H&R Block Q4 FY22

Financial Results Conference Call Transcript

August 9, 2022

[Introduction & Forward-Looking Statements]

Michaella Gallina, Vice President, Investor Relations: Thank you, Operator. Good afternoon everyone and welcome to H&R Block's full year fiscal 2022 financial results conference call. Joining me 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 press release and presentation.

The content of this call contains time-sensitive information accurate only as of today, August 9, 2022. 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.

[Key Results]

Jeff Jones, President, and Chief Executive Officer: Thank you, Michaella. Good afternoon, everyone, and thanks for joining us. Fiscal 2022 marked another year of strong performance, continuing a multi-year trend of improved results. We delivered another great tax season and achieved meaningful milestones in our

Block Horizons journey, including a record year in Small Business, launching our new mobile banking platform, Spruce, and more than tripling the use of virtual tools among tax clients. As a result of the strength in our business, we are pleased to also announce another increase to our dividend and a new share repurchase authorization.

I'll begin as usual by discussing the progress we've made across our strategic imperatives, share more on the tax season, and then Tony will provide details on our results and discuss our fiscal 2023 outlook.

[Small Business Tax]

In small business tax, we are delivering exceptional results. We saw strong growth in both Assisted and DIY clients as well as improved mix, which led to a double-digit revenue increase this tax season versus last year. Our various client acquisition and retention efforts are working, including enhanced marketing efforts and the introduction of an advanced certification for tax professionals. In addition, we are building out our bookkeeping and payroll offerings, and testing new services. Overall, it was a record year, and we are focused on building upon the momentum we saw in fiscal '22.

[Wave]

Turning to Wave, we had another solid year of performance. Revenue grew 28% over last year, and average revenue per user, or ARPU, continued to accelerate on both a sequential and year over year basis. I am excited about the ongoing innovation, including the development of a unified mobile experience that will strengthen Wave's product ecosystem.

We acquired Wave three years ago, and it has since achieved important financial and operational milestones. As such, founder and CEO Kirk Simpson believed it was the right time to hand over the reins to a new leader to take Wave into its next phase of growth. I want to thank Kirk for his leadership and many accomplishments. Importantly, Kirk was instrumental in selecting our new leader, Zahir Khoja. Zahir was formerly the General Manager of North America for Afterpay, where he led the company's rapid market expansion. Previously, he was the Executive Vice President, Global Merchant Solutions and Partnerships at MasterCard. His significant fintech, management, and product development experience make him an excellent fit to lead and scale the business, and I'm excited for this next chapter at Wave.

Overall, small business continues to execute, and I'm pleased with the progress we made in fiscal '22.

[Spruce]

Moving to Financial Products, we are focused on driving innovation within our mobile banking platform, Spruce. We've had four new app releases since the January launch, streamlined the signup process, and made enhancements to the existing credit score feature to help clients understand how it's calculated and how they can improve it.

As of June 30, we have 160 thousand signups and $83 million dollars in customer deposits. As a reminder, we introduced clients to Spruce only in the DIY channel at launch to learn and gain customer insights. Now that we are outside of tax season, we are continuing to innovate the feature set, test customer acquisition, and prepare for launch in the Assisted channel next tax season.

[Block Experience]

Our Block Experience imperative, which is all about blending digital tools with human expertise, continues to drive a better experience for our clients. For example:

- Our technology investments enable clients to be served fully virtually to fully in person, and everything in between. During the 2022 tax season, virtual uptake from clients more than tripled. Embedded machine learning in the DIY user interface is producing a better experience for customers by streamlining the time to complete their return. And we are better anticipating when to offer a DIY user help from a tax pro, which adds expertise to maximize their outcome.
- Our new, innovative fulfillment network enables tax pros with capacity to process a return from anywhere in the country, regardless of location, which results in our clients being more quickly served, and better leverages our tax pro availability. This was one of the reasons we saw strong tax pro productivity this season.

Our enhanced virtual technologies have the added benefit of providing efficiencies for the business. We have begun reducing our existing square footage without closing stores, as most of our tax pro training is now online, and we no longer have a need for large conference rooms in many offices. We have also tested drop off only locations this year to better leverage the fulfillment network, serve clients quickly, and optimize staffing. Finally, robotic process automation, or RPA, have streamlined highly manual back-office processes, eliminating nearly 40 thousand human labor hours in fiscal ‘22 alone.

As you can see, we continue to achieve significant milestones in our Block Horizons journey, and I am very pleased with our trajectory.

[2022 vs 2019 Compare]

Turning now to results: we finished the year strong in both the Assisted and DIY channels, serving more clients than typical in the May and June period. We exceeded our guidance on both revenue and EBITDA and continued a multi-year trend of creating value for shareholders. Since 2019, the last normal year prior to the pandemic, our performance speaks for itself: we have grown total clients, grown Assisted market share, grown revenue and EBITDA more than 12% each, and reduced shares outstanding by 21%, leading to adjusted EPS growth of nearly 50%, and grown the dividend. Stepping back over double that time frame, since

2016, we have grown adjusted EPS by approximately 110%. We emerged from the pandemic much stronger as a company and are on a path of growth.

In summary, it was another great year for H&R Block, delivering on our purpose to provide help and inspire confidence in our clients and communities everywhere. I am excited about the momentum in the business, the strength of our capital allocation, and where we are headed. Tony will now share more on our financials and outlook.

[FY22 Results]

Tony Bowen, Chief Financial Officer: Thanks, Jeff, and good afternoon, everyone. Our results continue to be strong, and I am happy to be here today to share more detail. I'll begin with a review of our fiscal '22 results, provide an update on the ongoing strength of our capital allocation practice, discuss our outlook for fiscal year '23, and share thoughts on how we deliver total shareholder return over time.

As a reminder, the prior year included the end of tax season ’20 which was extended to July 15th of that year; that causes our results to decline when you compare fiscal year ‘22 to the prior year.

In fiscal ’22, we delivered 3.46 billion dollars of revenue, which decreased 3.5% or 125 million dollars over the prior year. When normalizing prior year results for the tax season impacts recognized in July of 2020, and the impacts of Emerald Card stimulus, total revenue increased by $165 million, or 5%.

Total operating expenses were approximately 2.7 billion dollars, an increase of approximately 1% or about 21 million dollars, primarily due to higher marketing and technology costs, partially offset by lower depreciation and amortization and bad debt. We continued our efforts of identifying savings to fund our investments and our expense management remains strong.

EBITDA was approximately 890 million dollars, a decrease of 15% or about 162 million dollars. Compared to the normalized prior year, EBITDA increased by 9%, or about 75 million dollars.

Interest expense was approximately 88 million dollars, a decrease of about 11 million dollars, or 11%, driven by lower draws this year on our line of credit, partially offset by the 500 million of notes we issued last June. As planned, in the fourth quarter we paid off the 500 million 5.5% maturing notes that were originally due in November, which will result in material savings given the new notes we issued at a 2.5% interest rate.

Pretax income was 659 million dollars compared to 797 million dollars in the prior year, and our effective tax rate was 14.9% compared to 13.4% last year. Compared to the normalized prior year, pretax income increased by $99 million, or 18%.

Turning to share repurchase, we bought a total of 23 million shares for 550 million dollars this year at an average price of $23.84. This was 13% of our shares outstanding, and today we announced another share repurchase authorization that I will share more about in a moment.

Earnings per share from continuing operations decreased from $3.67 to $3.26, while adjusted earnings per share from continuing operations decreased from

$3.94 to $3.51. Compared to the normalized prior year, adjusted earnings per share increased from $2.97 to $3.51, or 18%.

In fiscal ‘22, we acquired 125 franchise locations. We view this as a good use of capital given that we are able to repurchase locations at attractive EBITDA multiples and integrate the businesses into our existing company operations. We believe we can continue to acquire franchise locations, which, as we shared previously, can contribute approximately a point of growth annually to our topline.

Regarding Sand Canyon, two long outstanding litigation matters, which we refer to as the Homeward cases, were recently fully resolved in Sand Canyon’s favor, as reported in our Form 10-Q last quarter. We feel great about this outcome for Sand Canyon, and do not plan on providing regular updates going forward outside of disclosures in our Forms 10-K and 10-Q, and other SEC filings, unless there is other material news to share.

[Ongoing Strength of Capital Allocation]

Switching gears - we have a long track record of generating significant cash flow and returning value to shareholders through dividends and share repurchases, which helps drive earnings per share growth.

As we have shared, we believe free cash flow yield, defined as free cash flow divided by market capitalization, is an important metric for our company. Despite the increase in our market cap in recent months, our fiscal year '22 free cash flow yield remains strong at approximately 13%, which is more than double that of the S&P 500.

Because of the momentum and strength in our business, we are pleased to further enhance our capital allocation by announcing another increase to the quarterly dividend to $0.29 per share, or more than 7% growth, and a new share repurchase authorization of 1.25 billion dollars which is effective through fiscal year 2025. Since 2016, we have increased the dividend by 45% and retired nearly one third of our shares outstanding. In total, we have returned over 2.7 billion to shareholders in that time frame, and we will continue to drive ongoing value with these practices.

[FY23 Outlook]

Let me now turn to our fiscal year ‘23 outlook. Given the rollback of the Child Tax Credit for this upcoming year, and an expected increase in our effective tax rate from the mid-teens to the low twenties, we are pleased to provide an outlook with topline growth, EBITDA that outpaces revenue growth, and EPS that grows even faster.

We expect revenue to be in the range of 3.535 to 3.585 billion dollars.

We expect to generate EBITDA of 915 to 950 million dollars from growing the topline and leveraging our fixed cost structure.

As I just shared, our effective tax rate is expected be approximately 22%.

We are also adding EPS guidance, which more holistically captures the value we are creating. For FY23, we expect adjusted earnings per share to be in the range of $3.70 to $3.95.

On that note, let me share more about how we are driving EPS growth, and how we think about total shareholder return. We believe we can grow revenue 3-6% annually over time, driven by the many levers we have in place, including about a point from steady industry growth, a couple points from modest low single digit price increases, a point from franchise buybacks, and nearly a point from Wave. From there, we have additional upside with our Block Horizons imperatives.

We then have the opportunity to grow EBITDA at a rate of nearly 1.5x that of revenue, due to the leverage in our fixed cost structure.

After layering on opportunistic share repurchases, we see a path to double digit earnings per share growth annually through 2025.

On top of the P&L expansion, we continue to grow our quarterly dividend, which we have paid since Block became public in 1962.

As Jeff shared, over the last six years, we have grown adjusted EPS 110%, or a CAGR of 13%. You can see that H&R Block has had multiple strong years of performance and I am more excited than ever about what is in front of us. With that, I'll turn things back to Jeff for closing remarks.

Jeff Jones, President, and Chief Executive Officer: Thank you, Tony. Before closing I want to reiterate just how pleased I am with our performance in fiscal '22 and the path we are on. We had another great tax season, achieved significant Block Horizons milestones, and continue to return value to shareholders through our capital allocation practice.

Our success is made possible by the collaborative efforts of our entire organization: thank you to our steadfast tax professionals, franchisees, and associates, who embody our purpose every day to provide help and inspire confidence in our clients and communities, as well as the team at Wave, who continue to execute and drive innovation. My sincere thanks go out to the team for another great year, and I look forward to all that lies ahead of us as we continue to build on this momentum in fiscal 23.

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 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, free cash flow yield, normalized revenues, normalized pretax income, normalized EBITDA, and normalized adjusted earnings per share, which management believes provide additional meaningful information regarding the Company's performance and financial strength. All non-GAAP financial measures in this presentation 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.