H&R Block Q1 FY23

Financial Results Conference Call Transcript

November 1, 2022

[Introduction & Forward-Looking Statements]

Michaella Gallina, Vice President, Investor Relations: Thank you, Operator. Good afternoon everyone and welcome to H&R Block's first 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. 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.

The content of this call contains time-sensitive information accurate only as of today, November first, 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.

[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 fiscal ’23 Q1 results and share more about our Block Horizons progress. Then, Tony will provide an update on our financials.

While the first quarter is small in comparison to our fiscal year - just about 5% of our total revenue - our Q1 performance met expectations, and we are reaffirming our full year outlook. We’ve done a good job of converting extensions, which increased 5% over prior year, and we saw healthy, ongoing adoption of virtual tools in the quarter.

We also managed expenses well despite the high inflationary environment. On the capital allocation front, we bought back another 3% of shares outstanding; and in October, paid our quarterly dividend of $0.29 per share, which is an increase of 7% to last year. Overall, I’m pleased with our start and am looking forward to the rest of fiscal ’23.

[Small Business Tax & Wave]

We are in the third year of our Block Horizons transformation, and we are gaining momentum. Beginning with Small Business, we see a significant runway of growth and opportunity with both small business tax and Wave.

In Assisted small business tax, we continued to see double digit revenue growth driven by both volume and net average charge. In Q1 we broadened our marketing efforts with a bold message focusing on the value we deliver vs. independent CPAs, which is meaningful. While early, bookkeeping and payroll are growing nicely, driven by our dedicated team of company bookkeepers and franchisees.

We are also capitalizing upon the growth trends we saw last year in two ways. First, we're building an inside sales capability to convert tax leads into small business services. Second, we saw significant opportunity to help clients incorporate their small business. In response, we launched a self-serve business formation product in October that enables business owners to create an entity. This can result in significantly better tax outcomes and a greater level of legal protection for our clients, and simultaneously provides the benefit of having two returns filed with Block – both the individual and the entity. As you can see, we have a lot of good things happening in Small Business.

Turning to Wave, our new CEO has successfully onboarded, is completing a strategic review of the business, and is assessing levers to drive future performance. While Wave customers saw increased invoice volume, there was less payment activity than we anticipated. As a result, revenue growth was 18% in the quarter.

[Financial Products: Spruce]

Moving to financial products, recall that we brought our new mobile banking platform, Spruce, to market in the DIY channel this past tax season. Given most of our marketing efforts are currently timed around the tax season, our metrics are relatively unchanged to the results we shared last quarter with approximately 160 thousand signups and 98 million dollars in customer deposits.

We know that Spruce customers want to improve their financial health. One of the most proven and effective ways they can do this is by saving money, even in small amounts, which is why we’ve continued to focus on savings-related innovation within the app.

We recently added capabilities that enable users to ‘round up’ their purchases to the nearest dollar, with the difference automatically deposited to their savings account, as well as the ability to deposit checks with their mobile phone.
We’re also enhancing our unique Smart Tax Refund feature, which allows customers to make a pre-commitment to save a portion of their tax refund rather than spending it right away. Last year this feature empowered the average user to set aside more than a quarter of their tax refund.

One of the greatest challenges of engaging clients to load money is the process of switching their payroll. In an upcoming release, users will be able to change their payroll deposit settings from within the Spruce app, without having to go back to their employer, making this process much simpler.

Alongside product innovation, we are preparing for launch in the Assisted channel by educating tax professionals on the clear and different value propositions between Spruce and the Emerald Card to help clients make the best decision for their needs.

[Block Experience]

Regarding Block Experience, we're making great strides blending digital capabilities with human help, resulting in a better, more personalized process for our clients. We believe this is the key to winning in both Assisted and DIY, and we have a multitude of exciting projects underway.

Last year we increased the number of clients using a virtual tool by more than 3 times. We're continuing to help the customer understand the benefit of these offerings, such as digital drop off and approving returns online. Machine learning models are improving how we serve Assisted and DIY clients, as well as driving advancements in matching the complexity of a clients' return to the right tax professional. This makes for a better customer experience and increases our productivity.

We have expanded remote work options for tax professionals and are seeing early, positive signs in hiring and retention. Our first-year tax pro role has been reshaped to accelerate their expertise, which increases productivity by enabling them to serve more clients. In fact, we have already hired to 75% of our goal for this new role.

Over the last few months, we have evaluated how we can more effectively highlight our DIY value proposition. We've been doing research with our clients and our competitor's clients, and we know that our product is strong, our value is strong, and the number one opportunity we have is increasing awareness that we offer a DIY product. As a result, you'll see us come to market with a new approach.

In all, expanding virtual capabilities enables us to be well positioned to help our clients however they want: completely virtually or completely in person, and everything in between.

Our Block Horizons progress continues to build, and we're excited about the magnitude and the impact of this work.

[Annual ESG Report]

Lastly, I'd like to mention that we recently released our annual Environmental, Social, and Governance, or ESG, report, which can be found on our website. While this is our third annual publication, in many ways we're just getting started. Being a responsible corporate citizen that connects our people, communities, and planet has been a part of our culture and aspirations from the very beginning, and I'm pleased with the work we are doing.

With that, I'll now turn it over to Tony.

[Q1 FY23 Results]

Tony Bowen, Chief Financial Officer: Thanks, Jeff, and good afternoon, everyone. Today I'll review our Q1 results, our capital allocation practice, and our outlook for fiscal year '23.

We delivered 180 million dollars of revenue in the first quarter, which decreased approximately 7% or 13 million dollars over the prior year. This decrease was due to the Advanced Child Tax Credit being loaded onto Emerald Cards last year, causing a 17-million-dollar impact in the quarter; we also expect a similar impact in the second quarter, both of which were contemplated in our fiscal year ‘23 outlook.

In addition, we had a 4-million-dollar negative revenue impact from our foreign exchange in our Australian and Canadian businesses.

These declines were partially offset by growth at Wave, and an increase in net average charge in our Assisted business.

Total operating expenses were approximately 389 million dollars, an increase of approximately 6% or about 22 million dollars, primarily due to higher compensation and technology related expenses, and partially offset by lower consulting and outsourced services. We just completed our annual merit process, which contributed to the increased compensation expenses during the quarter. While field and corporate salaried positions increased more than historical levels, tax pro compensation, which is our largest line item, is variable and fluctuates in line with return volumes.

EBITDA was a loss of 172 million dollars, an increase of 24% or about 33 million dollars.

Interest expense was approximately 16 million dollars, a decrease of about 7 million dollars, or 31%. Recall that last quarter we paid off the 500 million 5.5% notes early, which will result in material savings as we issued new notes in June of 2021 at an interest rate of 2.5%. Given that we are in a rising interest rate environment, the borrowing costs on our line of credit will be impacted, but higher deposit rates on our cash balances are acting as a natural hedge.

Pretax loss was 221 million dollars compared to a loss of 197 million dollars in the prior year, and our effective tax rate was 24.4% compared to 24.0% last year. Loss per share from continuing operations increased from 84 cents to $1.05, while adjusted loss per share from continuing operations increased from 78 cents to 99 cents.

[Ongoing Strength of Capital Allocation]

Turning to capital allocation, our practice remains strong. We repurchased 4.9 million shares for $220 million dollars this quarter at an average price of 44 dollars and 60 cents. This equates to another 3% of shares outstanding, and we now have repurchased approximately a third of our shares since 2016. We also paid our 29-cent dividend in October, which was an increase of 7% to last year, and an increase of 45% since 2016.

[FY23 Outlook Reaffirmed]

In summary, we are reiterating our fiscal year ‘23 outlook. As we have discussed, I am pleased with this guidance given the roll off of the Child Tax Credit, the increase in our effective tax rate compared to last year, and the headwinds we are seeing in the foreign exchange rates. We continue to expect topline growth, EBITDA that outpaces revenue, and EPS that grows even faster. In addition, we are confident in the longer-term target we provided in August, of adjusted EPS growing double digits annually through fiscal year ‘25.

Overall, we are off to a great start. With that, I will now turn it back over to Jeff for closing remarks.

[Closing Remarks]

Jeff Jones, President, and Chief Executive Officer: Thanks, Tony. We're focused on building upon the momentum we have driven over the last couple years. I'm excited about what's ahead, and in closing, 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.

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 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

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