Company Name: Intuit
Company Ticker: INTU US
Date: 2017-05-23
Event Description: Q3 2017 Earnings Call

Market Cap: 36,211.14
Current PX: 141.33
YTD Change($): +26.72
YTD Change(%): +23.314

Bloomberg Estimates - EPS
Current Quarter: 0.168
Current Year: 4.384
Bloomberg Estimates - Sales
Current Quarter: 807.455
Current Year: 5139.500

# Q3 2017 Earnings Call

## Company Participants

- Jerry Natoli
- Brad D. Smith
- R. Neil Williams

## Other Participants

- Kash Rangan
- Michael Nemeroff
- Walter H. Pritchard
- Jesse Hulsing
- Sanjit K. Singh
- Kartik Mehta
- Raimo Lenschow
- Ross MacMillan
- Scott Schneeberger
- Stewart Kirk Materne III
- James MacDonald
- Michael Millman
- Patrick E. Colville
- Yun Kim

## MANAGEMENT DISCUSSION SECTION

### Jerry Natoli

#### *GAAP and Non-GAAP Financial Measures*

Some of the numbers in these remarks are presented on a non-GAAP basis

We’ve reconciled the comparable GAAP and non-GAAP numbers in today’s press release

### Brad D. Smith

#### *Q3 Highlights*

##### *Consumer Tax Revenues and Small Business Franchise*

- We’re pleased with our performance in our third fiscal quarter
- As you know, this is our largest quarter of the year and we successfully delivered strong financial results in a complicated tax season

- Exiting the quarter, our Consumer Tax revenue is up 9% YTD and is on track to finish at the high-end of our guidance range for the full FY.
- We're also driving continued momentum in our small business franchise, with QuickBooks Online subscriber growth accelerating to 59% and over 2.2mm subscribers, which is above the upper end of the target we had established for the full FY.

### *QBO Subscribers*

- As a result, we're raising our outlook for QBO subscribers to 2.3mm
- We're raising our full year revenue guidance, and we're tightening the EPS range to the high end
- All-in-all, we're on track to deliver another good year

## *Tax Results*

With that overview, let me click down into the drivers of our performance in Q3, beginning with our tax results

- This tax season proved to be eventful from beginning to end, with the delayed start to the tax filing compared to prior years, a renewed competitive environment in the Free category, and new IRS requirements designed to reduce fraud

### *Four Drivers of Tax Business*

#### *Growth in number of Tax Returns Filed with IRS*

- The combination of these factors were reflected in the four drivers of the tax business that we discuss with you on a regular basis
- The first driver is overall growth in the number of tax returns filed with the IRS.
- The latest IRS data indicates that total returns are down slightly, below the 0% to 1% growth that we had forecasted
  - If this trend plays out for the remainder of the tax filing year, it will be the slowest growth in total tax returns since the year 2013

#### *DIY Category Growth and TurboTax's Share*

- The second driver is the percentage of returns filed using do-it-yourself software
- To date, DIY category share has grown about two-tenths of a point, less than the 1.2 points that we had expected
  - With that said, DIY category growth once again outpaced the y-over-y decline in the assisted tax prep method
- The third driver is TurboTax's share within the do-it-yourself category
  - After strong share gains the past several years, our share of DIY e-file this season was flat
- This performance is below the one point of share gain that we strive to achieve each year and we're already designing innovative ways to accelerate customer growth as we look ahead to next season

#### *Revenue per Return*

- The fourth driver is revenue per return, which finished stronger than our multiyear average of 1%
- Our pricing was relatively stable this season so the benefit resulted from a mix shift to the higher end of our product lineup

### *Execution and Innovation*

- So while the drivers of our tax results played out differently than expected, I am proud of the agile execution and innovation the team delivered this season
- If you recall the game plan that we shared at our Investor Day in the fall, we outlined a plan to extend our leadership in do-it-yourself tax, begin transforming the assisted tax category and run experiments to evolve beyond tax through a trusted open platform

### *SmartLook, Intuit Ecosystem, QuickBooks and TurboTax*

- This season, we made progress across several fronts
- We leaned into SmartLook, providing broad access to an expert with a simple touch of a finger at a much lower cost than going to a tax store
  - We also began driving value to the broader Intuit ecosystem, leveraging the credit score functionality in Mint to provide more than $1.3mm free credit scores to TurboTax customers this season
- And we introduced the self-employed bundle of QuickBooks and TurboTax targeting the freelancer and gig economy, driving strong results which I'll discuss in greater detail in a minute

### *Investments*

- All of this was built on the investments we've made in innovation over the past several years in areas such as artificial intelligence where we've applied for more than 100 patents and have more than 30 AI applications in market across the company
- Putting the bow around Consumer Tax, we're exiting this season with strong financial results although generated in ways that were different than what we had expected
- We'll learn from our experience this season and continue to invest in our multiyear strategy to deliver against the long-term objectives that we've set for ourselves
  - We'll share more details on our results and our long-term strategy at our annual Investor Day in the fall

### *Tax Results in ProConnect*

#### *Revenue Growth and QBO Subscribers*

- With that overview on consumer tax, let's shift to the assisted tax results in ProConnect
- This business delivered results that were better than our expectations with YTD revenue growth of 2%
- ProConnect plays an important role across our ecosystem with approximately 60% of the TurboTax SmartLook agents being staffed by our ProConnect tax experts this season

- We've also seen early success in driving QBO subscribers through our tax sales effort, fostering growth within the QBO franchise

### *Small Business*

#### *Subscriber Growth and QBO Subscribers*

- With that overview on tax, let me now shift to small business
- Subscriber growth continued to accelerate, driven by improvements across our platform that serves self-employed, small businesses and accountants
- We've also increased our marketing effectiveness and expanded our addressable footprint internationally in the self-employed segment
- As I mentioned earlier, total QBO subscribers grew 59% in the quarter, up from 49% growth in Q2
- Our TurboTax Self-Employed offering contributed 11 points to this subscriber growth

#### *U.S. Business & International Markets and QuickBooks Online*

- We continue to drive strong growth in both our core U.S. business and international markets
- Outside the U.S., our subscriber base grew 70% y-over-y to 433,000 subscribers
  - That's up from 61% growth in Q2
- Within QuickBooks Online, the QuickBooks Self-Employed subscribers doubled to 360,000, up from 180,000 last quarter and 75,000 just one year ago
  - During Q3, we launched QuickBooks Self-Employed in Singapore, adding another geography to our lineup, and we expect to launch in Hong Kong and South Africa soon

#### *TurboTax Self-Employed Offering*

- Finally, our TurboTax Self-Employed offering has contributed approximately 160,000 subscribers to the QuickBooks Self-Employed total so far this year
- Our tax customer base has proven to be a great channel for reaching the self-employed, and we know nearly 4mm TurboTax customers are self-employed tax filers
  - I'm also pleased to report that QuickBooks Self-Employed customers who come through the TurboTax channel have a higher product recommendation score as well

### *QBO Subscriber Growth*

- Our momentum in QBO subscriber growth is driving top line revenue, with online ecosystem revenue growing 30% again this quarter, at the high-end of our 25% to 30% target range
- We expect online accounting to be the primary driver of online ecosystem revenue for the seeable future, as we prioritize seeding the global market with QuickBooks Online
- Add-on services, such as payroll and payments, the blade to the QBO razor, certainly remain important, and they'll play an increasingly larger role in later chapters

- But our strategic priority at this time is getting more QBO razors in the market
  - This playbook should sound familiar, because it served us well for decades in the QuickBooks desktop franchise

### *Summary*

Putting it all together, our strategy of a vibrant One Intuit Ecosystem is gaining real momentum

We're seeing proof points with more ecosystem connections between customers and products that are creating greater value for our customers and building sources of competitive advantage for Intuit

Whether it's TurboTax, driving Self-Employed customers for QuickBooks, its ProConnect accountants serving TurboTax customers through SmartLook, or its the Mint credit scores being delivered to TurboTax customers, we're unleashing the power of the many for the prosperity of one

## R. Neil Williams

### *Financial Highlights*

#### *Revenues and EPS*

- For Q3 FY2017, we delivered revenue of $2.5B, up 10% y-over-y, GAAP operating income of $1.4B vs. $1.3B a year ago, non-GAAP operating income of $1.5B vs. $1.4B last year, GAAP diluted EPS of $3.70 vs. $3.94 last year, and non-GAAP diluted EPS of $3.90 up from $3.43 last year
- As a reminder, our GAAP results last year included $0.68 per share from the sale of discontinued operations

#### *Consumer Tax*

##### *Revenues and Unit Growth*

- Turning to the business segments, Consumer Tax revenue is up 10% in the quarter, 9% YTD.
- Our unit growth was 2%, and we saw a mix shift to the higher end of our product lineup, increasing our average revenue per customer
- We held share in the category this year, but we did not grow units faster than revenue
  - This is not consistent with our long-term principle, and we're addressing it in our strategy for next year

##### *Unit & E-File Growth and New Internal Revenue Service Security*

- We've had questions on the difference between unit and e-file growth this season, so let me explain
- We grew units 2% this season, but our e-file growth was flat
- New Internal Revenue Service security measures this tax year mandated the only way to e-file is to enter the prior-year-adjusted gross income or your existing filing PIN.
- Many of our new customers had difficulty with this, causing them to print and mail their returns instead of e-filing

    - Although these returns were prepared with our software, and customers paid for them, the mail returns are not included in e-file results reported by the IRS.
  - Nor are they counted in our share calculations, which are based on e-file returns
    - We saw at least an incremental 500,000 returns this year that were paid for but not e-filed

### *ProConnect Revenues*

- ProConnect revenue was $116mm in Q3, down 8% from Q3 last year
- This reflects the timing shifts from forms availability we discussed last quarter
- YTD, our ProConnect revenue is $327mm, a little better than our expectations and last year

### *Small Business*

#### *Revenues and Online Subscriber Growth*

  - Moving to small business, total small business revenue grew 16% in the quarter
  - QuickBooks Online subscriber growth remained strong, and we exceeded our guidance for the quarter and the full year, reaching 2,220,000 subscribers, up 59% y-over-y
  - TurboTax was a significant channel for QuickBooks Self-Employed in Q3, accounting for 11 points of growth
  - Small business online ecosystem revenue grew 30% for the second consecutive quarter
    - This is at the high end of the 25% to 30% growth range we've talked about and is driven by continued growth of online accounting revenue

### *Online Payroll and Payment Businesses*

- Our online payroll and payment businesses remain healthy, growing 19% and 9% this quarter respectively
- As we've told you before, a portion of each of these businesses are attached to QuickBooks Online, and a portion is made up of standalone customers who are not connected to QuickBooks

#### *Revenues*

  - Online payroll revenue attached to QuickBooks makes up about 45% of online payroll revenue
    - That revenue grew 35% in the quarter with subscriber growth of 21%
  - In contrast, online payroll revenue unattached to QuickBooks grew 1%
  - Online payments revenue attached to QuickBooks makes up about 60% of our online payments revenue
    - That revenue grew 33% in the quarter, with active payments customer growth of 47%
  - As we've mentioned in the past, we're not investing in acquiring standalone payments customers, and that portion of the portfolio is declining
    - Revenue for these online payments customers not attached to QuickBooks fell 15%

### *Desktop Ecosystem Revenues*

- Our small business desktop ecosystem revenue grew 12%
- About 6 points of this revenue growth is related to a SKU we introduced at retail last year
    - This SKU gave desktop customers a QuickBooks license and the right to access QuickBooks Online service for one year at no additional charge
- This required us to defer a portion of the related revenue
    - These rights expired in Q3, resulting in recognition of this revenue
- Desktop units declined 15% y-over-y and units were 3% below last year on a YTD basis
- For FY2017, we expect QuickBooks desktop units to decline mid-single digits and desktop ecosystem revenue to be up mid-single digits
    - That growth is driven by ratable revenue recognition and continued strength in our QuickBooks Enterprise business

### *Cash and Investments*

- Turning to our financial principles, we continue to take a disciplined approach to capital management, investing the cash we generate in opportunities that yield a return on investment greater than 15%
- With approximately $1.6B in cash and investments on our balance sheet, our first priority is investing for customer growth
- Our goal is to drive double-digit revenue growth and to grow operating income in the mid-teens

### *Share Repurchasing and Dividends*

- We return excess cash to shareholders via both share repurchases and dividends
- We repurchased approximately $90mm of shares in Q3, and $1.9B remains on our authorization
- We used some of our operating cash to repay $500mm in senior notes that matured in March and $150mm on our revolver
    - The board approved a dividend of $0.34 per share payable on July 18, 2017

### *Full-Year*

#### *QBO Subscribers, Revenues and EPS*

- We're raising our full-year QBO subscribers and total company revenue guidance and narrowing operating income and EPS to the high end of the range
- We now expect total company revenue growth of 9% to 10% for the year
- You can find our FY2017 Q4 guidance details in our press release and on our fact sheet

## Brad D. Smith

***Summary***

Q3 was another strong quarter for Intuit with a hard-fought tax season that brought some bright spots as well as opportunities to improve, but ultimately delivered at the high end of our revenue guidance for the tax business

Small business continues to gain momentum with accelerating QBO subscriber growth leading to an increase in our full-year subscriber outlook and online ecosystem revenue topping the high end of our 25% to 30% target range for the second consecutive quarter

Collectively, we're driving strong progress with our One Intuit Ecosystem strategy, creating greater value for our customers and building new sources of competitive advantage

# QUESTION AND ANSWER SECTION

**<Q - Kash Rangan>**: It looks like these additional discoveries that you had, 4mm self-employed individuals that are also TurboTax customers, how near term of an opportunity would this be to the QBO franchise as regards your ability to make this something of a bigger – I know 2.3mm is fantastic, but at what point in time are we looking for and shooting for a 5mm type target, which all the more given your disclosure looks feasible, given the correlation and the data that you've uncovered? Thank you so much.

**<A - Brad D. Smith>**: I love your optimism and your positive view on the business. We feel the same way about the opportunity with self-employed. We know that this is a secular trend that continues to build momentum around the globe, and we discovered in TurboTax we do indeed have a channel, with 4mm of those tax filers being self-employed.

And we discovered that now with a bundle that this year was really the first full year of having it in season that we know how to optimize that conversion and get more of those customers in the funnel. So we haven't put any outlook out there yet. We'll talk more about FY2018 in August. But like you, we see the real opportunity here, and we think this is just the early innings of what could be a long-term growth driver for the company.

**<Q - Michael Nemeroff>**: Just digging in a little bit on the tax season. A lot of your paid subscribers in the next year come from your Free filers in the previous year, so I'm wondering what, if any, impact you think the flat market share in 2017 is going to impact the 2018 tax season?

**<A - Brad D. Smith>**: Let me start by saying that we do believe that we left opportunity on the table. We have very clear principle to grow our customers faster than our revenue, and we want to continue to take share in the category.

This year we did not do either of those. We actually did not grow our customers faster than revenue, and we held share. But I would also tell you that that doesn't mean next year is not going to be a good year for us. If you go back to 2013, that was a year where we grew our units at about 3%. We stepped back, we took the lessons, we laid out a game plan, and in 2014, we grew units 9%; 3x. And I can assure you, we've got a highly motivated team, and as Neil would say, bad batch, not a bad recipe. So we're back to the cooking table and we're ready to do it again.

**<Q - Walter H. Pritchard>**: Another tax question. On the SKU mix, is there any way you could give us a sense as to what your mix looked like of the Free, the Deluxe, the Premier? Any color there? Was it a mix within those categories, or did you actually see higher prices in certain categories that helped on the revenue per filing?

**<A - Brad D. Smith>**: Let me break it down a little bit, and I'll break it into a 60%, 20%, and 20% sort of bucketing for you.

The reason why we were able to still grow revenue at the high-end of the range, 9% YTD, while we grow units 2%, that's primarily because of mix. 60% of that effect was the fact that we did not get as many three Free customers as we set out to do every year. And as I just mentioned in my prior response, we're going to sharpen our pencils and get back at that next year cause we want to continue to grow the category and we want to continue to grow share.

So by taking three Free out of the mix, that means that your average revenue per return or revenue per customer for the remainder is going to be higher. That takes me to the 20% tranche, and that 20% is we have continued to get more sophisticated in finding ways to add value to customers that they're willing to pay for.

Some of those may have been prior year Free customers, some of those could be existing paid customers, but they see value bundles that they think are worthy of them actually paying, and that's helped us increase our revenue.

And then the third bucket is the higher end of the product lineup, in particular, TurboTax Self-Employed. With that success we just talked about QuickBooks Self-Employed, there's a real winner there, and that's the most expensive or the highest priced product in our product lineup.

So when you put that all together, it was fewer three Free, which we actually view as an execution opportunity. We continue to get better at creating value that customers are willing to pay for, and we're also seeing some early success at the higher end of our product line which we think bodes well for the future.

**<Q - Walter H. Pritchard>**: And then just for Neil, on the margins, so I mean, I hear you talking about wanting to drive small business subscribers and you have a history of monetizing those over time, which I'd agree. When I look at your margins in small business from Q1 to Q2 to Q3, they actually have improved every quarter here if I look y-over-y. And you're showing some nice margin expansion in Q3 in small business over where you were last year. Is there something anomalous there, or is that a – are you able to kind of do both at once?

**<A - R. Neil Williams>**: We're kind trying to balance, Walter, to do both at once. We have opportunities to grow and expand by investing in the product and marketing. But those have to be at a positive NPV. And so at the midpoint of our range this year, we think we'll see maybe 50BPS of margin expansion, which I think is a really good balance between funding the growth opportunities we see in front of us and taking advantage of those, and being true to our financial principles.

**<Q - Jesse Hulsing>**: You mentioned – or maybe it was Neil – the razor blade model for QBO, and you've used that in your small business segment for decades now. I'm curious, when you look at self-employed, how do you see that evolving? Where do you see opportunity to drive incremental add-ons into that self-employed base, which doubled quarter over quarter and seems to be on pace to pretty quickly get to north of 1mm subscribers? I'm wondering what can you sell into those users that's incremental? And how do you see that business evolving?

**<A - Brad D. Smith>**: And first of all, I would say that we don't need to sell anything else to a self-employed customer for that to be a great business. There's hundreds of millions of these prospects around the world. And as we look at that opportunity and even at our current price at roughly $10 a month, so $120 a month, with the low cost to acquire those customers, that is a very good and profitable business that could be substantial for the company. But with that said, we're discovering already, they have additional problems to be solved that they're willing to pay us for if we solve them well.

A great example is we added invoicing functionality into self-employed, and that connects the payments. And the ability for us to have them actually send an invoice and get paid in a matter of eight days vs. 28 days is a real opportunity for us to have razor blades.

Another example is the one we talked about earlier in the opening comments, which is tax returns. The ability to have them do their self-employed, separating personal from business management throughout the year, and then come tax time press a button and have it going to TurboTax or go to one of our accounts to do a Pro return, that's also another razor blade. And we'll stay focused on other opportunities down the road, but by and large the opportunity is getting more of these units, and then solving additional problems, whether it's getting paid faster with an invoice, or doing a tax return, and those are the razor blades that are already emerging, and we're still in the very early innings.

**<Q - Jesse Hulsing>**: And then a quick follow-up on international, which again was strong and accelerated. How are you feeling about where Brazil and France are? And are you looking at launching in any other geographies with QuickBooks Online? Thank you.

**<A - Brad D. Smith>**: We are proud of that momentum we're seeing. Obviously the three countries that drove the bulk of that were Canada, and the UK, and Australia, where we got product-market fit right coming out of the last summer, and we've really been hitting the accelerator. Brazil is on track, looking good. We're feeling confident that as we head into the summer months that that one's closer to flicking into that green light that we're looking for on product-market fit. France is right on its heels, and we're still in the investigative phases of how to really figure out India. The good news is there's changes in India with GST, which is basically a new tax legislation, that will drive more compliance. And so our teams are really rolling up their sleeves to take advantage of that.

In terms of additional countries, we're leading now with QuickBooks Self-Employed. We have found that to be the fastest, lightweight, easy to get into market and solve a problem and build a base. So I just mentioned that we introduce QuickBooks Self-Employed in Singapore in the last quarter, and we're going to be introducing it in Hong Kong and South Africa soon. And then from there, we'll talk about in the fall whether we see other countries that we'll take QBO to, but right now self-employed will be the point of the spear.

**<Q - Sanjit K. Singh>**: Just another sort of question on the tax business. If you can sort of give us a sense, sort of behind the scenes, as you saw the tax season progress, were there certain initiatives that you guys put in place? And if so, if we think through into next year, is this a situation where you guys have so much flexibility given the strong franchise in tax that you guys can sort of toggle strategies in the middle of the tax season?

**<A - Brad D. Smith>**: Behind the scenes, you might imagine, it's a lot of scenario planning and a lot of adjusting on the fly. It's a highly instrumented business. We're able to see, at any moment in time, how many people are in the product vs. the same minute at the same day last year. And then our teams are able to look at that and say, okay, do we need to adjust anything as we look ahead? We made adjustments throughout the season. I think we talked about a little bit of this on our last call.

We had put some investment in advertising early in the season and then when we saw a delay to the tax filing, we had to go ahead and belly up to the bar and put a little more money into what we would typically think of as the trough, which is after the season gets started, there's a little bit of a lull before the back half procrastinators jump if. But we advertised through the trough this year because we said they're going to have to come at some point. And that paid off for us.

In terms of next year, I'll say this, we don't take anything for granted. We're telling you now, we know there are things we could've done differently and better and the neat thing about this business is we'll step back and we'll sharpen our pencils there and we'll lay out our game plan and we'll be ready for next year. And I anticipate another very competitive season next year, but I think this year demonstrates we have the ability to adjust, make the right calls, and deliver the results that were promising. So that's what we're looking forward to.

**<Q - Sanjit K. Singh>**: And then one quick follow up just mark-to-market on the desktop business. You guys guided that's going to be down mid-single digits. Any sort of update on whether those desktop customers are making the shift to QBO? Or is it still in line with what we've seen over the last couple of years?

**<A - Brad D. Smith>**: It's a little bit faster but let me give you some context. I am excited to tell you now that of customers that are coming into the QBO franchise, QuickBooks Online, if you throw in self-employed, it's now over 90% are new to the Intuit franchise. And so that is an acceleration of even getting further category expansion and people into our business for the first time.

And then if you look at the desktop, we have through three quarters now 132,000 people who've migrated from desktop to QBO. That's up about 25% y-over-y. And so we've basically done in three quarters what we did in four quarters last year, but that's not driving the bulk of this growth. 90% of these customers are new to the franchise, which is exactly what we wanted. That's driving our overall active base and it's enabling us to capitalize on this TAM.

**<Q - Kartik Mehta>**: I wanted to get your perspective a little bit on the tax business. If you look this year, there wasn't as much growth in the DIY category and I'm wondering going forward, do you anticipate any changes? Or if you think this was an anomaly?

**<A - Brad D. Smith>**: I would say, first of all, we take the responsibility as the champion of the do-it-yourself category to grow the category. We have a 65% share and I believe this year a combination of things, there was a little bit of funkiness in the overall tax season that everyone is still seeking to explain and no one yet has answers, including the IRS. So we'll have to sort through that. And then this year we definitely leaned our advertising and marketing more into the transform assisted strategy, which is showing people they would never be alone and with SmartLook, you're having access to an expert. And that certainly played out well for what we wanted to do, but I'm not sure that that succeeded in helping us expand the DIY category at large.

And so we'll step back and take responsibility of what can we do to continue to accelerate that growth. What we do know is we've got secular tailwinds, and the secular tailwinds are showing that DIY is still growing faster than the assisted methods. And we just have to find ways to continue to accelerate that secular trend, and we will do that as we look at next year.

**<Q - Kartik Mehta>**: And then finally, Brad, this year we saw some aggressive competition on the DIY side from a product standpoint and what companies were willing to offer. Now, how do you see this changing the landscape of the industry over the next couple years?

**<A - Brad D. Smith>**: It will actually tie to your prior question. This is good news for the category. As you know, we've had lots of very good competition across many of our franchises over the years. And every time a new competitor comes in, especially one that is well-funded and they're aggressive in advertising and in pricing, that tends to accelerate the category growth because it gets more people and another masses to raise their head and get out of spreadsheets or come out of stores and say wow, there might be a better way to do this.

So I believe you saw the early days of what hopefully is going to be a continuing advertising and marketing message that says there is a much better way to get your taxes done. And if we just do what we know we have to do, have the best product and have the cleanest value prop, I think that's going to be good news for the category and good news for us. So I anticipate a continuation of this year's ultra-aggressive competition, and I think that's a good thing for consumers and I think it's a good thing for the category.

**<Q - Raimo Lenschow>**: That was very truly amazing results. Okay, two quick questions. First of all, Brad, a couple of years ago when we talked about QuickBooks Online and the QuickBooks whole category, we always said there's a big, white, greenfield opportunity, 40% of guys are still doing it in Excel, et cetera, et cetera. And I'm going back quite a few years now. How do you think if you look at the self-employed category, are those the guys that you were talking about back then, or is this like – because of change in the economy like a whole new growing wave that is coming our way? That's the first question.

And then one for Neil quickly, any update on ASC 606? That's coming obviously soon at some point. Thank you.

**<A - Brad D. Smith>**: We'll divide and conquer on this one. So let me start with the first one and the number of small businesses that are still not in the accounting software category, they're using spreadsheets, shoeboxes, ink pens, and checks. And that number is still, believe it or not, 42%. And it is equal, not only those that are self-employed, but those that clearly could be in QuickBooks Online. In fact, in the U.S., the number of people who are ripe for QuickBooks Online are about 20mm, and we have 1.8mm of them today. So there is a huge opportunity for us to show that there's a better way, and that's why we're starting to lean in with more advertising and more category awareness in addition to working with accountants. So still lot of greenfield, and that represents itself not only in the U.S. but all the countries we're going to around the globe.

**<A - R. Neil Williams>**: We've been working on this for quite some time. But for us, ASC 606 won't be applicable until our FY2019. And based on what we've seen so far in our analysis, there's really not incentive for us to adopt early. We can't really say at this point what the impact will be on our financial results because we haven't completed the analysis and worked with our external accounting firm. But you can just remember that the desktop products we have are declining as a percentage of our total revenue. And the percentage of those desktop products that involve a long-term contract or long-term commitment is even smaller than that. So we'll keep you posted, but just remember for us it's probably a FY2019 issue, and we'll keep you updated as we move along.

**<Q - Ross MacMillan>**: I had two questions, Brad. First on tax, was there any price/mix benefit this year from your traditional raising of prices as you moved through the season? I wondered if that happened any earlier this season and whether that was a contributor to the price/mix. And related to that, I wondered if there was any comment on non-core revenues, such as audit insurance or fraud protection fees or other avenues of revenue generation that you might be starting to see. And then I have a quick follow-up.

**<A - Brad D. Smith>**: The answer to your first question is no. We really did not have any material changes in pricing or even the timing of pricing that would have affected the results the way that we're talking about here.

In terms of the non-core revenue I think is the question, we have created value bundles, and we marketed those this year, bundles that include, we call them Plus and other kinds of bundles that have things like fraud, audit defense, and the ability to make sure that if anything happened we had the ability for you to go in and keep an eye on your credit card and your credit reports. Those value-added bundles, they were ways that we were able to basically continue to help customers see value and pay for it. But there wasn't anything that jumped out that was meaningfully different than any prior-year trend, to be honest with you. You said you had another question after that?

**<Q - Ross MacMillan>**: Just one for Neil or maybe Jerry. Just a clarification that when we looked at the QuickBooks Online subscribers and we look at 360,000 self-employed, 433,000 international, are those mutually exclusive, or does some of the international include self-employed? And if so, do you have a sense of how much? Thanks so much.

**<A - R. Neil Williams>**: Some of those international subs do include QuickBooks Self-Employed. We've had self-employed out there in the UK and in Australia now and in Canada. And we've just launched, as Brad said a minute ago. We haven't broken out that specific number for QuickBooks Self-Employed within the 433,000 international. It's a pretty small fraction at this point.

**<Q - Scott Schneeberger>**: We haven't heard a lot about fraud this year, and obviously some of the late start to the year was probably related to some IRS changes. And I know you're not going to share your strategies for next year at this juncture, but what are you hearing and seeing out of the IRS for how the tax season may start next year and then again circling back to that fraud discussion and what you saw y-over-y, just as an industry perspective?

**<A - Brad D. Smith>**: I would say what we saw was incredibly encouraging. The industry once again locked arms, not only the do-it-yourself industry but the professional tax preparers and the banking industry as well as the IRS at the federal and at the state level too. And I think we all feel like we continue to push the ball forward in terms of getting the bad guys out of the system. We won't know the dimensions of how much we're able to do until the IRS comes out and reports that out in late summer, early fall, but every one of us collectively believe that we continue to advance the cause, and we're going to stay active. It's going to be a multiyear ongoing effort until we get every cybercriminal out of the system that we can, so that's sort of bucket one.

Now what are the impacts to next year? There were a lot of things this season that everyone's still processing, things that we ended up requiring tax filers to do. Next year we hope to be able to do with less friction and one of them was the one that Neil mentioned in his opening comments, which is in an effort to try to ensure we got cyber criminals out, if you did not know your prior-year adjusted gross income or you didn't know your tax filing PIN, then you were able to process your return using our software but then you had to print it out and mail it. You could not e-file it without those two pieces of information. And that ended up in our case with about half a million people who are able to do their taxes in TurboTax but had to put it in an envelope and send it into the IRS.

So I think next year the industry and the IRS and the states will say is that the experience we want to continue or is this something that we can do that's just as equally protective but less friction for the taxpayer? But right now it's too early to know what those are. We'll work those over the summer and talk to you about them in the fall when we do our investor day.

**<Q - Scott Schneeberger>**: And then just following up, Neil, and you may have already covered it in your discussion of return of capital, but YTD, little bit lighter than would've been expected I think on share purchases. I realized there was some debt reduction going on in this recent quarter, but is there any thoughts to share count for the full year? Any change to that outlook or any catch-up anticipated, back to prior-year levels and you may not want to address this year because it's near-term, but how should we think about share repurchase going out on a run rate a few years out? Thanks.

**<A - R. Neil Williams>**: I would tell you that I think Q3 is a bit of an anomaly. As you mentioned, we did have those senior notes that were due in March, and so we had some cash we allocated to debt reduction. And frankly, the matrix that we had in our 10b5 also was a little more conservative at higher stock prices, so we didn't buy as many shares in at some of the higher price points, at times during the quarter, when we had to be out in the market for other reasons. So our stock repurchase plan has worked really great for us and so I would view Q3 being more of an anomaly than a trend going forward.

**<Q - Stewart Kirk Materne III>**: In your prepared comments you mentioned that there's about 11% contribution from TurboTax on the QBO business. And I was wondering if you could just sort of comment on was that about as expected, was it better than you thought? I'm just trying to get a sense on you guys obviously were expecting some contribution from TurboTax to QBO. Did that outperform and I guess was there any specific reason why when you look back at the strength in the quarter on QBO subs? Thanks.

**<A - Brad D. Smith>**: You're referring to the 11 points of QuickBooks Online growth that we got from TurboTax Self-Employed sending customers over. That was healthy. We had aspirations that we thought would be very positive. I've got to tell you that we were delighted and surprised that we saw the strength in the TurboTax channel feeding QuickBooks Self-Employed, which gives us even more reason to lean in more aggressively next year. And so I would say that we did not have 11 points modeled in. At the same time, we'll take it, and we're going to say how do we blow on that ember and turn it into a raging fire as we look at next year?

**<Q - Stewart Kirk Materne III>**: And if I can ask just one quick follow-up, I assume when you're getting benefits from the TurboTax channel, that tends to be more disproportionate in the U.S., on the U.S. business – QBO business than on the international just based on sort of where your channel's based right now, is that fair?

**<A - Brad D. Smith>**: We have TurboTax in the U.S. and Canada, so we'll have the ability to tap into that channel that way. But we're also working with QuickBooks Self-Employed in all the other countries to say it doesn't have to go to an Intuit tax product. It can seed in accountants. And as a result, accountants will recommend QuickBooks Self-Employed to get more tax customers. So think about this being a strategy that works everywhere. It just may not go into TurboTax like it does in the U.S. and Canada.

**<Q - James MacDonald>**: Just following up on Scott's question on fraud, do you think that affected the unit growth in the market as a whole and maybe will affect unit growth in future years?

**<A - Brad D. Smith>**: I knew the explanation on the unit growth at the IRS level. We can go back to 2013 where the industry really lined up and everyone got aggressive and we were all trying to get security beefed up and get cyber criminals out. And in 2014, we actually saw the IRS returns grow over 1%. So even though we took a big bite at the apple then, it didn't slow down total tax returns.

Now we've continued to get better and better each year, so I really can't tell you, and we are trying to hesitate to put out other hypotheses because I've probably heard a half a dozen myself just having conversations. I think we'll have to wait and see what the IRS comes out with, and then we'll be able to compare their data with ours. And we will be as transparent as possible at Investor Day what we think ultimately led to this very unusual tax filing season with the IRS.

**<Q - James MacDonald>**: And just a quick follow-up. You haven't given a number, but is it proper math to say if you grew TurboTax units – or revenue 9% and units 2% that the price/mix impact was 7%, or is that incorrect math?

**<A - Brad D. Smith>**: You know what? That math works for me. Coming from where I come from, that's exactly the way we calculated it too. Okay.

**<Q - James MacDonald>**: I'm just trying to figure out if units had a bigger impact in some way, shape, or form.

**<A - Brad D. Smith>**: You actually got it. We looked at it. We actually broke it down and looked at it at revenue per return, and it's roughly 7% as well. And it was driven by that 60:20:20 mix I mentioned a little while ago.

**<Q - Michael Millman>**: Just quickly following up on the last question, to what extent did the 500,000 returns that didn't get counted as do-it-yourself gets counted however in your tax revenue? And then I have several more.

**<A - Brad D. Smith>**: Let me take this one then, and then we'll get back to your other ones. That 500,000, they ended up processing using our product and paying us, so that's in that revenue per return. But then when they showed up at the IRS, the IRS counted them as paper because they showed up in an envelope and not coming through an e-file. So you have to throw those 500,000 back into the mix, which is why you heard Neil say those don't show up in the IRS category growth numbers and they don't show up in our share count because we always compare our stuff against the IRS.

But there's 500,000 that we did get paid for, so that shows up in our revenue. But it doesn't necessarily show up when the IRS prints its numbers and says whoa, paper grew for the first time in a few years. Why? It was because people processed with software and then had to mail it in because they didn't know their PIN.

**<Q - Michael Millman>**: It would suggest that the 7% that you just talked about increase in price really doesn't particularly jibe with what you just said about increased number of returns.

**<A - R. Neil Williams>**: The 500,000, Michael, are in our unit number that we disclosed that we said was up 2%.

**<Q - Michael Millman>**: They are in your numbers?

**<A - R. Neil Williams>**: In our unit numbers.

**<A - Brad D. Smith>**: We're talking two different things here, Michael. I'm sorry. We're talking units, which we said were up 2%. E-files, which are ultimately the IRS, when you receive those, and then they count those as were those paper or software, that's where the numbers get a little bit out of sorts. But our numbers are 2% unit growth, 9% YTD revenue growth, and the average revenue per unit went up about 7%. And that was the math that Jim was just asking about a few minutes ago as well.

**<Q - Michael Millman>**: It does seem when you look at your numbers down from up 15% to 2%, the IRS 5.7% down to 0.2%, that there was a bigger – you had a bigger effect than the IRS. And that leads to the next question, is that you indicated that you were affected at the low end or Free end. And so I wondered to what extent that was Block doing many more Free, but also increasing what Free covered, which would seem to hurt your potential complexity. I was also interested in the effect of Karma, which a lot of people talked about, but maybe you can give us some numbers on it. And then the other side of the coin is TaxAct going the other way. And do you see that as having some impact on the industry?

**<A - Brad D. Smith>**: Let me try to parse that, and I'll say that I think it was the collective competitive environment with all the names that you mentioned, including us, that led to a little more of an even distribution of who got the free Free customers. And over the last several years, we were out there pretty much along with the Absolute Zero program. And this year everyone dove in and decided they wanted a piece of that pie.

Now it happened to coincide with the fact that after three years of that being our main message, we chose to pivot our broadcast, our TV advertising to more SmartLook, which was the transform assisted. So we went dark in terms of broadcast media on the Free message. We still had that in digital, and they all came out with TV ads. And so I think that's why we allowed ourselves to let some of this free Free customers go elsewhere. Suffice it to say, regardless of whether it was the competitors you named or others, we don't plan to play the game the same way next year.

**<Q - Patrick E. Colville>**: Can you help me understand the acceleration in self-employed? Judging by the other questions asked on the call, it's clear that was due to an inflection in growth in the U.S. So what was the cause of that inflection?

**<A - Brad D. Smith>**: It's a combination of things. First of all, there's just a secular trend of the gig economy. It's now estimated to be about 34% of the workforce and expected to be 43% by the year 2020. And these individuals have complexity. They have to separate their personal and business expense. And then in the case of the United States, they have to file a Schedule C. And so ultimately when you put that together, you say there's a lot more of them. We've been signing partnerships with Uber, Lyft, TaskRabbit, DoorDash, you name it, we've got all kinds of partnerships out there.

And we've been working aggressively with the accountant channel, because for the accountants, these are some of the hardest customers to serve, because they don't have this sorted out. They come in at tax time, and it's really laborious for the accountant to get the stuff all separated. So the accountants and the partnerships have been driving it.

Then the second thing is we have 60mm people who come to QuickBooks Online and QuickBooks.com every year. That is a huge funnel. And now by introducing this as one of the product lineup SKUs, we're able to capitalize on our own web traffic and convert those into customers.

The last piece I would say is two-part. One is new channels. One was TurboTax.com, which added 160,000 QuickBooks Self-Employed units in the last quarter. And the other was new geographies, where we just introduced it in Singapore, and will be opening up to other countries as well. So I'll put a bow around it and say secular trends, we have channels with accountants in our own web marketing and partnerships like with Uber that are growing the core business. You add to that the opportunity to go with TurboTax as a channel and then open new geographies, and we think Self-Employed has a lot of opportunity for growth as we look ahead.

**<Q - Patrick E. Colville>**: And can I just quickly follow up? So do you think this Self-Employed is expanding the category? Or is there some small amount of cannibalization at the low end of kind of the desktop product?

**<A - Brad D. Smith>**: I was even going to add it to my closing comments if no one asked. So over the last several quarters, actually for the last couple of years, we've been talking about what percent of customers are new to the franchise coming into QuickBooks, and then what percent of new customers are choosing an online version vs. desktop. We used to say 80% of all the customers coming into QBO were new to the franchise. Well now with Self-Employed it's moved above 90%.

The other thing is now when you have a customer going to our website and saying, do I want the desktop version or Online, we now have over 80% of them choosing an online version of the product, whether it's Self-Employed or QBO. That was 70% just a quarter ago, and it was just in the 60s 12 months ago. So this is expanding the category. What does that mean? If you count the number of customers who bought one of our products and paid for it in the last 12 months, that total paying customer base is up 40%, and that's up from 34% just 90 days ago. So it is expanding the category with some pretty exciting opportunities ahead of us.

**<Q - Yun Kim>**: Can you just talk about what you are thinking about the overall ASP headwinds that you're obviously experiencing some level as your Self-Employed mix becomes larger and larger? If I do my math right, I think about half of the new QBO subs saw that in the quarter was driven by self-employed. Obviously, given the opportunity to aggressively add new QBO subs especially around Self-Employed subs, what are some of the parameters and metrics that you are monitoring or using to ensure some cost discipline around the QBO subs acquisition cost? Thanks.

**<A - Brad D. Smith>**: And first of all, I would say this is why we've tried to articulate the two things that we measure inside and we talk about in our operating reviews and with our board, and it is growing the subscriber base north of 40%, and growing the total online ecosystem revenue 25% to 30%. And we just posted 59% on the first number, and we just posted the second consecutive quarter of online ecosystem revenue growing at 30%, so at the high end of that 25% to 30%.

The second point I would say is our emphasis right now is razors, not blades. Whether it's Self-Employed going after the hundreds of millions around the world is the point of the spear, or it's QuickBooks Online where we're trying to continue to accelerate and get new customers into the franchise and out of spreadsheets, that is our absolute top priority. And as you can see, that is driving online ecosystem revenue growth, where we're at the high end of the range at 30% two quarters in a row.

In terms of the discipline, Neil referred this a few minutes ago when we were asked about the margins continuing to expand, even while we're in a pretty heavy investment mode to expand into new countries. And that's because we watch LTV to CAC, the lifetime value divided by the cost to acquire a customer. And every country has a target. And as you know, we've collectively been driving our LTV to CAC. If you look at QBO across the globe, it's around five-and-a-half, 5.5. And if you throw in desktop, it's like 6.9. So we are maintaining that discipline, but we're focused on the razors, whether it's Self-Employed or it's QBO, we aren't worried about whether one is $10 a month and one is $24 a month, because we focus on LTV to CAC to make sure we have the right discipline in cost to acquire. And that's driving overall revenue growth and margin expansion.

**<Q - Yun Kim>**: Real quick on the tax business, it's just a quick follow-up question, Brad. Are you still committed to going after the new taxpayers coming into the market, even if it means that there could be some incremental margin headwinds to get those customers, given the increasing competition for those customers?

## Brad D. Smith

### *Closing Remarks*

Obviously, we're feeling good with the quarter

More importantly, we feel like we have momentum that we're building as we enter Q4, and we have some important lessons learned that will sharpen our thinking as we look ahead to next year