

Blucora, Inc. (BCOR): Long

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<p>Important Company Financial Data</p> <p>Share Price: 14.71 Market Cap: 600.96M 52-week Range: 9.5-18.63 EPS: 14.65 Beta: 0.94 EV/EBITDA: 7.19 EBITDA Margin: 25.41% FCF/NI Conversion: 116.05%</p>	<p>Company Description</p> <p>Blucora changed company's name from Infospace on June 7, 2012 after its acquisition of TaxACT in January 2012. Blucora operates two leading Internet businesses—InfoSpace and TaxACT. InfoSpace provides online search and monetization solutions to a network of over 100 global partners While TaxACT provides online tax preparation solutions to consumers and professional preparers.</p>
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<p>Thesis / Key Points</p> <ul style="list-style-type: none"> ➤ Strong and stable search segment ensures constant growth of Blucora <p>Blucora search segment, known as Infospace, generates revenue by combining Yahoo! & Google's results and presenting them in a format that distribution partners needed (toolbar or entire portal) and takes cuts and charges fees. This segment generates 73% of Blucora's revenue and performs great in the past few years (Exhibit 2) with 62% growth in Q3 2012 compared to 2011.</p> <ul style="list-style-type: none"> • Huge market opportunities bring Blucora numerous new customers and create revenues. <ul style="list-style-type: none"> - The search market is growing 15% to 20% annually and opportunities for distributed search is expanding really rapidly for the past few quarters as we can see increase rate for distribution revenue became faster and percentage of it increase (Exhibit 3). - This change is because of the trend of demanding individualized search results and increasing diverse ways that people access search such as social platform and mobile devices. - Another trend was Blucora did a great job attracting new customers, which implied huge growth potentials. While revenue from existing customers increase at 4% CAGR, Revenue from new customers increase at 13% and the portion will double in a year. (E4) <ul style="list-style-type: none"> • New and potential search results suppliers bring prominent and oversea opportunities. - Blucora just added Yandex to its list of search results. Yandex is the largest Russian search engine with over 62% market share. This diversified Blucora's results provided and attracted more customers. We saw an 84% revenue growth internationally in 2010 because Infospace (there was no Blucora at that time) launched an auction website focusing on European Market. - From my VAR with Zheng who worked in executive board both in Sina and Baidu before—two biggest search engine in China, Blucora already showed interests in partnering with Baidu to further diversify their search result. This is huge is if really happen! <ul style="list-style-type: none"> • No direct competition with Google and Yahoo! - Many people think Google & Yahoo are huge competitors with Blucora, which is not true. When paid Ads are clicked from Blucora's customers' websites, both Google and Blucora get cut. Google & Yahoo can also increase their traffic from Blucora. - Google does not bother to get into Blucora's market and resell its results. Since Blucora adds value to the results by tailoring and providing toolbars & portals, it captures revenue from small companies who are not big enough to talk to Google directly. - Since a lot of people see Blucora as Google's competitor, Blucora is useful to Google from a regulatory perspective to avoid monopoly, so Google would like to see Blucora take some cuts and therefore more likely to have longer agreement with Blucora. <ul style="list-style-type: none"> • Blucora already partnered with Google & Yahoo for more than 10 years, which is really stable. And Blucora just renewed its agreement with Google and Yahoo to 2014, which reduce the risk for search segment to minimal. The difficulty to get another agreement with either Google or Yahoo creates a high barrier to entre this market for potential competitors. ➤ The successful acquisition of TaxAct brings diversification and huge profitability to Blucora <p>Blucora acquired TaxACT in January 2012 with only 287.5 M. This is such a great deal since EV/ EBITDA was only 3.7, which were extremely low compared to its profitability. TaxACT did amazing job in 2012 tax season and boost Blucora's financials (Exhibit 5).</p> <ul style="list-style-type: none"> • TaxAct played majorly in online tax preparation market. There is a tendency among taxpayer to use DIY software or services to fill tax, and Online filling is the fastest growths segment in DIY with huge potentials as well. (Exhibit 8&9). • High cost efficiency enables TaxAct stand out from its competitors. <ul style="list-style-type: none"> - TaxACT has the lowest price among competitors. \$10 for all the fillings is affordable for most households. (Exhibit 7). - The filling results of TaxACT is as accurate as TurboTax but with lower price according to tax experts. Because of its neat algorithms and source codes, IRS bought part of TaxACT's codes for training use (Uva CASH program is part of it) (VAR). - TaxACT has really attractive EBITDA margin around 50%. The reason for this is TaxACT mainly focus on Online tax filling, which is much less labor-intensive than other fillings. So the cost of TaxACT is really low, which generate the high margin (Exhibit 5&11). - G&A expense decreased a lot and R&D expense decreased after a bump for the technically preparation of tax season in Q1 2012. <ul style="list-style-type: none"> • Competitor buying intention: H&R Block tried to acquire TaxACT and negotiated the price but aborted because of monopoly regulation. We can see that H&R Block saw TaxACT as a really strong competitor and wanted to eliminate it. • The reason for low price for acquiring TaxACT was that when the H&R Block' acquisition was denied in the end of 2011, Blucora gave its offer immediate with the same price and made it. But it was already two years from 2010. TaxACT has extremely strong profitability, with 27% of revenue in Blucora, it generate 52% of EBITDA (Exhibit 10). With financials like this, 3.7 multiple was definitely low when acquiring TaxACT. 80% repeating business makes TaxACT more attractive.
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- Future potential: TaxACT has 13% and 18% market share in Total tax filing and online filing market respectively, but it accounts for 28% of the Ads deployed. TaxACT is building up customer base. The margin and profit will be even higher in the future when it get larger market share and marketing expense decrease (Exhibit 12).
- **Stable business model associate with Blucora will result in long-term healthy growth and long-term profits for investors**
 - Low capital requirement and great cost management from experienced management team.
 - Both of Blucora's businesses require minimal capital and % of PPE in asset further decrease from 3% to 1.1% in a year.
 - Low capital intensity and little number of employees make cost management easier. G&A expense keeps decreasing for the past two years even when acquiring new company. R&D expense decreased constantly and only bumped before tax season (Exhibit 5)
 - Management team has experience in online investing in general; two main leaders both did online investing and IB previously. They can spend free cash efficiently and play around with NOLs. Leaders for two segments spent all their careers in that industry.
 - Strong Free Cash Flow and attractive FCF/NI Conversion
 - Blucora started to generate huge amount of cash since Q3 2011 because of cash-generating nature of TaxACT and monetization of Infospace's investments & marketing expense in previous years. The FCF/NI Conversion is approaching 180% (Exhibit 12).
 - People argued that the high conversion was out of net loss in Q32012, but the conversion is still 130% if we remove effect of loss.
 - With leaders had experience in IB and PE, Blucora has shown interests in acquiring new companies in different areas to further diversify and stabilize its business model and capturing good deals of companies that can't be acquired out of regulatory reason.
 - Tow segments compensate each other (Exhibit 13)
 - Many people argued that TaxACT's revenue is seasonal, which brings instability and uncertainty to the Blucora's performance. That's true but the good part about Blucora is that it's not just a tax preparation company. Infospace provides stable revenue and steady cash flow, which offset the seasonal problem with TaxACT. We should also notice that Infospace still generates 73% of Blucora's revenue. But the strength about TaxACT is high margin. So these two businesses compensate each other to provide both constant growth and seasonal boost. We can see this perfect combination from Exhibition 10.
- **The stock of Blucora was extremely undervalued out of lack of awareness of company's profitability and future tax deduction**
 - Blucora has really high profitability and strong growth rate. Earning will grow at 25% CAGR over the next 5 year, which is much higher than industry average 18%. With P/E ratio about 14 and EV/EBITDA only 7, the company is apparently undervalued.
 - One of the hidden favorable factors is Blucora's future tax deduction. Blucora just started earn profit since 2010 and all their NOLs before can be used to reduce future tax. With more than \$800 M NOLs, Blucora can save \$275 M of tax in next 10 years, which has \$148 M of present value using 12.5% discount rate. This \$148 M is what a lot of people missing right now. (Exhibit 15).
 - I use two ways to calculate the target price for Blucora and I conclude that the target price is about \$27. (Exhibit 16).

Misperception

- The biggest misconception is that Blucora is overvalued, which can be explained in the last thesis. The stock price dropped 17% on November 2nd after the earning release of Q3. Blucora had a net loss in Q3, which freaked investors out and the stock price dropped irrationally. Actually the net loss was due to a \$4.3 million loss on the warrant, which was just one-time loss. Blucora will definitely experience a great profit in Q4 so this drop gives MII a golden opportunity to initiate Blucora with low price.
- Many people think with the competition of Google, Infospace's future is not bright, but actually Blucora uses totally different business model as Google with high added value. This misconception also ensures Google's partnership with Blucora (Thesis 1).
- Tax preparation business is seen as unstable because of seasonal revenue. However, Infospace has steady revenue and cash flow and TaxACT has high margin, so they can offset each other's weakness and form a perfect combination (Thesis 3).
- Many people focus too much on decrease margin of TaxACT questioning its profitability. Actually TaxACT is shifting its focus from software to online service, which has lower margin out of the cost associate with maintaining the server but will generate more stable and recurring revenue. And as TaxACT building up user base, marketing expense will decrease and margin will increase.

How It Plays Out

- With increasing diversified search result and trend to mobile, Infospace will get more new customers and make more profits.
- If Infospace manages to add Baidu to its list, it will gain huge market not only in China but also Chinese related market in U.S.
- With all the preparations and marketing campaign, TaxACT will earn huge profits in the coming tax season and boost stock price.
- More households will switch from competitors to TaxACT for low prices and TaxACT will be popular in low-end tax prep market.
- TaxACT decreases marketing expenses as a result of increasing market shares and the margin will create a new high record.
- With huge amount of cash, Blucora will search for more acquisitions and the company will be more diversified and profitable.

Risks / What Signs Would Indicate We Are Wrong?

- Since the only barrier to enter Infospace's market is agreement with Google, so if some companies can get it, this will be a bad sign for Infospace.
- If TaxACT does not perform really well and increase its market share in the coming tax season as expected, investors will loss faith and stock price will fall.
- There has been only insider sells in the past three months, although small amount (E17)
- If earning does not recover in Q4, investors will further lose confidence and we should doubt if the loss in Q2 was only out of one-time loss.
- With huge amount of cash, Blucora will acquire new companies, but it's hard to find a deal as attractive as TaxACT, so if leaders make a bad acquisition, stock price will suffer.

Signposts / Follow-Up

- Emerging competitor for Infospace
- TaxACT's performance in the coming tax season and change in user base
- Price change of TaxACT's competitors
- Potential acquisitions
- Earning in Q4
- Any management team change
- Trend of insider trades.

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Exhibit 1: The Stock Chart of KITD



Exhibit 2: Good performance in search segment

Financials for Search Segment (M)

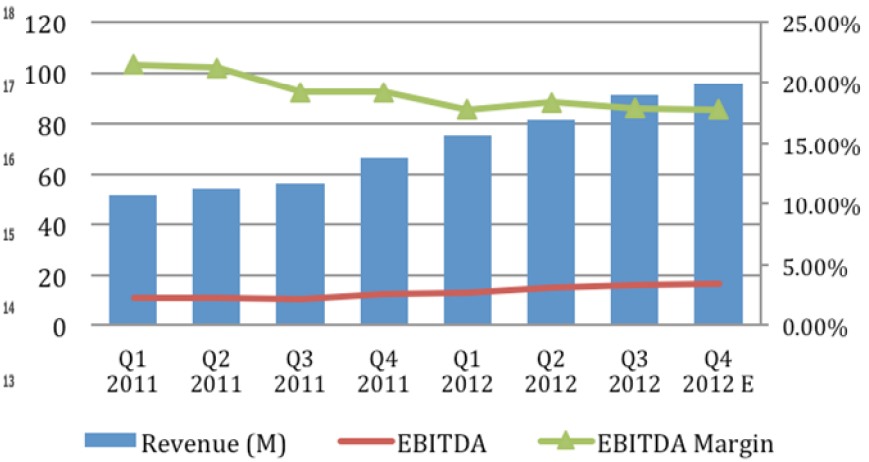


Exhibit 3: Distributing Revenue increases with faster rate and represents high % in Search Segment

Distribution Revenue in Search Segment(M)

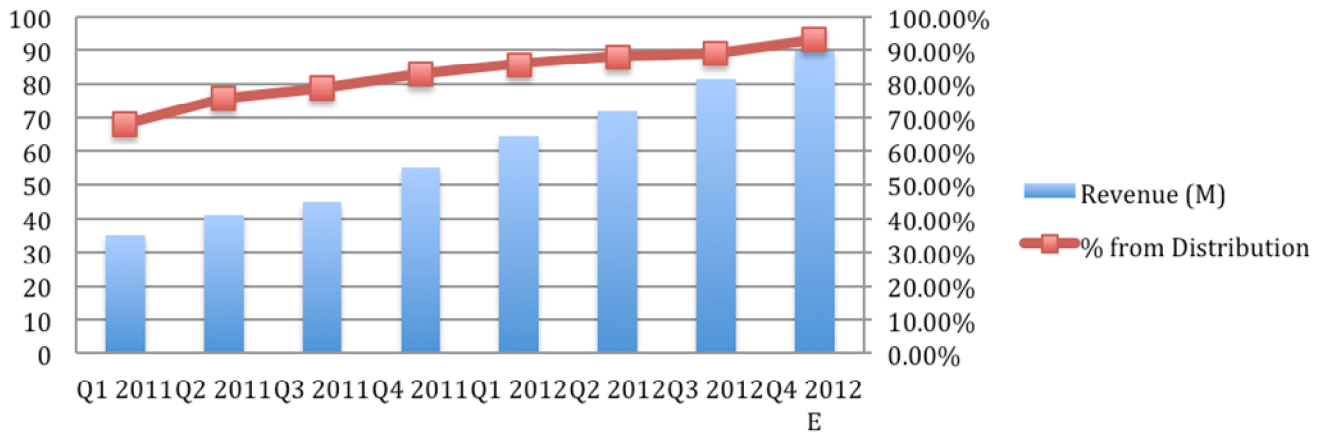
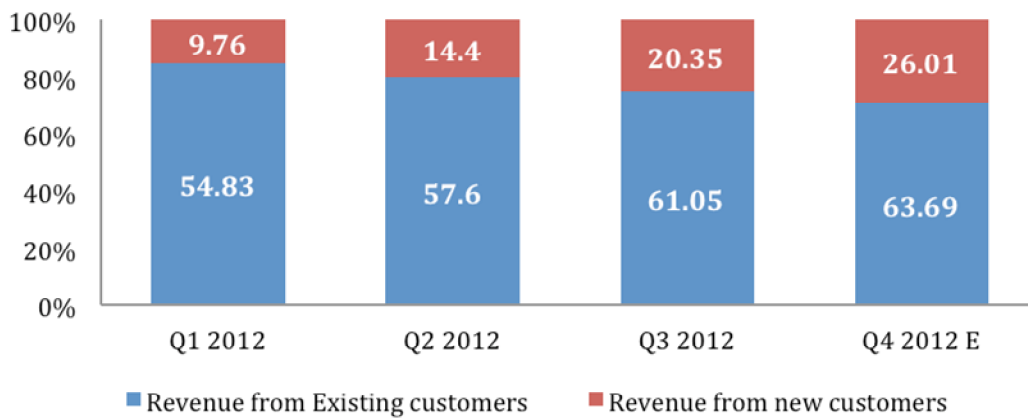


Exhibit 4: Percentage of revenue from new partners increase

% of Revenue from new customers



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Exhibit 5: Financials for Blucora was boosted in Q1 2012

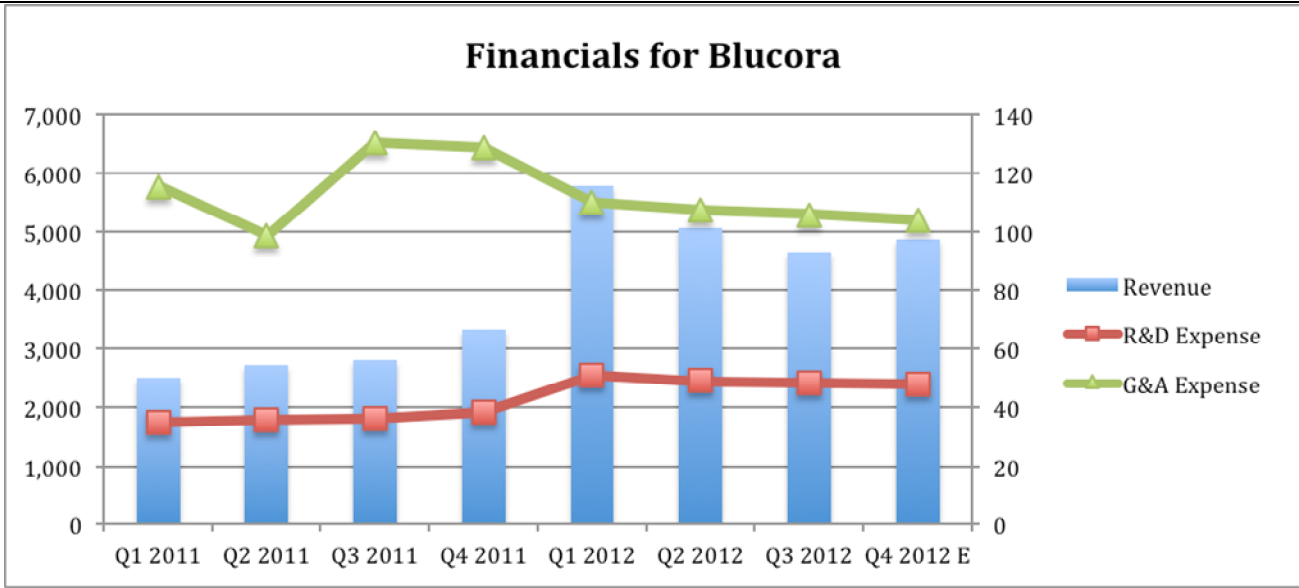
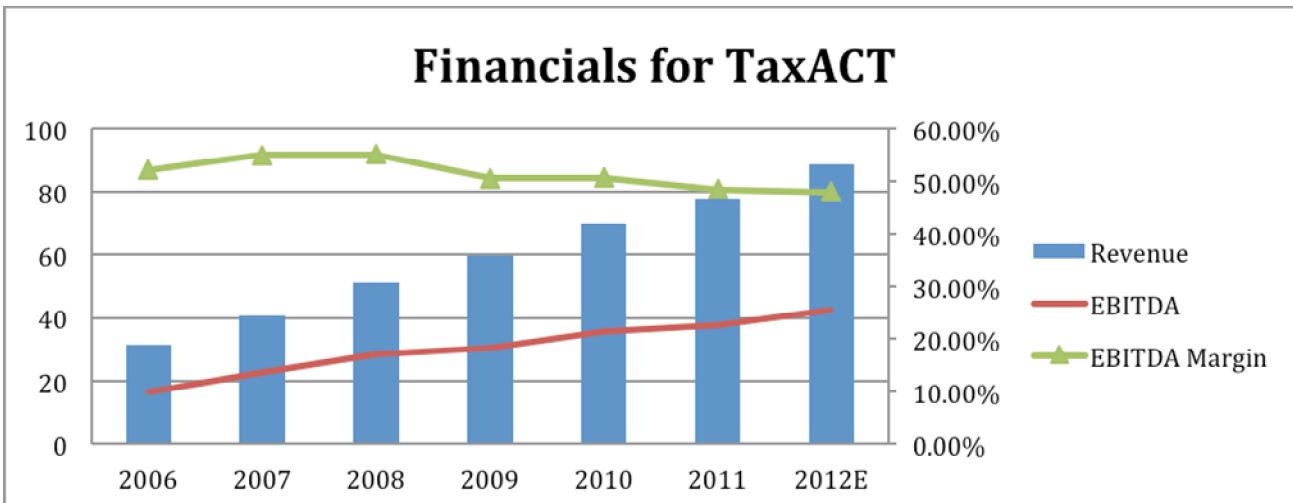


Exhibit 6: Financials for TaxACT is really promising



The reason that the margin decreased was that TaxACT is shifting to a lower margin but more stable business model.

Exhibit 7: TaxACT's price is the lowest among competitors

	Online Federal Tax Basic	Online Federal Tax Deluxe	Plus State Tax
H&R BLOCK	\$29.71	\$42.46	\$34.95
TurboTax	Free	\$49.95	\$36.95
TaxACT	Free	\$9.95	\$8
Taxbrian	\$19.95	\$39.95	\$29.95
CompleteTax	Free	\$25.46	\$25.46

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Exhibit 8: DIY portion increase in total filing

DIY Portion of Total IRS Returns

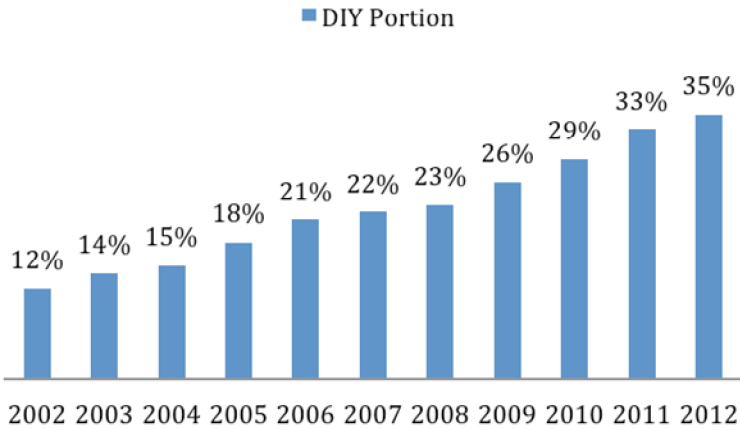


Exhibit 9: Online filling is the trend

Growth of Digital Age % of Filing Population

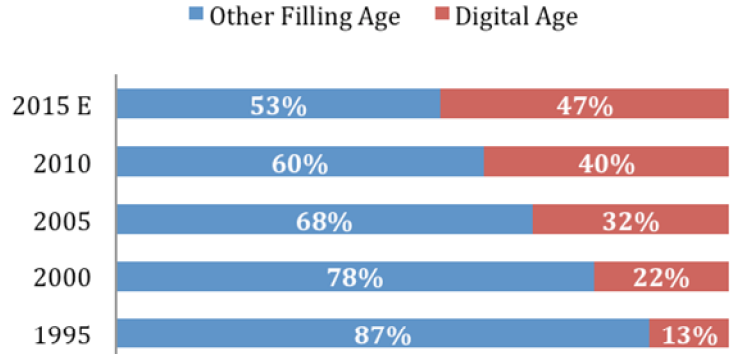


Exhibit 10: Financials breakdown of Blucora

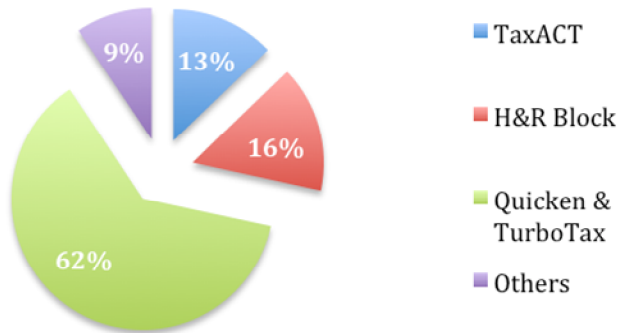
	Infospace	TaxACT
Revenue (M)	211.88 (73%)	78.09 (27%)
EBITDA	34.72(48%)	37.81(52%)
Margin	16.40%	48.40%

Exhibit 11: Employees efficiency

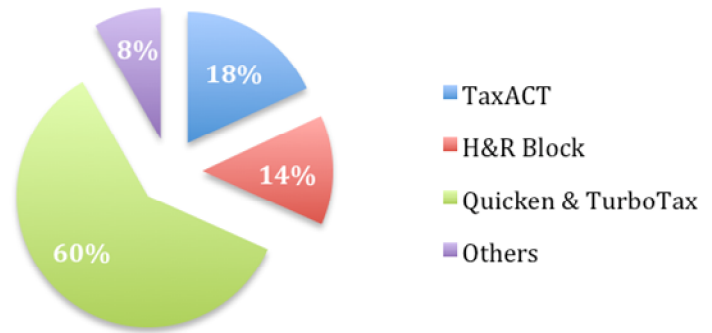
	TaxACT	H&R Block	Intuit
Number of Employees	70	137,200	8,500
Revenue (M)	406.449	2793.971	4121
Revenue per employees (M)	5.8	0.02	0.48

Exhibit 12: Market share and growth potential

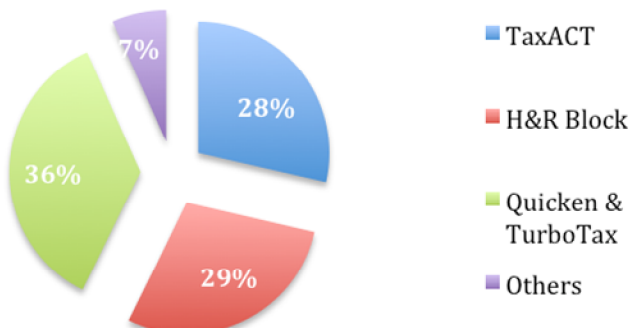
Market Share of All Tax Filing



Market Share of Online Filing



Share of Ads Displayed



1. TaxACT majorly focuses on Online filling as we can see its market share increases 5% when we only focus on Online filling rather than total filling.
 2. It's true that share for TaxACT is still low compared to its competitors but this also implies huge growth potential. It's hard for customers in filling market to switch companies because the companies have customers' info saved. But this also implies that as long as TaxACT make this change happen, it will be a permanent profits for TaxACT. That's why TaxACT is spending that much money on marking to increase market shares. TaxACT will dominate tax prep market in the future. No kidding.

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Exhibit 13: Leaders are experienced in operating and investing online

	CEO: William J. Ruckelshaus	Executive vice President: George Allen
Online Investing Experience	VP of Corporate Development for Expedia	Founder of Geronimo Capital focusing on media and tech
IB Experience	M&A Team in Credit Suisse	M&A team in Warburg Pincus, a global private equity firm

Exhibit 14: Strong Free Cash Flow and attractive FCF/NI Conversion

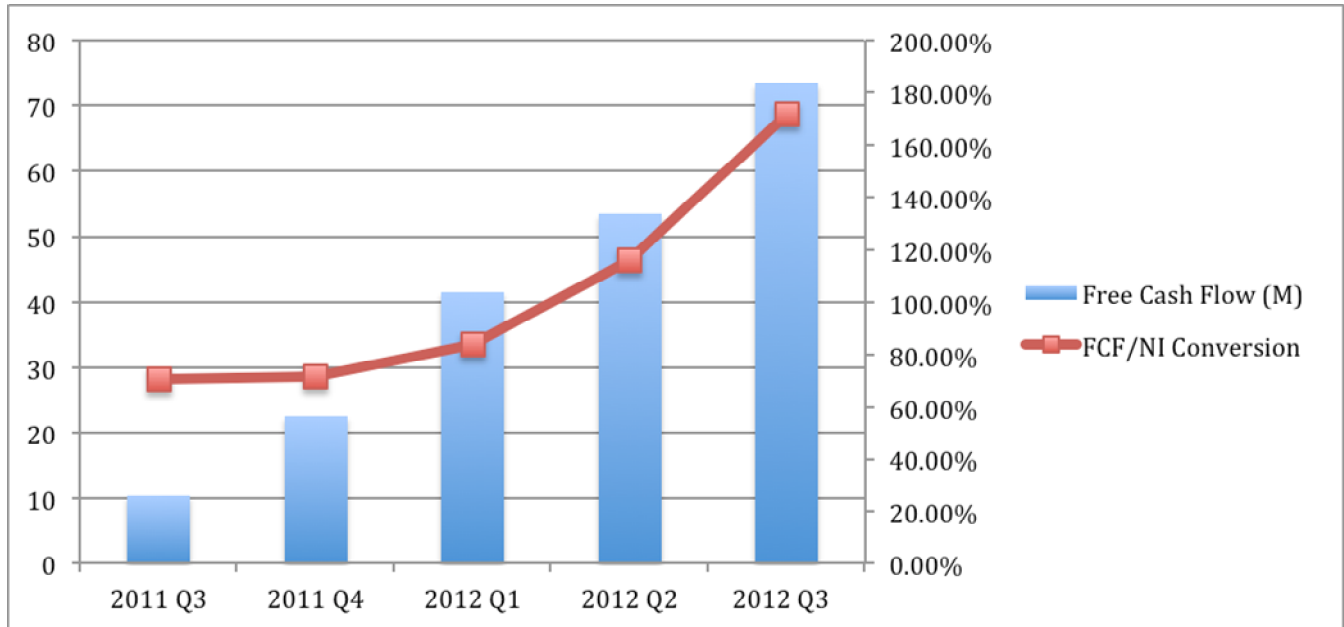


Exhibit 15: Blucora's future tax deduction

Column1	2013	2014	2015	2016	2017	2018
NOLs Used (M)	60	61.8	63.7	65.5	67.5	69.6
Tax saved (M)	24	24.7	25.5	26.2	27	27.8
DCF value (12.5% discount rate) (M)	21.3	19.5	17.9	16.4	15	13.7

2019	2020	2021	2022	TOTAL
71.6	73.8	76	78.3	687.8
28.7	29.5	30.4	31.3	275.1
12.6	11.5	10.5	9.6	148

Exhibit 16: Blucora's Valuation

I use two easy ways to estimate the valuation and target price.

- The first way is calculating the estimate P/E ratio of Blucora:
 - Since Blucora is operating two businesses in two different industries, so it does not have a similar competitor that Blucora can compare its P/E with, so I calculate the P/E average in the two industries first and then assign them to a weight according to do revenue breakdown, then I conclude the estimate P/E ratio for Blucora—24.76.
 - Then I want to calculate the price of Blucora if it reach this ideal P/E ratio, so I time 24.76 by estimate earing in 2013, then I got this price: **23.84**
 - Then I calculate the effect of tax deductions to the stock price: Simply divide present value of NOLs by number of shares outstanding: 148 (M)/ 40.74 (M) = \$3.6
 - Therefore, the final target price in this method is: 23.84+3.6 = **27.44**

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	Google	Yahoo!	H&R Block	Intuit
P/E	20.33	21.49	15.84	21.11
Industry	27.07		18.18	
73% Search+ 27% Tax	24.67			

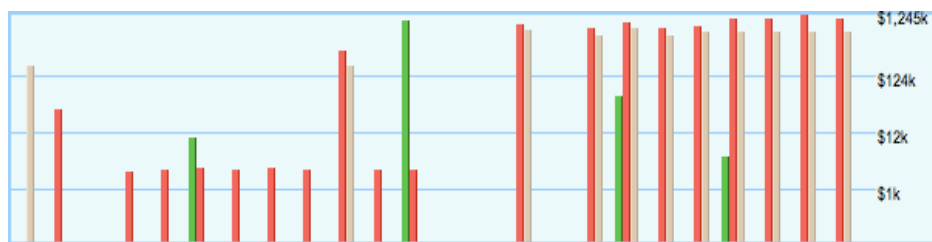
- The second way is calculating the estimate market cap:

Calculating the Market Cap from Estimate EBITDA (In Million)					
	Revenue (M)	Multiple	Market Value (M)		
TaxACT	44.3	10x	442.8		
Infospace	61.6	7x	431		
Corporate	-11.6	7x	-81.4		
Total	94.2	8.4x	792.4	EV (M)	572
		+ Cash	150.4	% of FCF generate	14%
		+ 1 year of Cash Flow	80	1 year FCF (M)	80
		- Debt	73.8		
		Market Capital	949		
		Target price	23.29405989	Number of shares (M)	40.74
		+ NOLs effect	3.6		
		Final Price	26.89405989		

Source: Forbes.com
www.valueinvestorclub.com

Therefore, the target price of Blucora is \$27.

Exhibit 17 Insider Trades



All Insider trades are sells in the past three years and most of them are from one of the Director-- Voelker James. All of the sells are in small amounts so there is chance that Voelker got out his money for personal financing usage instead of losing confidence. Voelker is retiring; he stepped down from president in 2009 and from Chairman in 2011, so he probably just wanted to get out his money and enjoy life. However, these are still potential risks.

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Exhibit 9: VAR Research Reference Chart

Category	Name/Positions	Takeaways
Blucora	Stacy Ybarra ☒ Senior Director, Corporate Communications	<ul style="list-style-type: none"> • The Blucora name change marks our evolution as the owner of two online businesses and will help further distinguish our parent company from our operating units. • The origin of the name was from a brainstorm for the goal of establishing a unique, strong, and diversified corporate identity. • The acquisition of TaxACT turned out to be a huge success and create a lot of value. • The leaders of Blucora have sufficient experience in online investing.
Blucora (Infospace)	Matt Boisen Corporate Counsel for search segment	<ul style="list-style-type: none"> • We reach out third part website, which Google does not want to deal with, and sell them combined search results of Google, Yahoo, Yandex etc. along with database, search toolbar building, and even the whole portal sometimes and create values. • The search growth is really stable in Blucora with distinguished market positioning. • Infospace already partnered with Google for more than 10 years and just renewed it. • Infospace is still the main business company even the name was changed to Blucora.
Blucora (TaxACT)	Jessi Creative Solutions Manager, ☒ Former Public Relations	<ul style="list-style-type: none"> • For TaxACT, our main goal is building user base and increasing market share. We are aiming to be the best in Tax Prep. In this industry, the initial change for customers is the hardest part because customers have all their information in our competitors' system. So market penetration can be hard, but as long as customers start to use TaxACT, at least 80% will keep using because they don't need to type in their info again. • Joining Infospace not only will provide TaxACT with more fund to spend in marketing and building user base but also higher search rank in search result because of Infospace's ability to reorder results when it sell them and its long term agreement with Google. • The 50% margin is real. This is because of efficiency—minimal capital and employees.
Competitor (TaxACT)	Jerry Green Social Media and Community Management H&R Block	<ul style="list-style-type: none"> • TaxACT's market share is still really small. But we will keep eyes on them. • There must be something wrong if they have 50% margin because its price is so low. • TaxACT is not well rounded with only online part. Our personal tax service in very profitable. • TaxACT indeed got some customers from us in the last tax season, but most of them are people who choose the cheapest options. We experienced huge revenue increase in professional personal tax service, which is out main focus right now. • TaxACT spent so much money on Ads everywhere, Pandora, Spotify, MSN, CBS, and the most expensive Ads on Yahoo! It's either crazy or planning something big.
User (TaxACT)	Grantwiscour Internet user on Yahoo Answer, User of TaxACT	<ul style="list-style-type: none"> • I used TaxACT for the past 4 years and it's great. • It's really safe with all the passwords and authorization just like it advertised. • It process very fast, and I got my money in five days. • It's generate the similar amount of return as TurboTax did when I used TurboTax before, but TaxACT is much cheaper.
Customer (Infospace)	Scott Morris Network Service Technician windstream.com	<ul style="list-style-type: none"> • Marketing Director asked my team to build an Google Search bar that customers can access all the information related to us but we are small company so it's very expensive and unrealistic for us to building the whole search bar and portal. • Infospace's product is really neat and works really well with our database and system. • The charge is reasonable and cheaper than if we build and maintain it by ourselves. (But he refused to tell me the specific price)
Expert in Tax	Sheri Showalter Director of Human Resources, Former program analyst in IT division at IRS, UC Berkeley	<ul style="list-style-type: none"> • TaxACT's software and online service' filling results are very accurate. • The algorithms and source codes are simpler than its competitors' and that they charge for lower price. • IRS bought part of TaxACT's code because its efficiency and used it for training purpose. After few years of using in training, IRS created simulation software based on TacACT's codes and used in VITA program. (Called CASH in UVA)
Expert in Searching Industry	Zheng ma, VP of Lashou.com, Former VP of Corporate Development in Baidu	<ul style="list-style-type: none"> • After adding MSN and Yandex to its search results, Infospace achieved great results diversification since Google and Yahoo only share 11% same search results (1% same on the first page), even added MSN, Bing and Yandex, this number will be 15%. • Infospace has not expanded in Chinese market but it showed interests in doing that 3 years ago and they are planning on adding Baidu to its search result, which will further diversify its results and attract more customers.

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