H&R Block FY23

Financial Results Conference Call Transcript

August 15, 2023

[Introduction & Forward-Looking Statements]

Michaella Gallina, Vice President, Investor Relations: Thank you, Lateef. Good afternoon, everyone, and welcome to H&R Block's full year fiscal 2023 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 our presentation.

Finally, the content of this call contains time-sensitive information accurate only as of today, August 15, 2023. 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: Thanks, Michaella. Today we'll provide an update on our fiscal year '23 results. Then, I'll share more on the progress we continue to make within our Block Horizons strategy, provide initial thoughts on fiscal year '24, and Tony will discuss our financial performance and outlook in more detail.

[Results Overview]

Starting with 2023 results, we had a good finish to the year and delivered revenue growth, material EBITDA growth, and adjusted EPS growth of 9%. As we discussed at the beginning of the year, we knew we were facing headwinds due to the rollback of the advanced child tax credit payments that were loaded onto the Emerald Card. During the year we also had foreign exchange impacts, stimulus filers that returned to the sidelines, and California’s deadline extension.

Overall, I’m pleased with the results we produced despite these challenges. Our DIY strategy delivered this year, resulting in meaningful share gains. We demonstrated pricing power in the Assisted channel and saw positive customer satisfaction metrics, small business tax continued to be a growth driver, and we also added about 150 thousand new signups to our Spruce mobile banking platform.

In addition, our capital allocation story is driving ongoing value for shareholders. We completed another 200 million dollars of share repurchases in Q4 alone and today announced a 10% increase to the dividend.

Entering fiscal year ‘24, we are well positioned and expect a return to ordinary industry growth, which Tony will discuss in more detail later in the call. Before that, let me share more about our Block Horizons progress.

[Small Business & Wave]

Let’s start with our Small Business imperative that includes tax and Wave. Small Business Assisted Tax continues to be a growth driver. This business delivered 6% revenue growth for the fiscal year, on top of strong growth last year, led by net average charge, or NAC, which grew 5%.

We also see a nice runway of longer-term opportunities in services. While early, bookkeeping and payroll are gaining traction, and this year we launched a business formation tool. Our new internal sales team more than doubled appointment to sale conversion rates, accelerating growth in services. All in all, we are pleased with the trends in Small Business and continue to see significant opportunity ahead.

Turning to Wave, our top priorities are driving revenue growth and improving profitability. For the full year, revenue increased 12%. In the fourth quarter we grew average revenue per user while also becoming more efficient with our customer acquisition spend. We also launched a new feature for receipt processing that scans and imports data in seconds, reducing manual bookkeeping. Its uptake has been faster than anticipated, and we are now working on a robust roadmap of other new features to roll out in the coming months.

[Financial Products: Spruce]

Moving on to our Financial Products imperative -

Regarding Spruce, our mobile banking platform, we have been utilizing learnings from its first year in the Assisted channel to address and solve the needs of our clients. Since launch through June 30, we have had 300 thousand signups and 334 million dollars in customer deposits.

Spruce is committed to helping customers be good with money, and we are seeing progress toward that impact goal. A higher percentage of users are now saving money, and the balances accumulating in savings accounts continues to grow. These savings accounts allow users to customize goals in order to save for the things they want in their lives – whether it be emergency savings or a new car. Our newest feature, a budget watchlist, utilizes flexible guardrails to help build healthy spending habits. Feedback from users indicate that these tools give them the visibility and control that they have been missing in their financial lives.

From here, we are focused on acquiring clients both in and out of the tax season.

[Block Experience]

Now let’s turn to Block Experience, which is all about blending digital tools with human expertise to serve clients however they want to be served: fully virtual to fully in person and everything in between.

In DIY, we delivered on what we set out to do, and we were especially pleased with the results. As you recall, our goal was to return to share growth by increasing awareness that we offer a DIY product, by improving the product, and by making it easier to switch from TurboTax®. This multifaceted strategy worked, and as we reported last quarter, we saw online client growth of 2.5% through April 30 and 35 basis points of share growth. We are looking forward to continuing this momentum in fiscal ‘24.

In Assisted, through April 30, we successfully increased company NAC by 4% while receiving strong customer satisfaction metrics. We also attracted higher income clients and saw over 10% growth in those with more than 100 thousand dollars of income; and as we shared last quarter, we continue to see progress in the adoption of virtual tools. Although we saw stimulus filers return to the sidelines, the data shows that dynamic is now behind us, and we are focused on bringing more new clients into the Assisted channel next year.

[Generative AI]

As you may have seen from our recent announcement, we entered into an industry-leading partnership with Microsoft to leverage its Azure OpenAI services and leading genAI technology to fuel faster and better experiences for taxpayers. While we have been building in house capabilities for some time, we believe we can further accelerate our progress by leveraging the most advanced AI models in the world while continuing to keep data security a top priority.

We will initially be focused on two areas. First, using genAI to reduce expenses and increase productivity, and second, to deliver enhanced customer experiences. We have dedicated teams working on these efforts, and we are excited about the possibilities for H&R Block.

Looking back over the last few years, we have made significant strides in our products, services, and features within our Block Horizons strategy, and we are looking forward to what lies ahead. Now let me turn it over to Tony to discuss our financials and outlook.

[FY23 Financials]

Tony Bowen, Chief Financial Officer: Thanks, Jeff. Good afternoon, everyone. Today I'll review results for fiscal year '23, provide detail on our outlook, and share more on our strong capital allocation practice.

We delivered nearly 3.5 billion dollars of revenue, an increase of 9 million dollars over last year. The increase was due to higher U.S. Assisted tax preparation revenues, partially offset by a decrease in Emerald Card revenues. As a reminder, the impact from the Emerald Card was over 30 million dollars due to the rollback of the advanced child tax credit. We also had a negative foreign exchange impact of 19 million dollars. Given these variables, I'm pleased that we were able to grow the topline this year.

Total operating expenses were 2.7 billion dollars, an increase of approximately 5 million dollars, primarily driven by higher field wages and partially offset by lower consulting and outsourced services. We saw about 5 million dollars of savings from our footprint optimization efforts as we continued to eliminate unnecessary square footage.

Interest expense was 73 million dollars, a decrease of 15 million dollars, or about 17%, due to lower interest expense on our notes compared to last year, partially offset by higher interest expense on our line of credit due to higher interest rates and higher draws.

Other income increased 33 million dollars primarily due to higher interest income. As we've discussed, higher interest rates were a net benefit given our cash position throughout the year. Pretax income was 711 million dollars, an increase of 52 million dollars, or about 8%.

Earnings per share from continuing operations increased from $3.26 to $3.56, and adjusted earnings per share from continuing operations increased from $3.51 to $3.82, or 9%. This is meaningful growth despite the aforementioned headwinds as well as our effective tax rate increasing from 15% to 21%.

Lastly, we acquired just over 200 franchise locations in '23. We feel great about franchisees' willingness to sell to us and are pleased with how this opportunity supports our longer-term revenue growth.

[Capital Allocation Story is Strong]

As you can clearly see in our results, our capital allocation story remains strong. We completed another 200 million dollars of share repurchases in the fourth quarter at an average price of $30.94 after already completing 350 million dollars of repurchases in the first half of the year. In fiscal year '23, we retired 9% of shares outstanding at an average price of $37.59.

Over the last five years, we have reduced shares outstanding from 209 million to 146 million, or approximately 32% of our float. We continue to believe share repurchase is a great use of capital.

As Jeff mentioned earlier, today we also announced a 10% increase to the dividend. Over the last five years, we've increased the dividend by about 30%. What is great about the capital allocation approach is that despite increasing the dividend, the total dollars paid has been decreasing because we have acquired so many shares, which has created a nice flywheel.

As we've consistently shared, we produce significant and stable cash flow, pay a growing dividend, and buy back a meaningful amount of shares. Our goal is to return 100% or more of free cash flow to shareholders annually. This year alone we generated over 700 million dollars of free cash flow and returned a similar amount to shareholders. For fiscal year '23, our free cash flow yield, calculated as free cash flow divided by market cap, was over 16%, which is more than three times the S&P 500.

[FY24 Outlook]

Now turning to our fiscal year ‘24 outlook. First, let me share more about the assumptions we’ve made:

We believe next year will return to typical industry growth of about 1%. This is in line with the historical average, and we do not foresee any industry dynamics that would change this assumption. Data shows that stimulus filers are now behind us, there are no major tax law changes anticipated, and employment has remained strong this year, which is usually correlated to filers in the next year.

We are also assuming we maintain overall US tax market share, but our goal is always to increase share.

We expect to continue to take low single-digit pricing, as we successfully executed in FY23. Our customer satisfaction scores specific to price for value have remained strong.

Additionally, we continue to see value in repurchasing franchise locations, and remain committed to our capital allocation strategy with ongoing, opportunistic share buybacks.

As a result, our fiscal year ‘24 outlook is for:

- Revenue to be in the range of 3.53 billion dollars to 3.585 billion dollars,
- EBITDA to be in the range of 930 million dollars to 965 million dollars,
- Our effective tax rate to be approximately 23%, and
- Adjusted earnings per share to be in the range of $4.10 to $4.30 cents.

In summary, we feel great about how we are positioned. With that, I will turn it back over to Jeff for some closing remarks.

[Closing Remarks]

Jeff Jones, President, and Chief Executive Officer: Thank you, Tony. As I reflect on the passing of another year, I’d like to thank our tax professionals, franchisees, and associates, who embody our Purpose every day to provide help and inspire confidence in our clients and communities everywhere.

I am looking forward to all we will accomplish in the next year and sharing our results for the first quarter in November.

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

[Q&A]

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), earnings before interest, taxes, depreciation, and amortization (EBITDA), free cash flow and free cash flow yield, 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.