NATIONAL HOLDINGS CORPORATION
FISCAL 2019 Q3 EARNINGS CALL AND CORPORATE UPDATE

August 15, 2019
8:30 am ET

Chelsea Nantz: Good morning and welcome to National Holdings Corporation's Third 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 third quarter results, after which we'll open the line up for some questions. Before we 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 and in other filings that National makes with the SEC from time-to-time, which are available on our website again that's www.yournational.com and on the SEC's website. 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 and welcome to National's Fiscal Third Quarter Earnings Call.

Our fiscal third quarter rebounded as we had hoped from our fiscal second quarter results which were materially impacted by the U.S. government shutdown.

Overall, we reported revenue of $50.8 million, net income of $200,000. We reported a pre-tax profit of $1.2 million and adjusted EBITDA of $2 million. We finished the quarter with $30.7 million in cash and cash equivalent and no debt.

This performance was a team effort, and even though we have upgraded a significant portion of the team over the last few years, I'm proud of how well we all worked together to grow our value of our company and service our clients.

Some highlights, with the government shutdown behind us and a less volatile global market this past quarter, investment banking and investment advisory rebounded as we had hoped. The shutdown pushed out our banking calendar quite a bit. We closed on many of the offerings this quarter that were delayed by the SEC shutdown.

Our private shares business continues to grow as we continue to focus on this important vertical, and we have built a robust pipeline of future transactions. It's worth noting we liquidated our Slack private shares SPV at the end of the quarter, which generated significant returns for our clients.

Our focus on intelligently scaling our business remains paramount to us. The breadth of our differentiated solutions platform has allowed us to successfully onboard high quality wirehouse advisors. We have onboarded over $1 billion in represented AUM this year alone and our recruiting pipeline is the strongest than at any point in this company’s history to my knowledge.

This focus on scale will allow us continued growth on the recurring revenue side of our business and improve the overall earnings power of our company. I look forward to sharing updates on our successful additions in future calls.

Our company continues to face headwinds with our legal expenditures. A positive note, most of the legal spend has been on settlements and accruals for legacy issues from registered personnel we have previously exited over the last few years.

I do expect this expense to eventually decline due to our overall enterprise risk management, and when it does, the true earnings power of our organization will be more apparent.

Our focus remains on growing our business and doing so in a culture of compliance. But we also focus on our operating expenses. Glenn Worman will share more details on our operating expense decline shortly.

Lastly, important components of our differentiated solutions platform are our technology services that we continue to develop and implement. This past quarter, we successfully rolled out the National Customer Relationship Management tool, CRM, which was built on the Salesforce Financial Services Cloud platform.

And we have recently begun the rollout of G Suite, the cloud-based productivity and collaboration tools developed by Google. The implementation of G Suite will help us further reduce operating expenses in future quarters, but more importantly it significantly enhances our cybersecurity framework.

Finally, we expect to go live with our new General Ledger, Workday, on October 1st. This new general ledger will allow us to report future quarter results and host these update calls more timely.

Now let me now turn the call over to Glenn Worman, our President and Chief Financial Officer to share with you the details of our financial results. Glenn?

Glenn Worman: Thanks, Mike. Good morning, everyone. As Mike noted, National had a solid quarter with most of our revenue categories improving nicely from the headwinds that we experienced in the second quarter of 2019.

Revenue of $50.8 million increased to $4.1 million from the second quarter on strength in investment banking, investment advisory and tax preparation and accounting.

Revenue declined by $5.4 million from $56.2 million in the third quarter of fiscal 2018. However, this difference is misleading as the net difference between the two third quarter periods was significant $4.5 million advisory fee that we recorded in third quarter last year. That created an extraordinary quarter for investment banking in the year ago period. I'll discuss individual revenue category shortly.

From an expense perspective, total expenses of $49.6 million declined approximately $1 million versus the second quarter of this year on an increase in revenue and $5.1 from the third quarter of 2018. Our variable compensation expenses continue to stay under our target ratios due to attention to power rates and overall costs, and the increasing diversity of our product platform has helped increased our gross margins.

The benefit of stable and then some products' increasing gross margins continues to be challenged by provisions for legacy arbitration, and litigation provisions, and legal fees for several corporate issues in the current year.

As Mike noted in his remarks, we're confident that our current enterprise risk management controls and the elimination of registered representatives from our platform that did not show our quality approach to business will ultimately result in a decrease in overall legal expenses, adding the earnings power of this company and higher margins.

For the quarter, revenue of $50.8 million increased $4.1 million as I said from the $46.7 million recorded in the current year second quarter. Again, total revenue declined from the $56.2 million recorded in third quarter fiscal '18 on a net basis due to the advisory fee noted earlier.

Commissions and related revenue were $22.9 million, down 9% from the second quarter of fiscal 2019 and down slightly from the $23.2 million recorded in the first quarter of this year. In comparison to the third quarter of 2018, these revenues were down approximately $7 million from a very significant $30 million in the comparative period.

We believe that the current level is more representative of future quarters, unadjusted for organic and inorganic growth for several reasons including current enterprise risk management control and the reallocation of revenue to investment advisory, and quality investment banking, and private shares offerings.

These levels will, of course, be impacted by market levels, market volatility and future growth through recruiting and the business growth of our existing representatives.

Investment banking increased to $15.8 million, up as expected approximately $6 million from the second quarter, but down from the $2.9 million from the very strong $18.7 million recorded in the third quarter of 2018. Again, the $4.5 million advisory fee contributed to that very strong quarter a year ago. Year-to-date investment banking numbers were up nicely and I'll cover that shortly.

Investment advisory revenues increased to $7.6 million, a significant 37% increase over the second quarter of 2019, and a 43% increase over the third quarter of 2018. Our strategy of increasing investment advisory assets under management and high market valuation of pricing for the current third quarter were further enhanced by the recognition of carried interest on the liquidation of our private shares investment in Slack Technologies this quarter.

Accounting and tax revenue continues to grow with the addition of new small strategic acquisitions. Revenue of $2.7 million increased $0.2 million, up 9% from the third quarter of last year. The third and fourth quarters are slower quarters for this business so we're currently focusing on adding further practices before the beginning of the 2019 tax season.

Expenses declined $49.6 million, down $5.1 million or 9% from the third quarter of 2018. Variable compensation contributed $6 million of this reduction. Obviously, these expenses fluctuate with revenue generation. But, in addition, our gross margins have improved and are well within our corporate goals.

While most of our operating expense categories were either down or up immaterially, the current quarter on a third quarter comparative basis saw an increase of $0.9 million from an increase in litigation and arbitration reserves and corporate legal fees.

These results produced income before other income and income taxes of $1.2 million versus a loss of $3.9 million in the current year second quarter and income of $1.6 million in the third quarter of 2018.

Now on a year-to-date basis, total revenue of $155.6 million declined $11 million from the $166.7 million recorded the year ago. Revenue across all main categories with the exception of commissions and related revenue increased year-over-year, which is a good indication that our product diversification is taking hold.

Commissions and related fees totaled $70.4 million, down $20.7 million from the comparative 2018 period. As noted earlier, enterprise risk management controls and the diversification of revenue to other products and businesses, combined with earlier market headwinds has contributed to this decline in trend.

Investment banking revenue for the nine-month period increased $4.9 million to $52.7 million, up 10.3% on strong traditional banking and private share revenues year-to-date.

Investment advisory continued to add assets, improves revenue of $18.9 million versus $15.8 million a year ago. As noted, current period results rebounded on strong equity market values, continuing increase in assets under management and carried interest revenue on the liquidation of our private share investment in Slack Technologies.

Accounting and tax revenue increased to $7.6 million from $6.8 million a year ago, up 11.8%. We continue to be positive on this revenue line due to continued client growth, small acquisitions, and the result in exposure to new clients.

Total expenses for the year-to-date period were down $3.6 million, or 2.2%, to $160.6 million. As in the current quarter, our variable expense ratio largely due to our mix of businesses has continued to improve in line with our goals and objectives. This improvement produced an approximately $11.6 million decline in variable expenses on the reduction in revenue as well as improving variable costs.

As mentioned earlier, legal expenses, the continuing infrastructure spend, and acquisition-related and tangible amortization resulted in an $8 million increase in operating expenses.

For the nine months, the net loss attributable to common shareholders was $1.6 million versus the net loss of $9.5 million a year ago, and adjusted EBITDA declined to $4.2 million from $12.1 million in the fiscal year-to-date period 2018.

The decline in adjusted EBITDA is due to the revenue decline on our average gross margin plus the increase in overall legal expenses year-over-year. The year-ago net loss was negatively impacted by the change in the fair value of the firm's warrant liability, which totaled $11.2 million in the 2018 year-to-date period.

Finally, our balance sheet remains healthy with no long-term debt outstanding, $49.3 million of stakeholders' equity and cash and cash equivalents of $30.7 million.

Back to you, Mike.

Michael Mullen: Thank you, Glenn. (Rita), I would like you to now open the call up to see if there're any questions please.

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.

Mr. Mullen, we have no questions at this time. I will now turn the call back to you. Please continue with your presentation or closing remarks.

Michael Mullen: Thank you, (Rita). In closing, today's press release and a replay of the conference call can be accessed from the Investor Relations tab on our website, www.yournational.com.

I want to close by thanking the more than 1,000 employees, advisors, and financial professionals of National. Your hard work and dedication means everything to us.

On behalf of our board of directors and my executive management team, I want to thank all of our stakeholders for their continued faith and support of our firm. Have a good day.

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