we reaffirmed our commitment to ***divest*** our Infospace and Monoprice businesses. Since then, we have made substantial headway on these efforts, having earlier this month announced a definitive agreement to sell Infospace to OpenMail for $45 million. This transaction, which we expect to complete in the coming weeks, marks an important step in our transition and will enable us to monetize a non-core asset to pay down debt and reduce our operating expenses.

Additionally, we are focused on the sale of our Monoprice business and, although the process is taking longer than we had hoped, the process is competitive with multiple parties interested and actively conducting due diligence. We are optimistic that we will enter into a transaction in the coming months.

Second, we remain focused on our efforts to ***de-lever*** our business by paying down debt, and are well on our way to achieving our goal of a 3x net leverage ratio. During the second quarter, we retired $20 million of debt, bringing our total debt reduction for the first half of the year to $88 million. Our ability to quickly and consistently de-lever demonstrates our strong cash flow generation capabilities at both businesses. Looking to the third quarter, we expect to pay down more than $40 million in debt with the net proceeds we will receive from the sale of Infospace. In addition, by de-levering we will be able to better tap into the benefits of our substantial NOLs.

Third, we ***delivered*** strong growth in Adjusted EBITDA, up 36% over prior year and within our expectations. This growth was fueled by very strong performance from TaxAct, counterbalanced by shortfalls versus our revenue expectations at HD Vest. I want to spend a few moments discussing our results in more detail while sharing context on the operating environment.

**Starting with Tax Preparation**

TaxAct completed this year's tax season in the second quarter and delivered another strong performance with revenue and segment income up 18 percent and 21 percent for the full season.

This was an important year for TaxAct, as we successfully pivoted our strategy to one focused on driving profitable share growth. The changes we made to our go-to-market strategy better position the business for long-term growth. One key reason for this is our price points now align to those of the volumetric leaders, enabling consumers to see our substantial price-value advantage. From a market perspective, we were pleased to see the DDIY category grow overall and view the enlarged pool of DDIY filers as a future opportunity for TaxAct.

Before I move on to Wealth Management, I want to take a moment to thank JoAnn Kintzel for her valuable contributions in building TaxAct into the successful business it is today. Earlier this month we announced that she will be stepping down as president of TaxAct once a successor is named. Thanks in large part to JoAnn's leadership over the last five years, TaxAct is in a strong position to take advantage of the significant opportunities ahead for the business.

**Turning now to Wealth Management**

Revenue performed below our expectations at $76.1 million down 6% compared to the prior year. Segment income came in within guidance at $9.9 million, but was down 7%. Now, let me share more insight into the revenue shortfall.

Advisor-driven revenues were down year-on-year in each primary area of fee-based, trailers and transactional. Transactional revenue is the largest driver and was also down sequentially. Here, we are seeing two developments.

1) In June we experienced an unforeseen decline in new investments in variable annuities. While the product line has historically exhibited variability, the dip in June was unusually large and centered on smaller average investment amounts. As you can imagine we are watching this extremely closely. For July, new investments have rebounded versus June, but early indications suggest we will continue to lag prior year. This challenge seems to be industry-wide as the market has been in decline from its cyclical peak in mid-2011. Our internal analysis also indicates that variable annuity demand we'd normally experience post-tax season was pulled into Q4 2015 and Q1 of this year, driven by the launch of a new sales automation tool that accelerated the closing of business, as well as a unique situation created by the buyout of a well-adopted annuity, by a large insurance company.

2) Compounding the softness in new investments, we also experienced declines in commission *rates*. Here, the product mix has gradually moved toward product options with lower upfront fees but with higher trailing commissions paid out over time. This is reducing our short term revenue in exchange for higher annuitized revenue. Generally, we like this trend as it moves toward more recurring revenue; however, it has been and will continue to be, a headwind. The good news is this is a gradual shift and we should begin to see some relief as trailer commissions typically kick-in one year after the initial investment.

In addition, we have seen softness in fee-based net flows which is affecting revenue performance. Given the continuance of a largely sideways market since early 2015, combined with greater market volatility, advisors are finding it more difficult to convert clients into and retain them in, a professionally managed, fee-based arrangement. Simply put, well-diversified portfolios have not delivered strong absolute returns, resulting in sluggish net new flows. Global uncertainties and macro-economic issues have not helped as these also weigh heavily on many investors, and have consumed advisor bandwidth on “hand holding” versus business development.

Lastly, given market volatility and uncertainty, we reevaluated our assumptions for the rest of the year and are revising our outlook to assume a flat equity market and no Fed Funds rate increases. As a result of these, we are lowering our full year guidance and Eric will share more details in his prepared remarks. Now, given the financial model of the business, we expect to achieve solid annual segment margin for HD Vest around 14% for the year.

Bigger picture, while we are disappointed with the revenue performance this quarter at HD Vest we believe in the attractive potential of this business. Net, the headwinds we face have become more clear, we are committed to taking the steps necessary to fight through these challenges, and we are focused on near-term execution to begin to regain momentum.

One such execution focus is making it simpler to process annuities by simplifying and streamlining operations. We know that making it easier to do business with us drives greater advisor productivity and product usage, and should enable us take advantage of second half opportunities, including end of year tax planning season.

A second key execution focus is helping our advisors better engage with clients. In June, we hosted our annual national conference in Washington DC with record attendance. A major focus of the conference was on recently developed tools that advisors can use to build their businesses regardless of the operating environment.

Usage of these technology-enabled tools drives growth in assets and high quality revenue, and we are delighted to see this usage increase. We are especially pleased with the adoption of VestVision®, our retirement planning tool facilitating client-personalized plans, which grew 22 percent versus the second quarter 2015. And, June was the strongest month of plan creation in VestVision® since its launch in 2014. Importantly, it was also the broadest month of plan creation as measured by unique advisor use. We anticipate continued growth in the use of planning tools as advisors seek to better meet client needs as well as look ahead to the fiduciary duties with respect to the new DOL rules. This adoption is important as advisors who work with clients on the basis of a plan drive more assets and create monetization through increases in fee-based relationships. It’s a “win” for clients too as they benefit – over time – from being in a well-diversified portfolio managed by a professional acting as a fiduciary.

A brief comment on DOL. As we continue to evaluate the new DOL rules, we believe we have an effective investment advisory platform which will be available to satisfy the DOL requirements. We also continue to educate our advisors and encourage them to get their advisory licenses. Thus far in 2016, we are pacing ahead of last year’s record number of new advisory licenses obtained. That said, we are still assessing the impacts of the DOL and will be sharing more details in the near future.

Finally, to our fourth D - our teams remain focused on ***driving*** long term growth. We have a path to creating a more streamlined business and, opportunities to create shareholder value. I'd like to share my current thoughts with the benefit now of being on the job for nearly four months.

**Tax Preparation.** I like the hand we are playing in this business. The largest competitor in the digital do-it-yourself space is growing the category by attacking the outdated and low-value storefront model. For those that prefer or are considering DDIY, TaxAct offers incredible value. Right now, most people that are filing with larger players could come over to TaxAct, get a great experience and pay a lot less. And, the largest player churns more filers annually than we currently serve in a given season. So, we foresee substantial opportunities to drive growth through:

1. Sharpening our differentiation versus competitors;
2. Getting the credit we deserve for our superior price-value;
3. Tightening our marketing focus, while better utilizing data;
4. Improving the client experience, which will be an ongoing focus.
5. Additionally, we continue to be well positioned to grow in areas outside of the U.S. consumer tax business including professional, small business and international. We have only begun to scratch the surface of these opportunities.

**Wealth Management.** Our long view on HD Vest continues to be positive as well. I like businesses in this space that feature:

1. Revenue streams that are migrating toward more fee-based and recurring revenue;
2. Value to clients through a quality, trusted relationship;
3. Where there is upside overtime associated with the increased valuation of publicly traded securities;
4. That offer greater revenue as interest rates rise, with strong flow-through to the bottom line;
5. Where there is upside to key levers that drive long term value creation.

HD Vest checks the box in all five of these areas. So, while it's clear the IBD sector faces a number of challenges, I believe HD Vest will be the one to beat in the IBD space. This is not just because of the aforementioned, but because in addition we offer a better mousetrap. Our "grow your own" approach to adding new advisors creates a significant net revenue advantage versus others in the sector and there is real value added for the client. It's better for investors to work with an advisor who has an eye on tax alpha because you simply can't assume away tax implications and properly advise a client on their investments. Yet it's the very thing that the majority of wealth mangers and brokers do.

Regarding the 5$^{th}$ point around value-producing metrics, we continue to see significant opportunity in each key value lever including:

- Increasing the number of advisors in our network. We currently have 4600 advisors out of an addressable market of approximately 250,000.

- Increasing the breadth of wealth management inside of tax provider practices. Today, our advisors average about 25% penetration among their tax client base.
- And, increasing the depth of penetration of their wealth management clients by gaining greater wallet share and increased adoption of fee-based solutions.

Additionally, these two businesses make sense together. There is an opportunity to tap into TaxAct's 20,000 professional customers who are not yet HD Vest advisors and to better serve TaxAct's 5 million consumer tax filers by leveraging HD Vest capabilities to offer wealth management services.

Supporting these strategic initiatives is our new operating model, which is centered on the idea of Blucora as "one company." We are in the process of transitioning from a portfolio holding company operating model with separate operations to a more unified and collaborative structure. Inherent in this is a shift in the role of corporate functions from adding value through M&A to being directly accountable to help the business units grow profitably. Moving to this model will help us attract the right talent to build our team and create a more flexible, nimble Blucora.

I am committed to building the best team in the business – the one everyone wants to be on. Inevitably, there will be some new folks brought in overtime in order to meet this commitment. While we are undergoing positive change at Blucora, I believe we are laying the foundation for long term growth and value creation.

With that, I would like to turn over to Eric Emans to discuss our financial performance over the past quarter,

**ERIC EMANS, CHIEF FINANCIAL OFFICER**
Thanks, John.

Today I will cover second quarter results and then provide third quarter outlook and update our full year outlook.

Our consolidated results and year-on-year pro forma growth for the second quarter are as follows:

- Revenue of $120.1 million up 7%,
- Adjusted EBITDA of $35.3 million up 36%, reflecting year-on-year segment income growth of 30%, and,
- Non-GAAP net income of $23.4 million up 61% and EPS of $0.55 per diluted share

GAAP net loss for the second quarter was $14.4 million or a $0.34 cent loss per share and reflects impairment charges associated with our discontinued operations.

Turning to the balance sheet, we have cash, cash equivalents and short-term investments of $82.1 million. As John mentioned, we paid down $20 million of term loan B, bringing our net debt down to $437.2 million. Net leverage exiting the quarter was 4.5 times, down from 5.2 times as of March 31, 2016. In the third quarter we expect to utilize 100% of the net proceeds from the

Infospace divesture to further pay down debt as we remain focused on reaching our net leverage goal of 3 times in 2017.

**Shifting to segment performance, starting with Tax Preparation**

Second quarter revenue was $44.0 million and segment income was $29.8 million. For the first half of 2016, which encompasses the entire tax season, revenue was $132.5 million up approximately 18% versus the first half of 2015, and segment income was $77.4 million up approximately 21%. Segment margin for the first half of 2016 was 58.4%.

As we discussed during our first quarter call, we pivoted our offering this year to better position us for future growth and we are pleased with the performance and future potential of the business. In the back half of the year we are making investments in technology and marketing to help set up the business for a successful 2016 tax year and beyond. We are gearing up this off season, focusing on revitalizing our value leadership position in consumer DIY. We look forward to sharing more on our 2017 outlook in the coming months.

Closing out on 2016 we expect full year revenue of $137.5 to $138.5 million and segment margin in the 47 to mid-47 percent range which reflects increased investment as we spend back a portion of 2015 tax season over-performance. Second half 2016 revenue will be slightly weighted toward fourth quarter as will segment loss as we begin to ramp up our investment leading into tax season.

**Transitioning to Wealth Management**

Second quarter revenue was $76.1 million, down 6 percent versus prior year and below our expectations for the quarter. As John mentioned, the revenue miss was largely driven by an unforeseen decline in the back half of the quarter in our variable annuity transaction revenue. To provide some context, June variable annuity investment volumes were down over 35% versus June 2015. This coupled with declines in commission rates as advisors have gradually shifted toward product options with lesser upfront fees, has pressured transaction revenue in the quarter. John noted, that thus far in July volumes have bounced back on a sequential basis and we are also seeing commission rates holding steady sequentially and are up year-on-year.

Touching quickly on assets, advisory AUM grew 2% sequentially versus the first quarter 2016 but was down 1 percent versus the second quarter 2015. Advisory net flows were up $11 million as advisors continue to battle client sentiment driven by volatile market swings. Total AUA was also up 2% sequentially driven entirely by market.

Segment income for the second quarter was $9.9 million, down 7 percent year-on-year and consistent with our outlook as the team managed costs to offset revenue shortfalls.

Turning to the third quarter and full year 2016, we have reset our advisor driven revenue outlook acknowledging the headwinds the business is facing. Our revised expectations take into account the following factors:

- Second quarter performance versus the second quarter outlook,

- Transaction revenue rate and volume variability, and
- Market volatility

As it relates to market volatility, we have removed all market related upside from our 2016 outlook. We are holding the S&P 500 flat thru the end of the year and have also assumed no fed fund rate increases for the remainder of the year. Our previous outlook range had included S&P 500 appreciation in the back half of the year and one fed rate increase. As a reminder, a 25bps increase is approximately $500 to $600 thousand of revenue and segment income per quarter. Lastly, given environmental considerations, we have adjusted down our net flow expectations for AUA and AUM for the remainder of the year.

Our third quarter outlook for wealth management is revenue of $74.6 million to $78.0 million at a segment margin range of mid-12 to mid-13 percent. For the full year we expect wealth management revenue of $303.0 to $313.0 million at a segment margin range of mid-13 to low-14 percent.

**Finishing up second quarter performance with unallocated corporate operating expense**

Second quarter expense was $4.5 million, down 4 percent from the prior year. This included approximately $900 thousand in non-recurring costs including a severance charge of approximately $400 thousand.

As we think about the rest of the year we are increasing our full year corporate cost expectations to a range of $19.5 to $19.8 million. This increase is primarily the result of increased second quarter severance costs, legal fees associated with ongoing and potential litigation matters and recruiting related expenses. The key takeaway is our run rate expenses are in line with our expectations and we have a path to our $12 million annual run rate goal in the first half of 2017. However, there are likely to be some one-time costs to achieve the reduction in run rate, and we will share these once they become more clear.

For the third quarter we expect unallocated operating expenses of $5.2 to $5.4 million.

**With that let's turn to consolidated outlook for the third quarter and an update to our full year outlook**

For the third quarter we can expect revenue between $77.0 and $81.0 million, adjusted EBITDA between a negative of $2.3 million and negative $200 thousand, non-GAAP net loss from continuing operations of $15.0 to $12.6 million or a $0.36 to $0.30 cent loss per share and GAAP loss from continuing operations of $16.2 to $14.8 million or a $0.39 to $0.36 cent loss per share.

For the full year, we are lowering our outlook as follows – we expect revenue between $440.5 and $451.5 million, adjusted EBITDA between $85.8 to $90.5 million, non-GAAP net income from continuing operations of $35.8 to $40.9 million or $0.84 to $0.96 cents per diluted share and GAAP loss from continuing operations of $5.5 to $2.0 million or a $0.13 to $0.05 cent loss per share.

To reiterate, our lowering of our full year revenue outlook is driven by headwinds in our wealth management segment which captures both increased variability in our transaction revenue trends, evidenced by the second quarter revenue softness, and environmental factors associated with increased market volatility.

Full year outlook for adjusted EBITDA and Non-GAAP net income have been lowered to reflect gross profit decline associated with the lowering of wealth management revenue as well as an increase in non-recurring unallocated corporate expenses.

With that, let me turn the call back over to John for his closing remarks.

**JOHN CLENDENING, PRESIDENT AND CHIEF EXECUTIVE OFFICER**
Thanks, Eric.

In my short time with the Company, we have made substantial progress towards our transformation objectives. Our focus on the four D's is already beginning to yield results and we are excited about the future of the new Blucora.