

## H&R Block Q2 FY23

### Financial Results Conference Call Transcript

February 7, 2023

#### [Introduction & Forward-Looking Statements]

*Michaella Gallina, Vice President, Investor Relations:* Thank you, Lateef. Good afternoon everyone and welcome to H&R Block's second quarter 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](https://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, February seventh, 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:* Thank you, Michaella. Good afternoon, everyone, and thanks for joining us. Today I will begin with a summary of our Q2 results, progress on Block Horizons, and the momentum we have entering the tax season. Then, Tony will provide details on our financial performance, and we'll open it up for Q&A.

Second quarter results met expectations and we've performed well in the first half of fiscal 2023. I feel confident about our positioning as we move into tax season and the third quarter, and I'm pleased to reaffirm our full year guidance.

In the second quarter revenue grew 5% to last year on continued business momentum and a strong ending to the 2022 tax season. We are seeing signs that consumers are feeling more pressure this year versus last year given the rollback of government stimulus and the broader inflationary environment. As a result, clients turned to H&R Block in Q2 to bridge the gap in their time of need, and we saw higher demand for our Emerald Advance product in December, which we view as a good leading indicator for tax season.

On the expense front, we managed well despite the macro environment, and our capital allocation practice remains solid as we repurchased another 2% of shares outstanding in the quarter.

### **[Small Business Tax & Wave]**

Turning to Block Horizons, I continue to be pleased with the progress we are making. Starting with Small Business, revenue growth was strong as a result of the extended filing season and our bold marketing of the up to 30% price advantage we provide over CPAs. As we've talked about, we're also building out our year-round services for bookkeeping and payroll, and we are seeing positive adoption signals on these products.

We are also feeling good about the value our new business formation tool is offering clients. There are often tax and legal benefits to small business owners from being incorporated, and we built this product with a partner to answer this clear need, with the added benefit of being a revenue driver to Block. It also provides an opportunity to increase tax prep revenue if we file both a personal and business return the following tax year.

Another way we're moving this segment forward is increasing training and certification levels. Half of our small business tax pros have achieved the advanced level, which focuses on levers to directly drive customer and revenue growth through 13 hours of additional training. In all, I'm very happy with the results we are producing in Small Business.

The second component of our Small Business imperative is Wave, which is a one-stop money management platform for small business owners offering invoicing, payments, accounting, banking, payroll, and advisory services. For the quarter, revenue growth was 13%. Our main focus is accelerating revenue growth and determining the ways we'll drive long-term profitability.

### **[Financial Products: Spruce]**

Moving to Financial Products, we were pleased to roll out Spruce in the Assisted channel via all company and franchise offices in January. We knew that educating our tax pros on the clear and different value propositions of Spruce and the Emerald Card would be critical to the success of both products. As such, we added dedicated training and feel good about the readiness of our field and how we're informing clients. The goal for Spruce this season is to educate clients on its value,

generate signups, and ideally have all or a portion of the tax refund deposited as an initial step. The next steps are about ensuring that once an account is open, clients are engaging with the platform, setting up direct deposit, and using Spruce for their day-to-day purchases.

In just the first few weeks, Spruce is living its purpose of helping our clients to be good with money and enabling them to grow in their own personal financial confidence. In fact, our very first Spruce sign up in the Assisted channel came from a longstanding H&R Block client who came to her appointment with an interest in Spruce because she had seen our marketing beforehand. This client had historically deposited her refund at another bank, but after learning about Spruce's specific value proposition and features, such as low fees, the ability to easily deposit cash at retail locations, the fee-free ATM locator in the mobile app, and FDIC backing, she chose to put her refund balance on Spruce.

At the same time, we are continuing to innovate the platform. Importantly, we are making it easier for clients to convert their payroll to Spruce – they will soon

be able to set up direct deposit electronically from within the app, skipping the manual forms and phone calls to HR.

Building on our learnings from the DIY launch last year, our marketing approach for Spruce was strategically planned for before, during, and after the tax event. As of December 31st, we had 171 thousand Spruce sign ups and 117 million dollars in customer deposits. Given the initial launch in the Assisted channel, we look forward to updating you on the trends and learnings after tax season.

### **[Block Experience]**

Turning to Block Experience, we are blending technology with human expertise, and we continue to make great progress. This imperative underpins many of the ways we will win in both Assisted and DIY, and our go to market strategy reflects these advancements this year. Let me share more about it and why we feel confident in our ability to execute this season, which just began with e-file opening on January 23<sup>rd</sup>.

I'll start with the Assisted channel. We are leveraging our technology to empower clients to choose how they want to be served – fully virtual or fully in person, and everything in between. You'll recall that last season we increased the use of virtual tools by more than three times and we are continuing to make progress on client adoption.

We are also improving the operational efficiencies within our innovative fulfillment network. You'll recall we piloted this last year and are further rolling it out this season. The network benefits our clients by allowing them to more quickly access tax professionals who have capacity and increases our productivity.

While the employment market is currently a challenge for many companies, we have successfully met our hiring and staffing goals. Our tax pros tell us that they return to H&R Block year after year because of our culture. They build strong relationships with their clients and teams, and are passionate about helping people. In addition, we hear positive feedback about the flexibility we offer related to scheduling and remote work.



In Assisted, we are taking modest price increases this season. Despite inflation being materially higher, we feel that these modest price increases are appropriate as we continue to deliver a great value for price. We've done the work to position ourselves for success and I'm looking forward to the rest of the season.

Turning to the DIY channel, we have spent a significant amount of time understanding how we can return to share gains by speaking to both our clients and our competitor's clients, and we came away with clear learnings: there is a large awareness gap that H&R Block has as a competitive product, DIY filers do not believe that it is easy to switch to new software, and they do not want to be surprised on pricing when they get to the end of the experience and are ready to file.

With these three challenges in mind, we responded.

First, on the awareness front, we've allocated more of our marketing spend to DIY-specific messaging and are boldly addressing the clear advantages of our product, such as a better product experience, a price advantage to our largest

competitor, how easy it is to switch, and the access to our network of expert tax professionals for assistance. We're also identifying underpenetrated markets where we have a large opportunity and are going deeper in these regions with even more personalized messaging. As you may have seen already, our television advertisements are focused on bringing top of funnel awareness and addressing the ease of switching, which we know is the biggest barrier. We then leverage digital to optimize conversion, such as search, display, and social content, like TikTok, Instagram, and Pinterest, to deliver messaging on the value proposition I just discussed. In addition, reflecting trends of the creator economy, we have targeted campaigns for groups such as the self-employed and students.

Second, we made it easier than ever to switch, including customized flows for clients moving from TurboTax. With just a couple of clicks, clients can drag and drop their previous year's TurboTax return into the H&R Block online flow, which then auto populates into the current year tax flow. We've also created simple, step by step instructional videos to demonstrate this to clients. At the same time, we launched newly built AI technology, which is powered by models from millions of returns and AI algorithms, and other technology such as optical character recognition. This new feature automatically scans the prior year TurboTax return

to identify if the client may have missed out on refund dollars. If it identifies opportunities, we notify the client and connect them to one of our expert tax professionals who can help them file an amendment. Clients only pay if they amend their return to get an additional refund. This technology is a game-changer, and as the possibility of a recession looms, it's important that consumers get every available dollar of their tax refund.

Finally, to solve for pricing transparency, we present price previews to clients throughout the DIY experience so there are no surprises when they get to the end.

Like in Assisted, we are taking modest price increases this year. We feel very good about our improved positioning and go to market strategy in DIY this season.

The progress we continue to make across the business is significant, and I am excited about what is ahead. With tax season upon us, and after spending time in the field already, I can't wait to see what we'll accomplish for clients this year.

With that, I will now turn things over to Tony to discuss our financial results.

## **[Q2 FY23 Financials]**

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

Our performance continues to be on track for the first half of the year and, as a result, we are pleased to reaffirm our full year outlook for 2023, as Jeff mentioned earlier.

In the second quarter, we delivered 166 million dollars of revenue, which increased 5% or 8 million dollars to the prior year. This was primarily driven by client volumes and net average charge improvements as we had a strong end to the 2022 tax season, partially offset by lower Emerald Card revenues. As we mentioned last quarter, we expected this impact due to Advanced Child Tax Credit payments being loaded on Emerald cards last year.

Total operating expenses were approximately 450 million dollars, an increase of about 3% or about 13 million dollars, primarily due to higher corporate and field wages, along with increased bad debt expense. This was partially offset by lower consulting and outsourced services as well as favorable developments in insurance loss reserves.

EBITDA was a loss of approximately 246 million dollars, an increase of 3% or 6 million dollars to prior year.

Interest expense was approximately 19 million dollars, a decrease of about 4 million dollars, or 18%. Recall that in June of 2021 we issued notes at 2.5% and paid off our 500 million dollar 5.5% notes early, in May of 2022. This was partially offset by increased interest expense on our CLOC due to higher interest rates.

Although we are seeing higher interest expense on our short-term borrowings, this will be more than offset with higher interest income in the 4th quarter when we enter a positive cash position, assuming interest rates remain similar to current levels.

Pretax loss was effectively flat to prior year at 298 million dollars and our effective tax rate was 25.9% compared to 36.7% last year. As a reminder, our effective tax rate in fiscal year '22 was 15% and we expect it to increase to approximately 22% in fiscal year '23.

Loss per share from continuing operations increased from -1.09 to -1.43, while adjusted loss per share from continuing operations increased from -1.02 to -1.37, primarily due to the larger net loss from lower income tax benefits in the quarter and fewer shares outstanding. As a reminder, the only adjustment we are currently making to adjusted earnings per share is amortization related to acquisitions.

**[FY23 Outlook Reaffirmed]**

Turning to guidance, we're pleased to reiterate topline growth, EBITDA that outpaces revenue, and EPS that grows even faster. As a reminder, we did not assume any benefit from 1099Ks in our outlook.

We also remain confident in the longer-term target we provided in August, of adjusted EPS growing double digits annually through fiscal year '25.

## **[Capital Allocation Strength & Business Resilience]**

Our capital allocation practice remains strong. In Q2 we bought a total of 3.2 million shares for 130 million dollars at an average price of \$40.22. As Jeff mentioned, this was another 2% of our shares outstanding, for a total of \$350 million dollars or 5% of shares repurchased in the first half of the year. Given our narrow trading windows, we have historically executed most of our share repurchase in the early part of the year. Overall, I believe this is a great use of capital and I feel good about what we have accomplished this year.

Before moving into Q&A, I'd also like to highlight the strength of our business during periods of economic downturns. Both the tax industry and H&R Block have a history of resilience. The industry is most correlated with employment, which remained strong in calendar year 2022, boding well for the tax season in '23. And, as trends over the last couple of decades have shown, when times are tough clients want to ensure they are getting their maximum refund by turning to our trusted brand. We've also seen more small businesses formed during tough economic times, and if the backdrop deteriorates more meaningfully, our

government has a history of stepping in to provide stimulus distributed through the tax filing system.

You'll recall our biggest compensation line item is for tax pros, which is largely variable in relation to filing volumes – meaning we can flex expenses in line with business trends. And as I mentioned before, rising interest rates are actually a near term positive for H&R Block. The bottom line is, our industry volatility is low and our business is resilient.

In summary, we feel very good about the performance of our business and are looking forward to the rest of this tax season. Our next update, including filing volumes, will be on our Q3 call in early May. With that, I'll now turn it back to Jeff for some closing remarks.



## **[Closing Remarks]**

*Jeff Jones, President, and Chief Executive Officer:* Thanks, Tony. In summary, we are pleased with our first half performance and are confident in our ability to drive value for shareholders through our business results and capital allocation practice.

As we end our prepared remarks, I would like to sincerely thank our hard-working associates, franchisees, and tax professionals, who inspire confidence in our clients and communities everywhere. With tax season in full swing, our Block family is hard at work - and I cannot thank them all enough. Now 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," "calls for," "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 also include the expected impact of the coronavirus (COVID-19) pandemic, including, without limitation, the impact on economic and financial markets, the Company's capital resources and financial condition, the expected use of proceeds under the Company's revolving credit facility, future expenditures, potential regulatory actions, such as extensions of tax filing deadlines or other related relief, changes in consumer behaviors and modifications to the Company's operations related thereto. 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, 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 and Industry 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.