H&R Block Q3FY24

Financial Results Conference Call Transcript

May 9, 2024

[Introduction & Forward-Looking Statements]

Michaella Gallina, Vice President, Investor Relations: Thank you, Lateef. Good afternoon, everyone, and welcome to H&R Block's third quarter fiscal year 2024 financial results conference call. Joining me today are Jeff Jones, our president and chief executive officer, and Tony Bowen, our chief financial officer.

Earlier today, we issued a press release and presentation, which can be downloaded or viewed live on our website at investors.hrblock.com. Our call is being broadcast and webcast live, and a replay of the webcast will be available for 90 days.

Before we begin, I'd like to remind listeners that comments made by management may include forward-looking statements within the meaning of federal securities laws. These statements involve material risks and uncertainties, and actual results could differ from those projected in any forward-looking statement due to numerous factors. For a description of these risks and uncertainties, please see H&R Block's Annual Report on Form 10-K and Quarterly Reports on Form 10-Q, as updated periodically with our other SEC filings.

Please note, some metrics we'll discuss today are presented on a non-GAAP basis. We've reconciled the comparable GAAP and non-GAAP figures in the appendix of the presentation.

Finally, the content of this call contains time-sensitive information accurate only as of today, May 9, 2024. H&R Block undertakes no obligation to revise or otherwise update any statements to reflect events or circumstances after the date of this call.

With that, I will now turn it over to Jeff.

[Opening Remarks]

Jeff Jones, President, and Chief Executive Officer: Thank you, Michaella. Good afternoon everyone and thanks for joining us. I will begin by providing commentary on the third quarter, detail on our tax season performance, and discuss our Block Horizons progress. Then Tony will share more on our financials, and we'll open it up for Q&A.

Beginning with Q3 results ending March 31, revenue grew 4%, EBITDA grew 6%, and EPS grew 18%. In the quarter, performance was driven by improvements in net average charge (or NAC) in both Assisted and DIY, DIY volume growth, and ongoing, disciplined expense management. Based on how we ended tax season and our third quarter performance, we now expect to finish the year near the high end of our outlook. Tony will share more thoughts on outlook in a moment.

Turning to the tax season, after a bit of a slow start, the overall industry grew about 2% this year with DIY growing 3% and Assisted growing about a percent. Our data indicates that last year's California extension had a positive impact on category growth this year. Our overall market share was about flat driven by share gains in DIY that were offset by Assisted. Let's discuss our results in more detail, beginning with DIY.

[DIY]

Our formula for success is to offer an award-winning product, make it easy for clients to switch, and price competitively. This strategy continued to work, and we are very pleased with the results in our DIY business.

We had meaningful growth in paid clients and NAC this season, which translated to strong revenue growth. We have an intentional focus on driving more paid SKUs and this effort is working well.

You'll see in the appendix of our presentation that for the first time we broke out free and paid DIY filings in the volume table to add additional transparency. We saw an increase in taxpayer identity fraud in the industry, concentrated in free SKUs, that were e-File accepted by the IRS. Beyond our own fraud prevention measures, we're in discussions on how the IRS and industry can partner to reduce fraud in the future.

As you can see, our paid DIY growth significantly outpaced the DIY category. Through April 30, paid volumes grew 6%, and many of these filers came from TurboTax. We saw strong NAC growth of 7% in paid clients, and at the same time, customer satisfaction metrics including Ease of Use and Price for Service, improved. In addition, we focused on curated experiences to help self-employed workers feel more confident in their tax outcome, which resulted in notable increases among those filers.

Our genAI powered AI Tax Assist performed well. As we've shared, this innovation was launched for the first time this year. Feedback indicated that the tool was easy to use and helpful in the tax prep process, and clients found value in it. Importantly, we saw greater conversion among new clients who leveraged AI Tax Assist. Both AI Tax Assist and human help were included at no additional charge in all of our DIY paid online SKUs, which we believe is a competitive differentiator. As a result, we exceeded our operational metrics with human help, and believe this combination provides clients with the confidence they need in DIY.

We also continued to see more DIY clients accessing human help with Tax Pro Review, which grew more than 15%, continuing its multiyear trend of double-digit annual growth. Overall, we feel great about the help we're providing DIY customers.

[Assisted]

Now let's turn to our consumer tax Assisted performance.

For several years, we've had a focus on transforming our Assisted tax client experience, we've been improving the quality and value of our service. We've developed plans to attract and serve more complex and higher lifetime value clients. We've made tangible progress in building better digital options for our clients and tax pros, and we've been modernizing our technology across the board.

This year, we saw many of these efforts yield encouraging results. We saw client growth in each segment above 60 thousand dollars of income. Like last year, our fastest growing segment was in those with more than 100 thousand dollars of income. Our efforts slowed the decline of EITC filers, which was a goal for this year, but we still have work to do in lower income segments. In total, our Assisted volumes declined about one percent through April 30. However, modest price increases alongside the mix shift among clients led to 4% NAC growth, while improving client satisfaction scores.

Our continuous improvement of MyBlock led to double-digit growth in the number of authenticated accounts, and a nearly 20% increase in the number of documents uploaded to share with a tax professional.

We also saw growth in the number of Assisted clients working with us completely virtually, increasing more than 25% year over year. We expect this number to continue to grow in the future.

Additionally, our genAI efforts to improve the customer experience in our call center operations provided great learnings in its initial pilot. We were pleased with its accuracy, which was relatively high compared to similar offerings. We are looking forward to applying our learnings in order to expand the usage so that we can better serve more customers, at a lower cost.

While I’m proud of our progress, I also recognize that our pace of change in field offices this year was high - we rolled out our new tax platform to all company and franchise locations. We introduced a new phone system. We set lofty goals for scanning more documents in the office and printing fewer pages. We modified our tax pro compensation model, and we introduced an entirely new system for measuring performance down to each tax professional. These kinds of changes are necessary to our future, but it was a lot in one year.

While the appointments and visits to our tax offices were encouraging, too many clients that started tax prep ultimately did not finish, and I see a large opportunity to ensure those who start with us become happy and loyal clients - and this will be a major focus in fiscal ’25.

Now, let’s move on to our Block Horizons imperatives.

[Small Business & Wave]

We continue to see positive trends in Assisted Small Business tax. Through April 30, NAC increased 3%. We are outperforming among higher income small businesses, and our focus on growing our share of the entity return market is paying off.

Bookkeeping and payroll services continue to increase double digits, driven by our dedicated salesforce. Overall, we are optimistic about the trajectory of Small Business and the long runway of this opportunity ahead.

Moving to Wave, revenue growth was 7% in the quarter. As you recall, a couple of months ago Wave launched a new, paid tier subscription service and a new paid receipt product. While early, monetization has been better than anticipated. We feel good about the strategic direction as we execute against our goals of accelerating revenue growth and driving profitability.

[Financial Products: Spruce]

Turning to Financial Products, this was the second season that Spruce, our mobile banking platform, was offered in the Assisted channel. Since launch, through April 30, Spruce had 470 thousand signups, and 852 million dollars in customer deposits. We saw strong growth this year and customer deposits have nearly tripled from last year. We're starting to gain traction with how we offer this product and I'm proud we saw significant growth this year.

This season was the first time we offered Assisted and DIY tax in the Spruce app, and we saw good results. Among new Spruce clients that also filed a tax return, 54% were new to H&R Block, and we were pleased with the low associated customer acquisition costs.

We continue to make significant improvements and release new features on the platform. Last month Spruce launched a variable interest rate feature that pays 3.50% APY on savings account balances, which is 7 times the national average. There are no monthly fees and no minimum balance or direct deposit requirements, making it an appealing option for clients versus other competitors in the marketplace. We're proud of how Spruce is delivering on its mission to help people take control of their finances.

Stepping back to review results holistically: In DIY, we were pleased with our strong performance driven by paid clients and paid NAC, tax pro review growth, customer satisfaction scores, and the launch of AI Tax Assist. In Assisted, I'm happy to see our brand resonating with higher value clients, the NAC increase this year, and the strength in Assisted small business tax. At the same time, we can improve the experience for Assisted clients, and with so many new changes now behind us, I'm excited to see the improvements I know we can make. From a financial perspective, as I shared earlier, we expect to deliver results near the high end of our outlook ranges, which means topline growth, robust cash flow generation, and double-digit EPS growth that allows for continued returns of capital to shareholders through dividends and repurchases.

With that, I will now turn it over to Tony to discuss our financials.

[Q3FY24 Financials]

Tony Bowen, Chief Financial Officer: Thanks, Jeff, and good afternoon, everyone.

In the third quarter, we delivered 2.2 billion dollars of revenue, which grew 4% or 91 million dollars to the prior year. The increase was primarily due to a higher NAC and higher company-owned volumes in Assisted, and higher volumes and NAC in DIY, partially offset by lower volumes in franchise locations due to franchise acquisitions.

Total operating expenses in the quarter were 1.3 billion dollars, an increase of 27 million dollars or 2%, primarily due to higher field wages because of greater company owned volumes and higher legal fees and settlements, partially offset by lower marketing and advertising expenses.

EBITDA was 964 million dollars compared to 910 million dollars in the prior year, an increase of 6%.

Interest expense was 26 million dollars, compared to 22 million dollars in the prior year due to higher borrowings on our line of credit, and the higher interest rate environment. We will benefit from higher interest rates as we move into a positive cash position.

Pretax income increased by 52 million dollars to 907 million dollars, primarily due to higher revenues in the current year, and our effective tax rate in the quarter was 23.8% compared to 24.5% last year.

We did not execute any share repurchases in the third quarter. You'll recall that given our narrow trading windows, we typically execute most of our share repurchases in the first half of the year. In Q1 and Q2, we completed 350 million dollars of share buybacks, or another 5.5% of our shares outstanding.

Both earnings per share from continuing operations and adjusted earnings per share from continuing operations increased 18% to $4.87 and $4.94, respectively.

We continue to be opportunistic in our franchise acquisitions, which are a core driver of our long-term revenue growth target of 3-6%. This year we have purchased 156 offices, which is lower than the approximately 200 offices we repurchased last year. We feel great about franchisees' willingness to sell to us and are pleased with how this strategy supports our longer-term revenue and earnings growth.

[Outlook]

As Jeff shared, based on how we ended the tax season and our performance in the third quarter, we now expect to finish the year near the high end of our outlook. We also expect our effective tax rate to be in the 21-22% range.

As I've said for a long time, despite year-to-year nuances, the strength of our capital allocation story remains the same: we produce consistent cash flow, pay a growing dividend, and buyback a meaningful amount of shares. Fiscal year '24 will be another year of topline growth, strong cash flow generation, and double-digit EPS growth.

Now, I will turn it back over to Jeff for closing remarks.

[Closing Remarks]

Jeff Jones, President, and Chief Executive Officer: Thank you, Tony. As we end our prepared remarks, I want to thank our tax professionals, associates, and franchisees for their efforts this tax season. Together, we are continuing to deliver on our Purpose of providing help and inspiring confidence in our clients and communities everywhere.

I look forward to sharing more details on our year-end call in August.

Now, operator, we will open the line for questions.

Forward-Looking Statements

These materials contain forward-looking statements within the meaning of the securities laws. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words or variation of words such as "expects," "anticipates," "intends," "plans," "believes," "commits," "seeks," "estimates," "projects," "forecasts," "targets," "would," "will," "should," "goal," "could," "may," or other similar expressions. Forward-looking statements provide management's current expectations or predictions of future conditions, events or results. All statements that address operating performance, events or developments that we expect or anticipate will occur in the future are forward-looking statements. They may include estimates of revenues, client trajectory, income, effective tax rate, earnings per share, cost savings, capital expenditures, dividends, share repurchases, liquidity, capital structure, market share, industry volumes, or other financial items, descriptions of management's plans or objectives for future operations, products or services, or descriptions of assumptions underlying any of the above. They may also include the expected impact of external events beyond the Company's control, such as outbreaks of infectious disease (including the COVID-19 pandemic), severe weather events, natural or manmade disasters, or changes in the regulatory environment in which we operate. All forward-looking statements speak only as of the date they are made and reflect the Company's good faith beliefs, assumptions and expectations, but they are not guarantees of future performance or events. Furthermore, the Company disclaims any obligation to publicly update or revise any forward-looking statement to reflect changes in underlying assumptions, factors, or expectations, new information, data or methods, future events or other changes, except as required by law. By their nature, forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. Factors that might cause such differences include, but are not limited to a variety of economic, competitive, and regulatory factors, many of which are beyond the Company's control, that are described in our Annual Report on Form 10-K for the most recently completed fiscal year in the section entitled "Risk Factors" and additional factors we may describe from time to time in other filings with the Securities and Exchange Commission. You may get such filings for free at our website at http://investors.hrblock.com. In addition, factors that may cause the Company's actual effective tax rate to differ from estimates include the Company's actual results from operations compared to current estimates, future discrete items, changes in interpretations and assumptions the Company has made, future actions of the Company, and increases in applicable tax rates in jurisdictions where the Company operates. You should understand that it is not possible to predict or identify all such factors and, consequently, you should not consider any such list to be a complete set of all potential risks or uncertainties.

Non-GAAP Measures

We refer to certain Non-GAAP financial measures in these materials, including adjusted earnings per share (EPS) and earnings before interest, taxes, depreciation, and amortization (EBITDA), which management believes provide additional meaningful information regarding the Company's performance and financial strength. All non-GAAP financial measures in these materials are from continuing operations. Non-GAAP financial measures should not be considered as a substitute for, or superior to, measures of financial performance prepared in accordance with accounting principles generally accepted in the United States (GAAP). Because these measures are not measures of financial performance under GAAP and are susceptible to varying calculations, they may not be comparable to similarly titled measures for other companies. For a description of these non-GAAP financial measures, including the reasons management uses each measure, and reconciliations of these non-GAAP financial measures to the most directly comparable financial measures prepared in accordance with GAAP, please refer to the tables accompanying these materials and previously filed press releases posted on our investor relations website at https://investors.hrblock.com.

Market, Industry, and Operational Tax Data

The data included in these materials regarding the tax preparation services industry, including trends in the market and the Company's position and the position of its competitors within this industry, are based on the Company's estimates, which have been derived from management's knowledge and experience in the industry, and information obtained from customers, trade and business organizations, internal research, publicly available information, industry publications and surveys and other contacts in the industry. The Company has also cited information compiled by industry publications, governmental agencies and publicly available sources. Although the Company believes these third-party sources to be reliable, it has not independently verified the data obtained from these sources and it cannot assure you of the accuracy or completeness of the data. Estimates of market size and relative positions in a market are difficult to develop and inherently uncertain and the Company cannot assure you that it is accurate. Accordingly, you should not place undue weight on the industry and market share data presented in these materials.

Unless otherwise noted, year-over-year comparisons of our operational tax metrics are calculated as July 1, 2023 to April 30, 2024 compared to the corresponding prior year period.