NATIONAL HOLDINGS CORPORATION
FISCAL 2019 Q2 EARNINGS CALL AND CORPORATE UPDATE

May 16, 2019
7:30 am CT

Chelsea Nantz: Good morning and welcome to National Holdings Corporation's Second Quarter Fiscal 2019 Earnings Call. My name is Chelsea Nantz, our Senior Vice President of Corporate Communications.

Joining me on today's call are National's Chairman and Chief Executive Officer, Michael Mullen and Glenn Worman, National's President and Chief Financial Officer.

On today's call, we will update you on the Company's second quarter results, after which we'll open the line for some questions.

Before I begin, I'd like to read our company's Safe Harbor statement:

In our earnings release which is now posted on our website, www.yournational.com, we have provided a reconciliation of GAAP to non-GAAP financial measures. We urge you to review this information in conjunction with today's call. I would also like to remind you that remarks made by management during this conference call may include forward-looking statements. Forward-looking statements are based on the current beliefs and expectations of management and actual results may be materially *different because of a variety of risks and other such factors. These statements are typically associated with the words such as anticipate, expect, estimate and believe or other such words. We caution investors not to rely unduly on forward-looking statements. These risks and uncertainties are described in our annual report on Form 10K for and in other filings that National makes with the SEC from time-to-time which are available on our Web site again that's www.yournational.com and on the SEC's Web site. Except as may be required by law National does not update forward-looking statements and expressly disclaims any obligation to do so.*

At this time, I'd like to turn the call over to Michael Mullen, Chairman and Chief Executive Officer of National.

Michael Mullen: Thank you, Chelsea. Good morning everyone and thank you for joining us. Our fiscal second quarter began with the volatile global markets and the continuation of the US government shutdowns which began on December 22, 2018. The volatility impacted our core commercial revenue business as fear and uncertainty drove retail investors to the sidelines.

Additionally, the US government shutdown had a significant impact on our quarterly financial results. The shutdown of the SEC and the subsequent backlog upon reopening pushed several material investment banking transactions into our fiscal third and fourth quarters.

Our proprietary banking is a key driver to our firm's overall growth and profitability. We remain hopeful that this will balance out over the remainder of the fiscal year and will end up being only delayed in recognition of this revenue.

Despite these headwinds, our efforts continued on the evolution of our solutions platform for advisors in service to their clients. Our platform continues to differentiate us from the competition, and this is further evidenced by the success we've had in recruiting. Despite the volatile markets, we had one of our very best recruiting quarters highlighted by a $3 million in revenue/ $400 million in assets wire house team who joined our New York City headquarters.

Additionally, our engagement in our independent channel continues to gain traction as we introduced our advisory solutions to our traditionally transactional based brokers. This evolution is an important step as we continue to ramp up our recurring revenue side of our business, which is core to our growth strategy.

Our net money flows on the advisory side of the business continue to grow this quarter and the tick-up in cost of revenue in our advisory business is evidence of the gaining momentum in our higher cost of revenue independent broker channel.

It is important to note and Glenn will highlight this in his remarks—our advisory revenue growth was somewhat muted since the quarterly pricing occurred right after the 20% decline in markets of December.

Lastly, we achieved a key milestone in our private shares business this quarter as the first of our Silicon Valley unicorn investments, Lyft went public on March 31. This public offering was a watershed moment for our firm.

However, due to the accounting standards adopted by National, we are not permitted to recognize the significant carried interest value the Lyft IPO created for the firm until it is realized via a distribution event.

Our fund remains subject to the market volatilities and our ultimate carried interest profit if any will be dependent upon how well our investors profit in our funds upon liquidation.

I recommend that every investor on this call review our Form 10-Q, which we filed yesterday with the Securities and Exchange Commission. You can view that on our Web site at www.yournational.com under the Investor Relations tab. And for those of you interested in a more financial detail on our unrealized private shares carried interest values, you will find it under the variable interest entities section of our 10-Q filing.

Let me now turn the call over to Glenn Worman, our President and Chief Financial Officer for a more detailed report of our financial results. Glenn?

Glenn Worman: Thanks (Mike). Good morning everyone. As (Mike) noted, National faced headwinds in our most material business lines in the current quarter, which resulted in a reduction in revenue to approximately $47 million versus a strong $60 million in the prior-year quarter.

Uncertainty regarding federal reserved interest rates direction, US-China trade negotiations and US government shutdown in late 2018 into early 2019 caused declines in brokerage commission and investment banking revenue and mitigated our investment management revenue growth as securities values dropped by approximately 20% at the end of calendar 2018.

From an expense perspective, total expenses declined approximately $5 million in the quarter. Variable commission expenses and investment banking compensation expenses, directly associated with lower revenue generation, declined by approximately $10 million. This decline was partially offset by an approximate $3 million increase in legal expenses and arbitration litigation reserves and higher compensation expenses associated with the build-out of our infrastructure platform.

We are strategically investing to become best-in-class and scale our organization for future growth. The majority of our legal expenses associated with historical/ aged customer claims with the remainder incurred for important current corporate initiatives.

What we have not included on our results is generalized carried interest revenue associated with our private shares portfolio. In late March, the largest investment in this portfolio, Lyft, came to market via its initial public offering, generating significant unrealized gains for investors on the company.

It is important to note that while these gains are unrealized and are subject to market fluctuation and shares held or restricted for a period of time, we are optimistic that future quarters will show beneficial results for both our clients' and National's earnings.

For the quarter, revenue of $46.7 million declined $13.6 million from the $60.3 million in the second quarter of 2018. Commissions and related revenue decreased by $8.8 million or 27% to $24.4 million on reduced retail client trading as noted earlier.

Investment banking revenue declined by $4.7 million to $9.8 million as several deals were deferred into our third and fourth quarters. Investment advisory revenues, while up $0.3 million to $5.5 million in the quarter, were mitigated by the approximate 20% decline in the market value of underlying investments when second quarter fee pricing was determined. Our assets under management do continue to grow.

Net dealer inventory gains were down $1.5 million. This business has undergone significant change and the results are representative of our future expectations. We've scaled back our trading businesses as noted in previous communications to focus on retail and institutional client facilitation and investment banking support.

Accounting and tax revenue continues to grow with the addition of new small strategic acquisitions, revenue of $4.1 million increased $0.3 million, up 7%. We continue to acquire practices where appropriate.

Expenses declined to $50.6 million, down $5.1 million or 9%. Variable compensation associated with brokerage commissions and investment banking fees were responsible for approximately $10 million of the decrease. This was offset by the continuation of spending on infrastructure and people. More importantly, we saw a fairly substantial increase in legal expenditures mainly for arbitration and legal results and to a lesser extent for corporate initiatives. This resulted in a pre-tax loss for the quarter of $3.9 million versus $2.6 million a year ago.

Adjusted EBITDA declined to a negative $2.1 million versus a positive $5.2 million in the year-ago quarter. The 2018 second quarter included a $5.6 million negative change to the fair value of our warrant liability from the 2016 Fortress tender offer.

Our six months results were much less volatile with total revenue of $104.8 million versus $110.4 million in the 2018 year-to-date period. The 5% decline was obviously isolated to the current quarter and due to the headwinds we experienced.

Commissions and related fees totaled $47.5 million, down $13.6 million or 22% from the comparative 2018 period. Our second quarter results improved in the first quarter however, revenue generation was still below recent historical levels.

The investment banking for the six-month period increased $7.8 million to $36.9 million, up 27% on strong traditional banking and private share revenue in our first quarter. Investment advisory continued to add assets and produce revenue of $11.4 million versus $10.5 million a year ago. As noted, current period results were mitigated by lower fee pricing, and we expect to see a rebound in our fiscal third quarter.

Accounting tax revenue increased to $4.9 million from $4.4 million a year ago, up 12%. We continue to be positive on this revenue line due to both continued growth and exposure to new clients.

Total expenses for the year-to-date period were up 1% to $107.4 million. Our variable compensation ratio, largely due to our mix of businesses, has continued to improve in line with our goals and objectives. As mentioned earlier, legal expenses and continuing infrastructure spend resulted in a slight increase in total costs.

As a result of our infrastructure spending over the past two years or so, we believe we are well-positioned to add scale to our platform going forward. For the six months, the loss before income taxes up $2.6 million versus the loss of $6.4 million a year ago, and adjusted EBITDA declined to $2.2 million from $7 million in the fiscal year-to-date period in 2018. The year-ago period was negatively impacted by the change in fair value in the firm's warrant liability, which totaled $11.2 million for the six-month period in 2018.

Finally, our balance sheet remains healthy with no term debt outstanding, $47.5 million of stockholders equity and cash and cash equivalents of $31.2 million.

(Mike), back to you.

Michael Mullen: Thank you, Glenn. That concludes our prepared remarks. I'd like to now turn the call back to our operator who can open up the lines to field any questions.

Operator: Thank you. If you would like to register a question, please press the 1 followed by the 4 on your telephone. You will hear a three-tone prompt to acknowledge your request. If your question has been answered and you would like to withdraw your registration, please press the 1 followed by the 3. One moment please for the first question. As a reminder, to register for a question, please press the 1-4.

At this present time no one has registered for any questions. Please continue with your presentation or closing remarks.

Michael Mullen: (Felina), thank you. In closing, the final two fiscal quarters will be key to our firm in delivering the results we set out for at the beginning of this year.

Third quarter to-date, banking has picked back up and two additional private share unicorn investments of ours have come public. Our recurring pipeline remains robust and our key net money flows continue to grow along with our assets under management.

Our focus remains on diversifying our business into more recurring revenue through engagement and scale and driving profitability and growth in shareholders' equity.

I want to conclude this call by thanking the more than 1,000 dedicated financial professionals of National, all of our clients, our stakeholders and all for their continued support.

I look forward to future business updates to report on our progress. Thank you all.

Operator: Thank you. That does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.

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